WYRE FOREST DISTRICT COUNCIL

CABINET
23rd April 2009

Treasury Management Update

OPEN	
COMMUNITY STRATEGY THEME	
CORPORATE PLAN THEME:	Improving Corporacy & Performance
KEY PRIORITY:	Financial and Asset Management
STRATEGY:	Financial Strategy
CABINET MEMBER:	Councillor John Campion
RESPONSIBLE OFFICER:	Head of Financial Services
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Appendix 1	Revised Lending List

1. PURPOSE OF REPORT

1.1 The purpose of this additional report is to identify the current position in relation to the Council's investments with the three banks with Icelandic connections, along with associated issues.

2. RECOMMENDATIONS

The Cabinet is asked to NOTE :-

2.1 The current position in relation to the recovery of funds from the three banks with which the Council has investments.

2.2 The recent reports in relation to this issue from the Audit Commission and the House of Commons Treasury Committee.

The Cabinet is asked to APPROVE:-

2.3 The revised lending list attached at Appendix 1

3. BACKGROUND

3.1 As previously reported the Council has investments with three banks which have either been placed into administration by the UK Government or receivership by the Icelandic Government in October 2008. These investments are as follows:

- o Heritable - £1m (UK based bank with Icelandic parent)
- o Landsbanki - £3m (Icelandic bank)
- o Kaupthing, Singer & Friedlander - £5m (UK based bank with Icelandic parent)

3.2 The Cabinet have received regular update reports in relation to the position of recovery of these funds along with reports in relation to the review of processes and procedures in relation to Treasury Management Issues.

3.3 The purpose of this report is to update Council following the announcements in the last week from the administrators for both the Heritable Bank and the Kaupthing Singer and Friedlander. The position in relation to Landsbanki remains unchanged from that previously reported.

3.4 This report will also consider the two reports which have recently been published by the Audit Commission and the House of Commons Treasury Committee in relation to the Icelandic banking collapse.

3.5 The report will also consider the current position in relation to the Council's approved lending list following downgradings issued by the Credit Rating Agency Moody's on a number of institutions during week commencing 13 April 2009.

Administrators Updates

3.6 Heritable

3.6.1 On 17 April 2009, Ernst & Young (the administrators appointed to the Heritable Bank) issued an update report following the first six months of the administration of the Heritable.

3.6.2 A full copy of the report has been deposited in the Members room. The report can also be accessed directly from the Heritable web site:

www.heritable.co.uk/Uploads/Documents/news/6_Month_Report.pdf

3.6.3 The report identifies the activity that has been undertaken in the last six months on realising the assets of the banks in order to make distributions to creditors. Specifically in relation to the distribution the following comments are made:

"Based on present information, the Administrators' projections indicate a base case return to creditors of between 70-80 pence in the pound. The Administrators have estimated that the return to creditors improves where the book is run-off over a longer time period (i.e. 70pence return through to end of 2010 and 80 pence return through to end of 2012).

The base case includes cautious assumptions in respect of a number of overriding factors that will influence these projections, including interest rates, the housing market and the wider economic environment as a whole. It is recognised that these are impossible to predict over long periods with any significant degree of confidence or accuracy. Any or all these factors could impact the return to creditors to the extent that it may be significantly higher or lower than the range of values provided in this report.

If conditions improve over this period of time it is possible that the final recovery could be higher than the base case above."

3.6.4 The report also mentions that the first dividend to unsecured creditors of c.15 pence in the pound in either July or August this year. This would equate to a dividend of around £150,000 against the Council's £1m investment.

3.6.5 Whilst the progress made so far is encouraging in relation to the run off there is still significant work required by the administrators. A further detailed report is required from the Administrators in 6 months time.

3.7 Kaupthing, Singer and Friedlander (KSF)

3.7.1 On 21 April 2009, Ernst & Young (the administrators appointed to Kaupthing, Singer and Friedlander) issued an update report following the first six months of the administration of the KSF.

3.7.2 A full copy of the report has been deposited in the Members room. The report can also be accessed directly from the KSF web site:

www.kaupthingsingers.co.uk/lisalib/getfile.aspx?itemid=20165

3.7.3 Again, the report identifies the activity that has been undertaken in the last six months on realising the assets of the banks in order to make distributions to creditors. Specifically in relation to the distribution the following comments are made:

"On the basis of current forecast recoveries from the bank book, ***prudent*** *estimates of realisations from other assets, and based on the maximum estimates of unsecured claims, and current market conditions not deteriorating, the Administrators currently estimate that total distributions should be a minimum of 50p in the £. The Administrators would stress that this estimate could be lower or higher if there are significant issues which impact either future realisations or the level of claims from creditors*".

3.7.4 Again, subject to necessary Court Orders being granted the administrators are seeking to make initial dividends of c.10 pence in the pound in either June or July this year. This would equate to a dividend of around £500,000 against the Council's £5m investment.

3.7.5 Unlike the position with the Heritable, other than a minimum figure the administrators are not able to give an indication of the likely settlement at this stage because of the following factors:

i.) The KSF loan book has three books (commercial property, private banking and a corporate book), in relation to which it is almost impossible to estimate with any certainty expected recovery levels in current market conditions, although a floor can be estimated.

ii) The asset finance division is made up of a group of trading companies, and it is not possible in the current market to be certain that refinancing and sale will ultimately be possible.

iii) Treasury positions are complex and may result in fluctuations dependent on the valuations of underlying assets and claims by counterparties.

iv) The recoverability of the sum from Kaupthing remains uncertain, with no estimate provided by the Kaupthing resolution committee.

3.7.6 Again, the administrators are required to provide a further update in relation to the administration in 6 months time.

Independent Reviews

3.8 Audit Commission

3.8.1 On Thursday 26 March 2009, the Audit Commission launched *"Risk and return: English local authorities and the Icelandic banks".* The review was undertaken in response to the collapse of the Icelandic Banks and examines the adequacy of treasury management in local authorities. Wyre Forest District Council was one of 37 English local authorities who were visited to examine such treasury management arrangements.

3.8.2 A full copy of the report can be found in the Members room, and is also available on the Audit Commission web-site:

www.audit-commission.gov.uk/Products/NATIONAL-REPORT/6AF6709B-9ACD-4F5C-B6C5-09B9C23BCF83/26032009IcelandRiskAndReturnREP.pdf

3.8.3 Whilst the report recognises *"The chaos in the financial system that led to the collapse of the Icelandic banks had not recent precedent".* The report identifies recommendations for central government, CIPFA and local authorities. In relation to local authorities these recommendations include:

- *Set the treasury management framework so that the organisation is explicit about the level of risk it accepts and the balance between security and liquidity and the yield to be achieved. At the highest level, the organisation should decide whether it has:*
    - *appetite and capability to be able to manage risk by placing funds with financial institutions; or*
    - *no appetite and/or insufficient capability to manage the risk of placing funds in the market, and should instead place funds with the UK government's Debt Management Office;*

- *Ensure that treasury management policies:*
    - *follow the revised CIPFA code of practice;*
    - *are scrutinised in detail by a specialist committee, usually the audit committee, before being accepted by the authority; and*
    - *are monitored regularly;*

- *Ensure elected members receive regular updates on the full range of risks being run;*

- *Ensure that the treasury management function is appropriately resourced, commensurate with the risks involved. Staff should have the right skills and have access to information and external advice;*

- *Train those elected members of authorities who have accountability for the stewardship of public money so that they are able to scrutinise effectively and be accountable for the treasury management function;*

- *Ensure that the full range of options for managing funds is considered, and note that early repayment of loans, or not borrowing money ahead of need, may reduce risks;*

- *Use the fullest range of information before deciding where to deposit funds;*

- *Be clear about the role of external advisers, and recognise that local authorities remain accountable for decisions made; and*

- *Look for economies of scale by sharing resources between authorities or with pension funds, while maintaining separation of those funds.*

3.8.4 The vast majority of these recommendations have already been implemented within the Council following the internal review undertaken and reported to the Cabinet in February 2009.

3.9 House of Commons : Treasury Committee

3.9.1 In addition to the Audit Commission report, the House of Commons Treasury Committee published their report *"Banking Crisis: The impact of the failure of the Icelandic Banks",* on 31 March 2009.

3.9.2 A full copy of the report is available in the Members room, and is also available on the parliamentary web site:

www.parliament.the-stationery-office.com/pa/cm200809/cmselect/cmtreasy/402/402.pdf

3.9.3 The findings of the committee are summarised within the report as follows:

"The failure of the Icelandic banks in October 2008 had potentially severe consequences for depositors. In this report, we consider three sets of such depositors: local authorities, charities and UK citizens who deposited in the Isle of Man and Guernsey subsidiaries of the Icelandic banks. We consider the case for the provision of assistance by the UK Government to these depositors. ***We do not accept that there is a need to provide assistance to the local authorities****. We recommend that, on this occasion only, all charities should be compensated for losses incurred as a consequence of the failures of the Icelandic banks. Finally, we agree that the overarching principle should be that the UK Government cannot provide cover for deposits held by British citizens in jurisdictions outside the direct control of the United Kingdom. As such, while we acknowledge the severe distress of those UK citizens suffering due to the Icelandic banking failure, we can only recommend that the UK authorities work with the Isle of Man and Guernsey authorities to resolve these issues"*

3.9.3 The findings of the report are therefore disappointing to the point that only charities are recommended to receive compensation. Indeed the report recommended that:

"Under these circumstances it would seem perverse to reward those authorities who failed to protect their investment with yet more money from the taxpayer."

Current Lending List

3.10 At the meeting of Council on 25 February 2009, a new lending list was approved which implemented more stringent lending criteria along with the consideration of all relevant information when investments are made. Given current market conditions the lending list is significantly reduced from previous years. This has led to the requirement to invest with the Debt Management Office.

3.11 As at 21 April 2009, the Council's investments are summarised as follows:

Counterparty	Size of Investment £m
Landsbanki	3.000
Kaupthing, Singer & Friedlander	5.000
Heritable Bank	1.000
Clydesdale Bank	2.520
HSBC	6.650
Nationwide Building Society	3.000
Debt Management Office (Bank of England)	2.000
Total	**23.170**

3.12 During week commencing 13 April 2009, Moody's (one of credit rating agencies used by the Council) have downgraded a number of financial institutions within the UK. The effect of these changes has further reduced the institutions that the Council can currently invest.

3.13 Although Moody's are not used as a criteria for the Council's use of Building Societies, given their current rating from this organisation, it is recommended that only the Nationwide Building Society is continued to be used.

3.14 The revised lending list is attached at Appendix 1.

3.15 The impact of this revised lending list will result in further use of the Debt Management Office, which will have the impact of providing lower returns (0.3%) than can be generated through the money markets.

4. <u>KEY ISSUES</u>

4.1 The position in relation to the two UK registered banks is progressing and estimates have been received on settlements. For both banks an interim dividend is expected over the summer. Further updates will be presented as available.

4.2 The position in relation to the investment with Landsbanki is still developing with the bank under a 2 year moratorium to realise assets.

4.3 The reduction in the lending list due to the deterioration of the credit ratings issued by Moody's introduces severe operational difficulties in placing investments. This will require the increased use of the Debt Management Office, which will in turn have an impact upon the returns that the Council will receive.

5. FINANCIAL IMPLICATIONS

5.1 The position in relation to the return of investments is noted and when received the interim dividends will be reinvested to generate interest receipts. However, as discussed in para 4.3 returns will have to be closely monitored throughout the year.

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6. LEGAL AND POLICY IMPLICATIONS

6.1 All of the investments the Council have made are in line with the Council's approved Treasury Management Strategy. This strategy was developed in line with the guidance issued by government under Section 15(1)(a) of the Local Government Act 2003.

7. RISK MANAGEMENT

7.1 The Council has always had a risked based approach in the management and implementation of its investments. Use is made of Credit Ratings to ensure that only those organisations with the Highest Credit Quality are used. However, in the events described above as a result of unprecedented global pressure four banks have either been placed into administration or receivership. It is generally accepted that these events could not have been reasonably foreseen.

8. CONCLUSIONS/ACTION

8.1 The news of interim dividends in relation to the two UK banks over the summer is welcomed as is the positive overall position in relation to the Heritable bank.

8.2 Due to the factors discussed in para 3.7.5 the position in relation to the KSF cannot be estimated in the same way as the Heritable, however, even with these issues outstanding the administrator has stated that a minimum dividend of 50 pence in the £ can be expected.

8.3 The position with both of these banks will be reported to future meetings of the Cabinet. However, the Council will continue to work with the administrators to ensure the final dividend is maximised.

8.4 The report from the Audit Commission is welcomed, and in the main the recommendations have already been implemented within the authority.

8.5 In relation to the overall financial climate it is becoming increasingly more difficult to place investments given the reduced lending list. This is forcing increased usage of the Debt Management Office, but this will have the impact of reduced investment returns.

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9. CONSULTEES

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10. BACKGROUND PAPERS

Council 25 February 2009 – Treasury Management Strategy
House Of Commons Treasury Committee Report –Banking Crisis: The impact of the failure of the Icelandic banks – 31 March 2009
Audit Commission Report – Risk and Return – 26 March 2009
KSF and Heritable Administration Update Report April 2009
CIPFA Treasury Management Panel Bulletin – Treasury Management in Local Authorities – Post Icelandic Banks Collapse – March 2009
Various updates to Cabinet Oct 2008 to date