



HM Treasury

# Contingent Liabilities

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March 2018

# Outline

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1. Overview of quantifiable contingent liabilities (CLs)
2. Approval and Monitoring of CLs
  - Old process vs. new process
  - The CL checklist
3. One year stocktake and year ahead
4. Annex



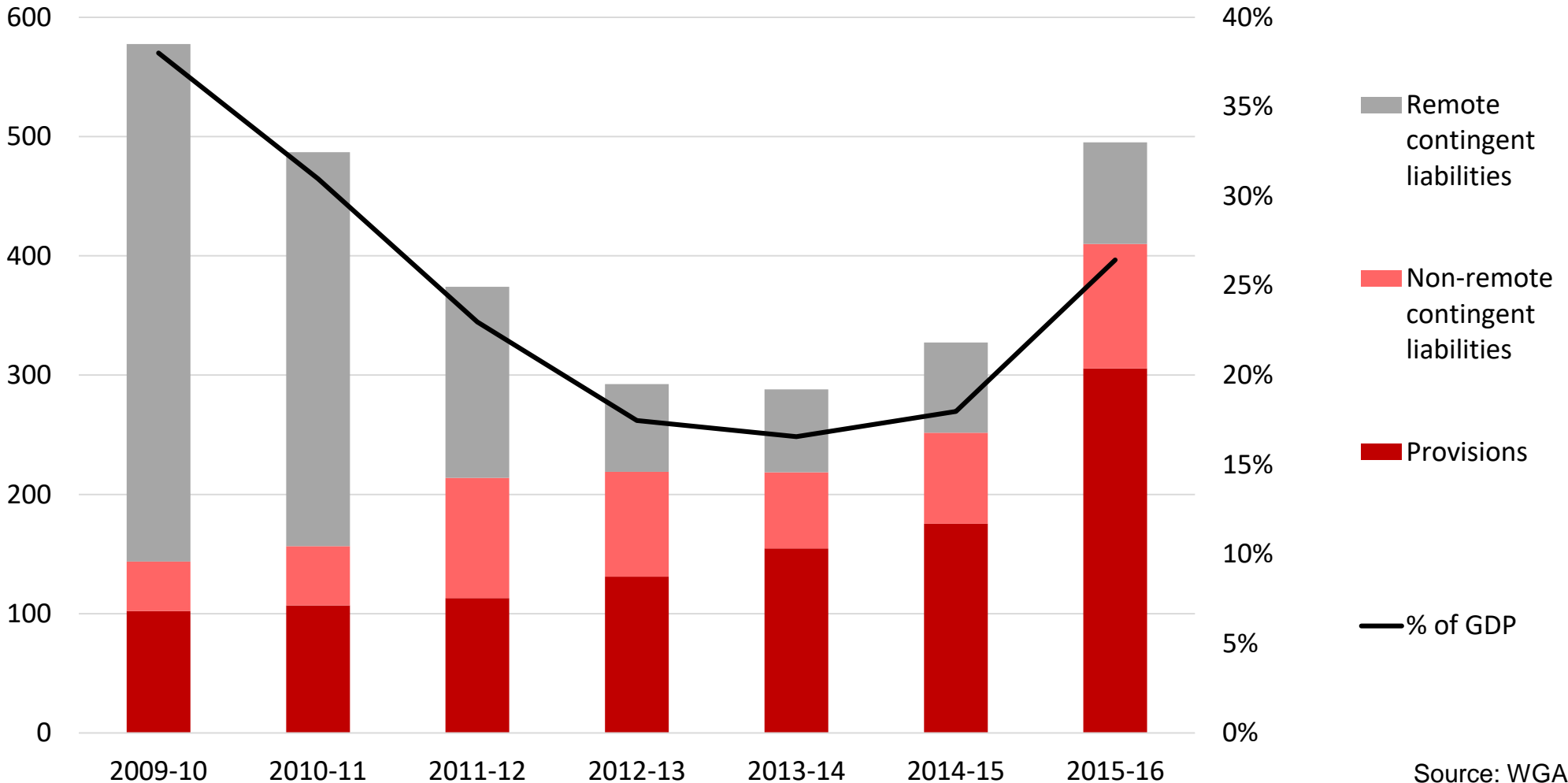
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# **1. Overview of Quantifiable CLs**

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# Growing fiscal risk?

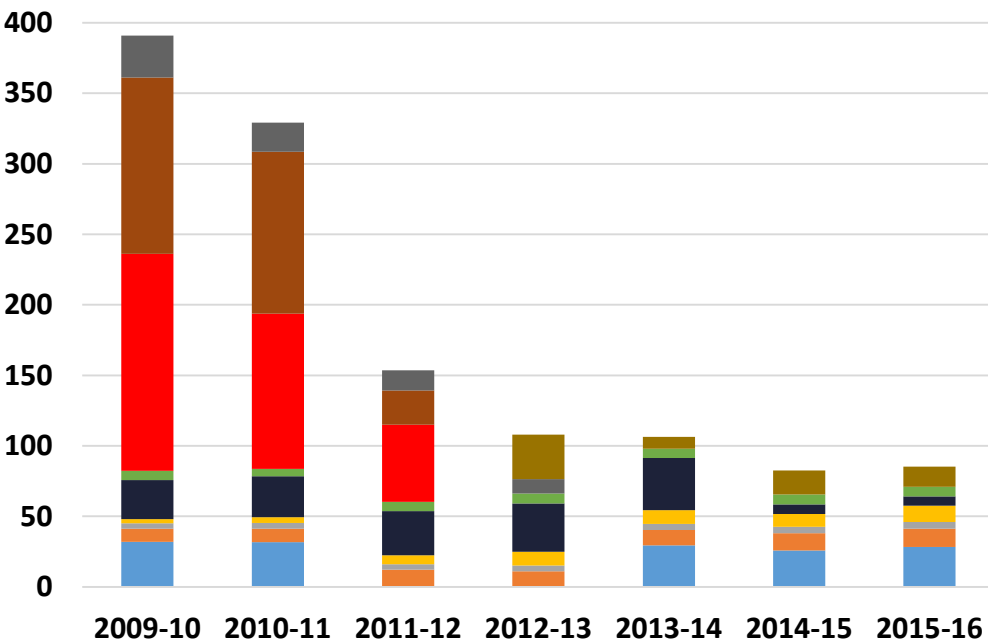
## Provisions and Contingent Liabilities (£bn)



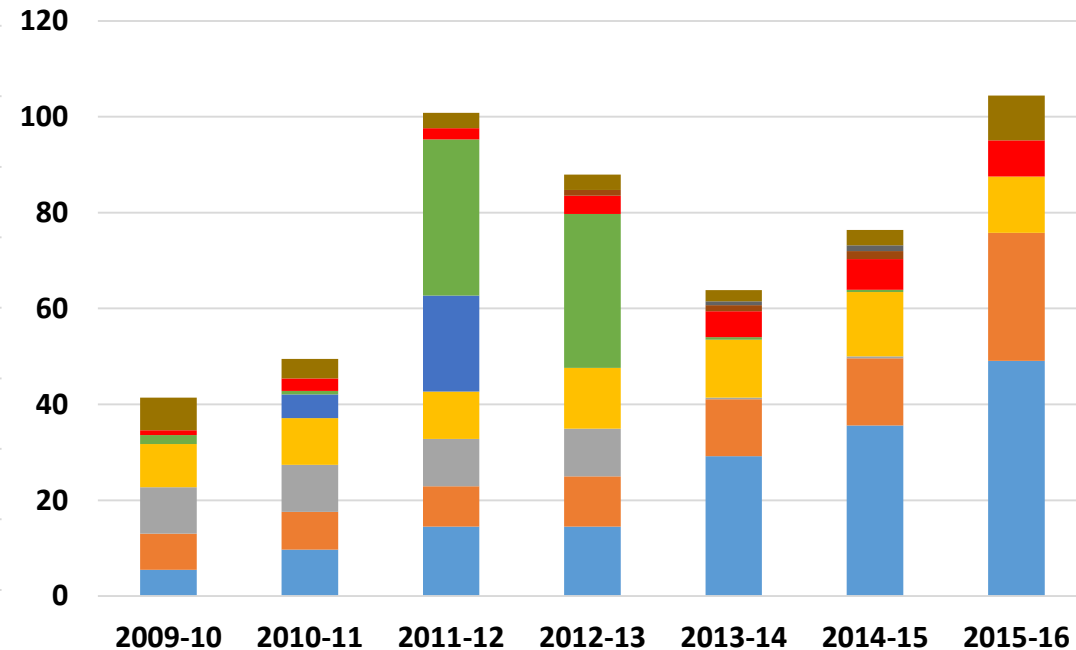
Source: WGA

# Remote CLs have fallen due to the closure of financial stability schemes set up during the crisis while the non-remote have more than doubled over the last 7 years, from c.£40bn to over £100bn...

Remote Quantifiable Contingent Liabilities (£bn)



Non-remote Quantifiable CLs (£bn)



- Other
- Financial Guarantees to depositors with public sector banks
- Credit Guarantee Scheme
- Asset Protections Scheme
- Government Indemnity Scheme DCMS
- National Rail
- Outstanding loans to EU member states
- Gov's potential obligations wrt coins in circulation
- Callable capital in International Financial Institutions
- Callable capital to Europe Investment Bank

- Other
- Pension Protection Fund
- Military contracts
- Transport infrastructure projects
- Supporting int orgs
- Loss of tax rev from oil and gas field decomm
- Export gurantees and insurance policies
- Financial stability interventions by HMT
- Clinical negligence claims DoH
- Taxes subject to challenge HMRC

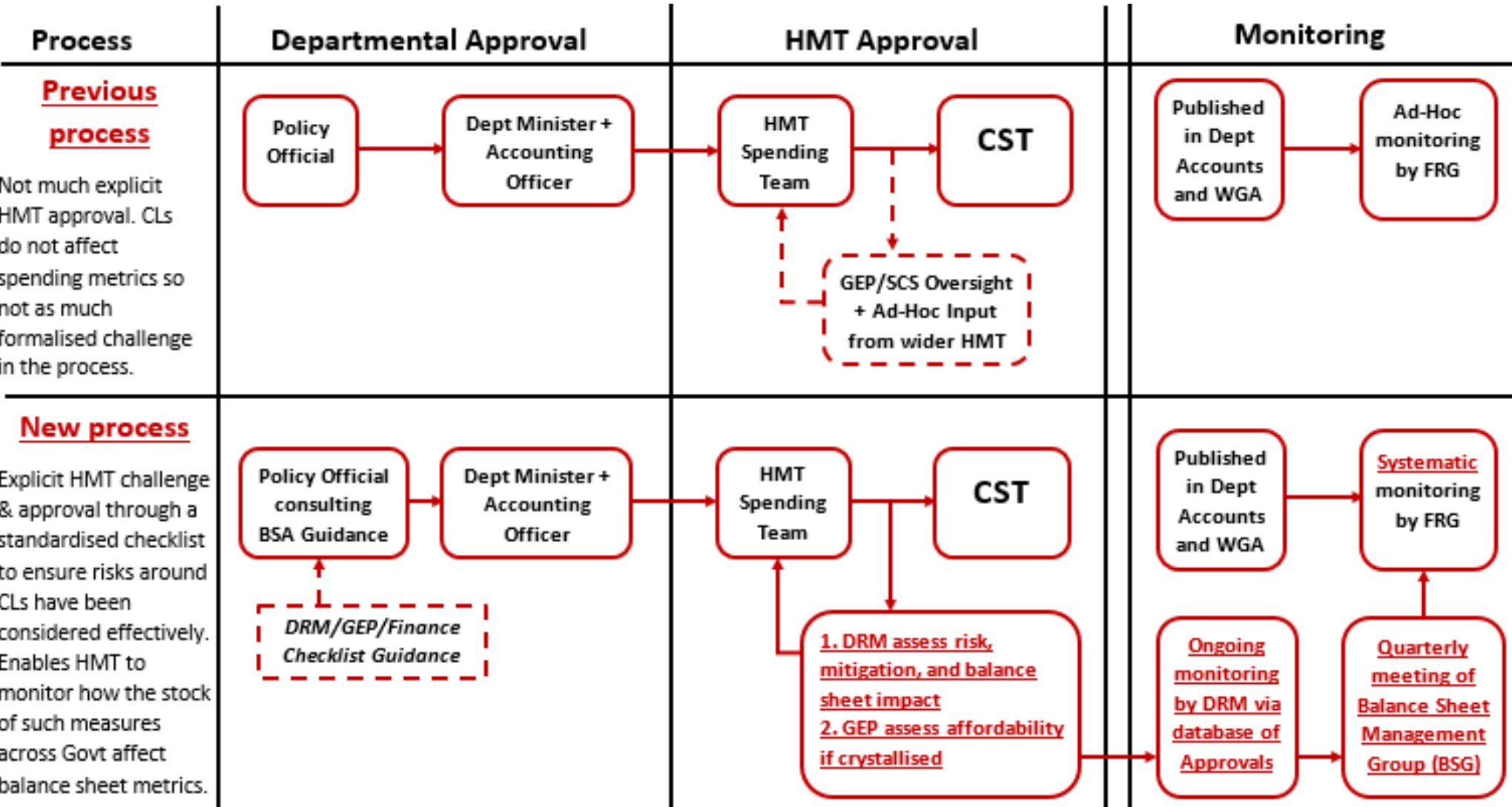


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## **2. Approval and Monitoring of CLs**

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# A more centralised and systematic approach to approving and monitoring CLs will help manage the growing fiscal risks...



# Each new contingent liability will go through a checklist composed of 5 key elements

## 1. Rationale

- a) What is the problem that needs to be solved and why is Government intervention necessary?
- b) Why is incurring/modifying a CL necessary to address the market failure? Why is it better than increasing spending?
- c) What other alternatives have been explored? E.g., subsidies.

## 2. Exposure

- a) What is the maximum size of the CL, if any?
- b) Why is this size necessary?
- c) What is the maturity of the CL, if any?
- d) Why is this maturity necessary?
- e) Do we have an exit strategy?

## 3. Risk and Return

- a) What are the triggers for potential crystallisation of the CL?
- b) What is the likelihood of complete crystallisation over what timeframe?
- c) What is the expected loss associated with the CL?
- d) What is the distribution of possible losses over the life of the CL?
- e) How do the risks compare to the returns on the CL?

## 4. Risk Management and Mitigation

- a) Who will manage the risks associated with the CL and what is the governance process around the management of these risks?
- b) What risk mitigation tools have been explored? E.g., partial guarantees, collateral, controls on risk-taking behaviour, reinsurance, etc.
- c) Is the Exchequer being adequately compensated for bearing the risk associated with the CL? E.g., guarantee fees, contingent claims, profit-sharing, etc.
- d) How should the Exchequer guard against the residual risk? E.g., contingency fund, setting aside financial assets, hedging, etc.

## 5. Affordability

- a) If the CL crystallised, to what extent would it be possible to meet the required payment out of the department's budget?
- b) What is the ratio of the CL's expected loss to the department's available resources?
- c) If the CL crystallised, how would it affect PSNB and PSND?





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## **3. One year stocktake**

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# Guidance Published and CST Letter July 2017



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## Contingent liability approval framework:

guidance

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OFFICIAL SENSITIVE



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July 2017

### NEW CONTINGENT LIABILITY APPROVAL PROCESS AND GUIDANCE

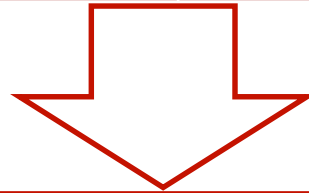
1. I am writing to inform you of the government's new framework for approval and monitoring of contingent liabilities. I would appreciate your help to



# Received over 40 requests for approval which we have compiled into a new centralised database

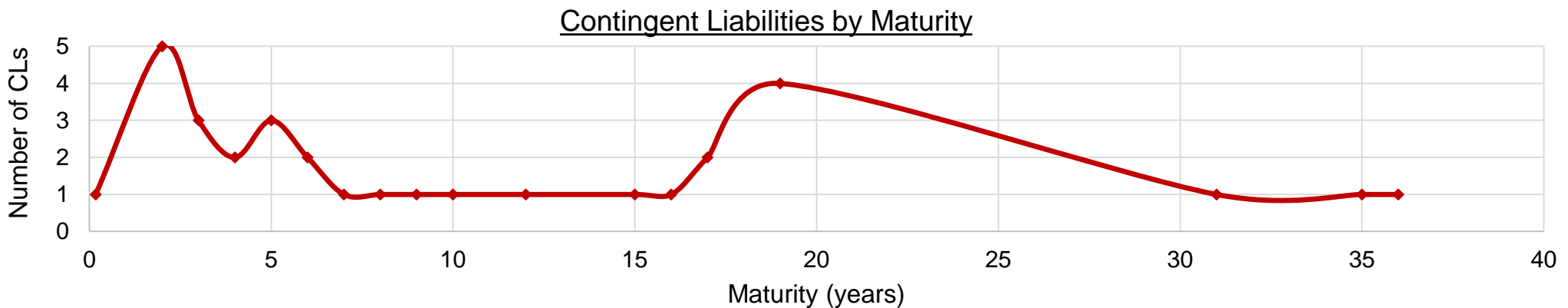
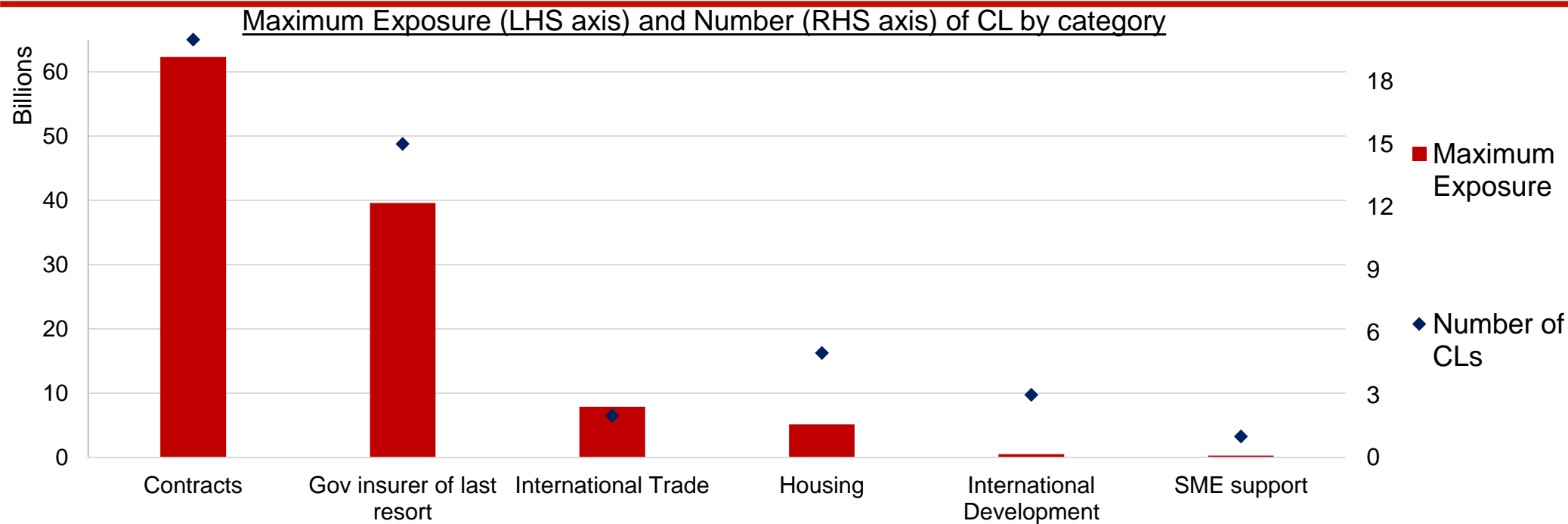
- Centralised database for monitoring portfolio of CLs
- 40+ new CLs gone through CL process

Section of checklist	Rationale	Exposure	Risk vs Return	Risk Mgt	Affordability
Where have we seen most improvement	✓	✓	X	✓	X



More than half have no credible estimate of expected loss

# The database allows for analysis by category of 'trigger' as well as maturity



## Challenges and further questions

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- How to **further embed the process** to shape policies that give rise to CLs at the earliest instance?
- How to ensure **robust analysis** (for example, credible estimates of expected loss)?
- How to **balance** fiscal risk management with policy priorities?
- How to **limit** overall CL exposure?

# Annex: Understanding Provisions and Contingent Liabilities in WGA

