AGENDA ITEM NO. 7(4)

CAERPHILLY COUNTY BOROUGH COUNCIL
CYNGOR BWRDEISTREF SIROL CAERFFILI

POLICY AND RESOURCES SCRUTINY COMMITTEE – 9TH JUNE 2009

SUBJECT: ICELANDIC BANK UPDATE

REPORT BY: DIRECTOR OF CORPORATE SERVICES

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1. PURPOSE OF REPORT

1.1 To update Members on developments in respect of the Authority's frozen funds of £15m in the Icelandic Banks, Heritable Bank UK (£10m) and Landsbanki (£5m).

2. SUMMARY

2.1 The report details information now available to the public from the Administrators, Local Government Association (LGA), the LGA's Legal Advisors Bevan and Brittan and more recently the agreed provisions in respect of the Impairment of the investments.

3. LINKS TO STRATEGY

3.1 The report has links to the four basic strategic themes of the Council, taking into account cross-cutting issues where relevant. It has specific links to the effective and efficient application and use of resources.

4. THE REPORT

4.1 The Authority's investments totalling £15m in Icelandic Banks, Heritable UK and Landsbanki were frozen on the 7th October 2008. The events of last October were part of a bigger financial crisis that affected not just Councils but also other parts of the public sector as well as charities, businesses and individual savers.

4.2 127 Public Authorities (comprising 105 Councils, 12 Police Authorities and 10 Fire and other Authorities) had invested £953m in four Icelandic Banks – Landsbanki, Glitnir, Heritable and Kaupthing, Singer & Friedlander, the Audit Commission (AC) itself had invested £10m in Icelandic Banks, Heritable and Landsbanki. In addition press reports suggest that private sector institutions, including a number of building societies, hold deposits of at least £10bn.

4.3 A recent AC report stated that as part of investing in Icelandic banks, local authorities:

- Stuck closely to Government guidelines stating that councils should balance risk and potential returns. The AC report states that there is 'no direct evidence that local authorities prioritise yield above financial security and liquidity', although there is pressure in some councils to ensure investments perform well.
- Took independent advice from financial advisers and credit ratings agencies. The ratings agencies continued to give Icelandic banks relatively high credit ratings right up until a few days before they went bankrupt.
- Invested money in a broad range of financial institutions to ensure that risk was spread evenly. The AC reports that at the start of October 2008, councils held deposits in 144 different organisations and that deposits were 'widely spread'.

4.4 During 2008, the creditworthiness of Icelandic Banks changed as a number of downgrades were announced. However, of the Icelandic Banks, Heritable and Landsbanki continued to get relatively high credit ratings until the afternoon of 30 September. Some had their ratings reaffirmed after reviews by the agencies. The LGA has called for an independent inquiry into the role of the ratings agencies.

4.5 The AC has found that the majority of Councils acted properly in managing their investments and were alert to risks. Seven local authorities breached guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA), and their own Treasury Management protocols, by investing £32.8m in Icelandic Banks in October 2008. Members will be aware that the Wales Audit Office undertook an audit of all the Authority's investments in early October 2008 and confirmed that all investments complied with the Authority's Treasury Management Strategy and Sector's Credit Worthiness Service.

4.6 Early indications suggest that Councils will get most of the money back through the administration process and the LGA is fighting hard to ensure that the council taxpayer is a priority as and when repayments are made. The administration process is long and thorough to ensure that as much money comes back as possible. A quick and easy 'fire sale' would not benefit council taxpayers – the LGA and other public sector creditors want to ensure that the administrators get a decent price for the banks' assets.

4.7 To date the Authority has had the following feedback from Administrators and Legal Representatives Bevan and Brittan in respect of prospects of recovery.

4.8 The Administrator for Heritable has said he expects to be able to make a 'material' dividend to creditors, and we are therefore optimistic that councils will receive a substantial return. Heritable Bank is UK based and is being dealt with under UK Administration Law. It has recently been agreed that a recovery rate of 80% of the value of investments should be assumed when preparing Local Authority accounts.

4.9 In respect of Landsbanki the picture in Iceland is complex, and a critical issue is whether councils are defined as depositor creditors, which is believed to be the case. Under Icelandic legislation, depositors have preferential status in the event of a bank insolvency, meaning that depositors' claims will be prioritised over those of other creditors. The expectation is that payouts to depositors would then be significant. It has recently been agreed that a recovery rate of 95% of the value of investments should be assumed when preparing Local Authority Accounts.

4.10 Further to the above, Members are also asked to note that the Authority's Treasury Management Advisors Sector have introduced a number of changes in April 2009 to their credit worthiness service, that is used by Officers to invest funds. The 2 significant changes are:-

- The introduction of the use of credit default market analysis information.
- The introduction of the use of sovereign ratings.

Currently the Treasury Management Strategy agreed by Council in February 2009 only allows for any new investments on maturity to be placed with the Debt Management Office or other Local Authorities (Public Bodies).

5. FINANCIAL IMPLICATIONS

5.1 Members are reminded that any Investment Strategy carries a risk and that since 2001 the Authority's Treasury Management Strategy has generated £7.6m of surpluses compared to budget. These surpluses have been invested back into services. In 2008/09 £1m of investment income surplus has been used towards financing the capital programme.

5.2 It is still very early on in the process of the recovery of funds in Icelandic Banks, but early indications are suggesting that there is a potential to recover a substantial amount of the £15m, albeit that this could take an estimated 2/3 years. The Authority will be required to make a provision in the Statement of Accounts for funds that are not likely to be returned. This provision is estimated at £3.5m when prepared in strict accordance with the Local Authority Accounting Panel Bulletin 82 - Guidance on the Impairment of Deposits with Icelandic Banks. This provision will need to be agreed with the Authority's External Auditors PricewaterhouseCoopers. The actual cash loss is estimated to be £2¼m. Any over provision will be realised when the administration and recovery process is complete. Ideally options will need to be considered by Members that use reserves held in the balance sheet. This would have the benefit of not affecting revenue spend or future budget proposals. It is unlikely that the General Fund will have sufficient funds to finance a provision, as underspends on service areas are unlikely to increase the General Fund reserves materially in 08/09 or 09/10. Fortunately, it has recently been established that it will now be possible to make a provision financed by a revaluation of the Insurance Fund in the Statement of Accounts for 2008/09.

6. PERSONNEL IMPLICATIONS

6.1 There are no personnel implications.

7. CONSULTATIONS

7.1 There are no consultation responses which have not been reflected in this report.

8. RECOMMENDATIONS

8.1 It is recommended that the Committee note the information.

9. STATUTORY POWER

9.1 The Local Government Act 1972.

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