

Local Government Association

Q&A on councils' credit ratings and Icelandic banks

Who are the credit agencies?

There are two main credit ratings agencies that most councils use when looking at the credit worthiness of banks and building societies:

- Fitch Ratings
- Moody's Investors Service

These are amongst the leading credit agencies in the world.

How do credit ratings work?

Each agency provides its own rating scale for both short-term and long-term ratings. These are not easily comparable. As per the guidance from the Office of the Deputy Prime Minister on 12 March 2004, councils only deal with institutions that receive the highest ratings.

What happened with the credit ratings for Icelandic banks?

Both Fitch's and Moody's reviewed Icelandic banks in the early part of this year, and Moody's reduced their long-term rating for Landsbanki at the end of February – although it was classified as A2 (the middle of 'good'). In May 2008 Fitch reduced their long-term and short-term ratings for Glitnir and Kaupthing to A minus and F2 respectively. Both agencies' ratings then remained steady over the summer before a more significant downgrade by Fitch's on the afternoon of 30 September.

There was no warning to councils from the agencies by way of reduced ratings over the summer.

How did the credit ratings change over 2008?

The agencies continued to review Icelandic banks over the course of the year, but were still offering good quality ratings up to the afternoon of September 30.

There was a further general downgrade by the rating agencies on October 8.

Did councils invest after the credit rating had gone down?

It is our understanding that only a tiny number of councils invested after 30 September 2008. We are conducting research with our member authorities to establish an exact figure. If a council did invest after 30 September, the LGA would urge it to conduct an internal inquiry.

What should happen now?

The LGA is today calling for a government inquiry – led by the Financial Services Authority – into how credit ratings agencies continued to give Icelandic banks high credit ratings right up until a few days before they went into administration or receivership.

How many councils are involved and how much was invested?

Information has been received from 236 authorities about whether they had investments in Icelandic banks. Most of these authorities have, where relevant, provided details of the amount and maturity of each investment.

Of these 236 authorities, 120 have confirmed that they do not hold investments with Icelandic banks (or UK subsidiaries of Icelandic banks). The 116 authorities who do have investments with Icelandic banks have total deposits of £858.3m. These figures include information from Welsh local authorities and Police Authorities where details were not fully known when we reported the figure of just under £800m last Thursday.

What is happening with the administrators, Ernst & Young?

The Local Government Association held talks with Alan Bloom, Joint Administrator of Heritable Bank Plc (“Heritable”) and Patrick Brazzill, Joint Administrator of Kaupthing Singer & Friedlander Limited (“KSF”) on 13 October.

In broad terms, the Administrators considered that the value of the book value of the assets of each business appeared to be of the same order of magnitude as the liabilities but that the recoveries for the local authorities would be dependent on the final level of actual realisations.

The Administrators confirmed that they were seeking to maximize value from both companies, for the benefit of creditors. The LGA said that local authorities were looking to the Administrators to do their utmost to recover monies deposited, and would expect vigorous action from the Administrators to that end.

The Administrators said that they could not currently give an estimate of the level of funds expected to be recoverable, nor when any payout could be expected. However, they agreed to provide estimated outcomes which local authorities could use (if they see fit), in planning their budgets, by mid-November.

What other discussions are taking place?

The LGA will work with the Government and individual councils on a case by case basis to ensure that satisfactory financial packages can be agreed for all councils that are affected. A meeting is scheduled for later this week.

Although we are not aware of a single council with imminent serious liquidity problems, one option could be for councils to defer payment of business rates to the Government. This could raise up to £1m a year for an average size authority.

The LGA is also seeking a meeting with the Icelandic Ambassador.

What will be the impact on councils?

We are not aware of any councils with serious imminent liquidity problems that would affect frontline services or mean that staff could not be paid. Authorities typically spread their deposits widely and have flexibility to manage their day to day cash position.

Councils also hold significant reserves. They saved money while the economy was strong and can make use of reserves now that times are not as good.

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