



HM Treasury

# **Exchange Equalisation Account:** **Report and Accounts 2021–22**

---



HM Treasury

# Exchange Equalisation Account: Report and Accounts 2021–22

---

Presented to Parliament pursuant to the  
Exchange Equalisation Account Act 1979  
(as amended by the Finance Act 2000)

Ordered by the House of Commons  
to be printed on 20 July 2022



© Crown copyright 2022

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit [nationalarchives.gov.uk/doc/open-government-licence/version/3](https://nationalarchives.gov.uk/doc/open-government-licence/version/3).

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

This publication is available at [www.gov.uk/official-documents](https://www.gov.uk/official-documents).

Any enquiries regarding this publication should be sent to us at [public.enquiries@hmtreasury.gov.uk](mailto:public.enquiries@hmtreasury.gov.uk)

ISBN 978-1-5286-3634-6

E02772868 07/22

Printed on paper containing 40% recycled fibre content minimum

Printed in the UK by HH Associates Ltd. on behalf of the Controller of Her Majesty's Stationery Office

# Contents

## Page

### Performance Report

#### Overview

Accounting Officer's statement 2

Purpose and activities of the Exchange Equalisation Account 3

Performance summary 7

Performance Analysis 8

### Accountability Report

#### Corporate governance report

Directors' report 12

Statement of the Accounting Officer's Responsibilities 13

Governance Statement 14

Parliamentary accountability and audit report 21

### Financial statements and notes to the accounts

Statement of Comprehensive Income 27

Statement of Financial Position 28

Statement of Cash Flows 29

Notes to the Accounts 30

**Accounts Direction 55**

**Glossary 56**

# Performance Report

## Overview

The Overview section provides information on the purpose and activities of the Exchange Equalisation Account and a summary of its performance.

## Accounting Officer's statement

In 2021-22 HM Treasury (the Treasury), together with its agent the Bank of England (the Bank), continued to manage the Exchange Equalisation Account (EEA) to ensure it remained fit for purpose as a fund ready to meet its policy objectives, which include: regulating the exchange value of sterling when necessary, to provide foreign currency services for government departments and agencies, and to fulfil its obligations as required by the UK's membership of the IMF.

The outcomes of the investment strategy review undertaken in 2019-20 continued to be implemented during the year. The principal outcome of the investment strategy review was a change in approach to the trade-off between policy readiness, financial risk, and investment return. Changes in the composition of the reserves resulting from the investment strategy are expected to span several years.

Every year the Treasury agrees a set of Key Performance Indicators (KPIs) with the Bank with the purpose of providing a basket of indicators that can be used to assess the effectiveness of the management of the EEA. An annual Service Level Agreement (SLA) between the Treasury and the Bank which specifies the parameters within which the reserves are managed is also agreed. All KPIs were materially met in 2021-22 and there were no significant breaches of the limits in the SLA.

During the year the Bank continued to actively manage the reserves in order to minimise the net cost of holding the reserves to the taxpayer and maximise returns, subject to the EEA's risk framework. The return from the Bank's active management of the reserves against the benchmarks during the year was £34 million.

The EEA continued to provide cost-effective foreign currency services to various government departments and agencies. Sales of foreign currency, to departments with foreign currency obligations, and purchases of foreign currency, from departments with foreign currency receipts, in aggregate totaled £16,257 million.

I would like to express my sincere appreciation to all Treasury staff and to colleagues at the Bank of England for their professionalism, commitment and support throughout the year. The successes of the EEA would not have been possible without their valued contribution.

## Purpose and activities of the Exchange Equalisation Account

1. The Exchange Equalisation Account (EEA) holds the United Kingdom's reserves of gold, foreign currency assets and International Monetary Fund (IMF) Special Drawing Rights<sup>1</sup> (SDRs). Combined with the UK's Reserve Tranche Position (RTP) at the IMF and lending to the IMF under the New Arrangements to Borrow (NAB), these assets comprise the UK's official holdings of international reserves ('the Official Reserves'). The RTP and NAB loans are held in the National Loans Fund (NLF) for which separate accounts are published by HM Treasury (the Treasury).
2. The EEA was established in 1932 to provide a fund that could be used, when necessary, to regulate the exchange value of sterling, and therefore is the mechanism through which any UK government exchange rate intervention would be conducted. The EEA Act 1979, as amended by the Finance Act 2000, provides the purposes for which the EEA shall be used. Those purposes are summarised in the table below, along with a non-exhaustive list of the types of activity which might be relevant to that purpose.

<b>Policy Objectives of the EEA</b>	
<b>Policy Objective (as set out in the EEA Act 1979)</b>	<b>Examples (non-exhaustive)</b>
Checking undue fluctuations in the exchange value of sterling	<ul style="list-style-type: none"> <li>• short-term action to mitigate or reduce market disruption or improve functioning of the sterling foreign exchange market</li> <li>• participation in coordinated foreign exchange market intervention to assist other central banks' interventions</li> <li>• providing medium-term support for sterling if required to assist broader macroeconomic policy</li> </ul>
Securing the conservation or disposition in the national interest of the means of making payments abroad	<ul style="list-style-type: none"> <li>• providing foreign exchange payment services to the government, on request</li> <li>• making investments to further broader economic policy aims</li> </ul>
For the purpose specified in Section 1(3) of the International Monetary Fund Act 1979 and carrying out any of the functions of the government of the United Kingdom under those of the said Articles of Agreement which relate to Special Drawing Rights	<ul style="list-style-type: none"> <li>• maintaining the UK's Reserve Tranche Position with the IMF, thereby supporting IMF lending programmes</li> <li>• participating in the purchase and sale of IMF SDRs, as necessary</li> </ul>

3. Under the Exchange Equalisation Account Act 1979, the EEA is permitted to invest its funds in any assets denominated in the currency of any country, to purchase gold, and to acquire SDRs.
4. Under section 2 of the Exchange Equalisation Account Act 1979, the EEA is funded by central government through the NLF and the net assets of the EEA represent a liability to the NLF (see note

<sup>1</sup> This and other terms are defined in the Glossary at the back of this document.

14 to the accounts for further detail). As the core functions of the EEA can be expected to continue for the foreseeable future, and there are no legislative changes in process, there is no reason to believe that funding will not continue to be forthcoming. Therefore, in accordance with the Government Financial Reporting Manual, it has been concluded as appropriate to adopt the going concern basis of preparation for the EEA Accounts.

### **Administration and Control**

5. The EEA is under the control of the Treasury whose prime objective in managing the EEA on behalf of the government is to ensure the reserves are fit for purpose in order to meet current policy objectives and any potential future changes in policy.

6. The Treasury has appointed the Bank of England (the Bank) to act as its agent in the day-to-day management of the EEA. The Bank executes foreign exchange transactions and invests the reserves in accordance with an agreed framework (see paragraph 10 below and paragraph 7 to 9 within the Performance Analysis).

7. The EEA's investment policy and approach to asset allocation are set out in an Investment Policy Statement (IPS). This, together with a Service Level Agreement (SLA) between HM Treasury and the Bank, specifies the parameters under which the reserves are managed. The SLA and IPS are both confidential documents which remain in force indefinitely and are reviewed annually. They are set within the context of all relevant legislation, particularly the EEA Act 1979, as amended by the Finance Act 2000.<sup>2</sup> In accordance with the SLA, the Bank manages the reserves so as to ensure adherence to Treasury policy objectives and reports against this to the Treasury as described in the Governance Statement.

8. The Bank also acts as the Treasury's agent for foreign currency liability management, including the issuance of foreign currency debt to finance some of the reserves. This debt is issued by, and is an obligation of, the NLF under the National Loans Act 1968 since it is that Act (rather than the Exchange Equalisation Account Act 1979) which provides the powers for the government to issue foreign currency securities. The foreign currency raised by issuing foreign currency debt is transferred to the EEA.

9. The Bank manages the foreign currency assets and liabilities associated with the reserves of the NLF in conjunction with those of the EEA as the Treasury's agent. This allows the foreign currency assets and liabilities associated with the reserves, and the associated risk exposures, to be managed collectively in an efficient way. These are the financial accounts of the EEA only, but where relevant the Performance Report commentary covers issues relating to the NLF assets and liabilities that are managed as part of the Official Reserves.

### **Investment Policy**

10. In light of the policy objectives, the Investment Principles of the EEA are:

- a) Investment Principle 1 (readiness) – The EEA must be ready to meet its policy objectives at all times, at an acceptable cost and high degree of certainty;
- b) Investment Principle 2 (risk tolerance) – The EEA must not take on risk that compromises the ability to meet Principle 1 or that could unduly influence fiscal metrics;

---

<sup>2</sup> A summary is included in a report produced by the Treasury entitled 'Management of the Official Reserves' available at <https://www.gov.uk/government/publications/management-of-the-official-reserves>.

- c) Investment Principle 3 (return) – Subject to meeting Principles 1 and 2, the EEA should seek to optimise return for a given level of risk.

11. The Investment Principles are set out in an order that ensures the EEA’s investment strategy is clearly and primarily linked to the policy objectives of the EEA. An assessment of the scale and likelihood of the EEA’s policy objectives over the investment horizon is used to set initial parameters and constraints on the EEA’s investments. Subject to those parameters and constraints, the EEA’s strategic asset allocation is chosen to ensure that the best possible return is made for the level of risk taken.

### **Eligible currencies and assets**

12. The EEA may invest in cash or securities denominated in the foreign currencies represented in the IMF SDR basket (US dollar, euro, Japanese yen and Chinese renminbi), as well as other advanced economy currencies (Canadian dollar, Swiss francs, Danish krone, Swedish krona, Norwegian krone, Australian dollar and New Zealand dollar).

13. In line with Investment Principle 1, the liquidity resilience of assets held is of primary importance. Therefore, the universe of eligible securities is those eligible under the Basel III Liquidity Coverage Ratio (LCR).

14. Currently, debt issued by the following types of entity will be considered for eligibility, subject to credit, liquidity and non-financial risk assessment:

- central governments or central banks;
- regional governments;
- supranational agencies (multilateral development banks and international organisations); and
- national public agencies (either guaranteed or otherwise).

15. The EEA is also permitted to use other financial instruments, including:

- conventional and inflation linked bonds, bills, commercial paper, discount notes and floating rate notes of any maturity;
- foreign currency spot, forward and swap transactions;
- interest rate, cross-currency and overnight indexed swaps;
- bond and interest rate futures;
- sale and repurchase agreements (collectively referred to hereafter as ‘Repo’ and ‘Reverse repo’);
- short-term bank deposits and sterling amounts placed with the Bank of England (i.e. in the EEA Sterling Account);
- Special Drawing Rights (SDRs); and
- Gold.

16. Derivative transactions entered into by the EEA are documented and collateralised under ISDA Master Agreements with counterparties. Swaps and foreign exchange transactions are governed by these agreements. Repos and reverse repos are governed by bespoke foreign currency repo documentation.



## Strategic Asset Allocation

17. Each year, the Bank will propose a strategic asset allocation for the EEA's currency reserves, for HM Treasury to review and agree. The proposed allocation must comply with the portfolio constraints and risk tolerance (Investment Principles 1 and 2). Beyond that, the objective of the allocation is to optimise return for a given level of risk (Investment Principle 3).

18. The proposed strategic asset allocation is informed by an asset allocation model. The asset allocation model chooses an allocation with the optimal return relative to the overall market risk tolerance. A fully unhedged portfolio is likely to breach this tolerance, so foreign exchange and interest rate hedging is required to ensure overall market risk remains within tolerance (Investment Principle 2).

19. The asset allocation model sets out portfolio weights by currency, issuer and maturity. A number of factors are considered in determining the proposed strategic asset allocation, including statistical analyses of risk and return input estimates, the operational feasibility of the allocation, and a broader set of financial and macroeconomic indicators. Important judgements are made in running the asset allocation model and any judgements to override the results of the model are explicit and agreed annually.

20. The Bank will seek to improve returns for the EEA through active management trading strategies beyond the strategic asset allocation. An annual active management return target is set each year in consultation between the Bank and HM Treasury. This target is set against the benchmark set by the strategic asset allocation and takes account of the limits on active management set as part of the SLA and detailed risk management framework. Active management must not compromise the portfolio constraints. There is no benchmark for the IMF RTP and bilateral lending in the NLF given that there is no discretion, under IMF membership rules, to alter this holding.

## Links between the International Monetary Fund and the Official Reserves

21. The primary means of financing the IMF is through members' quotas. Each member of the IMF is assigned a quota, based broadly on its relative size in the world economy, 25% of which is payable in a combination of SDRs or foreign currency and the rest in the member's own currency. The difference between a member's quota and the IMF's holdings of its currency is a member's RTP. As explained above, the UK's RTP is an asset of the NLF. A portion of the RTP is unremunerated and interest is earned on the remaining balance at the adjusted<sup>3</sup> SDR interest rate.

22. While quota subscriptions of member countries are the IMF's main source of financing, the IMF can supplement its resources through borrowing if it believes that resources might fall short of members' needs. Through a standing multilateral borrowing arrangement – the New Arrangements to Borrow (NAB) – a number of member countries and institutions, including the UK, stand ready to lend additional funds to the IMF. Any lending against this facility is an asset of the NLF.

23. The IMF has periodically issued SDRs and allocated them to members in proportion to their quotas. On 23 August 2021 the IMF issued a general allocation of SDRs to all members in proportion to their existing quotas in the Fund, of which the UK received SDR19,318m. The UK's SDR allocation is a liability of the EEA and the resultant holding of SDRs by the UK is an asset of the EEA. Holdings of SDRs are also used to lend to the IMF's Poverty Reduction and Growth Trust (PRGT). IMF members are credited with interest on their holdings of SDRs and pay interest on their allocation of SDRs at the same rate.

<sup>3</sup> Additional burden sharing adjustments, for the financial consequences of protracted arrears, are also applied to both the basic rate of remuneration and the basic rate of charge. The adjusted rate of remuneration is used to pay interest (remuneration) to members on their remunerated reserve tranche position with the Fund.

24. The SDR market functions through voluntary trading arrangements. Under these arrangements a number of members, including the UK, have volunteered to buy or sell SDRs within limits defined by their respective arrangements. Following the 2009 and 2021 SDR allocations, the number and size of the voluntary arrangements has been expanded to ensure continued liquidity of the voluntary market. In the event that there is insufficient capacity under the voluntary trading arrangements to ensure the liquidity of the market, the IMF can activate the designated mechanism. Under this mechanism, members with sufficiently strong external positions are designated by the IMF to buy SDRs with freely useable currencies up to certain amounts for members with weak external positions. This arrangement guarantees the liquidity and the reserve asset character of the SDR.

### **Key issues and risks**

25. The key issues and risks facing the EEA are considered in the Governance Statement. Financial risks related to the EEA are separately disclosed in note 18 'Risk management and control'.

26. In addition, the Bank also conducts monthly stress tests for a range of scenarios. A range of historical and theoretical scenarios involving large shifts in interest rates, inflation, spreads between securities and changes in yield curve shapes are applied to both the overall EEA holdings and the active management positions/component. These results are reviewed by the Bank's senior management and the associated risks accepted or actions taken. It is also presented to the Accounting Officer of the EEA.

### **Performance summary**

1. In the EEA Statement of Financial Position, assets increased over the course of the year by £21,309 million to £155,161 million with a matching increase in liabilities. Further details can be found in the Performance analysis.

2. The EEA's Statement of Comprehensive Income for the year ended 31 March 2022 shows a total comprehensive profit for the year of £2,111 million (*2020-21: £4,539 million loss*) with a net trading loss of £249 million (*2020-21: £3,935 million loss*).

3. The Treasury has agreed a set of Key Performance Indicators (KPIs) with the Bank with the purpose of providing a basket of indicators that can be used to assess the effectiveness of the management of the EEA (see paragraphs 9 - 12 in the Performance Analysis). All KPIs were materially met in 2021-22 and there were no significant breaches of the limits in the SLA.

## Performance analysis

1. In the EEA Statement of Financial Position, assets increased over the course of the year by £21,309 million to £155,161 million. The increase consisted primarily of rise in IMF Special Drawings Rights (£21,412 million), money market instruments (£5,493 million), cash balances (£3,147 million) and gold (£2,374 million), partly offset by falls in debt securities (£7,976 million), reverse repurchase agreements (£2,332 million), items in course of collection (£607 million) and derivative assets (£266 million). A matching increase in EEA liabilities consisted primarily of a rise in the SDR Allocation (£20,522 million), liability to the NLF (£1,811 million) and repurchase agreements (£1,043 million), partly offset by falls in derivative financial liabilities (£1,059 million), items in the course of transmission to banks (£790 million) and debt securities short positions (£227 million). A proportion of reserves is hedged for interest rate and currency risk in line with the strategic asset allocation.

### Analysis of returns for the period

2. The EEA's Statement of Comprehensive Income for the year ended 31 March 2022 shows a total comprehensive profit for the year of £2,111 million (*2020-21: £4,539 million loss*).

3. The price of gold rose from £1,235 to £1,474 per ounce, an increase of 19%, giving rise to a revaluation profit of £2,374 million.

4. The net trading loss for the year was £249 million (*2020-21: £3,935 million loss*) primarily due to exchange rate related losses as most reserve currencies depreciated against sterling. On a financial instrument basis, trading losses on debt securities net of short positions (£703 million), repurchase agreements (£247 million) and reverse repurchase agreements (£167 million) were partly offset by gains on foreign exchange transactions (£409 million) and interest rate swaps (£384 million). A full breakdown of net trading income by instrument is provided in note 2.

5. The Treasury sets a target for active management return as part of the Service Level Agreement (SLA), above the cost of managing the reserves. This target is set against the benchmarks for the portfolio (as detailed in the Purpose and activities of the EEA), and takes account of the limits on active management set as part of the SLA. This target is confidential for policy reasons. The return from the Bank's active management of the reserves against the benchmarks during the year was £34 million (*2020-21: £72 million*).

6. The EEA continued to invest in high credit quality assets throughout the year and has not crystallised any credit losses.

### Investment Policy Statement and Service Level Agreement

7. The EEA's investment policy and approach to asset allocation are set out in an Investment Policy Statement (IPS). This, together with a Service Level Agreement (SLA) between HM Treasury and the Bank, specifies the parameters under which the reserves are managed. The SLA sets out the obligations of both the Treasury and the Bank in the management of the EEA as well as KPIs. The IPS is a guide to the investment policies and implementation of the strategy for the foreign currency reserves: it details the investment principles, policy constraints, risk tolerance and the approach to the Strategic Asset Allocation (which represents the benchmark for the EEA's holdings of foreign currency reserves).

8. In addition to the SLA and IPS, a set of supporting documents exist containing detailed implementation and constraints, including: an Operational Risk Management Framework, a Financial Risk Management Framework and an Investment Processes document.

## Performance against Key Performance Indicators

9. The Treasury has agreed a set of Key Performance Indicators (KPIs) with the Bank with the purpose of providing a basket of indicators that can be used to assess effectiveness of the management of the EEA. The KPIs reflect the overall objectives for holding the reserves and are separated into Financial and Operational KPIs.

10. The Financial KPIs for 2021-22 specified that:

- a) The foreign currency reserves, while not used in operations to deliver policy objectives, will be invested in assets that meet the minimum liquidity requirements and the currency composition, as set out in the IPS – subject to operational tolerances agreed.
- b) With the exception of Renminbi assets, only purchases of eligible securities in eligible currencies – and with an acceptable creditworthiness – are made.
- c) That overall portfolio volatility, and volatility arising specifically from active management, should be below the level set out in the IPS.
- d) In order to aim to at least cover costs, the Bank will actively manage the EEA portfolio against the foreign currency reserves to meet the active management return target set by the Treasury, whilst ensuring compliance with the financial risk limits as detailed in the Financial Risk Management Framework.

11. The Operational KPIs for 2021-22 specified that:

- a) The Bank will observe the limits as set out in the SLA. In line with that, all unauthorised breaches of the limits and/or any related operational errors will be reported to the Treasury as reportable incidents as soon as possible, along with advice if necessary as to how best to deal with them. Any significant breach will be reported publicly (e.g. in the annual accounts).
- b) The Bank will ensure that all transactions related to Government departments and the IMF shall be handled efficiently, accurately and in a timely fashion.
- c) In carrying out its services, the Bank will as far as possible ensure that:
  - its management and staff are of high repute and integrity;
  - staff training and experience are appropriate for the tasks they are expected to undertake and consistent with the amount of risk they are authorised to take;
  - its internal systems and controls are adequate for the size, nature and complexity of EEA operations and comply with best market practice so far as possible; and
  - appropriate preparations are made for possible policy deployment of the reserves (e.g. FX intervention).

12. All KPIs were materially met in 2021-22 and there were no significant breaches of the limits in the SLA.

## Intervention

13. No foreign exchange intervention was undertaken by the government in the foreign exchange market during the year.

### **Provision of foreign currency services to Government departments**

14. The EEA continued to provide foreign currency services to various government departments and agencies. Sales of foreign currency, to departments with foreign currency obligations, and purchases of foreign currency, from departments with foreign currency receipts, in aggregate totalled £16,257 million (*2020-21: £11,789 million*). These purchases and sales, both spot and forward, were hedged through offsetting trades with the market.

### **Reconciliation of EEA Statement of Financial Position to IMF Reserves Template**

15. As described in the Overview, the UK's Official Reserves comprise £146,660 million (*2020-21: £124,079 million*) which is held in the EEA and £5,541 million (*2020-21: £5,041 million*) which is held in the NLF.

16. The relevant foreign currency assets and liabilities of the NLF are managed together with the EEA to enable a more integrated management of the overall UK official foreign currency reserves. The foreign currency elements of the UK's total Official Reserves are published in the monthly IMF Reserves Template.<sup>4</sup> The Template shows the net foreign currency position in the Official Reserves, which at 31 March 2022 was the equivalent of £66,342 million. The assets and liabilities in the Template differ from those of the EEA Statement of Financial Position on page 28 of these accounts. This is for a number of reasons but principally it is because the Template is designed to reflect the UK's foreign currency position. It therefore includes foreign currency assets and liabilities of the NLF (notably the RTP) and excludes all items denominated in domestic currency (i.e. sterling). The most significant of these are the liability of the EEA to the NLF and the valuation of the sterling leg of foreign currency forwards and currency swaps. These factors, coupled with the effects of differing treatment of unsettled items and short positions in debt securities, mean that gross reserve assets shown in the Template (the equivalent of £152,201 million at 31 March 2022) differ by £2,960 million from the assets held in the EEA. A reconciliation between the EEA's Statement of Financial Position and the Template is provided below.

---

<sup>4</sup> This can be viewed at: <https://www.gov.uk/government/collections/statistical-release-uk-official-holdings-of-international-reserves>

**As at 31 March 2022:**

	<b>£ millions</b>	<b>\$ millions</b>
<b>Total assets per EEA statement of financial position</b>	<b>155,161</b>	
<i>Adjustments to reflect IMF Reserves Template presentation:</i>		
Sterling cash balance	(1,664)	
Reclassification between assets and liabilities	(6,863)	
Other adjustments <sup>5</sup>	26	
Reserve assets held in the EEA	<u>146,660</u>	
Reserve assets held in NLF	5,541	
<b>Sterling total assets using Template presentation</b>	<b><u>152,201</u></b>	
<b>Dollar equivalent per Template</b>		<b>200,329</b>
<b>Total liabilities per EEA statement of financial position</b>	155,161	
EEA's Reserves and liability to the NLF (see note 14)	(103,479)	
<i>Adjustments to reflect IMF Reserves Template presentation:</i>		
Sterling leg of derivative trades	41,032	
Reclassification between assets and liabilities	(6,863)	
Other adjustments	8	
Reserve liabilities held in NLF	-	
<b>Sterling total liabilities using Template presentation</b>	<b><u>85,859</u></b>	
<b>Dollar equivalent per Template</b>		<b>113,007</b>
<b>Net assets per Template</b>	<b><u>66,342</u></b>	<b><u>87,322</u></b>

*Conversion rate into US dollars is 1.3163 as at close 31 March 2022.*

**Long-term expenditure trends**

Since the function of the EEA is primarily to hold foreign currency reserves on a precautionary basis to meet any change in exchange rate policy in the future, if required, or in the event of any unexpected shocks, it has no long-term expenditure trends.

**Clare Lombardelli**  
Accounting Officer

12 July 2022

<sup>5</sup> Other adjustments include a bid-offer spread provision. Financial accounting assets and liabilities are reported using bid or offer prices as appropriate, whereas the reserves are reported using mid-point prices.

# Accountability report

The accountability report contains a Corporate Governance report and a Parliamentary accountability and audit report. The purpose of the Corporate Governance report is to explain the composition and organisation of the EEA's governance structures and how they support the achievement of the EEA's objectives. It includes the Statement of Accounting Officer's responsibilities and the Governance Statement. The Parliamentary accountability and audit report includes key Parliamentary accountability information on regularity of expenditure and remote contingent liabilities as well as the Certificate and Report of the Comptroller and Auditor General to the Houses of Parliament.

## Corporate Governance report

### Directors' Report

The operations and management of the EEA are undertaken by Treasury and Bank employees. The EEA does not have any employees of its own.

### Directors' conflicts of interest

In 2021-22, no material conflicts of interest have been noted by the senior management overseeing the EEA.

### Personal data related incidents

The EEA does not hold any protected personal data.

## Statement of the Accounting Officer's Responsibilities

Under the Exchange Equalisation Account Act 1979 (as amended by the Finance Act 2000), the Treasury is required to prepare for each financial year a statement of accounts in the form and on the basis set out in the Accounts Direction. The accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of the EEA and its income and expenditure and cash flows for the financial year.

In preparing the accounts, the Accounting Officer is required to observe the applicable accounting standards and be consistent with the relevant requirements of the Government Financial Reporting Manual, and in particular to:

- observe the Accounts Direction issued by the Treasury, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards have been followed, and disclose and explain any material departures in the accounts;
- prepare the accounts on a going concern basis; and
- confirm that the Annual Report and Accounts as a whole is fair, balanced and understandable and take personal responsibility for the Annual Report and Accounts and the judgements required for determining that it is fair, balanced and understandable.

The Treasury has appointed its Chief Economic Adviser as the Accounting Officer of the EEA. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding the EEA's assets, are set out in *Managing Public Money* published by the Treasury.

The Accounting Officer confirms that, as far as she is aware, there is no relevant audit information of which the EEA's auditors are unaware, and that she has taken all the steps that she ought to have taken as Accounting Officer to make herself aware of any relevant audit information and to establish that the EEA's auditors are aware of that information.

The Accounting Officer confirms that the annual report and accounts as a whole is fair, balanced and understandable and that she takes personal responsibility for the annual report and accounts and the judgments required for determining that it is fair, balanced and understandable.

### Audit arrangements

The EEA accounts are audited by the Comptroller and Auditor General (C&AG) under the requirements of the Exchange Equalisation Account Act 1979 and in accordance with the Accounts Direction issued on 6 January 2012 (on page 55 to the accounts). The National Audit Office (NAO) bears the cost of all external audit work performed on the EEA. No non-audit work was undertaken by the NAO in relation to the EEA in 2021-22.



## Governance Statement

### 1. Scope of responsibility

1.1 The Exchange Equalisation Account (EEA) is managed within the Treasury's overall risk and governance framework as set out in the Treasury's Annual Report and Accounts 2021-22. This includes the Treasury Board's assessment of its compliance with the *Corporate governance in central government departments: Code of Good Practice*. The Chancellor of the Exchequer, as Minister in charge of the Treasury, is responsible and answerable to Parliament on all the policies, decisions and actions of the Treasury and ultimately of the EEA.

1.2 As Accounting Officer for the EEA, I have responsibility for maintaining a sound system of internal control that supports the achievement of the policies, aims and objectives of the Exchange Equalisation Account Act 1979 (as amended by the Finance Act 2000) as well as the targets set by Treasury Ministers, whilst safeguarding the public funds and assets for which I am personally responsible, in accordance with the responsibilities assigned to me in *Managing Public Money*.

1.3 Overall management of the EEA is the responsibility of the Treasury which delegates day-to-day management to the Bank, which acts as its Agent and Advisor. The Debt and Reserves Management (DRM) team at the Treasury has oversight of the Bank's EEA operations and agrees an annual Service Level Agreement (SLA) with the Bank that specifies the parameters under which the reserves are managed. The SLA sets out the guidelines for investing the reserves, including risk limits and the associated management information required and is described in more detail in the Performance Report. The Exchequer Funds and Accounts (EFA) team at the Treasury reports directly to me on operational risk issues and works closely with the Bank to produce the annual accounts.

### 2. The purpose of the system of internal control

2.1 Although the reserves are not held in order to make a profit, consistent with the KPIs described in the Performance Report, the Treasury seeks to minimise the cost of holding the foreign currency reserves while avoiding exposing the public purse to unnecessary risk.

2.2 The system of internal control is designed to manage risk to an acceptable level, balancing the impact of potential risks with the resources to manage them, rather than to eliminate all risk. It can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of the EEA's policies, aims, and objectives; to evaluate the likelihood of those risks being realised and the impact should they be realised; and to manage them efficiently, effectively and economically. The system of internal control has been in place throughout the year ended 31 March 2022 and up to the date of approval of the annual report and accounts, and accords with Treasury guidance.

### 3. Capacity to handle risk

3.1 The risk management strategy is set annually via the SLA – with further detail in supporting Financial and Operational Risk Management documents – which is signed by me as Accounting Officer. There is clear segregation of duties within the Bank and the Treasury for the management of the EEA and the supporting processes.

3.2 At the Bank, senior management are responsible for ensuring their staff have skills and receive training appropriate to their responsibilities. Those involved in managing financial and other risks have their objectives set accordingly, including responsibility for relevant aspects of the control framework. Policy and procedures manuals as well as job instructions are maintained to ensure staff

carry out their responsibilities in a controlled manner. Where there are instances of control failure, staff are required to maintain a record in an incident log. These are reviewed on a regular basis to ensure lessons are learned and control improvements implemented. Control improvements and responses to control failures are summarised in the quarterly operational risk reports from the Bank to EFA described below. The Bank will also notify the Treasury of any material incidents as soon as possible and any potential losses that may have arisen.

3.3 At the Treasury, management ensures that specific DRM and EFA staff members are trained in risk appraisal and management. Job instructions are maintained for time and business-critical tasks.

#### **4. The risk management framework**

4.1 Within the Bank, the Financial Risk Management Division is responsible for financial risk analysis, risk methodologies, risk management information and for producing and reconciling the EEA financial and management accounts. Middle Office is responsible for the pricing, valuation and financial control of exposures and collateral positions arising from the EEA's market operations, including counterparty and instrument data management. The Bank's Chief Operating Officer Division oversaw the management of operational risks and undertook all Markets-wide crisis and contingency planning. Those teams are all separate from the Foreign Exchange Division where transactions are executed. The Financial Risk Management Division, Middle Office, MBR Chief Operating Officer Division, and Foreign Exchange Divisions are also separate from the Market Services, Central Banking Operations Division and Customer Banking Divisions in the BPI Directorate where the transactions are settled and custodian arrangements are managed.

4.2 The Risk Directorate houses the second-line risk and compliance functions charged with providing effective oversight of financial and non-financial risks, ensuring compliance with their overarching Risk Management Framework, to provide consistency and transparency in risk management processes across the organization. The frameworks identify the roles and responsibilities of the key parties involved in the risk management processes; risk tolerances; policies for how risks are managed; and managing the reporting outputs that are generated to the Executive Risk Committee (ERC). ERC is responsible for the operation of the risk governance framework; including monitoring the Bank's risk profile against tolerance and prioritising mitigating actions. The framework is overseen by the Bank's Audit and Risk Committee (ARCo).

4.3 At the Treasury, EFA is responsible for monitoring the risk environment and providing the Accounting Officer with the assurance to sign off the Governance Statement. DRM is responsible for monitoring the performance of the Bank in managing the reserves. To support these processes, the Bank provides the following management information:

- monthly reports to the Treasury on the size, composition and liquidity of the reserves, their consistency with policy objectives, investment performance, returns made and risk exposures. The management accounts are reconciled to the financial accounts.
- quarterly assurance is provided to me, as the Accounting Officer, that the processes and framework in place are sufficient to identify current and future sources of material risk, as well as appropriate mitigants, and adequately meet the quarterly assurance requirements relating to the Bank's management of the EEA business. The assurance also states that it is evidence which can be relied upon in making this Governance Statement. In addition, EFA are provided with quarterly management reports on operational risk. These reports contain information on significant risk events, control improvements and other factors relevant to the control environment. Any material incidents including SLA breaches are reported as they occur. This process is supported by Operational Risk Officers in each division and, with

specific responsibility for the co-ordination of the quarterly reporting framework, the MBR Chief Operating Officer Division.

- the Bank's Internal Audit Division conducts an agreed internal audit programme. The Bank's Executive Director for Markets forwards the Internal Audit quarterly reports on this activity to me as the Accounting Officer and the results of all relevant internal audits are provided to EFA.
- Bank and Treasury officials meet quarterly to review performance against the parameters set out in the SLA and to consider wider operational and policy issues. The MBR Chief Operating Officer Division meet with EFA when needed to discuss operational risk issues. Additionally, I as the Accounting Officer and the Bank's Executive Director for Markets hold half-yearly meetings to discuss overall strategy and governance issues.

4.4 EFA considers and discusses the information provided with the Bank and Exchequer Funds Internal Audit and provides me as the Accounting Officer with quarterly reports that highlight the key risks.

4.5 Exchequer Funds Internal Audit provides an independent and objective opinion to me as the Accounting Officer on risk management, control and governance of the EEA. Assurance is provided following reviews of relevant Bank Internal Audit reports and EFA's oversight of the Bank's work, as agreed by me as the Accounting Officer and the Treasury Audit and Risk Committee. Exchequer Funds Internal Audit's reviews aim to measure and evaluate the effectiveness of the Treasury in achieving its agreed objectives in respect of the EEA. Exchequer Funds Internal Audit also reviews EFA's quarterly report to me as the Accounting Officer (mentioned above).

#### **EFIA Head of Internal Audit Report**

On the basis of my review of the Bank of England's Quarterly Assurance reports and the work of the Bank Internal Audit Division (BIAD) plus discussions with EFA Management and staff at the Bank, in my opinion the framework of governance, risk management and control for the EEA was adequate and effective during 2021-22. There were no matters arising from the work EFA Internal Audit (EFIA) have carried out in 2021-22 that would give rise to a separate comment in the governance statement nor areas of concern that I needed to bring to the specific attention of the Accounting Officer. This is the same level of assurance on the adequacy and effectiveness of governance, risk management and internal control that was issued to the Accounting Officer in 2020-21. Overall, from the review of the BIAD's reports and the quarterly assurance reports provided by the Bank, it is apparent that the processes within the Bank are well established and operating effectively.

The annual internal audit opinion is a key element of the assurance framework, which the Accounting Officer needs to inform her annual Governance Statement. It does not detract from the Accounting Officer's personal responsibility for the framework of governance, risk management and control, nor the effectiveness with which they take assurance from their senior management and format controls, as well as from internal audit.

BIAD's planned internal audit programme, including revisions to the programme during the course of the year, was reviewed and agreed between the Bank and HMT and endorsed by the Bank's Audit and Risk Committee. EFIA are sent copies of BIAD reports when they are issued.

Throughout the year, EFIA has continued to liaise with the EFA team. Quarterly meetings are held with BIAD and an annual meeting is also held between the two Internal Audit teams along with representatives from EFA and NAO. EFIA also attends the HMT Audit and Risk Committee meetings.

Malcolm Copeman  
Head of Internal Audit  
Exchequer Funds Internal Audit

4.6 The Audit and Risk Committee (ARC) supports the Permanent Secretary and the Treasury's additional accounting officers in their oversight responsibilities on financial reporting, systems of internal control as well as managing risk and governance in relation to the Treasury Group's Annual Report and Accounts, Central Funds (Consolidated Fund, National Loans Funds, Contingencies Fund and Exchange Equalisation Account) and Whole of Government Accounts. In accordance with the ARC Handbook, the Committee provides independent challenge on the robustness of the mechanisms in place, and the evidence provided, to deliver the assurance needed by the Board and Departmental Accounting Officers. Details on the overall risk and governance structure of HM Treasury can be found in the Governance Statement in the Treasury's Annual Report and Accounts.

4.7 Members of the Committee are appointed by the Chair along with the Principal Accounting Officer. The Chair of the Committee reports directly to the Permanent Secretary and is also a non-executive member of the Treasury Board.

4.8 The membership of the Audit and Risk Committee at the close of 2021-22 was:

- Zarin Patel (chair from 1 January 2022) – Zarin is a Qualified Chartered Accountant and brings broad experience, both executive and Non-Executive, from the public and private sectors. She is an experienced ARC Chair, Board Director, and a previous Chief Financial Officer with expertise in managing transformation within complex digital-centric businesses and broad experience across finance, investment, procurement, large capex, audit and corporate finance, as well as general management. Zarin's other roles include: NED and Chair of ARC, Member of Environment, Social and Governance Committee at Pets at Home Group PLC (2021 to date); NED, member of ARC, Senior Independent Director at Post Office (2019 to date); NED, Chair of ARC, Member of Nominations and Remuneration Committee of Anglian Water Services Limited (2018 to date); Trustee and Chair of ARC at National Trust, (2018 to date); Independent Member, ARC at John Lewis Partnership PLC, (2015 – 2021); Independent Governor and Chair of ARC at the University of Arts, London (2006 – 2012) and NED, Chair of Remuneration Committee and Chair of Audit Committee at BBC Worldwide Ltd (2005-2013).
- Sir Peter Estlin – Peter is an Alderman of the City of London Corporation. He is also an Independent Director at Rothschild & Co and Chair of the Association of Apprentices. Peter was also previously Group Financial Controller and acting Group CFO at Barclays.
- Edward Braham - Edward is Chair of M&G, having previously been the Senior Partner of the international law firm, Freshfields and a leading international M&A lawyer., As the Senior Partner, his focus was particularly on strategic growth in the US, addressing all aspects of sustainability, including culture and diversity and building on the firms existing environmental, social and governance (ESG) commitments. Edward's other roles include: Director of TheCityUK, Chair of its International Trade and Investment Group and member of its Nominations and Remuneration Committee; for the City of London Corporation: Mayoral and Shrieval Independent Panel, Innovation and Growth Advisory Board and Lord Mayor's Appeal Advisory Board; Member of the Campaign Board at the Museum of London (2021 to date); Member of the Advisory Council at Capital as a Force for Good (2021 to date); Member of the Court of the Goldsmiths Company, Trustee of the Goldsmiths' Charity and Chair of the Goldsmiths' Centre, the leading educational and workshop charity for the UK trade.

The following members reached the end of their appointments in 2021-22:

- Richard Meddings CBE - Richard provided risk and banking experience having been at Standard Chartered plc from 2002 until 2014 as Group Executive Director responsible for

Risk and as Group Finance Director for 8 years. He chaired ARCs for a number of FTSE 100 companies within the Financial Services sector. Richard served as a NED on the Boards of 3i plc, Legal & General plc, Deutsche Bank AG and Jardine Lloyd Thompson. He stepped down as Chair of TSB Bank in November 2021. Richard serves on a number of Boards including as a NED on the Board of Credit Suisse Group AG, as Deputy Chair of the charity Teach First and as Chair on the Hastings Opportunity Area. Richard has been appointed as Chair of NHS England, starting in March 2022.

- Tim Score - Tim's experience covered financial management and an in-depth knowledge of the technology sector. He was Chief Financial Officer of ARM Holdings plc from 2002 to 2015, Senior independent director, Chair of Audit and Interim Chairman at National Express Group (2005-2014), CFO of Rebus Group and William Baird PLC, and Group Financial Controller at BTR Plc and LucasVarity PLC. Tim's other roles include: Chair of The British Land Company plc. Member of the Board of Trustees of Royal National Theatre; Chair of the Audit Committee and interim independent NED of the Football Association; NED, Chair of Audit Committee and Senior Independent Director of Pearson plc; and NED and Chair of the Audit Committee of Bridgepoint Group plc.

4.9 The Treasury Audit and Risk Committee met seven times during 2021-22. Pre-meeting discussions with the National Audit Office and Internal Auditors were held before each session. Attendance is outlined in the table below:

	<b>Attended</b>
Zarin Patel	7/7
Richard Meddings	5/5
Tim Score	5/5
Sir Peter Estlin	6/7
Edward Braham	2/2

4.10 The Audit and Risk Committee has a robust Conflicts of Interest Policy, which requires members to excuse themselves from discussions where potential conflicts may occur. Members are required to inform the Permanent Secretary about any potential conflicts and highlight these at the start of each meeting as appropriate.

4.11 In addition to the independent members, the appropriate Accounting Officers, the Treasury's Group Director of Finance and the Treasury Accountant (or, in their absence, the Head of Exchequer Accounts) also attend Audit and Risk Committee meetings. Members have the opportunity for a pre-committee discussion with the National Audit Office, Group Head of Internal Audit for Treasury and Head of Exchequer Funds Internal Audit.

4.12 The Audit and Risk Committee challenged and approved the Internal Audit work programme throughout the year and followed up on management action to address audit recommendations.

4.13 The Chair of the Audit and Risk Committee is invited to report concerns or issues to the Treasury Board (Sub-committee). EFA feeds into the Treasury's Quarterly Performance and Risk Report (QPRR) which assesses the level of risk to delivery of the department's strategic objectives. The QPRR is discussed by both the Treasury Executive Management Board and the Treasury Board (Sub-Committee).

## 5. Risk profile

5.1 A detailed Risk and Control Self-Assessment is maintained by the Bank. In pursuit of its objectives, the EEA manages various risks which are inherent to trading in financial markets. These risks and the strategy for their management are kept under close review and if necessary additional mitigating actions are put in place to maintain the continuity and safe operation of the EEA for example to respond to a business continuity event. The material risks and associated controls are:

- **Transaction processing:** this includes the risk of a failure to instruct, execute or settle transactions correctly resulting in financial impact and/or trading with/across the wrong entity, identified/unidentified breach of policy (e.g. SLA Limits), or staff failing to meet compliance obligations when executing or settling trades. Processes are managed through control frameworks and independent review. Controls include validating trade confirmations with counterparties; reconciliations; dealer training; clear dealer mandates; segregation of duties, and assessment of incidents. There is system enforced checking of deals against limits and frequent risk reporting to identify and escalate breaches, as well as a clear operational governance framework and documentation. Markets has compliance policies specific to trading activities which are benchmarked and monitored by the MBR Chief Operating Officer Division, who also provide compliance training to staff. To mitigate any risks arising from hybrid working, the division has implemented enhanced compliance monitoring, e.g. reviewing dealer activity to ensure it is in line with working from home mandates etc. The division also manages contingency plans to ensure that all business critical functions continue to be operational. A central Bankwide compliance function and code of staff conduct are also in place.
- **IT systems and infrastructure:** this includes the risk that inadequate IT infrastructure and/or provision of IT services adversely impacts operations. To protect its information assets, including from cyber threat, the Bank maintains robust technology solutions, security policies and processes. The Bank aims to maintain a robust and flexible capability such that even if an event disrupts critical processes it is able to respond quickly and effectively and recover safely. Incidents are investigated with appropriate action taken where necessary and reported to Treasury. Locally there is proactive monitoring of all critical IT systems and the resources required to maintain and develop these, as well as change control procedures that are aligned to industry best practice. The Bank Cyber Defence Centre is currently operating additional security and threat intelligence monitoring checks in response to the threat of retaliatory cyber-attacks from Russia following the UK's response to the invasion of Ukraine.
- **People:** this includes the risk of insufficient or inadequate resources to deliver EEA objectives. The Bank is committed to attracting and retaining people of the highest calibre and relevant experience, and aims to be fully and appropriately resourced. Staff turnover, existing experience levels and welfare statistics are regularly monitored by senior management who also perform ongoing reviews of business priorities. Proactive contingency planning seeks to ensure there is sufficiently experienced staff available to deal with infrequent or unexpected events.
- **Legal:** this includes failure to comply with legal requirements or regulations including non-UK Tax reporting and/or withholding requirements. The Bank has in place business processes to ensure compliance with legal requirements. Third party expertise is employed to advise and support on fulfilling requirements. Internally, the Bank operates cross-directorate oversight of tax issues led by the Finance Directorate and the Legal Directorate review legal agreements prior to execution.

- **Project:** this includes the risk that a project objective is adversely impacted by a congested portfolio; budget constraints or an external event. Bank wide governance forums alongside MBR COO Division provide oversight and assurance– this includes the prioritisation and resource allocation to projects as needed. Other controls include horizon scanning for potential delivery risks.
- **Information security:** this includes the risk that confidential EEA information/data is compromised. The Bank seeks to operate within a highly secure environment and has established information security policies and processes in place, including standards for securing information both on and off premises. Given the shift to hybrid working, the MBR COO Division has enhanced monitoring in relation to mishandling information risks.
- **Data integrity:** this includes the risk that static data loaded incorrectly into systems impacts business processes, and/or leads to an identified/unidentified breach of policy (e.g. credit limits). The Bank has established processes for data integrity that includes an annual review and attestation process for all static data managed through an agreed governance structure. Other controls include staff awareness training on principles and improved processes for the input and authorisation of static data requests.
- **Model:** this includes the risk that a significant change in market fundamentals or lack of an effective model design lead to a sub-optimal asset allocation resulting in the EEA reserves not achieving set targets. The Bank has established controls in place including multiple price data sources along with an annual data review, in order to combat the potential for significant change in market fundamentals.

5.2 As noted above, the risk management strategy is set annually via the SLA, which is signed by me as Accounting Officer. The exposures to credit and market risk are detailed in note 18.

## 6. Review of effectiveness

6.1 In line with HM Government guidance, set out within the Corporate Governance Code of Good Practice for central government departments, I have reviewed the effectiveness of the system of internal control. My review is informed by the work of Exchequer Funds Internal Audit and Bank Internal Audit, who both provided primarily positive assurance as to the management and control of the EEA in 2021-22 and the executive managers within DRM, EFA and in the Bank, who have responsibility for the development and maintenance of the internal control framework, as well as by comments made by external auditors in their management letter and other reports. I have been supported by the Treasury Audit and Risk Committee and risk owners in addressing weaknesses and ensuring continuous improvement of the system is in place. Information about the effectiveness of the Treasury's overall system of governance including board effectiveness, attendance, compliance with the Corporate Governance Code and quality of management information reviewed, is reported in the Treasury's Annual Report and Accounts.

6.2 The Treasury Audit and Risk Committee considered the 2021-22 accounts in draft and provided me with its views before I formally signed the accounts.

6.3 No significant control issues, including personal data related incidents, have been identified in 2021-22, and no significant new risks have been identified in the year. No ministerial directions have been given in 2021-22.

6.4 In my opinion, the system of internal control was effective in all material aspects throughout the financial year, and remains so on the date I sign this report.

# **Parliamentary accountability and audit report**

## **Regularity of expenditure**

The expenditure and income of the EEA have been applied to the purposes intended by Parliament.

The investments of the EEA have been applied to the purposes intended by Parliament.

The above statements have been audited.

## **Losses and special payments**

The Official Reserves comprise two components: reserves that are hedged for currency and interest rate risk (the 'hedged reserves') and the remaining reserves which are unhedged for currency and interest rate risk (the 'unhedged reserves'). Any currency losses due to fluctuations in exchange rates are disclosed within the financial statements and the Annual Report.

The above statement has been audited.

## **Fees and charges**

The EEA does not have any fees and charges.

The above statement has been audited.

## **Remote contingent liabilities**

The EEA had no remote contingent liabilities as at 31 March 2022.

The above statement has been audited.

**Clare Lombardelli**  
Accounting Officer

12 July 2022



## THE CERTIFICATE AND REPORT OF THE COMPTROLLER AND AUDITOR GENERAL TO THE HOUSES OF PARLIAMENT

### Opinion on financial statements

I certify that I have audited the financial statements of the Exchange Equalisation Account for the year ended 31 March 2022 under the Exchange Equalisation Act 1979.

The financial statements comprise the Exchange Equalisation Account's

- Statement of Financial Position as at 31 March 2022;
- Statement of Comprehensive Income, Statement of Financial Position, and Statement of Cash Flows for the year then ended; and
- the related notes including the significant accounting policies.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and UK adopted International Accounting Standards.

In my opinion, the financial statements:

- give a true and fair view of the state of the Exchange Equalisation Account's affairs as at 31 March 2022 and its total comprehensive income for the year then ended; and
- have been properly prepared in accordance with the Exchange Equalisation Act 1979 and HM Treasury directions issued thereunder.

### Opinion on regularity

In my opinion, in all material respects, the income and expenditure recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

### Basis for opinions

I conducted my audit in accordance with International Standards on Auditing (UK) (ISAs UK), applicable law and Practice Note 10 *Audit of Financial Statements and Regularity of Public Sector Entities in the United Kingdom*. My responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements section* of my certificate.

Those standards require me and my staff to comply with the Financial Reporting Council's Revised Ethical Standard 2019. I have also elected to apply the ethical standards relevant to listed entities. I am independent of the Exchange Equalisation Account in accordance with the ethical requirements that are relevant to my audit of the financial statements in the UK. My staff and I have fulfilled our other ethical responsibilities in accordance with these requirements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

### Conclusions relating to going concern

In auditing the financial statements, I have concluded that the Exchange Equalisation Account's use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Based on the work I have performed, I have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Exchange

Equalisation Account's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

My responsibilities and the responsibilities of the Accounting Officer with respect to going concern are described in the relevant sections of this certificate.

The going concern basis of accounting for the Exchange Equalisation Account is adopted in consideration of the requirements set out in HM Treasury's Government Financial Reporting Manual, which require entities to adopt the going concern basis of accounting in the preparation of the financial statements where it anticipated that the services which they provide will continue into the future.

### **Other Information**

The other information comprises information included in the Performance Report and the Accountability Report, but does not include the financial statements nor my auditor's certificate and report. The Accounting Officer is responsible for the other information.

My opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in my certificate, I do not express any form of assurance conclusion thereon.

In connection with my audit of the financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the audit or otherwise appears to be materially misstated.

If I identify such material inconsistencies or apparent material misstatements, I am required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact.

I have nothing to report in this regard.

### **Opinion on other matters**

In my opinion, based on the work undertaken in the course of the audit:

- the parts of the Accountability Report subject to audit have been properly prepared in accordance with HM Treasury directions made under the Exchange Equalisation Account Act 1979;
- the information given in the Performance and Accountability Reports for the financial year for which the financial statements are prepared is consistent with the financial statements and is in accordance with the applicable legal requirements.

### **Matters on which I report by exception**

In the light of the knowledge and understanding of the Exchange Equalisation Account and its environment obtained in the course of the audit, I have not identified material misstatements in the Performance and Accountability Report.

I have nothing to report in respect of the following matters which I report to you if, in my opinion:

- I have not received all of the information and explanations I require for my audit; or

- adequate accounting records have not been kept by the Exchange Equalisation Account or returns adequate for my audit have not been received from branches not visited by my staff; or
- the financial statements and the parts of the Accountability Report subject to audit are not in agreement with the accounting records and returns; or
- the Governance Statement does not reflect compliance with HM Treasury's guidance.

### **Responsibilities of the Accounting Officer for the financial statements**

As explained more fully in the Statement of Accounting Officer's Responsibilities, the Accounting Officer is responsible for:

- maintaining proper accounting records;
- the preparation of the financial statements and Annual Report in accordance with the applicable financial reporting framework and for being satisfied that they give a true and fair view;
- ensuring that the Annual Report and accounts as a whole is fair, balanced and understandable;
- internal controls as the Accounting Officer determines is necessary to enable the preparation of the financial statements to be free from material misstatement, whether due to fraud or error; and
- assessing the Exchange Equalisation Account's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Accounting Officer anticipates that the services provided by the Exchange Equalisation Account will not continue to be provided in the future.

### **Auditor's responsibilities for the audit of the financial statements**

My responsibility is to audit, certify and report on the financial statements in accordance with the Exchange Equalisation Act 1979.

My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue a certificate that includes my opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

### **Extent to which the audit was considered capable of detecting non-compliance with laws and regulations including fraud**

I design procedures in line with my responsibilities, outlined above, to detect material misstatements in respect of non-compliance with laws and regulations, including fraud. The extent to which my procedures are capable of detecting non-compliance with laws and regulations, including fraud is detailed below.

### **Identifying and assessing potential risks related to non-compliance with laws and regulations, including fraud**

In identifying and assessing risks of material misstatement in respect of non-compliance with laws and regulations, including fraud, we considered the following:

- the nature of the sector, control environment and operational performance including the design of the Exchange Equalisation Account's accounting policies.
- Inquiring of management, the Exchange Equalisation Account's internal auditors and those charged with governance, including obtaining and reviewing supporting documentation relating to the Exchange Equalisation Account's policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud; and
  - the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations including the Exchange Equalisation Account's controls relating to the Exchange Equalisation Account's compliance with the Exchange Equalisation Act 1979 and Managing Public Money.
- discussing among the engagement team how and where fraud might occur in the financial statements and any potential indicators of fraud; and
- reviewing the sterling cash balance held by the EEA at the Bank of England to assess whether it has remained within the Service Level Agreement limits throughout the year.

As a result of these procedures, I considered the opportunities and incentives that may exist within the Exchange Equalisation Account for fraud and identified the greatest potential for fraud in the following areas: revenue recognition, posting of unusual journals and bias in management estimates. In common with all audits under ISAs (UK), I am also required to perform specific procedures to respond to the risk of management override of controls.

I also obtained an understanding of the Exchange Equalisation Account's framework of authority as well as other legal and regulatory frameworks in which the Exchange Equalisation Account operates, focusing on those laws and regulations that had a direct effect on material amounts and disclosures in the financial statements or that had a fundamental effect on the operations of the Exchange Equalisation Account. The key laws and regulations I considered in this context included the Exchange Equalisation Act 1979 and Managing Public Money.

### **Audit response to identified risk**

As a result of performing the above, the procedures I implemented to respond to identified risks included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described above as having direct effect on the financial statements;
- enquiring of management and the Audit and Risk Committee concerning actual and potential litigation and claims;
- reading and reviewing minutes of meetings of those charged with governance and the Board and internal audit reports;
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

I also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

A further description of my responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of my certificate.

### **Other auditor's responsibilities**

I am required to obtain evidence sufficient to give reasonable assurance that the income and expenditure reported in the financial statements have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them

I communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

### **Report**

I have no observations to make on these financial statements.

**Gareth Davies**  
Comptroller and Auditor General  
14 July 2022

National Audit Office  
157-197 Buckingham Palace Road  
Victoria  
London, SW1W 9SP

## Statement of Comprehensive Income

### For the year ended 31 March 2022:

	Note	2022 £ millions	2021 £ millions
Net trading income/ (loss)	2	(249)	(3,935)
Fair value changes in gold		2,374	(596)
Fees and commissions		(2)	(2)
Management charge	3	<u>(12)</u>	<u>(6)</u>
<b>Total comprehensive income/(loss) for the year</b>		<b><u>2,111</u></b>	<b><u>(4,539)</u></b>

The notes on pages 30 to 54 form an integral part of these accounts.

## Statement of Financial Position

	Note	31 March 2022 £ millions	31 March 2021 £ millions
<b>Assets</b>			
Cash	16	7,188	4,041
Items in the course of collection from banks	16	1,361	1,968
Money market instruments	4	10,117	4,624
Debt securities	5	73,829	81,805
Gold	6	14,696	12,322
Reverse repurchase agreements	7	10,954	13,286
Derivative financial assets	8	2,792	3,058
Other financial assets	9	446	382
Holdings of IMF Special Drawing Rights	13	33,778	12,366
<b>Total assets</b>		<b>155,161</b>	<b>133,852</b>
<b>Liabilities</b>			
Items in the course of transmission to banks	16	1,276	2,066
Debt securities - short positions	10	1,545	1,772
Repurchase agreements	11	17,058	16,015
Derivative financial liabilities	12	861	1,920
Other financial liabilities		10	1
SDR allocation	13	30,932	10,410
Liability to the National Loans Fund	14	103,479	101,668
<b>Total liabilities</b>		<b>155,161</b>	<b>133,852</b>

The notes on pages 30 to 54 form an integral part of these accounts.

**Clare Lombardelli**  
Accounting Officer  
12 July 2022

## Statement of Cash Flows

**For the year ended 31 March 2022:**

	Note	2022 £ millions	2021 £ millions
<b>Net cash inflow/(outflow) from operating activities</b>	15	<b>8,264</b>	<b>(1,695)</b>
<b>Cash flows from financing activities:</b>			
Cash inflow from National Loans Fund	14	4,900	6,800
Cash outflow to National Loans Fund	14	<u>(5,200)</u>	<u>(7,200)</u>
<b>Net cash inflow from financing activities</b>		<b><u>(300)</u></b>	<b><u>(400)</u></b>
<b>Net increase/(decrease) in cash and cash equivalents during the year</b>	16	<b>7,964</b>	<b>(2,095)</b>
<b>Cash and cash equivalents at the beginning of the year</b>	16	6,597	8,692
<b>Cash and cash equivalents at the end of the year</b>	16	<b><u>14,561</u></b>	<b><u>6,597</u></b>

The notes on pages 30 to 54 form an integral part of these accounts.



# Notes to the Accounts

## 1 Accounting policies

### Basis of preparation

The EEA produces accounts under the Exchange Equalisation Account Act 1979, as amended by the Finance Act 2000. These accounts have been prepared in accordance with the Accounts Direction, reproduced in the Annex to this report. The financial statements have been prepared in accordance with the current Government Financial Reporting Manual (FReM) issued by the Treasury. The accounting policies contained in the FReM apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector context. Where the FReM permits a choice of accounting policy, the accounting policy which is judged to be most appropriate to the particular circumstances of the EEA for the purpose of giving a true and fair view has been selected. The particular policies adopted are described below. They have been applied consistently in dealing with items that are considered material to the accounts.

These accounts are prepared on a trade date basis and all assets and liabilities are initially recognised at cost on their trade dates and then subsequently in line with the relevant accounting policy. The EEA is stated in millions of pounds sterling (£m). Under section 2 of the Exchange Equalisation Account Act 1979, the EEA is funded by central government through the NLF and the net assets of the EEA represent a liability to the NLF (see note 14 to the accounts for further detail). As the core functions of the EEA can be expected to continue for the foreseeable future, and there are no legislative changes in process, there is no reason to believe that funding will not continue to be forthcoming. Therefore, in accordance with the Government Financial Reporting Manual, it has been concluded as appropriate to adopt the going concern basis of preparation for the EEA Accounts.

### New and amended accounting standards

The accounting policies are consistent with the prior financial year, and there are no new or existing accounting standards, in issue or revised but not yet effective, that would impact on the EEA.

### Recognition of financial assets and financial liabilities

The EEA is managed and its performance evaluated on a fair value and homogenous basis. It has an overarching purpose to remain liquid and secure at all times to ensure the capability to intervene at short notice. Therefore, in accordance with IFRS 9, the financial assets and liabilities of the EEA are effectively 'held for trading' and therefore measured at fair value (as defined by IFRS 13), with gains and losses taken through the Statement of Comprehensive Income.

The EEA's liabilities are irrevocably measured at fair value through the Statement of Comprehensive Income, in accordance with IFRS 9, also eliminating accounting mismatches between the assets and liabilities of the portfolio.

There have been no reclassifications of financial instruments during the year. Financial assets are derecognised when the rights to receive cash flows have expired or where the EEA has transferred substantially all the risks and rewards of ownership. Financial liabilities are derecognised when they are extinguished, that is, when the obligation is discharged, cancelled or expires.

Details of the methodologies used to revalue different instrument classes are given below.

**i. Net trading income**

Net trading income comprises all gains and losses from changes in the fair value of the EEA financial assets and liabilities, together with related interest income and expense. Realised gains and losses on disposal or maturity are also included.

**ii. Special Drawing Rights (SDR) interest**

The EEA earns interest (in SDRs) on its holdings of SDRs and pays interest on its SDR allocation. This is included within net trading income. Interest (in SDRs) on loans to the IMF, both the UK's Reserve Tranche Position (RTP) and any lending under the NAB (NLF assets), is also received by the EEA and is recognised in these accounts as net trading income. All SDR interest is accounted for on an accruals basis.

**iii. Fees and commissions**

Fees and commissions are not material and are recognised in the Statement of Comprehensive Income as incurred.

**iv. Foreign currency translation**

Transactions denominated in foreign currencies are recorded in sterling using the rate prevailing at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities at the Statement of Financial Position date are recognised in the Statement of Comprehensive Income within net trading income.

**v. Cash and cash equivalents**

For the purpose of the Statement of Cash Flows, cash comprises balances at central banks and loans and advances to banks. Cash equivalents comprise highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments normally have maturities of less than three months from the date of acquisition and include settlement balances and money market instruments. Longer term deposits have maturities of more than three months from the date of acquisition and are classified as other financial assets.

**vi. Loans and advances to banks**

Loans and advances to banks comprise short-term deposits and cash held at commercial banks. These are initially recorded at the cost of funds advanced and are then revalued using a discounted cash flow valuation technique. All inputs into the pricing model are externally sourced and assumptions used are supported by observable market prices. Changes in the fair value of loans and advances are recognised in the Statement of Comprehensive Income, within net trading income, when they arise.

**vii. Items in course of collection from or transmission to other banks**

Money market instruments, debt securities, loans and advances to banks, reverse repos, deposits by banks, debt security short positions and repos are recorded on a trade date basis. For these financial assets and liabilities, between trade date and settlement date, any amounts payable to or receivable

from bank counterparties are recorded separately on the Statement of Financial Position, within items in the course of collection from banks or items in the course of transmission to banks, until settlement occurs.

### **viii. Money market instruments**

Money market instruments are reported at fair value. Money market instruments are initially recognised at cost, as the best estimate of fair value and are subsequently revalued to their market price daily. Changes in the fair value of money market instruments are recognised in the Statement of Comprehensive Income, within net trading income, when they arise.

Fair values are either determined by reference to quoted market prices, or by using internal models where no market price is readily obtainable. All inputs into the pricing models are externally sourced and assumptions used are supported by observable market prices. Money market instruments are priced at bid prices.

### **ix. Debt securities (including short positions)**

All debt securities are reported at fair value. Debt securities are initially recognised at cost, as the best estimate of fair value and are subsequently revalued to their market price daily. Changes in the fair value of debt securities are recognised in the Statement of Comprehensive Income, within net trading income, when they arise.

All bonds are valued directly by reference to published price quotations at 31 March 2022. Bonds are valued at bid prices. Short bond positions are valued at offer prices.

### **x. Gold**

Gold is treated as being similar to a financial asset and, as such, is reported at fair value. Gold holdings on deposit are valued at the sterling equivalent of the dollar denominated spot bid price as at 31 March 2022. Revaluation gains and losses on gold assets are recognised within fair value changes in gold in the Statement of Comprehensive Income.

### **xi. Repurchase (repo) and reverse repurchase (reverse repo) agreements**

Securities which have been sold with an agreement to repurchase remain on the Statement of Financial Position and the sale proceeds are recorded as a repo. Securities acquired in reverse sale and repurchase agreements are not recognised on the Statement of Financial Position and the purchase amount is recorded as a reverse repo.

Repurchase and reverse repurchase agreements are initially recognised at cost as the best estimate of fair value and subsequently revalued daily. These are valued using a discounted cash flow valuation technique. All inputs into the pricing model are externally sourced and assumptions used are supported by observable market prices. Changes in the fair value of repos and reverse repos are recognised in the Statement of Comprehensive Income, within net trading income, when they arise. Repos and reverse repos are marked to bid or offer prices, as appropriate.

### **xii. Derivative transactions**

Derivative transactions are used to manage risk in the reserves. Such instruments include exchange rate forwards, currency swaps, interest rate swaps and interest rate and bond futures. Derivatives are

carried at fair value and changes in the fair values are reported within net trading income in the Statement of Comprehensive Income. Fair values are either determined by reference to quoted market prices, or by using internal models where no market price is readily obtainable. All inputs into the pricing models are externally sourced and assumptions used are supported by observable market prices. Derivatives are marked to bid or offer prices, as appropriate.

Derivatives with positive fair values are recognised on the Statement of Financial Position within derivative financial assets. Derivatives with negative fair values are included within derivative financial liabilities.

Any cash flow receipts and payments relating to derivative transactions are recognised in net trading income as they occur.

### **xiii. International Monetary Fund Special Drawing Rights (SDRs)**

SDRs are an international reserve asset created by the IMF. It is currently valued in terms of a weighted basket of five currencies (US dollar, sterling, yen, euro and renminbi). SDR exchange rates are published by the IMF and SDRs are recognised on the Statement of Financial Position at their closing sterling value.

### **xiv. Collateral and netting**

The EEA enters into ISDA Master Agreements with counterparties requiring collateral to be pledged by both parties as appropriate. An ISDA Master Agreement contains close-out netting provisions which provide that, if an event of default occurs and a party chooses to close out its transaction(s) with its counterparty, all transactions documented under the ISDA Master Agreement with such counterparty will be closed-out at the same time and netted off against each other. A single resulting cash-flow will be owed from or to the EEA. The EEA also enters into bespoke foreign currency repo agreements with all repo counterparties, featuring close-out netting provisions.

Collateral is received in the form of cash or securities. Collateral received in the form of securities is not recorded on the Statement of Financial Position, and any coupons received are paid back to the counterparty. Collateral pledged remains on the Statement of Financial Position within Debt Securities.

Collateral received in the form of cash is recorded on the Statement of Financial Position with a corresponding liability, assigned to deposits by banks. Any interest arising on cash collateral received or pledged is recorded within net trading income.

Although master netting agreements are in place, the lack of intention to settle on a net basis results in the related assets and liabilities being reported gross in the Statement of Financial Position.

### **Critical accounting judgements and key sources of estimation uncertainty**

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the entity's accounting policies.

Judgement would be necessary in the valuation of financial instruments and gold should there be no readily available market prices. Further information about how financial instruments are valued in such circumstances is provided in the 'Debt securities' and 'Derivative transactions' accounting

policies above. At 31 March 2022 there were no valuations which are not supported by observable market prices or rates (2020-21: *£nil*). Gold and gold assets are treated as being similar to a financial asset and are reported at fair value as described in the ‘Gold’ accounting policy. The valuation of gold at 31 March 2022 was £14,696 million (2020-21: *£12,322 million*).

The financial assets and financial liabilities of the EEA are classified as held for trading, as they all form part of a portfolio that is managed as a whole and for which there is evidence of a recent pattern of short-term profit taking.

**2 Net trading income**

	2022 £ millions	2021 £ millions
Money market instruments	67	(432)
Debt securities (incl. short positions)	(703)	(7,169)
Reverse repurchase agreements	(167)	(877)
Repurchase agreements	(247)	1,386
Futures	(41)	(1)
Foreign exchange transactions	409	(564)
Currency swaps	(44)	3,855
Interest rate swaps	384	16
Loans and deposits	43	(3)
Reserve Tranche Position	5	4
Special Drawing Rights	56	(138)
Nostros	(11)	(12)
<b>Total</b>	<b>(249)</b>	<b>(3,935)</b>

**3 Management charge**

There was a management charge of £12 million (2020-21: £6 million). The increase against the prior year reflects the adoption of full cost recovery by the Bank of England for costs incurred in managing the EEA.<sup>6</sup>

**4 Money market instruments**

	2022 £ millions	2021 £ millions
Treasury bills	4,039	1,035
Commercial paper	6,078	3,589
<b>Total</b>	<b>10,117</b>	<b>4,624</b>
	2022 £ millions	2021 £ millions
<b>Amounts maturing:</b>		
In not more than 3 months	7,288	2,654
In 1 year or less but over 3 months	2,829	1,970
<b>Total</b>	<b>10,117</b>	<b>4,624</b>

<sup>6</sup> In 2021-22 the cost sharing arrangement between the Treasury and the Bank for the EEA management charge ended. The Treasury now covers the full management charge under the principle of full cost recovery as set out in the 'Financial Relationship between HM Treasury and the Bank of England'. See <https://www.bankofengland.co.uk/-/media/boe/files/memoranda-of-understanding/financial-relationship-between-hmt-and-the-boe-memorandum-of-understanding.pdf>

**5 Debt securities**

	2022	2021
	£ millions	£ millions
<b>Issued by:</b>		
Government	59,952	70,366
Other Public Sector	<u>13,877</u>	<u>11,439</u>
<b>Total</b>	<b><u>73,829</u></b>	<b><u>81,805</u></b>
	2022	2021
	£ millions	£ millions
<b>Amounts maturing:</b>		
Current	9,556	10,778
Non-current	<u>64,273</u>	<u>71,027</u>
<b>Total</b>	<b><u>73,829</u></b>	<b><u>81,805</u></b>

**6 Gold**

	2022	2021
	£ millions	£ millions
Gold Stock	<u>14,696</u>	<u>12,322</u>
<b>Total</b>	<b><u>14,696</u></b>	<b><u>12,322</u></b>

There were no gold loan/deposit or swap trades undertaken during the year (2020-21: nil).

**7 Reverse repurchase agreements**

	2022	2021
	£ millions	£ millions
<b>Amounts maturing:</b>		
Current	<u>10,954</u>	<u>13,286</u>
<b>Total</b>	<b><u>10,954</u></b>	<b><u>13,286</u></b>

An analysis of reverse repos together with their backing collateral is provided in note 18.

The EEA is permitted under the terms of its reverse repo transactions to sell debt securities held as collateral. The carrying amount of short positions in debt securities arising as a result of selling collateral held is given in note 10.

**8 Derivative financial assets**

	2022 £ millions	2021 £ millions
Foreign exchange transactions	488	810
Currency swaps	1,877	1,912
Interest rate swaps	422	336
Futures	5	-
<b>Total</b>	<b>2,792</b>	<b>3,058</b>

An analysis of derivative financial assets together with their backing collateral is provided in note 18.

**9 Other financial assets**

	2022 £ millions	2021 £ millions
Margin accounts	14	2
Prepayments and accrued income	11	2
Longer term deposits	421	378
<b>Total</b>	<b>446</b>	<b>382</b>

**10 Debt securities - short positions**

	2022 £ millions	2021 £ millions
Debt securities – short positions	1,545	1,772
<b>Total</b>	<b>1,545</b>	<b>1,772</b>

Short positions in securities relate to the sale of bonds acquired as collateral through reverse repurchase transactions (see note 7).

**11 Repurchase agreements**

	2022 £ millions	2021 £ millions
<b>Amounts maturing:</b>		
Current	17,058	16,015
<b>Total</b>	<b>17,058</b>	<b>16,015</b>

An analysis of repos together with the collateral pledged is provided in note 18.



**12 Derivative financial liabilities**

	2022	2021
	£ millions	£ millions
Foreign exchange transactions	266	563
Currency swaps	453	763
Interest rate swaps	142	594
Futures	-	-
<b>Total</b>	<b>861</b>	<b>1,920</b>

An analysis of derivative financial liabilities together with the collateral pledged is provided in note 18.

**13 SDR Allocation and SDR Holdings**

The EEA has a liability to the IMF for those SDRs that have been allocated since the UK became a participant in the Special Drawing Rights Agreement. If the UK withdraws from participation or the Agreement is wound up, payment to the IMF would be required at current exchange rates. The SDR liability as at 31 March 2022 rose to £30,932 million (*2020-21: £10,410 million*) primarily due to the IMF general allocation issued on 23 August 2021.

The SDR holdings of the EEA as at 31 March 2022 was £33,778 million (*2020-21: £12,366 million*). These holdings result from SDR allocations made by the IMF, any subsequent purchases and sales of SDRs from or to other IMF members and fair value changes. SDR holdings may include SDR denominated promissory notes issued by the IMF in return for the advance of SDRs via the Poverty Reduction and Growth Trust facility. At 31 March 2022 £2,782 million worth of such notes were held by the EEA (*2020-21: £2,214 million*). During 2021-22, the EEA purchased £829 million (net) worth of SDRs (*2020-21: purchased £371 million*).

Further detail on the SDRs is provided in paragraphs 23-24 in the Overview section of the Performance Report.

**14 Liability to the National Loans Fund**

The net assets of the EEA represent a liability to the NLF. There are two elements of the Liability to the NLF: a specific liability, recognised in accordance with the National Loans Act 1968 of £65,947 million at 31 March 2022 (*2020-21: £66,247 million*) that represents the balance of advances made by the NLF and not repaid; and a separate amount that represents the EEA's total assets, less recognised liabilities. This second element consists of the capital contribution reserve and the accumulated income and expenditure reserve.

The EEA is funded by central government through the NLF. Over time, the NLF has advanced sterling to the EEA in order to finance the reserves. Similarly, when the NLF issues foreign currency securities in order to raise foreign currency finance, that would subsequently be transferred to the EEA. As a result, the EEA's net assets, having been derived from initial NLF financing, are ultimately due to the NLF, and are recognised as such on the Statement of Financial Position. If a policy decision is taken to reduce the assets of the EEA, the sterling excess raised via sale of foreign currency assets would be paid to the NLF, at the direction of the Treasury.

### **Specific liability to the NLF**

The specific element of the liability to the NLF, described in the National Loans Act 1968, is the mechanism through which the EEA's day to day sterling cash flows are managed.

The sterling balance held by the EEA at the Bank of England is maintained within a range, agreed by management. When the balance falls below the minimum level, it can be increased by a fresh issue of capital from the NLF under the terms of section 7 of the National Loans Act 1968. This creates a liability of the EEA to the NLF. Conversely, when foreign currency is sold for sterling with the result that the sterling balance is in excess of the EEA's requirements, the Treasury can decide that some reduction should be made by a transfer from the EEA to the NLF.

If there is no outstanding specific liability to the NLF at the time of a sterling transfer from the EEA to the NLF, then the transfer is treated as a 'capital repayment' and is used to reduce the capital contribution reserve. The effect on the combined liability to the NLF, recognised in the Statement of Financial Position, is identical.

The remainder of the liability to the NLF consists of the capital contribution reserve and the accumulated income & expenditure reserve. These items are described in detail below.

### **Capital contribution reserve**

When UK GAAP compliant accounts were prepared for the first time for the EEA, being for the year ended 31 March 2001, an amount equivalent to the total recognised assets, less liabilities, less the balance on the specific liability to the NLF in the opening Statement of Financial Position of that year, was taken to be the opening balance for the capital contribution reserve. The amount of the capital contribution reserve is periodically reduced, as explained above, because when there is no outstanding specific liability to the NLF, sterling repayments by the EEA to the NLF are taken to the capital contribution reserve. There were no reductions during the year (2020-21: nil).

### **Accumulated comprehensive income reserve**

All gains and losses of the EEA, since UK GAAP compliant accounts were first prepared in 2001, have been taken to the accumulated comprehensive income reserve.

The following table shows the movements in each of the elements described above, and the overall liability to the NLF, during the year.

All amounts in £ millions	Accumulated comprehensive income reserve	Capital contribution reserve	Specific liability to the NLF	2022 Overall liability to the NLF
Balance at 1 April 2021	26,184	9,237	66,247	101,668
Transfers from the NLF	-	-	4,900	4,900
Repayments to the NLF	-	-	(5,200)	(5,200)
Total comprehensive income	2,111	-	-	2,111
Balance at 31 March 2022	<b>28,295</b>	<b>9,237</b>	<b>65,947</b>	<b>103,479</b>

All amounts in £ millions	Accumulated comprehensive income reserve	Capital contribution reserve	Specific liability to the NLF	2021 Overall liability to the NLF
Balance at 1 April 2020	30,723	9,237	66,647	106,607
Transfers from the NLF	-	-	6,800	6,800
Repayments to the NLF	-	-	(7,200)	(7,200)
Total comprehensive income	(4,539)	-	-	(4,539)
Balance at 31 March 2021	<b>26,184</b>	<b>9,237</b>	<b>66,247</b>	<b>101,668</b>

## 15 Reconciliation of Statement of Comprehensive Income to net cash outflow from operating activities

	2022 £ millions	2021 £ millions
Total comprehensive income/(loss) for the year	2,111	(4,539)
Net decrease/(increase) in money market instruments	(859)	2,826
Net decrease/(increase) in debt securities	7,976	10,353
Net decrease/(increase) in gold	(2,374)	596
Net decrease/(increase) in reverse repurchase agreements	2,332	(4,461)
Net decrease/(increase) in derivative financial assets	266	(1,636)
Net decrease/(increase) in other assets	(64)	21
Net decrease/(increase) in holding of SDRs	(21,412)	498
Net (decrease)/increase in debt securities - short positions	(227)	(147)
Net (decrease)/increase in repurchase agreements	1,043	(397)
Net (decrease)/increase in derivative financial liabilities	(1,059)	(4,062)
Net (decrease)/increase in other financial liabilities	9	(7)
Net (decrease)/increase in SDR allocation	20,522	(740)
<b>Net cash (outflow)/inflow from operating activities</b>	<b>8,264</b>	<b>(1,695)</b>

**16 Cash and cash equivalents**

	1 April 2021 £ millions	Cash flow £ millions	31 March 2022 £ millions
Cash at Central Banks	4,041	3,147	7,188
Loans and advances to banks	-	-	-
	<u>4,041</u>	<u>3,147</u>	<u>7,188</u>
<i>Amounts with original maturity less than 3 months:</i>			
Items in the course of collection from banks	1,968	(607)	1,361
Money market instruments	2,654	4,634	7,288
Items in the course of transmission to banks	<u>(2,066)</u>	<u>790</u>	<u>(1,276)</u>
	2,556	4,817	7,373
<b>Total</b>	<b><u>6,597</u></b>	<b><u>7,964</u></b>	<b><u>14,561</u></b>

	1 April 2020 £ millions	Cash flow £ millions	31 March 2021 £ millions
<i>Cash at Central Banks</i>	5,160	(1,119)	4,041
<i>Loans and advances to banks</i>	1	(1)	-
	<u>5,161</u>	<u>(1,120)</u>	<u>4,041</u>
<i>Amounts with original maturity less than 3 months:</i>			
<i>Items in the course of collection from banks</i>	1,352	616	1,968
<i>Money market instruments</i>	4,173	(1,519)	2,654
<i>Items in the course of transmission to banks</i>	<u>(1,994)</u>	<u>(72)</u>	<u>(2,066)</u>
	3,531	(975)	2,556
<b>Total</b>	<b><u>8,692</u></b>	<b><u>(2,095)</u></b>	<b><u>6,597</u></b>

## 17 Related Party Transactions

The NatWest Group plc<sup>7</sup> is regarded as a related party of the EEA. On 1 December 2008, the UK Government, through the Treasury<sup>8</sup>, became the ultimate controlling party of The NatWest Group plc. At 31 March 2022, the government's holding is 48.03%. During the year the EEA entered into various transactions with The NatWest Group plc, which were all conducted on an arm's length basis and were part of the EEA's normal activity. There was no outstanding exposure at 31 March 2022 (31 March 2021: £52 million).

During the year, the EEA has not entered into transactions with any other financial institutions in which the UK government has an investment.

The EEA has provided foreign currency services for a number of government departments and agencies during the year.

## 18 Risk management and control

A summary of the key features of the control framework for the EEA during the year and management's objectives and policies for managing risks is provided in the Governance Statement (page 14).

A detailed review of the financial risks to which the EEA is exposed and how they are managed is given below, along with quantitative data in respect of those risks. In each case, the data provided reflects the year-end position unless stated otherwise.

### a. Market risk

Market risk is the risk arising from exposure to movements in market variables. Through its investments in fixed income assets, the main market variables to which the EEA is mostly exposed are interest rates and exchange rates. To limit any undue influence of the EEA on fiscal metrics, market risk as a whole is tolerated up to the level set out in the EEA Investment Policy Statement (IPS).

Each year, the Bank proposes a strategic asset allocation for the EEA's currency reserves, for HM Treasury to review and agree. The strategic asset allocation represents a benchmark for the portfolio and sets an allocation which seeks to achieve optimal return relative to the amount of market risk taken. Performance of the portfolio, in terms of mark-to-market values, return and market risk, is regularly compared to that of the strategic asset allocation.

Active Management (where positions are taken relative to the benchmarks set for the reserves) may involve exposure to market risk over and above that of the benchmark positions.

A proportion of assets held are hedged, which reduces foreign currency and interest rate risk; and a proportion are unhedged. Using currency swaps and interest rate swaps, the future cash flows from the assets held are swapped back into the currency and interest rate profile of the originating liability (either sterling swapped into foreign currency or through foreign currency issuances on the NLF).

<sup>7</sup> Formerly The Royal Bank of Scotland Group plc.

<sup>8</sup> Details of HM Treasury's holdings can be found on UK Government Investments Ltd's website at <http://www.ukgi.org.uk>.

In broad terms, the Bank monitors market risk by tracking changes in the value of the EEA; specifically, the standard deviation of rolling 12-month fluctuations in the sterling mark-to-market value of the EEA's Foreign Currency Reserves and gold investments.

### Value at Risk

Additionally, the Bank monitors and controls market risk primarily by using a Value at Risk (VaR) model, which estimates a loss level that will not be exceeded at a specified confidence level, over a defined period of time.

For the calculation of the VaR, the Bank applies a 99% confidence interval and a 10-day holding period (i.e. it is expected that losses will not exceed the VaR figure in ninety nine out of a hundred days). The VaR estimates are based on the historic volatility of returns on different asset classes – in some cases a simplified set – and the historical correlation between returns on those asset classes.

VaR is supplemented by a suite of stress tests comprised of both static stress scenarios (e.g generic curve shifts or specific historic stress scenarios) and a range of dynamic stress scenarios calibrated to specifically target certain aspects of the EEA's current risk profile or exposure to prevailing market conditions.

VaR is calculated separately for hedged and unhedged assets in the Foreign Currency Reserves, and separately for active management activities. VaR data is reported in USD primarily because the risk limits are based in USD and it is the main reporting currency used for performance and risk management purposes.

#### *Foreign Currency Reserves*

The Bank calculates the VaR on the Foreign Currency Reserves annually. The values for the Foreign Currency Reserves are based on marked-to-market prices at the end of the period.

VaR as at 31 March	\$ millions	<i>\$ millions</i>
	<u>2022</u>	<u>2021</u>
Foreign Currency Reserves Total	2,609	3,088
<i>of which</i> <sup>9</sup> :		
Unhedged Assets	2,608	3,085
Hedged Assets	92	65

#### *Active Management*

Two VaR measures are used to assess risk arising from active management: an unweighted VaR where an equal weight is assigned to all historic market data, and an exponentially-weighted VaR which gives greater weight to more recent historic market data. The higher of these two numbers is reported as the overall VaR.

VaR on active management positions is measured on a daily basis and subject to monthly back-testing reporting to HMT. Assuming that both models are appropriate, and that the volatility and correlation inputs are an accurate reflection of current market conditions, losses greater than the VaR figure are expected to occur with a probability of 1%.

<sup>9</sup> The two VaR figures may not sum to the Total VaR; VaR is not sub-additive due to the role of correlations within the portfolio.

Under the SLA, the Treasury sets the Bank a VaR limit for active management relative to benchmarks, with the VaR being calculated at close of business each day. In 2021-22 the VaR limit for active management was \$20 million. During the year the Bank's use of VaR did not exceed \$14.83 million. The average VaR during the year was \$9.48 million and the lowest VaR on any one day was \$6.33 million.

Active management VaR during the year, (calculated at the close of business each day in US dollars), was as follows:

	\$ millions	<i>\$ millions</i>
	2022	2021
VaR as at 31 March	9.93	8.04
Average during the year	9.48	7.28
Maximum VaR during the year	14.83	14.43
Minimum VaR during the year	6.33	5.30
VaR limit during the year	20.00	20.00

The minimum VaR is the higher of unweighted and exponentially weighted on a given day.

The Bank also measures the change in value of the active management portfolio from a one basis point shift in the relevant yield curve.

## **b. Credit risk**

The reserves are exposed to credit risk through exposures to trading counterparties and to the issuers of securities. The creditworthiness of these counterparties and issuers is subject to regular scrutiny by the Bank, through analysis in the Financial Risk Management Division (FRMD) and review by the Bank's Credit Ratings Advisory Committee (CRAC) chaired by the Head of FRMD. Assessments are performed both routinely, and dynamically, in response to market or specific entity conditions.

Credit risk is controlled by counterparty and issuer limits and collateralisation. Exposure to issuers and counterparties is monitored against limits in real time wherever possible. In the case of derivatives contracts, exposure is measured as the marked-to-market value plus an estimate of the potential future exposure calculated using a parametric approach, volatility and correlation data. Limits are set for both individual entities and groups of related entities. Limits are also set on the maturity of repo, swaps and foreign exchange transactions with counterparties. Any limit excesses are reported to the Treasury each month.

The arrangements for custody of EEA assets in 2021-22 were as follows: US Treasury bonds and other US dollar denominated securities were held in custody at the Federal Reserve Bank of New York and Canadian dollar denominated securities were held in custody at Bank of Canada. Euro and renminbi denominated securities were held in custody at Clearstream. Japanese bonds were held in custody at the Bank of Japan. The gold bars and gold coin in the reserves were stored physically at the Bank's premises.

The EEA continued to invest in high credit quality assets throughout the year. Foreign currency assets held in the EEA inevitably carry some element of credit risk. In order to keep this risk at a low level, the majority of the EEA funds are invested in high quality sovereign, both government and non-government guaranteed issuers or supranational bonds, and are predominantly invested in securities issued by the national Governments of the United States, Canada, Australia, Eurozone countries and Japan. The amount that best represents the EEA's maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements is the carrying value of the EEA's assets.

*Concentration of exposure*

Concentration of credit risk arises when a number of issuers or counterparties have comparable economic characteristics, or are engaged in similar activities or operate in the same geographical areas, so that their collective ability to meet contractual obligations is similarly affected by changes in economic, political or other conditions.

The tables below illustrate the concentration of the assets held by the EEA first by geographical region and, second, by credit rating.

*Concentration of EEA assets by geographical region*

2022

£ millions	United Kingdom	Europe	North America	Asia-Pacific	Other	Total
Cash	1,664	3,300	958	1,266	-	7,188
Items in course of collection from banks	910	-	451	-	-	1,361
Money market instruments	-	9,539	578	-	-	10,117
Debt Securities	(95)	24,492	44,017	5,312	103	73,829
Gold	-	-	-	-	14,696	14,696
Reverse repurchase agreements	5,135	4,809	1,010	-	-	10,954
Derivative financial assets	488	1,215	1,064	25	-	2,792
Other financial assets	14	103	-	317	12	446
IMF SDRs	-	-	-	-	33,778	33,778
<b>Total Assets</b>	<b>8,116</b>	<b>43,458</b>	<b>48,078</b>	<b>6,920</b>	<b>48,589</b>	<b>155,161</b>

2021

£ millions	United Kingdom	Europe	North America	Asia-Pacific	Other	Total
Cash	1,539	470	850	1,182	-	4,041
Items in course of collection from banks	499	825	644	-	-	1,968
Money market instruments	-	4,624	-	-	-	4,624
Debt Securities	(86)	31,932	45,526	4,333	100	81,805
Gold	-	-	-	-	12,322	12,322
Reverse repurchase agreements	2,695	8,057	2,534	-	-	13,286
Derivative financial assets	1,051	815	1,153	39	-	3,058
Other financial assets	2	109	-	269	2	382
IMF SDRs	-	-	-	-	12,366	12,366
<b>Total Assets</b>	<b>5,700</b>	<b>46,832</b>	<b>50,707</b>	<b>5,823</b>	<b>24,790</b>	<b>133,852</b>



*Concentration of EEA assets by credit rating*

2022

£ millions	1	2	3	Other	Total
Cash	4,297	1,224	3	1,664	7,188
Items in course of collection from banks	312	578	471	-	1,361
Money market instruments	9,530	587	-	-	10,117
Debt Securities	67,257	6,540	32	-	73,829
Gold	-	-	-	14,696	14,696
Reverse repurchase agreements	86	6,869	3,999	-	10,954
Derivative financial assets	627	1,378	648	139	2,792
Other financial assets	-	434	-	12	446
IMF SDRs	-	-	-	33,778	33,778
<b>Total Assets</b>	<b>82,109</b>	<b>17,610</b>	<b>5,153</b>	<b>50,289</b>	<b>155,161</b>

2021

£ millions	1	2	3	Other	Total
Cash	1,318	1,181	4	1,538	4,041
Items in course of collection from banks	236	1,511	221	-	1,968
Money market instruments	4,072	552	-	-	4,624
Debt Securities	76,658	5,062	85	-	81,805
Gold	-	-	-	12,322	12,322
Reverse repurchase agreements	371	6,334	6,581	-	13,286
Derivative financial assets	654	1,193	654	557	3,058
Other financial assets	-	380	-	2	382
IMF SDRs	-	-	-	12,366	12,366
<b>Total Assets</b>	<b>83,309</b>	<b>16,213</b>	<b>7,545</b>	<b>26,785</b>	<b>133,852</b>

The Bank carries out an internal, independent credit assessment of EEA counterparties and issuers. For the purposes of aggregated tables each internal rating has been assigned to category 1, 2 or 3.

Category '1' comprises banks, banking groups, central banks, sovereigns and supranational organisations with a very low risk of default, approximately equivalent to an external rating agency rating of AA and above.

Category '2' comprises banks, banking groups, central banks, sovereigns and supranational organisations with a low risk of default, approximately equivalent to an external rating agency rating of A to AA.

Category '3' comprises exposures to counterparties and issuers which, although less able to withstand severe unexpected shocks without risk of insolvency, there are no immediate concerns about their credit worthiness, approximately equivalent to an external rating agency rating of below A.

Category 'Other' comprises unrated positions including Gold and SDR holdings and balances with UK Government agencies and the Bank of England.

None of the EEA's financial assets are past due or impaired.

At 31 March 2022, credit exposures to issuers of money market instruments, debt securities (less debt securities – short positions) and bond futures stood at £84,204 million (2020-21: £84,936 million).

In addition to the use of credit limits, exposure to credit risk is managed through other mitigation measures, as outlined below.

#### *Netting agreements and collateral*

The EEA's credit exposure in respect of its derivative transactions is mitigated by provisions in the Bank's ISDA documentation, specifically those relating to collateral and netting arrangements. Additional collateral can be requested from a counterparty in response to changes in the market values of underlying transactions or a deterioration in such counterparty's credit standing. In the case of a counterparty defaulting on its obligations and the EEA closing-out such transactions, any resulting exposure will be netted across all outstanding transactions under the ISDA documentation with such counterparty, so as to produce a single cash flow.

Similar netting provisions are in place for transactions governed by bespoke foreign currency repo documentation.

For funds advanced under reverse repo, the EEA takes collateral in the form of high quality securities, which must be of a type that the EEA is authorised to hold as an investment and as agreed in the EEA's repo documentation.

For interest rate and cross currency swaps and foreign exchange transactions transacted under ISDA Master Agreements, collateral can take the form of high quality securities or, in exceptional circumstances, cash denominated in US dollar and euro.

**Maximum exposure and effects of collateral**

<i>Reverse repos</i>	2022	2021
	£ millions	£ millions
Reverse repos	10,954	13,286
less: securities received as collateral	(11,042)	(13,549)
less: margin called under terms of loan agreement	178	69
<b>Reverse repos - collateral (surplus)</b>	<b>90</b>	<b>(194)</b>
<i>Derivatives</i>	2022	2021
	£ millions	£ millions
Derivative assets gross exposure	2,792	3,058
less: securities received as collateral	(2,099)	(884)
<b>Derivative asset - collateral deficit</b>	<b>693</b>	<b>2,174</b>
Derivative liabilities gross exposure	(861)	(1,920)
less: securities pledged as collateral	9	356
<b>Derivative liability – collateral (surplus)</b>	<b>(852)</b>	<b>(1,564)</b>
<b>Derivatives - net collateral deficit/(surplus)</b>	<b>(159)</b>	<b>610</b>

**Collateral pledged**

The EEA has pledged the following amounts as collateral for liabilities:

	2022	2021
	£ millions	£ millions
Repos	16,422	15,601
Derivative liabilities	9	356
	<b>16,431</b>	<b>15,957</b>

*Settlement processes*

Wherever possible, trades are settled as Delivery versus Payment, with simultaneous exchange of cash and stock. Settlement limits are used to control FX settlement risk

**c. Liquidity risk**

The NLF provides sterling funding to the EEA when required, and therefore the EEA, as an individual entity, is not exposed to sterling liquidity risk.

The EEA maintains a sterling account with the NLF that is used as the mechanism via which funding is transferred to the EEA, and excess cash is repaid to the NLF. This account is monitored daily and is maintained within a range. Forward looking cash flow forecasts are used to predict likely demand for cash in the EEA. Requests for funding from the NLF, and for repayments to be made, are processed when the account is forecasted to fall below, or to exceed, the range.

*Undiscounted contractual cash flows of financial assets and liabilities*

The tables below present the cash flows to/from the EEA arising from financial assets and liabilities until their contractual maturity date. The amounts disclosed in the tables are the contractual undiscounted cash outflows, whereas amounts are presented in the Statement of Financial Position at their carrying values, as detailed in note 1 – Accounting policies.

The maturity analysis for derivative financial assets and liabilities includes both known cash inflows and outflows projected by current forward rates for the floating leg of currency and interest rate swaps.

*Undiscounted contractual cash flows of financial assets***As at 31 March 2022:**

<b>All amounts in £ millions</b>	<b>Up to 1 month</b>	<b>1 to 3 months</b>	<b>3 to 12 months</b>	<b>1 to 5 years</b>	<b>More than 5 years</b>	<b>Undated</b>	<b>Total</b>
Cash balances	7,188	-	-	-	-	-	7,188
Items in course of collection from banks	1,361	-	-	-	-	-	1,361
Money market instruments	1,944	5,344	2,823	-	-	-	10,111
Debt securities	444	1,801	8,267	34,280	34,655	-	79,447
Gold	-	-	-	-	-	14,696	14,696
Reverse repurchase agreements	5,887	4,753	313	-	-	-	10,953
Derivative financial assets - inflow	2,609	5,096	8,893	16,244	16,964	-	49,806
Derivative financial assets - outflow	(2,513)	(4,879)	(8,422)	(14,665)	(15,927)	-	(46,406)
Other financial assets	95	287	68	-	-	-	450
SDR Holdings	-	-	-	-	-	33,778	33,778
<b>Total</b>	<b>17,015</b>	<b>12,402</b>	<b>11,942</b>	<b>35,859</b>	<b>35,692</b>	<b>48,474</b>	<b>161,384</b>

*Undiscounted contractual cash flows of financial liabilities***As at 31 March 2022:**

<b>All amounts in £ millions</b>	<b>Up to 1 month</b>	<b>1 to 3 months</b>	<b>3 to 12 months</b>	<b>1 to 5 years</b>	<b>More than 5 years</b>	<b>Undated</b>	<b>Total</b>
Items in the course of transmission to banks	(1,276)	-	-	-	-	-	(1,276)
Debt securities – short positions	(1,545)	-	-	-	-	-	(1,545)
Repurchase agreements	(7,584)	(9,165)	(313)	-	-	-	(17,062)
Derivative financial liabilities – inflows	825	2,282	6,790	7,667	1,042	-	18,606
Derivative financial liabilities – outflows	(843)	(2,500)	(7,177)	(7,964)	(1,081)	-	(19,565)
Other financial liabilities	(10)	-	-	-	-	-	(10)
SDR Allocation	-	-	-	-	-	(30,932)	(30,932)
Liability to the NLF	-	-	-	-	-	(103,479)	(103,479)
<b>Total</b>	<b>(10,433)</b>	<b>(9,383)</b>	<b>(700)</b>	<b>(297)</b>	<b>(39)</b>	<b>(134,411)</b>	<b>(155,263)</b>

*Undiscounted contractual cash flows of financial assets***As at 31 March 2021:**

<b>All amounts in £ millions</b>	<b>Up to 1 month</b>	<b>1 to 3 months</b>	<b>3 to 12 months</b>	<b>1 to 5 years</b>	<b>More than 5 years</b>	<b>Undated</b>	<b>Total</b>
Cash balances	4,041	-	-	-	-	-	4,041
Items in course of collection from banks	1,968	-	-	-	-	-	1,968
Money market instruments	1,680	973	1,967	-	-	-	4,620
Debt securities	433	2,081	9,249	51,990	19,678	-	83,431
Gold	-	-	-	-	-	12,322	12,322
Reverse repurchase agreements	7,433	5,852	-	-	-	-	13,285
Derivative financial assets - inflow	5,975	7,882	9,866	22,765	4,477	-	50,965
Derivative financial assets - outflow	(5,824)	(7,506)	(9,234)	(21,367)	(3,991)	-	(47,922)
Other financial assets	65	146	174	-	-	-	385
SDR Holdings	-	-	-	-	-	12,366	12,366
<b>Total</b>	<b>15,771</b>	<b>9,428</b>	<b>12,022</b>	<b>53,388</b>	<b>20,164</b>	<b>24,688</b>	<b>135,461</b>

*Undiscounted contractual cash flows of financial liabilities***As at 31 March 2021:**

<b>All amounts in £ millions</b>	<b>Up to 1 month</b>	<b>1 to 3 months</b>	<b>3 to 12 months</b>	<b>1 to 5 years</b>	<b>More than 5 years</b>	<b>Undated</b>	<b>Total</b>
Items in the course of transmission to banks	(2,066)	-	-	-	-	-	(2,066)
Debt securities – short positions	(1,772)	-	-	-	-	-	(1,772)
Repurchase agreements	(8,861)	(6,863)	(291)	-	-	-	(16,015)
Derivative financial liabilities – inflows	1,658	2,892	8,984	8,328	8	-	21,870
Derivative financial liabilities – outflows	(1,721)	(3,053)	(9,922)	(9,090)	(12)	-	(23,798)
Other financial liabilities	-	-	-	-	-	-	-
SDR Allocation	-	-	-	-	-	(10,410)	(10,410)
Liability to the NLF	-	-	-	-	-	(101,668)	(101,668)
<b>Total</b>	<b>(12,762)</b>	<b>(7,024)</b>	<b>(1,229)</b>	<b>(762)</b>	<b>(4)</b>	<b>(112,078)</b>	<b>(133,859)</b>

#### d. Derivatives

The EEA uses derivatives to manage its exposure to interest rate and exchange rate risks. All derivative instruments are held at their fair values. Fair values are determined by reference to market rates prevailing on the date of valuation or by discounting future cash flows. The notional principal amounts<sup>10</sup> of these instruments indicate the volume of transactions outstanding as at 31 March 2022 and are not a representation of the amount of risk.

Notional principal amounts and fair values of trading instruments entered into with third parties were as follows:

All amounts in £ millions

	2022			2021		
	Notional Principal Amounts	Fair values Assets	Liabilities	Notional Principal Amounts	Fair values Assets	Liabilities
<b>Exchange rate contracts:</b>						
Forwards	22,905	488	(266)	31,286	810	(563)
Currency swaps	39,611	1,877	(453)	38,720	1,912	(763)
	<u>62,516</u>	<u>2,365</u>	<u>(719)</u>	<u>70,006</u>	<u>2,722</u>	<u>(1,326)</u>
Interest rate swaps	25,999	422	(142)	32,944	336	(594)
Futures	4,009	5	-	562	-	-
	<u>30,008</u>	<u>427</u>	<u>(142)</u>	<u>33,506</u>	<u>336</u>	<u>(594)</u>
<b>Total</b>	<b><u>92,524</u></b>	<b><u>2,792</u></b>	<b><u>(861)</u></b>	<b><u>103,512</u></b>	<b><u>3,058</u></b>	<b><u>(1,920)</u></b>

#### 19 Fair Value Valuation Basis

The table below provides an analysis of the various bases described in the notes which have been deployed for valuing the financial instruments measured at fair value in the financial statements.

The valuations of financial instruments have been classified into three levels according to the quality and reliability of information used to determine the fair values.

*Level 1* – Valued using unadjusted quoted prices in active markets for identical financial instruments.

*Level 2* – Valued using techniques that rely upon relevant observable market data curves. This category of instruments comprised derivatives, repurchase transactions, commercial paper and deposits.

*Level 3* – Valued using techniques where at least one input that could have a significant impact on the valuation is not based on observable market data.

<sup>10</sup> The notional principal amount is the amount on which calculations of interest payments are determined.

During the financial year no financial instruments were measured at fair value with significant unobservable inputs 2020-21: *nil*). There were no significant transfers between Level 1 and Level 2 of the fair value hierarchy.

### As at 31 March 2022

	Level 1 £ millions	Level 2 £ millions	Level 3 £ millions	Total £ millions
<b>Assets</b>				
Money market instruments	4,039	6,078	-	10,117
Debt securities	73,829	-	-	73,829
Reverse repurchase agreements	-	10,954	-	10,954
Derivative financial assets	-	2,792	-	2,792
Other financial assets	446	-	-	446
Holding of IMF Special Drawing Rights	33,778	-	-	33,778
<b>Total assets</b>	<b>112,092</b>	<b>19,824</b>	<b>-</b>	<b>131,916</b>
<b>Liabilities</b>				
Debt securities – short positions	1,545	-	-	1,545
Repurchase agreements	-	17,058	-	17,058
Derivative financial liabilities	-	861	-	861
Other financial liabilities	10	-	-	10
SDR allocation	30,932	-	-	30,932
<b>Total liabilities</b>	<b>32,487</b>	<b>17,919</b>	<b>-</b>	<b>50,406</b>

### As at 31 March 2021

	Level 1 £ millions	Level 2 £ millions	Level 3 £ millions	Total £ millions
<b>Assets</b>				
Money market instruments	1,035	3,589	-	4,624
Debt securities	81,805	-	-	81,805
Reverse repurchase agreements	-	13,286	-	13,286
Derivative financial assets	-	3,058	-	3,058
Other financial assets	382	-	-	382
Holding of IMF Special Drawing Rights	12,366	-	-	12,366
<b>Total assets</b>	<b>95,588</b>	<b>19,933</b>	<b>-</b>	<b>115,521</b>
<b>Liabilities</b>				
Debt securities – short positions	1,772	-	-	1,772
Repurchase agreements	-	16,015	-	16,015
Derivative financial liabilities	-	1,920	-	1,920
Other financial liabilities	1	-	-	1
SDR allocation	10,410	-	-	10,410
<b>Total liabilities</b>	<b>12,183</b>	<b>17,935</b>	<b>-</b>	<b>30,118</b>



## **20 Events after the Reporting Period**

There are no events after the reporting period to report.

## **21 Date of Authorisation for Issue of Account**

These financial statements have been authorised for issue by the Accounting Officer on the same date as the Comptroller and Auditor General's Audit Certificate.

**ANNEX A****ACCOUNTS DIRECTION GIVEN BY HM TREASURY UNDER THE EXCHANGE EQUALISATION ACCOUNT ACT 1979<sup>11</sup>**

1. This direction applies to the Exchange Equalisation Account.
2. The Treasury shall prepare accounts for the Exchange Equalisation Account (“the Account”) for the year ending 31 March 2012 and each subsequent financial year, which give a true and fair view of the state of affairs of the Account at the reporting date, and of its income and expenditure and cash flows for the year then ended.
3. The accounts shall be prepared in accordance with the requirements of the relevant version of the Government Financial Reporting Manual (FReM).
4. The accounts shall present a Statement of Comprehensive Income, a Statement of Financial Position and a Statement of Cash Flows. The Statement of Financial Position shall present assets and liabilities in order of liquidity.
5. The notes to the accounts shall include disclosure of assets and liabilities, and of income and expenditure, relating to other Central Government funds, including the National Loans Fund, and shall also include disclosure of management costs.
6. The report shall include:
  - (i) a brief history of the Account, and its statutory background;
  - (ii) an outline of the scope of the Account, its relationship to HM Treasury and other central funds, and its management operations;
  - (iii) a management commentary including appropriate information on financial performance and position reflecting the relationship between the Account and other central funds;
  - (iv) a governance statement.
7. Compliance with the requirements of the FReM will, in all but exceptional circumstances, be necessary for the accounts to give a true and fair view. If, in these exceptional circumstances, compliance with the requirements of the FReM is inconsistent with the requirement to give a true and fair view, the requirements of the FReM should be departed from only to the extent necessary to give a true and fair view. In such cases, informed and unbiased judgement should be used to devise an appropriate alternative treatment which should be consistent with both the economic characteristics of the circumstances concerned and the spirit of the FReM. Any material departure from the FReM should be discussed in the first instance with the Treasury.
8. This Accounts Direction shall be reproduced as an appendix to the accounts.
9. This Accounts Direction supersedes that issued on 17 March 2010.

Chris Wobschall  
Deputy Director, Assurance and Financial Reporting Policy, HM Treasury  
6 January 2012

---

<sup>10</sup> As amended by the Finance Act 2000

## Glossary

**Active management** is the difference between actual returns and the returns which would have been achieved from a passive investment strategy (see “Benchmark” below).

**Basis point (bp)** is equal to 100<sup>th</sup> of a percentage point, e.g. 0.5% is equal to 50bp.

**Benchmark** is the neutral or passive investment strategy for the reserve portfolio. Active management performance is measured against a target return over the benchmark.

**Certificate of deposit** is a savings certificate entitling the holder to receive interest and principle.

**Corporate commercial paper** is a short-term debt issued by companies.

**Counterparty** is the other party that participates in a financial transaction.

**Credit risk** is the risk of financial loss arising from a counterparty to a transaction defaulting on its financial obligations under that transaction.

**Currency risk** is the risk of financial loss arising from fluctuations in exchange rates.

**Custodian** is a bank or other financial institution that keeps custody of assets of the EEA.

**Delta** measures the change in the value of a portfolio for each one basis point shift in the relevant yield curve.

**Derivatives** are a collective name for contracts whose value is derived from the prices of another (underlying) investment. For the EEA, the main derivatives are futures, forwards and swaps.

**Discount note** is a short-term debt instrument issued at a discount to its face value.

**Euro area** is the area of 19 nations which have adopted the euro as a single currency.

**Floating rate note** is a debt instrument that pays a variable interest rate.

**Foreign currency reserves** consists of bonds and notes, money market instruments, foreign currency deposits and reverse repos, less unsettled trades.

**Forward rate agreement** is a contract obligating two parties to exchange the difference between two interest rates at some future date; one rate being fixed now and the other being a rate to be fixed in the future.

**Forward transaction** is an agreement to pay a specific amount at a specific time in the future for a currency or financial instrument.

**Future** is a contract to buy or sell a specified asset at a fixed price at some future point in time.

**Government Financial Reporting Manual (FRM)** – is the technical accounting guide that complements guidance on the handling of public funds published separately by the relevant authorities.

**Hedge** – is an asset or derivative whose market risk offsets the risk in another asset held or liability. Hedge refers to the economic purpose of an instrument and is not used in the accounting sense to imply the use of hedge accounting.

**Hedged reserves** refers to that part of the reserves, financed by repo or sterling swapped into foreign currencies or foreign currency securities, on which currency and interest rate exposure is hedged.

**Interest rate risk** is the risk of financial loss arising from fluctuations in interest rates.

**Intervention** is the purchase or sale of a currency by central banks or governments with the intention of influencing its market exchange rate.

**Issuer** is a legal entity, i.e. a government, supranational or corporation, that develops, registers and sells securities to investors in order to finance its own operations.

**Liquidity** is the ease with which one financial claim can be exchanged for cash as a result of the willingness of third parties to transact in these assets. Liquidity risk is the risk that financial claims can only be turned into cash with a delay or at some cost, or both.

**Mark to market** – refers to recording the price or fair value of a security, portfolio or account to reflect its current market value rather than its book value.

**Market risk** is the risk of financial loss arising from movements in market variables such as in interest rates or exchange rates.

**National Loans Fund (NLF)** is the account used for most of the Government’s borrowing transactions, payments of debt interest and some domestic lending transactions.

**New Arrangements to Borrow (NAB)** is a set of credit arrangements between the IMF and 38 member countries and institutions, including the UK. The NAB is used in circumstances in which the IMF needs to supplement its quota resources for lending purposes.

**Nostros** – refers to accounts that the EEA holds foreign currency with at other banks.

**Operational risk** is the risk of loss arising from failures in the transaction, settlement and resource management processes associated with reserves and liability management. This broad definition includes risks such as fraud risk, settlement risk, IT risks, legal risk, accounting risk, personnel risk and reputational risk.

**Reserve Tranche Position (RTP)** is the difference between the IMF’s holdings of sterling and the UK’s subscription (or quota) to the IMF. It is in effect, the amount of the UK’s subscription the IMF has called. The RTP is a reserve asset as in the event of need, the UK could exchange sterling for useable foreign currencies up to the value of its RTP.

**Reserves** – refers to the UK holdings of international reserves, reported on a gross basis. Gross reserves consist of foreign currency reserves, IMF position (the RTP, NAB and the net SDR position) and gold holdings.

**Sale and repurchase agreements (repo)** refers to the sale of an asset with an obligation to repurchase it at a fixed price at some future date: essentially, a form of secured borrowing.

**Special Drawing Rights (SDRs)** are an international reserve asset created by the IMF in 1969 as a supplement to the then existing reserve assets. It is currently valued in terms of a weighted basket of five currencies (US dollar, sterling, yen, euro and renminbi).

**Spot transaction** is an agreement to pay the prevailing market price for a currency or financial instrument for delivery usually in two days’ time.

**Supranational** refers to an international government or quasi-government organisation.

**Swap** is a financial transaction in which two counterparties agree to exchange streams of payments occurring over time according to predetermined rules. Swaps can be used to change the currency or interest rate exposure associated with investments or liabilities.

**Unhedged reserves** refers to the part of the reserves where the currency and interest rate exposure is not hedged.

**Value at Risk (VaR)** measures the aggregate market risk on a portfolio. VaR is an estimate of a loss level that will not be exceeded with a certain confidence level during a certain period of time. For example, losses will not exceed \$10 million 99% of the time over a two week period.

**Yield curve** plots the relationship between bonds’ maturity and their yield.

## **HM Treasury contacts**

This document can be downloaded from [www.gov.uk](http://www.gov.uk)

If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Tel: 020 7270 5000

ISBN: 978-1-5286-3634-6

Email: [public.enquiries@hmtreasury.gov.uk](mailto:public.enquiries@hmtreasury.gov.uk)