OFFICIAL REPORT

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STATES OF GUERNSEY

SCRUTINY MANAGEMENT COMMITTEE

States of Guernsey Bond Issue Public Hearing

HANSARD

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Members Present:

Panel Chair: Deputy Chris Green
Deputy Mark Dorey
Advocate Peter Harwood – Non-States' Member
Mrs Gill Morris – Non-States' Member

Mr Mark Huntington – Principal Scrutiny Officer

Business transacted

Procedural 3

EVIDENCE OF Deputy Gavin St Pier, President, Policy & Resources Committee; Ms Bethan Haines, States' Treasurer 3

The hearing adjourned at 3.33 p.m. and resumed at 3.40 p.m. 22

The hearing adjourned at 4.35 p.m. 36

Scrutiny Management Committee

States of Guernsey
Bond Issue

The Committee met at 2 p.m.
in Room 6, Royal Court

[DEPUTY GREEN *in the Chair*]

Procedural

The Chairman (Deputy Green): Good afternoon.

I would like to welcome everybody here today, elected representatives, senior public servants and members of the public.

Our session today focuses on the Guernsey Bond, with the President of the Policy & Resources Committee. Deputy Gavin St Pier – welcome; and the Treasurer, Ms Bethan Haines – again, welcome.

The Panel today comprises myself, Deputy Chris Green, the President of the Scrutiny Management Committee; Deputy Mark Dorey and Non-States' Members, Advocate Peter Harwood and Mrs Gill Morris.

Can I just ask anybody who has any mobile devices to, please, put them on silent whilst the hearing is in progress? It is essential, during our session, that the Panel is able to hear from our witnesses, without any interruption from the public gallery.

I remind people that this is a Parliamentary Committee proceeding and members of the public are not permitted to speak during the hearing.

EVIDENCE OF
Deputy Gavin St Pier, President, Policy & Resources Committee;
Ms Bethan Haines, States' Treasurer

The Chairman: In turn, can our witnesses please introduce themselves? Deputy St Pier?

***Deputy St Pier*:** Yes, Gavin St Pier, President of Policy & Resources.

***Ms Haines*:** Bethan Haines, States' Treasurer.

The Chairman: Thank you very much and welcome.

***Deputy St Pier*:** Thank you.

The Chairman: Can I start by asking some questions in relation to the way in which the need for the Bond was portrayed in the first instance? Primarily, I think this question is for you, Deputy St Pier. I think the most appropriate place to start here is with the States' debate in October 2014. You may remember it well.

Deputy St Pier, do you feel now that, in October 2014, you gave a fair and accurate representation of the benefits and costs associated with the bond to the States' Assembly?

***Deputy St Pier*:** Yes, I do. I think, as the KPMG Report identified, there was clearly an error made by me during the debate, in response to a question which arose. I do not think that was a material miss-statement that had a material outcome on the debate. But, I think in terms of the overall picture and rationale for the issuance, it was fairly representative at that time and I do not think I would have changed the presentation, even with the benefit of hindsight.

The Chairman: Can I just take up the issue that I think you alluded to there and, just so we are talking about the same thing?

As I understand it, Deputy St Pier, you told the States, in October 2014, that at that time the States' entities were paying a blended rate of 4.87% on existing debt and that this figure included the cost of breaking any terms; but, as you know from the KPMG Report, they saw some correspondence from Ernst & Young, at T&R, dated October 28th, 2014. The figure of 4.87% in that letter indicated that it did not include the break costs or fees associated with re-financing of the debt.

How did you come to portray the 4.87% figure as inclusive of the cost in those circumstances?

***Deputy St Pier*:** I struggle to be able to answer that question, because it is asking me to go back to remember what I was thinking when I was on my feet nearly three years ago now.

At the time, I clearly believed it was the correct information that I was giving. But, again, I think in terms of the number of loans that were subject to break costs anyway, I think – again, Bethan may be able to help me here – at least one of them, in relation to Aurigny, was subsequently broken anyway.

The number that was subject to break costs was not material to the overall sum that was being borrowed, and therefore I emphasise again I do not think there was a material miss-statement.

The Chairman: You would accept that, unintentionally, the States was misled on that one isolated point though?

***Deputy St Pier*:** I accept that the information I gave in response to that particular question was not the correct information on that one point.

The Chairman: Okay. Can I draw your attention to the question and answer document that was circulated to States' Members the night before the debate, in October 2014? I do not know if you have got that to hand.

It is the document entitled States of Guernsey Bond and, in blue, at the top, Questions and Answers for States' Members. I believe it was circulated to Members of the States the night before the debate.
You have that document? (***Deputy St Pier*:** I do.)

Deputy St Pier, are you happy now with the accuracy of that document, overall?

***Deputy St Pier*:** I think the statement in the second sentence, in response to the question 'How much could be saved as a result of lower interest rates?' which reads:

'… however, the overall estimated blended rate of the date can be repaid is in the order of 4.87% … '

– is correct. But, clearly, it might have been better to have linked that to the response to the next question, which is, 'What is the cost of exiting the current borrowing? i.e. breakage costs', to make it clear that the 4.87% had not accounted for the £5.3 million referred to in the next question.

The Chairman: Just to pick up on the section there, half-way down, the question:

'What is the cost of exiting the current borrowing, i.e. breakage costs?'

The text says:

'The breakage costs are estimated at £5.3 million.'

It goes on to state, *'although this is a snapshot …'* etc. That figure of £5.3 million, presumably, has not proven to be accurate, is that what you are saying?

***Deputy St Pier*:** No, I am saying that it would have been better to have referenced, in response to the reference to the blended rate of 4.87%, to have qualified that sentence, subject to the breakage cost referred to in the next question.

I think that would have given greater clarity and probably would have avoided the response which I gave the following day in debate. Because I suspect I would have been referring to this document, in giving that response.

The Chairman: I see what you mean.

Just to come back to that point, though, in relation to the £5.3 million in terms of the breakage costs; that figure, has that proven to be accurate?

***Deputy St Pier*:** Do we know what the breakage costs were of the loan that was broken? But of course not all loans have been broken.

***Ms Haines*:** That is correct. The majority of those breakage costs would have been in relation to arrangements which have not been broken. So they have not materialised.

The Chairman: Do we know what the full cost of the breakage has been so far?

***Ms Haines*:** It is referenced in the KPMG Report, I believe. I am struggling to find it now, in relation to the breaking of the Guernsey Housing Association.

The Chairman: Yes. That figure was £4.2 million, only in respect of the Guernsey Housing Association. The figure quoted was £5.3 million in relation to all overall costs.

I am just wondering whether you think, in retrospect, that figure was really an accurate figure, Deputy St Pier?

***Deputy St Pier*:** I do not have any information, subsequent to that, which suggests otherwise, that that information was misleading.

The Chairman: Okay, well, let us move on to another point in the document. If you just go over the page, on the second page of the Q&A document, where it says,

'What are the issue costs of the bond?' and, on the top of the page, it says:

'As set out in the presentation circulated to all States' Members last week, the anticipated up-front costs relating to the issue of a public bond are £1.05m - £1.15m.'

That was inaccurate, wasn't it?

***Deputy St Pier*:** Well, if you refer to page 27 of the KPMG Report, the issuance costs were £1.483 million in total. So they were outside of that range.

The Chairman: Yes.
In terms of the of the issue costs of the bond overall, though, do you think the figure of £1.05 million-£1.15 million was an accurate way of representing the overall costs of the issue.

***Deputy St Pier*:** Are you referring to the hidden costs?

The Chairman: I am talking about the overall costs of the issue of the bond.

***Deputy St Pier*:** Well, it depends on what you want to include as being an issue cost. You could choose … we have accounted for a hidden cost as being an issue cost.

The Chairman: Deputy Dorey.

Deputy Dorey: I think the presentation that you gave and the slide which you put out –

***Deputy St Pier*:** I would expect no less!

Deputy Dorey: This was for States' Members who had a limited knowledge of bonds and I think, to put it down, to explain, you give the detail of each. There are six different lines within the table showing the make-up of the £1.05 million-£1.15 million, but there is no mention of the gilt-lock.

Do you not think that was seriously misleading States' Members about the costs, when they saw that slide, which showed the range that was being referred to?

***Deputy St Pier*:** The Budget Report did refer to hedging arrangements and it would not have been possible at the time of that presentation, to give an indication of the hedging costs, because of the nature of the hedge.

It could well have been that, had market rates moved the other way, actually, it would have been net receipt rather than a net cost. So it would have been a totally futile exercise to attempt to have put onto that slide, or indeed into the response to that question, what the issue costs were likely to be, irrespective of the hedging.

***Ms Haines*:** Could I?

The Chairman: Sorry, Ms Haines?

***Ms Haines*:** Can I add something there?

I think that at the time of the Budget Report as well, the hedging – although it was indicated in the Budget Report that hedging may be undertaken, it was not determined and, of course, the markets can move either way.

It is not, technically, a cost of issuing the bond; it was a cost of protecting movement in the interest rates in the interim.

The Chairman: What about the cost of the coupon rounding? Because that was not mentioned in debate either, was it?

***Ms Haines*:** That is not a cost of issuance either. Equally, that could have worked either way, as well, because it is just market norm to round down to the nearest one-eighth of a per cent and net out the amount of proceeds that you receive as a result.

That has not changed the overall cost of the bond over the 32-year period.

The Chairman: So what you are saying is the figure at the top of page two, in terms of the issue costs of the bond, you are saying it is appropriate to take a narrow definition of what costs of the issue were and that is what –?

***Deputy St Pier*:** To be fair, it does actually tie with your own report from KPMG, which refers to issuance costs as £1.483 million. They have described the other costs as being finance costs, rather than issuance costs.

Clearly, they have accepted, in their Report, that they regard the fees as being reasonable and, clearly, they would have been comparing like with like. So I think they had an understanding in undertaking their work as to what was included or what was not included.

The Chairman: Okay, can I take you to something else on the Q&A? This is probably the final item on that. Again, page one, in the section

'How much could be saved as a result of a low interest rate facilitated by the issue of the bond?' – particularly where it starts:

'It would not be unreasonable to expect the bond issue interest rate to save in excess of £2.5 million in year one and over £100 million over 40 years.'

As you know, from the report, KPMG were informed that there was no supporting audit trail or calculations existing, to support those assertions.

Deputy St Pier, is that something that you can explain? Does that surprise you that KPMG were not able to find an audit trail to support those figures?

***Deputy St Pier*:** I think they have covered the point quite well in their report, in terms of the calculation of that. So I do not really have much to add, to be honest, to that.

The Chairman: Perhaps the question is: is there any evidence now that we have actually saved anything, in terms of loan costs, so far? What is the evidence that you can point to at this stage?

***Deputy St Pier*:** Yes, I think again it referred to this in the last set of accounts, I cannot remember, on the timing of this?

Certainly, we provided a media release on 27th May this year, in response to the issuance of the KPMG Report and, in there, we certainly referred to Aurigny's interest costs having been reduced by approximately £1 million in 2016, as a direct result of taking a loan from the bond proceeds.

Clearly, the GHA have substantially re-financed as well. That is quite aside, obviously, from the net receipts in terms of the un-lent portion, which I am sure we will come onto.

The Chairman: I suppose the more general point, Deputy St Pier, is do you think that the way in which the benefits of the bond were portrayed by yourself, not only in debate, but in the surrounding documentation, were over-sold to any extent?

***Deputy St Pier*:** No.

The Chairman: No. Okay.
To what extent did the haste of the decision-making process contribute, do you think, to perhaps some of the information being given to the States not being entirely correct, or perhaps, being rather more limited than it could have been? Do you think that was a factor?

***Deputy St Pier*:** I do not think the decision-making process was particularly hasty. It was obviously a matter which Treasury & Resources, as a Committee, had been considering for some time leading up to the Budget. The Budget Report was obviously in the public domain for the normal period of time – three weeks before debate.

The Q&A was produced in response to matters that had been raised, in terms of public interest and comment, in response to the Budget Report, which of course is not unusual for any policy letter.

So I do not think that there was any particular haste over decision-making. The States clearly had as long as it wished in order to debate the matter. There was no curtailing of that.

I think the response which I gave on my feet, which is what we began this session with, I think could have happened in any debate at any time. I do not think it was the result of any time pressure in the way that your question suggests.

The Chairman: Do you think information given to the States could have been clearer?

***Deputy St Pier*:** Yes. With the benefit of hindsight, I think I have highlighted two areas where I think we could have been clearer: one in the Q&A and, clearly, in relation to the comments which I made in debate.

The Chairman: Advocate Harwood.

Mr Harwood: Can I just go back? Are you satisfied with the due diligence, or amount of due diligence that was undertaken in relation to the possibility of the re-financing?

You produced the list of existing loans which you sought to be re-financed. Are you satisfied there was adequate due diligence, in fact, to establish the viability of being able to re-finance all those loans?

***Deputy St Pier*:** Yes, I think, again, this is obviously a question which KPMG have given some consideration to.

Certainly, at the time, in recalling the Committee's consideration of the matter, before presenting it in the Budget Report, I felt that there was appropriate due diligence in terms of understanding the scale of the opportunity from those third-party loans.

Now, I think, as ever, with the benefit of hindsight, could more have been done? Then I think that is, in essence, what the KPMG Report is saying: that in their view, probably more could have been done.

Mr Harwood: Given that the justification for the bond issue was a re-financing, do you feel uncomfortable, in retrospect, actually, with the amount of due diligence that was done?

***Deputy St Pier*:** Not particularly, because I think that the largest part of those loans that could be-refinanced have been re-financed.

Mr Harwood: Who did the due diligence on that background information? Was it Ernst & Young who were your principal advisers?

***Ms Haines*:** If we are talking about due diligence in terms of –

Mr Harwood: Well, the justification for the bond issue was the possible re-financing of a schedule of loans, of existing loans. Who actually did the work on substantiating the information – which again goes back to the break costs issue as well – but, more importantly, the fact that there was a willingness on the part of those entities to actually accept a re-financing?

***Ms Haines*:** Yes, Ernst & Young did a report for the Treasury & Resources Department, which set out all of the opportunities and costs of existing arrangements, the cost of breaking those arrangements, etc.

In addition, the Treasury & Resources Department was the shareholder for Guernsey Electricity Ltd, Cabernet Ltd, JamesCo and joint regulator for the Guernsey Housing Association and so had dialogue over the period with those entities about their future capital requirements and their appetite for accepting money from a bond issue.

Mr Harwood: Had there been any sort of formal recording or memorandum of understanding with any of those organisations that they would take advantage of the bond issue and, if so, within what period of time?

***Deputy St Pier*:** No. You would not necessarily have expected that, because the terms of the loan were, clearly, unknown at that point, depending as they were on market rates.

So I think it was a conversation that could take place at the level that was largely appropriate, given that the information that we were handling at the time.

I say again, I think that if you look at the loans that were extant and those that have been re-financed, it largely proves the point that actually, with the exception of one Aurigny loan that has not subsequently been re-financed, it has come to pass as we expected.

Mr Harwood: You mention break costs. I am sorry, there is a lot of focus on those. But clearly the break costs would have increased anyway by virtue of the reduction of the interest rates. Do you accept that you got caught by the gilt-lock, so the costs of breaking existing loans and swaps would have been increased anyway within the organisations on lend too?

Sorry, that is more of a statement. That is my understanding of the situation: that their costs had increased as the interest rates fell on your bond issue?

***Deputy St Pier*:** Yes.

Mr Harwood: Because the cost of breaking their existing loans would have increased?

***Deputy St Pier*:** Correct.

Mr Harwood: I am just trying to move on from that. Can I understand, exactly, the mechanics of the gilt-lock? How it was put in place. Was it an option? Was it a re-pro arrangement? Can you describe, actually, how the gilt-lock was affected?

***Deputy St Pier*:** I will leave you to explain that!

***Haines*:** It was taken in two tranches.

Basically, it was a swap on the gilt yield at the time. Basically, we had hedged the rate of the gilt yield.

Mr Harwood: So it was done as a hedge? You did not go into the market and buy anything equivalent, or place an order for an equivalent amount of UK gilt?

***Ms Haines*:** No.

Mr Harwood: It was a hedge?

***Ms Haines*:** It was a hedge, yes.

Mr Harwood: The timing of the hedge, because it was some time after the States had approved the principle of the bond before you decided to put the hedge in place; is there any particular reason why there was that gap? Probably, it may have actually worked in your favour, but if you had put it on an earlier stage, you might even have increased the gilt costs within the lock costs.

***Deputy St Pier*:** Part of the gap between the debate and the hedge was inevitable, because there was still quite a lot of preliminary work to do, in terms of taking the proposition to the market, ascertaining whether there was going to be interest in it and therefore whether it was likely to fly.

So, in a sense, there was not anything to hedge, at that point, because we had not made a decision to commit to the project. It was only really once the decision was made that we were going to go ahead with it, we then needed to engage with the question of what do we do about the movement in gilts rates between the decision to press on and the closure of the deal? And do we do anything to try and mitigate that?

That was obviously the point we then had advice from our advisers and that led to the decisions that we took to place the two hedges that we did, over a portion of one.

Mr Harwood: What advice did you receive? Who was your principal adviser in relation to that decision?

***Deputy St Pier*:** E.Y.

***Ms Haines*:** E.Y., but also one of our book runners, Barclays, we engaged to provide us with advice on that transaction. But E.Y. were the ones who advised us on the mechanics of the gilt-lock, how it worked.

Mr Harwood: And the counter-party to that lock arrangement, was that purely Barclays?

***Ms Haines*:** Yes, Barclays were our counter-party.

The Chairman: The gilt-lock was taken out for 40 years, when the bond itself was for 32 years. The report refers to that maturity mismatch, as it were. Presumably, there was some inefficiency in that disparity. Do we know what that has actually cost the taxpayer?

***Ms Haines*:** I do not think there was a financial mismatch there. Because of the flatness of the curve at the long end of the market, the pricing on a 30-year bond and a 40-year were very similar. So there was not a pricing mismatch, and of course the lock was only taken out until the date of issue and so there was no real disadvantage to 40 years, versus 32 years.

Mr Harwood: Was there any particular science in the percentage of the issuance that you actually hedged?

***Deputy St Pier*:** I would need to go back to the papers at the time to recall the decision on the percentages.

***Ms Haines*:** I would need to refresh my memory, as well.

Mr Harwood: It would just seem a slightly odd figure in relation to the overall issue. It was not exactly 50% or 60% or 70%. I can understand why you would not want to hedge the whole 100% of the issue, I just wondered whether there was any significance until it was used?

Can I ask: you obviously relied on Ernst & Young and Barclays, and Barclays were the counter-party to that particular transaction; do you know what fees they generated over and above the actual cost of unwinding the hedge? Or was it all just rounded up in the figure?

***Ms Haines*:** If you bear with me, I can find a price.

Mr Harwood: Whilst you are doing that, can I ask the President a question regarding the timing of the lock or swap transaction? Which again is slightly odd, because by that time you were already showing a loss on the first lot. Why did you feel so confident in proceeding with the second lot?

***Deputy St Pier*:** With respect, it is very easy after the event to judge market movements with perfect 20/20 vision and hindsight. My recollection at the time was actually there was quite a lot of market volatility in the movement of gilt yields, so there was no certainty that it was just because it had moved against this one first that that trend was going to continue.

Absolutely, very much, the expectation of the market more generally at the time, and it is easy to forget this as we sit here three years later with base rates having gone down rather than up, but all the expectation at the time was for interest rates to go up, for base rates to move up. That was reflected in the volatility of the gilt yields at the time.

With the benefit of hindsight, you can say markets moved against you, so why would you feel it necessary to continue to hedge, but there was no suggestion that that trend, necessarily, would continue; but it was clearly a question that would have been considered by us, as a Committee, with the advice of the advisers.

***Ms Haines*:** Can I just add to that as well, the decision to take out the gilt-lock was not a market-timing decision, it was a security-of-cost decision and, therefore, once the decision had been taken that the gilt lock was executed, we did not wait for a change in the market.

Mr Harwood: What is the justification then for your sensitivity to the ultimate coupon cost? In your presentation at the other Budget Report, Mr President, you indicated a rate between 3.5% and 3.75% being the likely outcome. You were already giving yourself 25 basis points within that margin. I just wondered why you then felt it necessary to create the further lock. It showed you were saving money, even if you went up to 3.75% cost.

I just wondered why, to what extent, you were forced into this, because Ernst & Young and Barclays thought it would be a good idea; and whether or not you challenged that, or whether it was more your own instincts, from the Committee's point of view?

***Deputy St Pier*:** I certainly do remember robust discussion of the issue by the Committee and seeking to argue both ways, seeking to understand the rationale for locking in. But I think, as Bethan has said, the primary case made was this is about providing certainty of the total costs, rather than risking it moving against you and you ending up with a much higher cost than you originally anticipated.

So, in other words, having made a decision to go to market, you were effectively locking in at that gilt yield at that time, not the final yield at the date the deal closed.

That was, if you like, a commercial decision to provide certainty to the States.

Mr Harwood: But you were only providing partial certainty because you were not fully locked, were you? You were still accepting there was a risk of movement on the 45% or wherever it was locked?

***Deputy St Pier*:** Absolutely. But equally, accepting that if the market had improved, then we would have benefited from that as well.

Mr Harwood: Did it not occur to you or your Committee that actually you have almost had a natural hedge, through your investment portfolios that you were responsible for?

Some of the assets in that portfolio would have given you the hedge without having to go outside. Was it ever considered? Was it ever looked at, that you could have created your own internal hedge?

***Deputy St Pier*:** No.

The Chairman: Can I just come back to some of the issues about due diligence again? From a lay person's perspective, the States borrowed £330 million overall. The first tranche borrowed was £250 million, the second was £80 million. Can I just double check, as at today, how much of the £330 million has been lent on?

***Deputy St Pier*:** As at September 30th, £125.8 million is currently outstanding; £50.1 million has been agreed and is waiting to be drawn down and £1.4 million has been repaid.

The Chairman: Bearing in mind we have not lent on the full £250 million as at that date, was it really necessary to then get the second tranche of £80 million? What was the real justification for the further £80 million, if we have not even lent on the first £250 million?

***Deputy St Pier*:** The reason that the Policy Council agreed to that was the expectation that there would be sufficient infrastructure projects heading down the line that would be appropriate to be funded by a debt model, that would therefore support the loan in a way that the States had provided for, with the Resolutions that they had provided for and, actually, that remains the case today.

The Chairman: With the benefit of hindsight, do you think we really needed to borrow that extra £80 million in those circumstances?

***Deputy St Pier*:** With the benefit of hindsight, we would have been, probably, quite happy to borrow more, if I could.

The Chairman: More, if you could?

***Deputy St Pier*:** Yes.

Mr Harwood: Do you have adequate cashflow forecast to justify how you would be able to lend that money over the next 5, 10, 15 years?

***Deputy St Pier*:** Yes. I would expect it to be lent on before the next 15 years, certainly. In terms of forecasts, perhaps you (Ms Haines) are better to talk through the processes by which the profile is monitored and controlled?

***Ms Haines*:** Yes. Unfortunately, with all of these things, things change and you have the best of intentions. For example, take the Guernsey Electricity projects. Fortunately, I suppose we could say, the project that was going to be financed through the bond, which was the cable link to Jersey, was not required, because the original cable was secured.

What I am trying to say is, you can never have certainty over the profile. However, we have in the pipeline Guernsey Housing Association projects and some other large Guernsey Electricity infrastructure projects, although we do not have certainty, in full, around the dates.

Also, the STSB are looking at securing some financing from the bond.

The Chairman: What would that be for?

***Ms Haines*:** They are looking at the structure of the harbours. Guernsey Water, as you know, one of the loans that has been agreed this year has been to re-finance the Belgréve outfall, partially through the bond and then from other opportunities like that.

The Chairman: Advocate Harwood and then Deputy Dorey.

Mr Harwood: Can I follow up on the States' water one? As I understand it, the Belgréve outflow was funded from Capital Reserve and, therefore, it is not actually the equivalent of saving money, because they never borrowed from an external source. It was an internal capital grant. So I am not quite sure why that is seen to be a benefit? Can you perhaps just talk me through that point again? It is imposing an interest rate charge on Guernsey Water which, ultimately, I suppose has to be passed onto its consumers.

***Deputy St Pier*:** You are right, it was financed originally from the capital reserve but, clearly, absolutely part of the rationale was to ensure that the costs of infrastructure are borne by the consumers of those assets over the life of those assets and debt-financing is the best way to ensure that. That is why, of course, infrastructure projects do have a large element of debt, because that matches the profile of the asset.

If you put a cable in for 40 years, the cost of that cable is borne by the consumers, as they use that cable, for the next 40 years. The Belgréve outfall is no different from that and I think that was absolutely clear.

Part of the trouble with many capital projects is there is no cost of capital attributed to them and, absolutely, again, as I have said many times, it is important that we do ensure that an appropriate cost of capital is made, in order that we actually make the right decisions on whether to fund things through the Capital Reserve at all, or whether there is a different outcome, a different methodology for providing a particular asset, including leasing assets, for example, rather than buying them.

Mr Harwood: About re-financing. Does that mean, therefore, the Capital Reserve benefits, because money that was originally provided to Guernsey Water now comes back into the Capital Reserve, so that enhances the amount of money that is available for other capital projects? That is the justification?

***Deputy St Pier*:** Absolutely and other capital projects that would be unable to sustain any kind of interest burden, because of the nature of the projects, such as the school development.

The Chairman: Deputy Dorey?

Deputy Dorey: On the liquid waste. There were a number of stages of work that were done to enhance the liquid waste station. When the waste water tax was brought in, it was said that was not to finance those capital expenses, it was to finance the running expenses.

That was the States' decision on that. So all the other enhancements to it were financed from the Capital Reserve and the States' decision was also the retention of the pipe and it was financed from the Capital Reserve.

Do you think it was morally right to go back on a States' decision, which was to finance it from the reserve and the reason for bringing in the charge was to finance the running costs, to change it? Was that because you had the bond, you had all that money? Because if you did not have un-lent money in the bond, would you have demanded that they had gone out to the market and finance it from the market transaction?

***Deputy St Pier*:** I am not going to speculate as to what might happen if there had not been a bond. I am not sure I necessarily want to get into the moral philosophy. But, absolutely, the principle of ensuring that assets are funded in the right way, so that the cost of them is borne by the right group of people, I think, remains a sound philosophy; and I think that is why, moving to a different asset, I think the save-to-spend policy of, for example, Guernsey Electricity, you could argue that is a morally bankrupt policy, because it is putting all the cost of infrastructure on the current generation of consumers, rather than the future generations who will enjoy the asset. So I think you can play the argument both ways.

The Chairman: Mrs Morris.

Mrs Morris: Given that we have heard many times that the bond funds were only raised to support projects backed by, and I quote, 'a secure income stream', does the current lending to Aurigny/Cabernet fulfil those lending criteria? Isn't the loan interest just adding to the existing overdraft, which will need to be re-financed in the future?

***Deputy St Pier*:** Aurigny clearly has a strong revenue and cashflow from its business, self-evidently. It is clearly not currently earning a profit, as you well know. Having said that, there have been several false dawns and I think the States have been operating under the expectation, for some time, that it would be capable of breaking even, at the very least. Now, that has not yet come to pass –

Mrs Morris: You are an optimist, aren't you!

***Deputy St Pier*:** However, with some of the restructuring, the board remains of the view that it should be capable of paying its own way, albeit accepting that there will need to be a public subsidy for the Guernsey/Alderney route. But that, of course, may not necessarily be paid to Aurigny. It might be paid to another operator. So, in that sense, I do not think you can regard it in the same way; you cannot treat it as a loss in that sense, because it is revenue to whoever provides that service.

Mrs Morris: So, have you got any evidence, in terms of cashflow forecasts and so on, that Aurigny will ever break even and therefore not require further funding that generates interest that adds to its overdraft?

***Ms Haines*:** As set out in the 2018 Budget Report, there is a section in there, around Aurigny, which demonstrates that the majority of the losses that remained in Aurigny, having made some recent changes, are in relation to the Alderney routes and, if the States are to seek a public service agreement on those routes and manage that through Aurigny, or elsewhere, then I think the residual ongoing loss in Aurigny is very minor. It is circa £700,000.

The Chairman: Just on that, my colleague touched upon the criteria for lending and borrowing under our current arrangement, which is that there must be a secure income stream, however you define that. At this stage, Deputy St Pier, do you envisage any consideration of altering the criteria in terms of accessing of those funds, or is that something you are not considering?

***Deputy St Pier*:** That is not something that has been considered or is being considered at the present time.

The Chairman: Just finishing off some of the questions on due diligence. We were being buffeted around slightly, but I just want to cover one or two other points.

Do you accept one of the key KPMG conclusions, which is that the due diligence undertaken by the States on the trading bodies' lending requirements appears relatively limited in practice? Do you accept that, as a basic conclusion?

***Deputy St Pier*:** I do not feel sufficiently strongly to challenge it. *(Laughter)*

The Chairman: Is that a kind of yes?

***Ms Haines*:** Could I just come in there? Maybe it is not apparent in the KPMG Report, but of course the Treasury & Resources Department had undertaken due diligence in the majority of these arrangements previously, when it provided a guarantee. That has not been taken into account in the work that KPMG have done. Where there was re-financing to be done, generally a guarantee had previously been given and a robust challenge to the business case had been made at that time, for it to agree to the guarantee.

The Chairman: In relation to the guarantee, but obviously not in relation to the bond specifically?

***Ms Haines*:** No.

The Chairman: Obviously, with the exception of Aurigny, the amount of correspondence that the then T&R had with the Trading Bodies, was obviously fairly limited. I think one of the questions I would really like to ask is, was there any kind of exercise done to compare the Bond interest rates with what the Trading Bodies could potentially get, commercially, at that time. Was that kind of work done? Presumably not?

***Ms Haines*:** At that time, every time these entities needed to borrow, they required a guarantee, so we had a very clear understanding of what they could get in the market. But one of the things that, particularly the GHA for example found, was that they could not get long-term money, because it was not available in the market. They wanted to match the maturity of the assets. So we are not entirely comparing apples and apples.

The Chairman: What about in respect of other Trading Bodies, other than GHA?

***Ms Haines*:** Likewise, the Treasury & Resources Department had been providing guarantees, so it was very clear what rates these entities could get in the market, with a States' guarantee.

The Chairman: To what extent was any pressure applied to trading bodies to consider having access to the bonds' funds? Was there any pressure applied?

***Deputy St Pier*:** Before the Bond?

The Chairman: Yes, to encourage them. Put the word 'pressure' to one side. To what extent were the trading bodies encouraged to see the benefits of the Bond, *vis-à-vis* other funding?

***Deputy St Pier*:** Certainly, the dialogue with Cabernet, or with Aurigny, in other words, and with Guernsey Electricity was such that that they were aware that we were considering and looking at this issue, obviously subject to States' approval; and, I think, Guernsey Electricity were not encouraged by us, they were encouraged by the opportunity, because of the work that they felt was likely to be required, imminently, on the Guernsey/Jersey second cable link and the expectation that the first bond was not stable.

Similarly, with Aurigny as well, I think the recognition that the existing loans that were there, they knew that they were going to require borrowing and, therefore, anything that enabled that to be secured at low interest rates was clearly of interest to them.

I think the period point is very key, particularly in relation to the largest borrower, the GHA, to be able to provide certainty to their business model and, therefore, ultimately Islanders, being their customers, was particularly important to them.

Mrs Morris: So no pressure was put on the GHA to break their existing borrowing, to take the bond funds?

***Deputy St Pier*:** No.

Mrs Morris: Are you sure?

***Deputy St Pier*:** There was robust dialogue, after the bond was taken. The question was, was it before the bond was taken?

Mrs Morris: But there was a robust dialogue afterwards?

***Deputy St Pier*:** Absolutely, and you would expect that, because they are an independent, third party board of directors, with fiduciary responsibilities. You would expect them to negotiate as hard as they possibly can for the lowest possible interest rate, given those responsibilities. So, absolutely, I would expect it to be robust. I would be disappointed if it was anything otherwise.

The Chairman: Any other questions on due diligence? I think I have only got one more, before we move on.

Mrs Morris: I think one on the fiscal framework goes to due diligence too.

Deputy St Pier, you have explained to the Committee that the fiscal framework, as it stands, does not include the Bond. Do you think that it was clear to the States' Members, prior to the vote on the Bond, that that would be the case?

***Ms Haines*:** The fiscal framework does include the bond. It does not include the commercial borrowings of the entities. It is direct States' borrowing.

The Chairman: You are saying, prior to the issue of the bond, the borrowing at that stage would not have been captured by the fiscal framework, but the issuing of the bond made it formal Government borrowing?

***Deputy St Pier*:** Correct, which is why it was capped at £330 million, being 15% of GDP, so it was within the fiscal framework at the overall level, albeit that it was clearly breaching the fiscal framework for borrowings in-year, which had capped at 3%. Again, I think that was transparent to the States at the time.

The Chairman: Was it, though? I think you are right that in retrospect it is obvious, but was it actually explained to States' Members? I do not think it was, was it?

Deputy St Pier: It seems self-evident that if you are borrowing 15% of GDP in one go, that you would therefore be borrowing more than 3% in one year.

The Chairman: But was it made explicit?

Deputy St Pier: I cannot recall. Your recollection would be better than mine.

The Chairman: I do not believe it was made explicit.

Deputy St Pier: I will take your word for it.

The Chairman: Advocate Harwood.

Mr Harwood: Can I just follow up on that? Certainly, mention has been made of the fact that there is a number of trading entities which have benefited, either directly or indirectly, from the States' of Guernsey guarantee.

So, therefore, there is a liability on the States of Guernsey, ultimately. I am surprised to hear you say that actually you do not think that is included within the fiscal framework rule, because it is an ultimate liability on the States, albeit a contingent liability.

I am surprised that you are confident that it is not within that fiscal rule, that it does not feature.

Deputy St Pier: You are now talking about –

Mr Harwood: At the point of time at which the States took the bond, that was a maximum under the fiscal rule. There were a number of extant loans out there, which were covered by a States' guarantee.

Are you saying that those guarantees did not form part of that fiscal rule?

Deputy St Pier: Correct, sir. That is exactly what I am saying, but the key part of your description, of course, is the use of the word 'contingent'. Those liabilities are not liabilities of the States unless, and until, the underlying borrower defaults.

Mr Harwood: Yes, there is a measure of contingency made different from entity to entity. In the case of Cabernet/Aurigny it is probably more immediate than not.

Deputy St Pier: I cannot disagree with that, no, but certainly the fiscal rule, the 15% of GDP does not provide for the inclusion of contingent liabilities. Now, there may be an argument as to whether it should, but I do not think there is any ambiguity about that.

Ms Haines: It is clearly a case of Government borrowing.

Mrs Morris: So, given that the £330 million was the maximum as a calculation of the 15%, would we not have been in breach, other than contingent liabilities, were there any other Government liabilities at the point the £330 million was taken out? So, for a period of time, because it took a while for the loans to be made, that actually during that period, we would have been in breach?

Deputy St Pier: Hypothetically, Mrs Morris, yes.

Mrs Morris: Actually?

***Deputy St Pier*:** Fortunately, it did not happen.

***Ms Haines*:** Government had not borrowed previously, so there was no previous Government debt to cause that situation to arise.

The Chairman: It was not the first breach of the fiscal framework, though, was it?

***Deputy St Pier*:** And not the last.

The Chairman: Do you still feel, Deputy St Pier – very much a political question – that the fiscal framework has any relevance, given that we breach it all the time?

***Deputy St Pier*:** You are going well beyond the scope of your own review!

The Chairman: I know you like these questions, so feel free to answer it. Or do not, if you do not want to. You still feel there is some relevance?

***Deputy St Pier*:** Yes, I do.

The Chairman: Is that more political than fiscal and economic?

***Deputy St Pier*:** I am enjoying the banter, Deputy Green, but I do genuinely think it is more than just political. I think it helps, for example, the credit rating agencies. I think it helps with positioning the Island in the eyes of the Island's counterparts, by which, I do not mean Government counterparts, but those individuals and clients that deal with the Island. They have some clarity about the nature of Government and its view on its fiscal status, as encapsulated in that framework, so I do think it has broader application.

The Chairman: Okay, I think we will move onto the public information about the bond.
Deputy Dorey.
I assume you have finished, Mrs Morris?

Mrs Morris: Yes, I have finished. I am saving myself.

***Deputy St Pier*:** Oh, dear! *(Laughter)*

Deputy Dorey: I thought I would touch upon Section (e) within the KPMG Report where it refers to the questions that Deputy Queripel asked. In the Report, KPMG says:

'Whilst the responses …'

– to Deputy Queripel –

'… are factually accurate further details would likely have assisted a reader to gain a more comprehensive understanding.'

Do you think that was acceptable, that you effectively were not very helpful in your answers?

***Deputy St Pier*:** I am not sure I accept the interpretation that I was not being helpful. I am not sure that is what KPMG was saying.

Deputy Dorey: *'Assist the reader to gain a more comprehensive understanding.'*

***Deputy St Pier*:** Again, I do not feel sufficiently strongly that I am going to disagree with KPMG. They have been paid to review this matter. If that is their view, as an independent, taking a subjective assessment that it would have been helpful to have provided more details, I am not going to disagree with it.

Deputy Dorey: Going back, I think, in your summing up when we had a debate, you said:

'I would say, sir, this is a simple concept that is one we either grasp or we do not grasp.'

You previously said that it did not warrant 200 pages of States' report. It was very short, within the Billet, for such a significant transaction.

Are you confident now that you did give sufficient information for people to grasp, particularly when we have got the lock, where I did not think I understood that significant cost? The slide that you put to Members of what would the cost be, didn't mention the possible cost of the lock?

***Deputy St Pier*:** To answer your question, yes, I do think there was sufficient information and I actually stand by, I am afraid, those concluding remarks in debate.

I think, largely, those that supported and endorsed the decision at the time remain of that view and those that did not, remain of that view.

So I think it always was a polarising political matter and I am not sure that, had we presented 200 pages of Budget Report, it would have made a significant difference to the outcome of the debate. Those that supported it would have continued to support it and those that opposed it would have continued to oppose it, I suspect.

That is clearly all speculation. But, to answer your question, yes, I think there was sufficient information and sufficient understanding, for the States to make the decision.

With respect, I think the question of the hedging is, to some extent, a bit of a red herring. It is presented as being a substantial cost of issuance but, as is presented by KPMG themselves, it was really a finance cost of the loan over the term of the loan, because we were locking into the interest rate at the time a decision was made to proceed with the issuance.

Now, had that level of detail been apparent to Members at the beginning of the process, I am not sure it would have made much difference, because it is all about the total cost of the issue, which we estimated, as former Deputy Harwood said, as lying somewhere between 3.5% and 3.75% and, of course, that is exactly where we landed.

Deputy Dorey: With the benefit of hindsight, would you have acted differently, in terms of information provided to Deputies and the public?

***Deputy St Pier*:** Not significantly. Not materially. No.

Deputy Dorey: Even though there was significant information that was not given?

***Deputy St Pier*:** As I have sought to explain, Deputy Dorey, I do not regard it as necessarily being significant information that was not given, because I do not think it materially changed the information that was given to the States on the anticipated total cost of the loan. Ultimately, that information remained accurate.

Deputy Dorey: Within the 2015 Budget Report, you listed the existing £251 million loans; do you not think you should have explained to States' Members that these were not going to be taken up in the short-term, because I think the expectation, I certainly remember as a States' Member, was that we expected, a short time after the debate, those loans to have been taken up. The only question mark was over the £80 million, but that of course was not what happened.

In relation to that, are you still happy with the information you gave the States?

***Deputy St Pier*:** I do not think the Treasury & Resources' Committee's expectation was significantly different from your own and other States' Members. I think our expectation was that a significant portion of the Bond would be taken up more quickly than it has been. So I do not think, again, that there was any misleading of the States at that time, because I think we were all operating under the same assumption that the loans would be taken up more quickly. Clearly, that has not proven to be the case. There are reasons for that, which we know, but that does not change the presentation of the information at the time, in my view.

Deputy Dorey: In relation to my question, with the benefit of hindsight, would you act differently? You are implying that you would have because you gave the expectation that it would be taken up and, in fact, now we know –

***Deputy St Pier*:** As a nuance, with the benefit of hindsight, wonderful though it is, then it might have been helpful to make it clear that there were risks over the timing of the take-up of loans.

The Chairman: Alright. I think we will take a break for five minutes.
Thank you very much.

The hearing adjourned at 3.33 p.m.
and resumed at 3.40 p.m.

The Chairman: Thank you, very much.
Mrs Morris.

Mrs Morris: Deputy St Pier, we hear on a fairly regular basis – and in fact it is in writing, quoted in the *Press*, which of course we all believe – that the Bond has an excellent financial performance and affirms the decision-making around its issuance was appropriate and the cost of issues were reasonable.

What is the risk that the current investment strategy for the un-lent funds will provide sufficient returns to service the coupon until full proceeds are actually lent out, if indeed they ever are?

***Deputy St Pier*:** Well, a couple of things to challenge around that question, before I answer the main part of it.

Firstly, in relation to the cost of issuance, of course, KPMG themselves have said the costs of issuance were reasonable and, secondly, the suggestion that the entire proceeds will not be lent on, implicit in the last part of your question, I consider that to be most unlikely, indeed.

In relation to your question pending that, 'What are the risks?' clearly there are risks, in that the un-lent portion now forms part of our reserves, which are invested. They are invested in the medium- and the long-term reserves, which have investment targets of RPI plus 3.5% and RPI plus 4%. Clearly, over the medium- and long-term, those investment returns should be achievable and that is something that we constantly test and re-test with our investment managers, as part of our oversight of our investment portfolio as a whole.

However, it is clearly possible that, in the short-term, there will be dips and moves in the market and, clearly, if the portfolio, if the un-lent portion is lent on, during a period of one of those dips, then it is possible that it would be below the previous values.

However, the performance to date, which is that the bond reserve is £12 million above all the costs of issuing and servicing the loan, does give us a substantial cushion against a fall in the market.

Mrs Morris: So where we exceed the return required to pay the coupon, those funds are ring-fenced to prop us up for when they do not?

***Deputy St Pier*:** Correct. So it is added to, and forms part of, the Bond Reserve.

Mrs Morris: Okay. The thing that I struggle with is, that the stated reason for taking the Bond out in the first place, was to reduce the cost of borrowing and risk, but even at this early stage, and actually it might be because it is at this early stage, the position we find ourselves in, is that we are subject to the forces of market and, as you have said, the market goes up and down. In fact, even in this year, we have seen the first quarter where we were kind of under where we needed to be and now we are over where we need to be. So, with my fairly newly acquired risk hat on, I am sitting here thinking how on earth did this reduce Guernsey's risk?

***Deputy St Pier*:** Again, I think, to some extent, you have answered your own question; and also I think KPMG have as well, by emphasising the point, as they do, that it is a very early stage in the evolution of the Bond, obviously, written earlier this year with only two years of the 32 years having passed. But the issue of the Bond allows the States to lend to the States' Trading Bodies at a known, fixed rate, for the long-term period and that, of course, reduces the risks for the States and the States' Trading Bodies, by having locked into that low fixed-term rate, providing long-term interest rate protection in the event that rates rise.

So that is the mitigation of the risk. Significant benefits may well accrue over the life of the bond to the States, as well as the Trading Bodies. I think the report you commissioned absolutely sums it up well.

The Chairman: It is obvious that the investment performance in 2015 was not brilliant and, in fact, the value of the coupon was not exceeded in 2015. Clearly, the performance in 2016 and 2017 has been much better.

Is there not an issue, though, that the speed at which the funds were actually moved into medium-term and long-term accounts … it was not done that quickly, was it?

I suppose the question is, if we had actually moved the proceeds of the Bond rather quicker into those better performing accounts, wouldn't that have been much better? Do we know how much public money was, arguably, put at risk by keeping that money on the table, as it were, rather than being rather more swift?

***Deputy St Pier*:** Again, your question, Deputy Green, actually segues quite well from Deputy Dorey's question before the break, which is, that it was all of our expectations that a good portion of the proceeds would be lent on faster. So that explains why there was not a race to place them to be managed as part of the investment reserves, because of our expectations that others would be drawing down on it sooner rather than later.

The Chairman: But, even so, as the kind of custodian of the public purse, would it not have been possible to move quicker to safeguard and to maximise the returns?

***Deputy St Pier*:** Again, clearly, had proceeds been invested in the markets earlier, then, equally, that does not guarantee that there would have been any improvement in performance. Clearly, it would have depended on the markets at the time.

The Chairman: Advocate Harwood.

Mr Harwood: Can I just follow on to that question? Are you satisfied that you had adequate procedures in place to deal with a sudden massive in-flow of funds, which was £330 million, which came in mid-December, just before Christmas break and just before markets are slowing down?

You did not set up the Bond Management Committee until some time in March or April. I wondered what sort of governance you had in place, actually, to deal with the immediate receipt of those funds?

***Deputy St Pier*:** The Investment Sub-Committee did, of course, exist before that time.

Mr Harwood: Did it meet between the issue of the Bond and the end of the year?

***Deputy St Pier*:** I will leave the Treasurer to provide the detail of the action that was taken before Christmas. I cannot remember when it was discussed at the Investment Sub-Committee or at the main Committee, but that whole question of managing that risk and, in the knowledge that the funds were coming in, was absolutely something that was recognised and addressed, and steps were taken before Christmas in respect of receipt of the funds.

I am afraid I am going to have to refer to the States' Treasurer.

The Chairman: Could we see the minutes of that, if they exist?

***Deputy St Pier*:** I am sure.

***Ms Haines*:** I do not have the minutes of that here, but I can supply them to you.

I think, just to confirm, we were in dialogue with our investment advisers throughout the process of issue, so that preparations were being made for receipt of the funds. We were very conscious that it was just before Christmas, so we needed to get it invested quickly, to ensure that we were not sitting on cash in the bank, effectively.

As Deputy St Pier said, the Treasury & Resources Department and the Investment Sub-Committee were dealing with, in advance, how that was going to be managed and then decisions made very swiftly afterwards, especially in respect of the additional £80 million, which it was clear was not going to be required in the short order and that was invested fairly swiftly.

Mr Harwood: So you are happy, with the benefit of hindsight, you did have adequate procedures in place and that the public purse did not suffer?

***Deputy St Pier*:** Yes.

***Ms Haines*:** Yes, absolutely.

Mr Harwood: Okay. Was there any reason why the Bond Management Sub-Committee was not constituted until about March or April, following the Bond issue? Was there not some argument it should have been in place before the Bond proceeds were received?

***Deputy St Pier*:** Possibly. There is an argument that it could have constituted earlier.

I think it was really in dialogue with our investment adviser that we decided that, actually, an investment sub-committee was not the right place to provide the governance, in terms that that committee had been established to monitor the performance of our assets. So the question was, whether that was the right place or whether we should have a separate body dealing with the monitoring performance of our liabilities, i.e. the Bond.

Now, of course, subsequently to the general election in 2016, actually we decided, effectively, to revert to the *status quo* ante, which is to move the responsibility back to a single committee. We have now changed its name to the Investment and Bond Sub-Committee, but that, effectively, is where the governance sat before we created the Bond Management Sub-Committee. So I think it was just a change in view and I cannot recall any further …

***Ms Haines*:** I think any decisions that needed to be taken ahead of the Bond Management Sub-Committee were actually taken by the Treasury & Resources Committee as a whole.

The Chairman: Mrs Morris, I think we were interrupting your questions!

Mrs Morris: I can cope!
So, going back to a thread that we had before the break, do you think that States' Members were aware of the intention or the possibility that the funds that we were borrowing were likely to end up being invested, gambled on the Stock Market? Do you think they would have changed their decision, had they known?

***Deputy St Pier*:** I think, certainly in relation to the additional borrowing of £80 million, there was challenge from the States at the time as to what was going to happen to that in the meantime. From memory, I am probably looking to Deputy Dorey, because his recollection on these things is always much more encyclopaedic than anybody else in the room, but I certainly think that formed part of the challenge to those that were of the view that it might be appropriate to borrow £250 million, but not necessarily £330 million.

Mrs Morris: Is that why you did not borrow more?

***Deputy St Pier*:** Sorry?

Mrs Morris: You said earlier that, if it had been up to you, you would have borrowed even more.

***Deputy St Pier*:** No, the only reason I did not borrow more is because it would have breached the fiscal framework and the 15% cap.

Mrs Morris: What would you have done with it if you had? If, and I know this is hindsight, you had any chance of getting that through, what would you have done with it, because we cannot lend out what we have now?

***Deputy St Pier*:** I remain confident, Mrs Morris, as I said in response to your previous question, that over the period of this loan, which still has 29 years to run, there will be significant on-lending that will prove to be highly beneficial, because of the low interest rate secured in December 2014.

Mrs Morris: Will it ever get to the £330 million, given that some of the loans that you have in place are repayment ?

***Deputy St Pier*:** Yes, without any doubt, I am sure it will get to £330 million. Given that our infrastructure plan, indicatively, over the next 20 years, is for something like £1.5 billion of infrastructure assets required, then I do not think we will have any difficulty lending £330 million.

Deputy Dorey: Most of those infrastructure projects are due to finance from the Capital Reserve, so that they do not have an income source. So they are not relevant.

***Deputy St Pier*:** A substantial portion of them will be, but I think there are substantial infrastructure assets that we are likely to acquire over that period that would be entirely appropriate for debt financing.

Of course, even things like the Guernsey-France cable link, that is *circa* £100 million, that being one example.

Deputy Dorey: Do you, then, envisage creating income sources, like you did with waste water, by upping the charges to finance borrowing from the bond? It is effectively what happened, because it was never envisaged that capital would re-finance from that waste water charge.

***Deputy St Pier*:** As I am sure you will recall, in and outside the States, I have been of the view that there are opportunities for re-financing a number of our trading assets so, yes, absolutely, I do agree that there are opportunities that will ensure that those businesses are funded in a normal way, as opposed to being subsidised by taxpayers as a whole, through the provision of free capital.

Deputy Dorey: So charges will go up?

***Deputy St Pier*:** Not necessarily.

Deputy Dorey: But you cannot –

***Deputy St Pier*:** You can, because it depends on the management of those businesses. You are assuming that all those businesses are perfectly managed and there is no prospect, whatsoever, of them ever doing anything differently and, therefore, the only way they can bear the interest charge is by increasing charges. I do not accept that premise, in any shape or form.

Deputy Dorey: If those improvements and efficiencies to those businesses are there, they should be taken now and you do not need to make them borrow money to improve their efficiencies.

Mr Harwood: You have now announced that you are expecting the equivalent of a dividend return that was on the Trading Entities. Is that on top of the interest charge that they will be paying to the States for their borrowings? The borrowings you are so confident you will be able to raise?

***Deputy St Pier*:** I wonder whether we are talking cross-purposes. You say in terms of a dividend return?

Mr Harwood: I think you said you were expecting a shareholder return, or something equivalent. I think it was about £5.5 million in the current budget. (***Deputy St Pier*:** Correct.) Is that on top of the interest that you will be seeking to recover from those entities?

***Deputy St Pier*:** No, that, at the moment, is given their current capital structures. So you are probably in a better position to speak about the dialogue there has been with the States' Trading Assets about the opportunity to re-finance and what that actually means in practice.

***Ms Haines*:** Several opportunities are being considered. I mentioned a couple of them earlier on, in terms of re-financing existing assets that were previously funded through taxpayer funding, but those, or any loans that are given to those assets, will be on a commercial basis, in line with the arrangements we put in place for the Bond that place it in line with the market at the time.

So the return of capital would, strictly speaking, be in addition to, yes, any commercial rate that is in place –

Mr Harwood: Would you anticipate a return of capital be adjusted for the interest charge that they are having to bear as well?

You are obviously anticipating a return on the capital, on the existing structure, given that you are saying you are going to re-finance some of that structure, by using some form of proceeds and they will be paying an interest charge on the Bond proceeds. Are they then expected to find the same element of additional shareholder return on top of that, or will you be adjusting that?

I think it is quite important to know how some of these operations are going to go forward.

***Deputy St Pier*:** I do not think we are in a position to say at this point.

The dialogue is not sufficiently advanced to be able to give any solid information at that point. I think, as I have indicated in this year's Budget Report, the £5.5 million target for next year and the assumptions in the Medium-Term Financial Plan remain fairly high-level, simply because we have not had enough dialogue with the States' Trading Supervisory Board.

Those numbers are therefore likely to change. So the impact on the underlying business, particularly in relation to any interest charge on any loan is not something that has yet been worked through, but what I will say, in response to your question and in response to Deputy Dorey's concerns from his previous question, is I think both the States' Trading Supervisory Board and the Policy & Resources Committee, are very cognisant of the States' Resolutions in relation to the protection of the consumer, which again is a result of Resolutions of which Deputy Dorey has had a substantial part to play, I would suggest.

The Chairman: Mrs Morris, were you still dealing with Treasury, management and governance?

Mrs Morris: I am about to move on.

The Chairman: Okay.

Mrs Morris: Is everybody else happy that I move on?

Mr Harwood: I have a question that I think this falls within the current section.

You said with confidence that you expect the full amount of the Bond proceeds to be lent during the lifetime of the Bond.

At any one point of time, within the lifetime of the Bond, what do you anticipate will be the maximum exposure in terms of percentage of that Bond issue on lending into States' activities? What would you regard as a successful outcome? Would it be 70%, 80%?

***Deputy St Pier*:** £330 million.

Mr Harwood: The full amount?

***Deputy St Pier*:** Yes.

Mr Harwood: Even though, given cash flows, some will be coming back?

Deputy St Pier: Yes, absolutely. You are right, some of the borrowing is likely to be shorter-term, but then I would expect there to be other projects that would take the place of ones that have been repaid. For example, the £1.4 million that has been repaid as a result of the disposal of one of the aircraft from Aurigny has come back. That, now, is available for re-lending.

Mr Harwood: So, as long as you have not got £330 million on lending, you would consider that to be a failure?

Deputy St Pier: No, I would consider it to be part of the process that needs to be managed. My objective is to make sure that we have got £330 million left in the Bond Reserve at the end of the period. That is clearly the priority of managing this, overall.

Mr Harwood: Is your test £330 million committed or drawn-down?

***Deputy St Pier*:** I would be very happy for £330m to be drawn-down, as a maximum, absolutely.

The Chairman: Mrs Morris, are you ready to continue with governance now?

Mrs Morris: Governance, yes.
Moving onto Section (h) of the KPMG report. Are you happy with the current governance and Treasury management of funds, given some of the concerns expressed in the report and the recommendations there are?

***Deputy St Pier*:** I was not entirely happy with some of the recommendations, I think, as we commented in our response to you in relation to the role of IAM.

IAM are there, principally, as our investment adviser for the investment reserves, rather than the management of the Bond itself, and I think that role has been conflated in the recommendation, which has come forward from KPMG.

In particular, it is not their job to reconcile the investments. That is clearly the job of the custodians for portfolios, Northern Trust.

Certainly, as an aside, although I do not think it is strictly relevant to this review, if I may say, I think KPMG may have missed the point, but yes, we do review IAM's performance regularly, as part of a continuous process and, of course, you yourselves have undertaken, through your predecessors, a review of the investment advisers.

Again, we will keep that contract under review and re-tender as and when appropriate.

Mrs Morris: One of the things that was mentioned was the external auditor's management letter from 2015 and there were a number of recommendations there about the current methodology of managing – and I am not talking IAM – and tools used to track those loans. Have those recommendations from the 2015 audit been implemented?

***Ms Haines*:** Yes.

Mrs Morris: All of them?

***Ms Haines*:** Well, the only recommendation was that the status of the spreadsheet be clarified by P&R. Sorry, that was the recommendation that related to yours.

The recommendation from the external audit was that we put some more security around the spreadsheets, access to it, and additional controls around reconciliation. That has been done.

Mrs Morris: So, how often is it being reconciled now? It was, I think, annually.

***Ms Haines*:** There is a full reconciliation undertaken on an annual basis and it is updated on a quarterly basis.

Mrs Morris: And it is still on the spreadsheet?

***Ms Haines*:** Still on the spreadsheet, yes.

Mrs Morris: Are all the loans currently in place now properly documented with agreed terms and conditions?

***Ms Haines*:** Yes.

The Chairman: Deputy Dorey, do you have questions on the financial benefits?

Deputy Dorey: You spoke about the fact that earlier on there had been savings from GHA and Aurigny of £1 million by taking out the loans. When a Trading Board passes the loan, or looks at a loan, do you test it in the market whether they can borrow that money at a lower rate than the bond rate?

We know the market has been moved up and down and the value of the Bond has moved up and down through the period it has been issued.

***Deputy St Pier*:** As the gilt yield moves up and down, then the offer rate to the borrower moves up and down as well, albeit subject to the floor of the costs to the States of the Bond. That is a floor, so the borrowers are aware of that.

Do we test it against the market? There is not a possibility for some of those borrowers to take a small loan in the market for 30 years, or whatever period they are looking for, so you are not necessarily able to make a direct comparison.

The only real –

Deputy Dorey: Not all are looking for 30 years though, are they?

Deputy St Pier: No. They are not.

Deputy Dorey: If somebody was looking for a 10-year loan?

***Deputy St Pier*:** You specifically referenced the GHA in your question.

Deputy Dorey: And Aurigny, presumably actioned theirs, too?

***Deputy St Pier*:** Yes.

Deputy Dorey: If a trader and his team were looking to borrow money for a 10-year period, would you then say, 'Go for it within the market'?

***Deputy St Pier*:** Absolutely, that is part of the dialogue. Again, going back to the previous question about the dialogue with the GHA being robust at the beginning of this process, I would expect the fiduciary responsibilities of the directors of Guernsey Electricity or Aurigny … clearly if their business model requires a shorter-term loan, then I would expect them to see what is in the market and whether that is more suitable for their needs. That would become part of the dialogue.

Clearly, there may be a requirement for a States' guarantee, in many cases, and they have to recognise that comes at a cost. That is not something which the taxpayer should necessarily be taking on without charge.

Deputy Dorey: Have any entities resisted being involved in the bond?

***Deputy St Pier*:** The Ladies' College, who we were originally anticipating, decided to take, I think from memory, a 10-year loan in the market, rather than come to us.

Deputy Dorey: So they are the only entity that has resisted?

***Ms Haines*:** Guernsey Electricity have also decided to finance, they are currently financing the borrowing that was required for their generator, through short-term borrowing. That is a decision that has been made by the board of Guernsey Electricity. I would not characterise it as resisting, but it has been taken in the interests of Guernsey Electricity, by the board.

Mr Harwood: Is that, inevitable, because there is a mismatch between the fact the Bond rate is fixed at 32 years and they are looking at a 10-year loan?

***Deputy St Pier*:** Correct.

This is an important point, of course. Depending on the nature of the loan, that may mean that they carry more risk in relation to market movement and rates on their shorter-term loan, than would otherwise be the case.

But that, again, would be part of the commercial assessment, which you would expect any board to take, in terms of understanding the risks of taking one financing method over another.

Mrs Morris: To your point earlier, does the term of that loan match the life of the asset? Or is that an additional risk they are taking?

***Deputy St Pier*:** I think I commented at the time, in relation, for example, to the Ladies' College, that I do not think the 10-year loan does not match the life of the asset. That is a risk which the board of governors have presumably decided to take, but, absolutely, that is a commercial decision.

Mrs Morris: Maybe they just do not like borrowing.

The Chairman: Advocate Harwood.

Mr Harwood: You mention there is a floor to the rate that you are charging on the on-lend. There is no cap. Have you given any thought as to whether or not there may be merit in having a cap?

***Deputy St Pier*:** We have, but only hypothetically at this stage. We feel that it is something that would be, perhaps, best examined later in the life of the Bond, when the Bond Reserve has sufficient reserves in it that would allow us, looking at future cash flows, with greater certainty, to be able to say actually we can offer a less-than-market rate and the reserve will still be capable of repaying at the end of the period.

At this stage, that would not be appropriate. Certainly, it is something that, conceptually, has been considered as being something that may need to be considered in due course.

The Chairman: Deputy Dorey, would you like to continue to deal with financial benefits?

Deputy Dorey: When do you expect the rest of the Bond proceeds to be lent on? You said that you hoped they were lent on. When do you expect that happen?

***Ms Haines*:** The Guernsey Housing Association, as you know, has a regular programme of building and borrowing requirements, so there is a regular stream of requirements running from the Guernsey Housing Association.

The main change, really, to the profile of on-lending here is in respect of Guernsey Electricity and the cable. The requirement for the Guernsey-Jersey cable is no longer there, but there is a requirement, potentially, for the Guernsey-France cable, but we do not have the full timeline for that as yet, because of the complications in planning, etc. That is the major piece of on-lending that is outstanding.

***Deputy St Pier*:** Going back to the GHA, which I think perhaps links to the previous question and then, correct me if I am wrong, but I think the business model for the GHA largely envisages borrowing short-term for development. It will take development loans at a commercial rate, which are a shorter-term and lower rate and then, once the development is built, they then swap that loan out for the certainty of the longer-term loan available from the Bond.

Again, that profile, given their expectations of future developments – there is reason for visibility over the timeframes for that. Obviously, depending on planning permissions and how long it takes to build.

***Ms Haines*:** And transition of land, etc. But, yes, we have got a strong pipeline of requirements from the Guernsey Housing Association.

The Chairman: Advocate Harwood.

Mr Harwood: Can I ask one question? When do you think you had better drop the wording, the mantra, which has appeared in your 2016 Budget Report, 2017 Budget Report, 2018 Budget Report: you are basically saying, however, the reasons are largely considered to be short-term timing issues, it is reiterated that there are significant financial requirements for the short- to medium-term, which will be funded from the bond issue proceeds?

When do you think you had better drop that?

***Deputy St Pier*:** I think, in light of your comment, we will certainly have to give it serious consideration next year. We might want to word it in a different way!

The Chairman: Deputy Dorey, do you still have questions?

Deputy Dorey: Just to clarify on the breakage costs, you said in the question before that was £5.3 million in the question and answer document which we referred to at the beginning. In the KPMG report, they talk about £4.2 million was incurred for the GHA. Do you know what other breakage costs there have been and has the total broken £5.3 million?

***Ms Haines*:** I do not think there are any other breakage costs.

Deputy Dorey : There are no other breakage costs?

***Ms Haines*:** The breakage costs were in respect of the Guernsey Housing Association and Cabernet, specifically, in respect of some currency stocks that were put in place.

Deputy Dorey: So there was more than £4.2 million, because that is referred to as the GHA in the KPMG Report?

***Ms Haines*:** Sorry, the £5.3 million that was made up of costs of breaking the arrangements in place with Guernsey Housing Association and Cabernet, but only the Guernsey Housing Association element has come to pass, because the borrowing on the aircraft has not been put in place on those original ATRs. So those breakage costs have not been incurred.

The Chairman: Advocate Harwood?

Mr Harwood: One final point.
KPMG, in their report, on page 36, I think it is, did make the comment that it would be useful to have a fairly detailed cost benefit analysis of the on-lending and I just wonder whether that is something you feel that you are able to provide, going forward, so that people can actually assess the benefit that has arisen from the use of the bond to re-finance?

***Deputy St Pier*:** I certainly understand the rationale for the recommendation. I think, to some extent, I am not sure how accurate it is going to be, because it is quite difficult to determine the interest rates which some of those entities could have borrowed at. Therefore, whether you are actually going to properly compare, because some of those loans, as I said earlier, are going to be dependent on the either implicit or explicit States' guarantee. So, comparing what they might have been able to achieve as an entirely third-party borrower, versus the loan that has been provided.

I think it can be done and I think, in principle, we are happy to do it. But I would just add that caveat to really understanding its utility.

The Chairman: It is quite important, though, for people to be able to assess, in a fairly simple to understand way, what the cost or the benefit has actually been – for other States' Members, for example, on an ongoing basis, in terms of monitoring.

I take your point, but it is quite an important recommendation, in that respect, isn't it?

***Deputy St Pier*:** Which is why I think we are happy to try and do it. I am just saying that I am not sure it can be undertaken with the pinpoint accuracy that, perhaps, the recommendation implies.

It is a note of caution; there are some caveats about the information that has been prepared.

Mr Harwood: So, that is a no?

***Deputy St Pier*:** No, it was a yes.

Mrs Morris: It was a yes with some caveats?

The Chairman: Subject to a qualification.

***Deputy St Pier*:** Yes, it was a yes, but be careful how you use it or interpret it.

The Chairman: Have we got any other questions? Mrs Morris?

Mrs Morris: It has just been bothering me since the beginning, so, going right back to the beginning of the hearing, we were talking about the FAQs that went out the night before and the inaccuracies, or rather lack of clarity, that those encompassed. Who would have been responsible for reviewing that? Presumably, somebody within T&R prepared them, but who was responsible for checking them before they went out, given that they were very important to the States Members for the vote the next day?

***Ms Haines*:** They were prepared by my team, who worked on the Bond issue. All the documentation that we put out is always checked internally and then they were also signed off by the Treasury & Resources Department board.

The Chairman: Who drafted them?

***Ms Haines*:** A member of my team.

***Deputy St Pier*:** At officer level.

Mrs Morris: And they were reviewed before they went out?

***Deputy St Pier*:** Yes, in terms of responsibility at officer level, for the content, then ultimately that sits, at officer level, with the States' Treasurer and, at a political level, with me at the time, as Minister, obviously along with the rest of my board at the time.

***Ms Haines*:** Can I just add one further clarification? The aim of these was to provide clarity, because there were a series of questions being asked by States' Members and I note that you said they went out the night before the debate. The aim was to seek to provide clarity ahead of the debate, albeit somewhat late in the day, but that was because there was an ongoing dialogue throughout the period.

The Chairman: Well, just before we wrap up …
Sorry, Deputy Dorey.

Deputy Dorey: Just on the timing of going to the market, looking at the market price of the Bond, it has been up to over 32% above the issue price. It currently sits about 12% above the issue price; again, in hindsight, do you regret going to the market when you did, and you should have held back?

***Deputy St Pier*:** All I can say is, with any investment decision, any financial decision, whether it is an investment or taking on a loan, clearly you are doing it at a point in time with the best information that is available at the time.

I can only reiterate a response I gave earlier: that expectations, politically and in the market and with all economic commentary, were in expectation of interest rates to rise.

Now, we do not know actually if we went to market, although the market price is as you described it, we do not know, that if we had gone to market at any other time since then, whether, for a term of that period, we would have been able to obtain a rate that was either better or worse than that. Because, although the market price is reflected, gilt yields, the issuance depends on market conditions at the time and the appetite for the market to borrow at any given time and that is reflected in the spread over the gilt yield for the same period.

Of course, our credit rating has been downgraded twice, as a result of following the UK's downgrading post-Brexit, so I do not think, notwithstanding your reference to the way the market has moved since then, there can be any certainty that we necessarily would have got a better rate anyway.

I think that is an important point to make, as well as emphasising the point that, in hindsight, it is always possible to say that if you had gone a week later, a week earlier, a month earlier, a month later or a year later, you could have done things differently.

Fundamentally, I remain of the view – and I appreciate I have been robust in this view from the outset and, equally, others have been robust in a different view from the outset – that I have nothing whatever to be embarrassed about.

I am proud of the achievement of what we managed to achieve and I think it is something that we should be celebrating. So I have absolutely no regrets about it.

I think, in December 2046, if I am still here, I will be 79 –

The Chairman: We will get you in again!

Mr Harwood: I will not be here!

***Deputy St Pier*:** I think it will have proven to have been a very reasonable decision at that time, with the benefit of, then, 32 years' hindsight. At the moment we are only looking at it with the benefit of three and, even with that, I do not have anything to regret.

So I do appreciate that is a robust response, so I think hindsight is a wonderful thing and hindsight would have, perhaps, enabled a different decision on timing. But it would not, in any way, change the decision, as far as I am concerned, other than perhaps to have borrowed more.

Deputy Dorey: You say you could have borrowed more, but you broke the financial framework in terms of borrowings in one year. So you are happy to break 15% as well and have no qualms about that?

***Deputy St Pier*:** Politically, I did not believe that was deliverable, Deputy Dorey. Otherwise I would have tried.

Deputy Dorey: Were you given specific advice that this was the right time to go to the market? Was it just because it coincided with just after the Budget?

***Deputy St Pier*:** Yes, we were obviously in dealing with advisers at the time and it was not just because it coincided with the timing of the Budget, but it was as presented at the time of the Budget, in an expectation that interest rates were imminently going to rise, either by the year end or early in 2015.

Now, that did not come to pass. We have had several statements from Governor Carney, who has been described as an 'unreliable boyfriend', promising interest rates rises which have never happened. I think it was more driven by that environment than the timing of the Budget.

Deputy Dorey: So if there had not been a Budget you would have brought a specific policy letter to the States on this, instead of being as part of the Budget?

***Deputy St Pier*:** That is a hypothetical question.

The Chairman: Advocate Harwood, shall we make this the final question?

Mr Harwood: Given that the team you employed to advise you on the Bond issue was the same team that was used by Jersey, was there not an element of hubris about this: we want to get away a Bond issue at a lower coupon than Jersey?

***Deputy St Pier*:** I would not describe that as hubris, I would describe it as an admirable ambition to be able to achieve a better interest rate. But that was more a recognition of the movement in the market than specifically us versus Jersey.

Mr Harwood: But did it influence the timing?

***Deputy St Pier*:** No.

The Chairman: Thank you very much. I think we will call a halt there.

The proceedings have been recorded, so there will be a *Hansard* transcript produced in due course, which we will no doubt share with you for accuracy and factual accuracy checks.

Thank you very much.

***Deputy St Pier*:** Thank you very much.

The hearing adjourned at 4.35 p.m.