Taxpayer direct support to banks (Lloyds, RBS, Northern Rock, and Bradford & Bingley)

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Section Business and Transport Section

This Standard Note considers the Government's interventions ("direct support") in four major UK banks, namely Northern Rock, Bradford and Bingley, Royal Bank of Scotland, and Lloyds Banking Group (formerly Lloyds TSB and Halifax/Bank of Scotland).

It considers the background of the "direct support" in the four banks, the role of the Government-owned UK Financial Investments Ltd in managing the taxpayer's stakes in these banks, and the current valuation of these interventions. It also considers when the taxpayers' shareholdings in Royal Bank of Scotland and Lloyds Banking Group might be sold, and the possible privatisation of Northern Rock, and Bradford and Bingley.

In the 2010 Budget, the then Government estimated that the expected net loss to the taxpayer was £6 billion. This took account both of the direct support for the four banks, and other measures to support the financial sector including the Asset Protection Scheme, which is discussed in this Note.

The note includes a "ready reckoner" of the cost or benefit to the taxpayer of changes in the share price of Royal Bank of Scotland and Lloyds Banking Group. As a rule of thumb, for a 1p change in the share price, the value of the Government's holdings changes by about:

- £910 million in the case of RBS (break-even share price is 49.9p); and
- £280 million in the case of Lloyds (break-even share price is 63.2p).

Contents

1 Background on the Government's intervention in individual banks (direct support)

1.1 Summary

In summary, as of March 2010, the taxpayer held the following stakes in four UK banks:

Bank	Date(s) of interventions	Stake in company	Approximate value of intervention
Northern Rock	February 2008	100%	£20 billion
Bradford and Bingley†	September 2008	100%	£37 billion
Royal Bank of Scotland	Oct 2008, Jan* and Nov 2009	84%	£45.5 billion‡
Lloyds Banking Group	Oct 2008, Mar* and Nov 2009	41%	£20.3 billion‡

Sources: UK Financial Investments Limited, Update on UKFI Market Investments, March 2010, p4–5; National Audit Office, Maintaining financial stability across the United Kingdom's banking system, 2009–2010 HC 91, December 2009, p38, figure 17

† the retail deposit business and branch network was sold to Abbey National plc (owned by Santander Bank). The Government owns 100% of the remainder of Bradford and Bingley.

‡ these figures are partly offset by fees. As of March 2010, for RBS fees received by the Government were £305 million, for Lloyds they were £2,876 million.

* in January and March 2009, the Government converted its holdings of, respectively, RBS and Lloyds preference shares into ordinary shares; as such, there was no additional cash investment.

1.2 Northern Rock

Perhaps the most high-profile instance of the then Government's intervention, Northern Rock bank was one of the first institutional casualties of the credit crunch. Northern Rock had relied on borrowing short-term funds through the money markets to cover the long-term loans, primarily mortgages, that it, the bank, had made to customers. After the wholesale lending markets ceased to function normally following the onset of the credit crunch, Northern Rock turned to the Bank of England for emergency financial support, in the Bank's role as lender of last resort.

When BBC News reported this support in September 2007,[1] there was a run on the bank by its customers as savers sought to withdraw their funds.[2] In a bid to stop the bank haemorrhaging deposits, the then Chancellor of the Exchequer, Alistair Darling, announced that the Treasury would fully underwrite all deposits with Northern Rock, thereby ensuring that deposits were safe.[3]

Nevertheless, Northern Rock was forced by events to ask for expressions of interest in purchasing the business, although the then Government stated it would have to agree to any proposals from Northern Rock regarding its future.[4] The Treasury said that:

[1] "Northern Rock gets bank bail out", *BBC News*, 13 September 2007

[2] "Northern Rock savers rush to empty accounts", *Times*, 14 September 2007

[3] HM Treasury, Statement by the Chancellor of the Exchequer on financial markets, press release 95/07, 17 September 2007

[4] HC Deb 19 November 2007 cc960–961

> The Tripartite Authorities' [HM Treasury, the Bank of England, and the Financial Services Authority] objectives in relation to Northern Rock are to:
>
> (A) protect taxpayers;
>
> (B) promote financial stability; and
>
> (C) to protect consumers.
>
> The Tripartite Authorities will assess proposals in light of the full range of strategic options available, including any proposals to meet Northern Rock's liabilities to the public sector without any change in ownership of its business or assets. They will undertake this assessment with regard to the three objectives set out above, and additionally with regard to the timing and certainty of execution of any proposal.[5]

In February 2008, the then Government announced that it had decided to take Northern Rock into an (unspecified) "period of temporary public ownership". It had considered "two detailed private sector proposals": one from the Virgin Consortium and the other, a Northern Rock led restructuring plan. Both were considered alongside temporary public ownership.

The Treasury said:

> 14. The Government has concluded that the private sector alternatives do not meet the test of protecting the taxpayer's interest, when compared with the alternative. Accordingly, and taking all the wider considerations into account, the Government has concluded that the right approach is to take the company into a period of temporary public ownership.
>
> 15. It is also the Government's clear assessment that, under the approach the Government is taking, the taxpayer will see its outstanding loans to Northern Rock repaid in full, with interest - and that the business can and will be returned to the private sector as financial markets stabilise.[6]

The following day, legislation to enable the Government to take banks into public ownership, the *Banking (Special Provisions) Bill*, had its first reading in the House of Commons and received Royal Assent four days later.[7]

On the same day that the Bill received Royal Assent and so became an Act, *The Northern Rock plc Transfer Order 2008* (SI 2008/432) was laid before Parliament under the *Banking (Special Provisions) Act 2008*,[8] thereby nationalising Northern Rock.

The National Audit Office (NAO) subsequently reported that the cost to the taxpayer of the loan to, and the capital injection in, Northern Rock amounted to £20 billion.[9]

1.3 Bradford and Bingley

In contrast to Northern Rock, the nationalisation of part of Bradford and Bingley bank was exceptionally rapid. This was because the existing legislation, namely the *Banking (Special*

[5] HM Treasury, Principles for assessing Northern Rock proposals, press release 128/07, 19 November 2007
[6] HM Treasury, Northern Rock plc, press release 16/08, 17 February 2008
[7] The Library Research Paper on the Bill provides more information, see: House of Commons Library, Banking (Special Provisions) Bill, Research Paper 08/19, 19 February 2008
[8] SI 2008/432
[9] National Audit Office, Maintaining financial stability across the United Kingdom's banking system, 2009–2010 HC 91, 4 December 2009, p38, figure 17

Provisions) Act 2008, that had allowed Northern Rock to be nationalised could also be applied to Bradford and Bingley.

Over the weekend of 27/28 September 2008, the Financial Services Authority (FSA) determined that Bradford and Bingley "no longer met its threshold conditions for operating as a deposit taker under the *Financial Services and Markets Act 2000* and FSA rules". The Tripartite Authorities worked together in response, and "the Government, on the advice of the FSA and the Bank of England, acted immediately to maintain financial stability and protect depositors, while minimising the exposure to taxpayers". It said that it had devised a "part public, part private solution which best meets those objectives".

In response, the Treasury undertook a "competitive sale process" over that weekend for Bradford and Bingley's UK and Isle of Man retail deposit business, along with its branch network; this part of the business was sold to Abbey National plc (owned by Santander Bank, of Spain[10]).

The remaining rump of Bradford and Bingley — "principally comprising its mortgage book, personal loan book, headquarters and relevant staff, and treasury assets and its wholesale liabilities" — was taken into public ownership through the transfer to the Treasury of the company's shares.[11]

The Bradford & Bingley plc Transfer of Securities and Property etc. Order 2008 (SI 2008/2546),[12] made under the *Banking (Special Provisions) Act 2008*, came into force at 8am (the time the London Stock Exchange opened) on Monday 29 September 2009, thereby nationalising this rump of Bradford and Bingley, and so cancelling the stock exchange listing of Bradford and Bingley's shares.[13]

The Government also provided backing for all the deposits at Bradford and Bingley that were transferred to Abbey National. The Treasury explained that:

> Under the Transfer Order, the FSCS [Financial Services Compensation Scheme] has paid out approximately £14bn to enable retail deposits held in Bradford & Bingley and covered by the FSCS to be transferred to Abbey. The Treasury has made a payment to Abbey for retail deposit amounts not covered by the FSCS, amounting to approximately £4bn. In return, the FSCS and the Treasury have acquired rights in respects of the proceeds of the wind-down and realisation of the assets of the remaining business of Bradford & Bingley in public ownership.[14]

The National Audit Office subsequently said that Government support to Bradford and Bingley, specifically loans to the Financial Services Compensation Scheme and working capital facility for Bradford & Bingley and other debts, amounted to £37 billion.[15]

1.4 Royal Bank of Scotland

Bank Recapitalisation Fund

In response to the marked worsening of the credit crisis following the collapse of the US investment bank, Lehman Brothers, in September 2007,[16] the Government announced the

[10] Since 11 January 2010, "Abbey National" has been rebranded "Santander" in the UK
[11] HM Treasury, Bradford & Bingley plc, press release 97/08, 29 September 2008, paras 1, 3–4, 7
[12] SI 2008/2546
[13] HM Treasury, Bradford & Bingley plc, press release 97/08, 29 September 2008, para 14
[14] HM Treasury, Bradford & Bingley plc, press release 97/08, 29 September 2008, para 9
[15] National Audit Office, Maintaining financial stability across the United Kingdom's banking system, 2009–2010 HC 91, 4 December 2009, p38, figure 17

launch of its "Bank Recapitalisation Fund" on 8 October 2008. The intention of the Fund was for the Government to inject capital into banks (in return for equity) in order to avoid solvency difficulties.[17]

Around the time of its capital injections into Royal Bank of Scotland (RBS) and what became Lloyds Banking Group (see section 1.5), the then Chancellor said that:

> In assessing any [recapitalisation] proposals in relation to eligible institutions, HM Treasury will continue to focus on three key objectives:
>
> - maintaining financial stability;
> - safeguarding the interests of taxpayers; and
> - protecting depositors and consumers.
>
> In providing capital to any eligible institution, HM Treasury, on the advice of the Bank of England and Financial Services Authority, would need to be satisfied that these three objectives were met.[18]

Initial investment (share holding at 58%)

On 13 October 2008, the Government announced that it would make an investment of £20 billion in RBS. The scale of this investment in RBS potentially represented 63% of the company, although the NAO subsequently said that the investment gave the Government a holding of 58% of RBS.[19]

The former Chancellor told the House:

> For RBS, the Government will take up to £15 billion of ordinary shares and £5 billion of preference shares. This potentially represents a 63 per cent. interest in the bank, in return for which the Government will appoint three independent board members. Again, no bonus will be awarded to any board member this year, and any bonus paid next year will be in stock and linked to long-term growth in the bank. Mortgage and small and medium-sized business lending availability will be maintained at 2007 levels for the benefit of people up and down the country. These steps will help to put RBS on a stronger footing and allow it to build on its core retail banking operation.[20]

Conversion of preference shares (share holding at 70%)

In January 2009, the Government announced that it would convert its £5 billion holding of preference shares into ordinary shares, although it was keen to state that it was "not injecting new money into RBS". This action had several effects:

- increased the Government's stake in RBS from, according to the National Audit Office, 58% to 70%;

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[16] See Library Standard Note, *The Credit Crisis: a timeline*, SN/BT/4991
[17] HM Treasury, Financial support to the banking industry, press release 100/08, 8 October 2008
[18] HC Deb 18 Nov 2008 c7WS
[19] National Audit Office, Maintaining financial stability across the United Kingdom's banking system, 2009–2010 HC 91, 4 December 2009, p22, para 2.20
[20] HC Deb 13 October 2008 c545

- removed the need for the banks to pay fixed dividends on Government-held preference shares;[21]

- made available additional core tier 1 capital to the bank to strengthen its resources, so as to, as the Treasury put it, "enable it to absorb expected losses and permit it to restructure its finances";

- gave the bank the opportunity to build its capital further so that it was "able to maintain and increase its support for the real economy", according to the Treasury.[22]

Further capital injection (share holding at 84%)

In November 2009, HM Treasury announced that RBS would participate in the Asset Protection Scheme, or "APS" (see section 3.3) — a government-backed insurance scheme against losses on RBS's loan portfolio. As part of this agreement, the Government provided a further capital injection of £25.5 billion to purchase non-voting B-shares.

Summary of the Government's investment (March 2010)

In its update of March 2010, UK Financial Investments Limited (UKFI) said that the Government held a total of 90.6 billion shares in RBS, including 51.0 billion non-voting B shares. UKFI added that "this is equivalent to 70 percent of voting share capital and 84 percent of total share capital".[23]

Action	Date announced	Shares (million)	Total investment (£ million)	Investment per share (p)
Initial Recapitalisation	Oct 2008	22,854	14,969	65.5
Preference share conversion†	Jan 2009	16,791	5,058	31.75
APS associated B shares	Nov 2009	51,000	25,500	50.0
Total Investment		**90,645**	**45,527**	**50.2 (avg)**

† Total investment adjusted to take account of accrued dividends and redemption premiums received of around £270 million

Source: UK Financial Investments Limited, Update on UKFI Market Investments, March 2010, p4

1.5 Lloyds Banking Group (including Halifax/Bank of Scotland)

Initial investment (share holding at 44%)

Under the Government's bank recapitalisation scheme (see section 1.4 on RBS), on 13 October 2008, the Government announced that it would make an investment of £17 billion in Lloyds, amounting to 44% of the company.

At the time of this announcement, Lloyds TSB Bank had already said that it intended to takeover Halifax/Bank of Scotland, although the deal had, at that stage, yet to be completed.[24]

Alistair Darling told the House:

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[21] National Audit Office, Maintaining financial stability across the United Kingdom's banking system, 2009–2010 HC 91, 4 December 2009, p22, para 2.20

[22] HM Treasury, Treasury statement on restructuring its investment in RBS to deliver further bank lending to industry and homeowners, press release 06/09, 19 January 2009

[23] UK Financial Investments Limited, Update on UKFI Market Investments, March 2010, p4

[24] "Lloyds TSB seals £12bn HBOS rescue", *Financial Times*, 18 September 2008

> In the case of Lloyds TSB and HBOS, the Government will purchase both ordinary and preference shares once the merger is complete. HBOS will receive up to an £8.5 billion investment in newly issued ordinary shares on completion of the merger. The Government will also invest up to £4.5 billion in newly issued ordinary shares of Lloyds TSB at completion. At the same time, we will invest up to an additional £4 billion in preference shares in the merged institution, with £3 billion of which being invested in HBOS and £1 billion in Lloyds TSB. In return for this investment, which potentially represents around 44 per cent. of the proposed merged bank, the Government will appoint two independent board members. No cash bonuses will be paid to any board member this year. Directors in HBOS will be asked to relinquish their rights to bonuses, and directors in Lloyds TSB will receive restricted stock instead of cash for any 2008 bonus entitlements. The availability of lending to home owners and small businesses will be maintained at at least 2007 levels, and greater support will be given to people experiencing difficulties with their mortgage payments to help them stay in their homes.[25]

Conversion of preference shares (share holding at 43.5%)

In March 2009, as part of its announcement of Lloyds Banking Group's participation in the Asset Protection Scheme in principle (although it subsequently decided not to participate, see below under "Rights issue", and section 3.4), the then Government said that it would replace the Treasury's £4 billion worth of preference shares in Lloyds with new ordinary shares. It added the aims of this move were "supporting stability in the financial system; ensuring continued protection for ordinary savers, depositors, businesses and borrowers; and safeguarding the interests of the taxpayer".

The redemption of the preference shares was funded by a share placing by Lloyds Banking Group. The then Government participated in the share placing: the Treasury took up its pro-rata share of the open offer, buying 43.5% of the available shares and thereby consolidating its shareholding in Lloyds at 43.5%.

The Treasury had underwritten the share placing; if there had been no demand from existing shareholders or the market (for non-allocated shares), the Government's holding would have increased to 65%.[26]

Lloyds noted that by redeeming the preference shares that the Treasury had held, the bank would make a £480 million annual saving[27] that it would otherwise have paid to the Treasury on the preference shares which carried an interest rate of 12%.[28]

Rights issue (share holding at 41%)

Instead of participating in the Asset Protection Scheme (APS), improved market conditions allowed Lloyds to raise sufficient capital through the market to meet the FSA's capital requirements without the need for additional support from the APS. HM Treasury said that "this option represents better value for money for taxpayers, as the private sector will now provide the majority of the capital required to protect Lloyds from the downside risks to its balance sheet".[29]

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[25] HC Deb 13 October 2008 cc544–545

[26] HM Treasury, Asset Protection Scheme - agreement with Lloyds, press release 23/09, 7 March 2009

[27] Lloyds Banking Group, Lloyds Banking Group Announces the Successful Completion of the Placing and Compensatory Open Offer and Placement of all Non Accepted Shares, press release 60/09, 8 June 2009

[28] "Government poised to assume majority stake in Lloyds group", Guardian, 7 March 2009

[29] HM Treasury, Implementation of Financial Stability Measures for Lloyds Banking Group and Royal Bank of Scotland, press release 99/09, 3 November 2009

Lloyds announced plans to raise £21 billion through a combination of a £13.5 billion rights issue, and £7.5 billion by swapping existing debt for contingent capital.

The Government said that it would take up its rights as a shareholder in Lloyds to participate in the planned capital raising, making an investment of £5.7 billion (net of an underwriting fee). Although the Government took up its pro-rata allocation, the decision of Lloyds to pay bondholders in new shares meant that the Government's holding fell to 41%.[30]

Summary of the Government's investment (March 2010)

In its update of March 2010, UK Financial Investments Limited (UKFI) said that the Government held a total of 27.6 billion ordinary shares in Lloyds, including 15.8 billion shares taken up in Lloyds' rights issue. This was equivalent to 41 percent of the total share capital of Lloyds.[31]

Action	Date announced	Shares (million)	Total investment (£ million)	Investment per share (p)
Initial Recapitalisation	Oct 2008	7,277	12,957	182.5
Preference share conversion†	Mar 2009	4,521	1,508	38.43
Rights issue	Nov 2009	15,810	5,850	37.0
Total Investment		**27,609**	**20,315**	**73.6 (avg)**

† Total investment adjusted to take account of accrued dividends and redemption premiums received of around £230 million

Source: UK Financial Investments Limited, Update on UKFI Market Investments, March 2010, p5

[30] "Government stake in Lloyds shrinks", Reuters, 12 February 2010

[31] UK Financial Investments Limited, Update on UKFI Market Investments, March 2010, p5

2 UK Financial Investments (UKFI)

2.1 Establishment of UKFI and its overarching objective

In October 2008, in his statement on the recapitalisation of RBS, and Lloyds TSB and Halifax/Bank of Scotland, the then Chancellor said that the Government's shareholdings would be "managed on a fully commercial basis by an arm's length body with a precisely defined remit to act in the interests of taxpayers".[32]

In November 2008, the Treasury announced the details of this body, to be called UK Financial Investments Limited (UKFI). The Treasury said that UKFI's "overarching objectives will be to protect and create value for the taxpayer as shareholder, with due regard to financial stability and acting in a way that promotes competition".[33]

The Chancellor explained that this included:

- Maximising sustainable value for the taxpayer, taking account of risk
- Maintaining financial stability by having due regard to the impact of its value realisation decisions; and
- Promoting competition in a way that is consistent with a UK financial services industry that operates to the benefit of consumers and respects the commercial decisions of the financial institutions.[34]

After UKFI assumed responsibility for HM Treasury's shareholdings in Northern Rock and Bradford and Bingley, UKFI restated its overarching objective in further detail, as set out below:

> The Company should, in compliance with the Investment Mandate described in Section 4 (The Investment Mandate), develop and execute an investment strategy for disposing of the Investments in an orderly and active way through sale, redemption, buy-back or other means within the context of protecting and creating value for the taxpayer as shareholder and, where applicable, as provider of financial support, paying due regard to the maintenance of financial stability and to acting in a way that promotes competition. This overarching objective includes:
>
> (A) consistent with HM Treasury's stated aim that it should not be a permanent investor in UK financial institutions, maximising sustainable value for the taxpayer, taking account of risk;
>
> (B) maintaining financial stability by having due regard to the impact of value realisation transactions (in respect of the Listed Investee Companies) and disposal or restructuring transactions (in respect of the Wholly-Owned Investee Companies); and
>
> (C) promoting competition in a way that is consistent with a UK financial services industry that operates to the benefit of consumers and respects the commercial decisions of the financial institutions.[35]

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32 HC Deb 13 October 2008 c544

33 HM Treasury, New company to manage Government's shareholding in banks, press release 114/08, 3 November 2008

34 HM Treasury, Letter from Chancellor Alistair Darling to Chairman of the Treasury Committee, 3 November 2008, p1–2, para 4

As the NAO noted:

> The Government decided not to use the Shareholder Executive, a part of the Department for Business, Innovation and Skills, to undertake this role. There was a need to demonstrate to other shareholders in RBS and Lloyds Banking Group that the shares would be held on a commercial basis, rather than for policy ends. Creating an arms-length relationship from the Treasury and other Government departments was considered the best means of achieving this.[36]

2.2 Relationship with banks

UKFI stated that its role is "to manage the Government's investments, not to manage the banks". UKFI added:

> Our investee banks are run by their boards and management teams. As an engaged shareholder, UKFI is taking a close interest in the calibre and performance of the banks' boards and management teams – as well as in their financial incentives, which need to be fully aligned with the taxpayers' interests as shareholders.
>
> UKFI is also working closely with the banks, again as an engaged shareholder, to assure ourselves of their approach to strategy and to hold them rigorously to account for performance. We are also taking a close interest in their approach to managing risk.
>
> Within this overarching shareholder framework, operational management decisions are for the banks themselves, to be managed commercially without interference from shareholders including UKFI.[37]

2.3 Relationship with the Government

UKFI is a wholly Government-owned company that manages the taxpayer's investments in these banks (rather than the banks themselves, as noted in section 2.2).[38] UKFI is a Companies Act Company, with HM Treasury as its sole shareholder.

The precise nature of the engagement between UKFI and HM Treasury is set out in the UKFI's Investment Strategy:

> **4. Decision-making by UKFI; Engagement between UKFI and HM Treasury**
>
> 4.1 The UKFI Framework Document contemplates that representatives of HM Treasury and the board of directors of UKFI (the "UKFI Board") or other UKFI representatives will meet from time to time to review the strategic options available in implementing the Investment Mandate and in delivering the objectives set out in the UKFI Framework Document and the UKFI Business Plan.
>
> 4.2 The meetings referred to in paragraph 4.1 are to be held quarterly as part of the dialogue provided for in the UKFI Framework Document (referred to in this Investment Mandate as the "quarterly relationship meetings") and will focus on UKFI consulting and engaging with HM Treasury on actions and decisions taken,

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35 UK Financial Investments Limited, UKFI Shareholder Relationship Framework Document, January 2010, p2, para 3.1

36 National Audit Office, Maintaining financial stability across the United Kingdom's banking system, December 2009, p26, paras 2.36

37 UK Financial investments Ltd, UKFI Strategy: Market Investments and Annual Report and Accounts 2008/09, July 2009, p7

38 UK Financial Investments Ltd, UKFI Strategy: Market Investments and Annual Report And Accounts 2008/09, July 2009, p7

or proposed to be taken, in connection with UKFI's responsibilities under this Investment Mandate and providing:

(A) an assessment of market conditions and how they are affecting each of the Investments;

(B) an outline of UKFI's current investment strategy in respect of each of the Investments;

(C) an assessment of opportunities, or potential opportunities to:

(i) realise value with respect to the Investments in the Listed Investee Companies; and

(ii) implement disposal and restructuring transactions in respect of the Wholly-Owned Investee Companies

in accordance with the Overarching Objective outlined in the UKFI Framework Document (such assessment to include an update on the design, development or implementation of any "value-realisation" and "disposal and restructuring" transactions which have previously been discussed between UKFI's representatives and HM Treasury);

(D) an assessment of the extent to which each Investee Company is complying with the applicable Investee Company Conditions; and

(E) an update on actions and decisions which UKFI has taken, or is proposing to take, to give effect to its obligations under the UKFI Framework Document and this Investment Mandate.

4.3 In addition to the quarterly relationship meetings, UKFI will keep HM Treasury informed as to:

(A) the status of any Disposal Transaction (as defined in paragraph 5.1) and any Disposal and Restructuring Transaction (as defined in paragraph 11.1); and

(B) UKFI's (and its third party advisers') views on the design, development and execution of any Disposal Transaction or Disposal and Restructuring Transaction.[39]

2.4 Governance

The former Chancellor said that the governance of UKFI "will be consistent with the Government's intention to manage its investments on a commercial and arm's-length basis and not intervene in day-to-day management decisions" (see section 2.2).[40]

At the time of its establishment, HM Treasury said that "membership of the UKFI Board will comprise a private sector Chair, three non-executive private sector members, a Chief Executive and two senior Government officials from HM Treasury and the Shareholder Executive".[41]

[39] UK Financial Investments Ltd, UKFI Investment Mandate, January 2010, pp2–3
[40] HM Treasury, Letter from Chancellor Alistair Darling to Chairman of the Treasury Committee, 3 November 2008, p2, para 7
[41] HM Treasury, New company to manage Government's shareholding in banks, press release 114/08, 3 November 2008

Although UKFI was only established in November 2008, to date there have been a number of changes at Board level, as set out below:

- Chairmen
  - Sir David Cooksey (August 2009 onwards) was appointed, being also Chairman of London & Continental Railways Ltd and of Eurasian Natural Resources Corporation plc.[42]
  - Glen Moreno (January 2009 to July 2009) served in the role in an acting capacity, having been appointed as a non-executive director of UKFI earlier in January 2009. At the time of his appointment he was Chairman of Pearson, and senior independent director of Man Group, where he has been a non-executive director since 1994,[43] although it was his former position as a trustee of Liechtenstein Global Trust (LGT) that perhaps attracted the most attention.[44]
  - Sir Philip Hampton (November 2008 to January 2009), was appointed Deputy Chairman and Chairman-designate of RBS, and, as a result, stepped down from UKFI after only three months.[45]
- Chief Executives
  - Robin Budenberg (December 2009 to date) is the current Chief Executive, having joined from UBS investment bank;[46]
  - John Kingman (November 2008 to December 2009), former Second Permanent Secretary to the Treasury. He announced his intention to resign in July 2009, having been in post for nine months,[47] and was subsequently appointed as a Managing Director at NM Rothschild & Sons investment bank from March 2010.[48]

In addition, the Head of Market Investments, John Crompton announced his departure from UKFI in January 2010,[49] having joined UKFI in November 2008 from Merrill Lynch.[50]

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42 UK Financial investments Ltd, Leadership changes at UKFI, press release, 28 July 2009
43 UK Financial investments Ltd, UKFI announces appointment of four non-executive directors, press release, 12 January 2009
44 "Glen Moreno: Financier who changed sides", Guardian, 13 February 2009
45 UK Financial investments Ltd, UKFI welcomes appointment of Sir Philip Hampton as Deputy Chairman and Chairman-designate of RBS, Glen Moreno to be Acting Chairman of UKFI, press release, 16 January 2009
46 UK Financial investments Ltd, UKFI appoints new Chief Executive, press release, 28 October 2009
47 UK Financial Investments Ltd, Leadership changes at UKFI, press release, 28 July 2009
48 "Rothschild Names UKFI's Kingman as Managing Director (Update1)", Bloomberg, 23 November 2009
49 UK Financial Investments Ltd, Staff changes at UKFI, press release, 11 January 2010
50 UK Financial Investments Ltd, John Crompton joins UKFI, press release, 28 November 2008

3 The cost to the taxpayer of direct support

3.1 Summary

In the Budget 2010 "Red Book" published in March 2010, the Government estimated, at that time, the net cost of the intervention was £6 billion at the then prevailing market prices.[51] The Treasury said that, relative to the *Pre-Budget Report 2009*, "there have been no material changes to the Government's assessment other than changes in market prices [in the value of RBS and Lloyds shares]".

The table below shows the Treasury's estimates over time of the prevailing net cost to the taxpayer — this includes the net cost of both the direct support to the four banks (see section 3.2) and other, general, support the Government has given to the financial sector (see sector 3.3), offset by fees etc. received from the banks for the support:

Date	Publication	Estimated net cost to the taxpayer
March 2009	Budget 2009	£20 billion to £50 billion
December 2009	Pre-Budget Report	£8 billion
March 2010	Budget 2010	£6 billion

Sources: HM Treasury, Pre-Budget Report 2009, December 2009, Cm 7747, p199, box B4; HM Treasury, Budget 2010, March 2010, 2009-10 HC 451, p213, box C4

It should be noted that the Treasury assumes that there are only two key elements on which the final net cost will depend:

- the eventual net profit or loss on the recapitalisations of RBS and Lloyds; and
- net payouts under the Asset Protection Scheme.[52]

The Treasury assumes that "other interventions [are] not expected to have a material cost to the taxpayer after fees, other income and recoveries are taken into account"[53] — this, by implication, includes the interventions in Northern Rock, and Bradford and Bingley.

While, as the table above shows, the estimated net cost to the taxpayer has declined over time, there is no guarantee that this trend will continue. For example, if the credit crisis intensifies once more, causing financial markets to fall and bank losses to increase, then the estimated net costs could rise. Indeed, as the then Chancellor cautioned, in his Budget Statement in March 2010, "there are still uncertainties. Financial markets are febrile. Oil prices have increased by over 50 per cent. Bank credit, while improved, still remains weak in many parts of the world. Confidence has not fully returned to either businesses or consumers".[54]

In its report, the NAO also looked at the broader "value for money" assessment of the intervention, which took into account, for example, competition issues. On this basis, the

[51] HM Treasury, Budget 2010, March 2010, 2009-10 HC 451, p213, box C4
[52] HM Treasury, Budget 2010, March 2010, 2009-10 HC 451, p213, box C4
[53] HM Treasury, Budget 2010, March 2010, 2009-10 HC 451, p213, box C4
[54] HC Deb 24 March 2010 c250

NAO cautioned that the full cost (or benefit) to the taxpayer of the Government's support might not be apparent for a number of years:[55]

> **The final value for money of the support will depend not just on the prices a obtained for the bank shares, but also on ensuring that customers get a fair deal in a competitive market for financial services.** To comply with State Aid rules, RBS and Lloyds Banking Group will dispose of some of their assets. UKFI, in consultation with the Office of Fair Trading, should review the extent of the disposals taking into consideration wider economic factors. The prices obtained from the shareholdings should only be one factor in the equation, with due regard being paid to future competition in the banking sector and the long-term impact on consumers.[56]

In addition, the Government has borrowed the money necessary to finance the purchase of the direct holdings; JP Morgan investment bank estimates that the interest cost of this borrowing is about £3.2 billion per annum.[57]

3.2 Net cost to the taxpayer of direct support for banks

In terms of determining the final cost to taxpayers of the Government's support for the financial sector in general, the NAO said this "will not be known for a number of years". It added that "the major determinant will be the prices obtained for the taxpayers' current holdings [i.e. direct support] in the various banks", notwithstanding the substantial other support to the financial sector provided (see section 3.3).[58]

In the 2010 Budget "Red Book", the Treasury reported on the latest valuation of its direct support to the four banks:

> - [...] UK Financial Investments (UKFI) have today published updated details about the Government's investments. One way to value these investments is on the basis of current market prices. This would point to a cost of £12 billion which is net of the value of the Government's RBS dividend access share. However, the actual profit or loss will depend upon the share price at the time of sale. The Government has also received a total of £0.7 billion in underwriting fees and a £0.3 billion fee for the RBS contingent capital guarantee;
>
> [...]
>
> Other interventions, not expected to have a material cost to the taxpayer after fees, other income and recoveries are taken into account, are:
>
> - the repayment and recovery of financial support provided to protect retail depositors. As part of the resolution of a number of financial institutions during the crisis (Bradford & Bingley, Dunfermline Building Society, London Scottish Bank, Kaupthing Singer & Friedlander, Heritable Bank and the payout to Icesave depositors) the Government provided loans and other financial support in order to protect retail depositors. The outstanding amount totals £27 billion. The majority of this is repayable from the Financial Services Compensation Scheme through recoveries from the resolved institutions and, if necessary,

[55] National Audit Office, Maintaining financial stability across the United Kingdom's banking system, December 2009, p8, para 19
[56] National Audit Office, Maintaining financial stability across the United Kingdom's banking system, December 2009, p9, para 21a
[57] "Bailed-out bank stakes cost UK £3.2bn a year, JP Morgan says", FT Alphaville, 2 June 2010
[58] National Audit Office, Maintaining financial stability across the United Kingdom's banking system, December 2009, p8, para 19

levies on the financial industry. HM Treasury also has claims to proceeds from the winding-up of the relevant institutions and continues to expect full repayment of the loan to the Icelandic Depositor Compensation Scheme and is continuing to discuss the terms of the repayment with the Icelandic authorities;

- returns on the disposal and wind-down of Northern Rock. Northern Rock was restructured into two separate companies from 1 January 2010: Northern Rock plc and Northern Rock (Asset Management) plc. The Government remains the sole shareholder and has provided support to the two companies in the form of: a loan (current outstanding balance of £23 billion) to Northern Rock (Asset Management) plc; an equity injection of £1.4 billion into Northern Rock plc; and a Working Capital Facility of up to £2.5 billion to Northern Rock (Asset Management) plc to support the company's business plan. Certain wholesale deposit guarantees remain in place but notice has been given of the intention to lift the retail deposit guarantee from 24 May. Given the financial position of both companies it is expected that all of this money will be returned to the taxpayer;

- returns on the wind-down of Bradford & Bingley. The Government is also a sole shareholder in Bradford & Bingley and provides it with a Working Capital Facility (currently the commitment is up to £11.5 billion) and certain deposit and capital guarantees. Given the level of loss absorbing capital of Bradford & Bingley the Government expects to recover all of this money.[59]

3.3 Analysis of interest costs of direct support

The *Financial Times* reported that banking analysts at JP Morgan investment bank had issued a paper in June 2010 which considered the financing cost of the Government's direct support in RBS and Lloyds.

Because the Government's direct support was funded by borrowing, there was an interest charge to pay. The analysts estimated this "financing cost" to be "c.[circa]£3.2bn annually ... equivalent to a meaningful 8% of 2010E [estimated] UK budget interest expense".[60]

The analysts concluded that the Government should sell its stakes in RBS and Lloyds:

> From this exercise it would appear that whilst the exit prices [i.e. share prices at the time the Government sells its stakes in RBS and Lloyds] do have some bearing, it is not critical, and largely symbolic. What is more relevant is that the stake is sold, as the funding requirement [i.e. financing cost] still has a noticeable bearing on public finances. This could be especially important when we consider the commentary from Standard & Poor's credit research. S&P reiterated its negative outlook for UK sovereign debt in March 2010 and said that it expects [General Government Gross Debt] to continue to trend towards 100% of GDP, a level which if sustained over the medium term would be incompatible with a 'AAA' rating.
>
> Given how close to 100% we may be, the benefit from a sale may be significant.[61]

If the UK Government was to lose its "AAA" credit rating, one of the consequences would be that investors would demand a higher interest rate on (newly-issued) UK Government bonds (gilts), so increasing the cost of financing the deficit.

[59] HM Treasury, Budget 2010, March 2010, 2009-10 HC 451, pp213–214, box C4
[60] "Bailed-out bank stakes cost UK £3.2bn a year, JP Morgan says", FT Alphaville, 2 June 2010
[61] "Bailed-out bank stakes cost UK £3.2bn a year, JP Morgan says", FT Alphaville, 2 June 2010

In addition, the analysts noted that the Government's holdings in RBS and Lloyds are classed as "temporary" for the purposes of calculating their impact on the UK's debt, given the Government's intention to dispose of them (see section 4).

As such, under EU rules for calculating government debt, the direct holdings in RBS and Lloyds have increased the UK's net debt to GDP ratio by about 4 percentage points. However, if their status for this purpose moved from temporary to fully consolidated, JP Morgan calculates that "UK net debt to GDP would go from 64% (2009) to 165%".[62]

3.4 Net cost of broader support to the financial sector

In addition to the direct support in the four banks (Northern Rock, Bradford and Bingley, RBS and Lloyds) that the Government has made (see section 1), the Government has also undertaken a number of other measures to support the financial system against the effects of the credit crisis.

The National Audit Office summarised this additional support by the Treasury as follows:

- indemnified the Bank of England against losses incurred in providing over £200 billion of liquidity support;
- agreed to guarantee up to £250 billion of wholesale borrowing by banks to strengthen liquidity in the banking system;
- agreed in principle in January 2009 to provide insurance covering nearly £600 billion of bank assets, reduced to just over £280 billion in November 2009 [i.e. Asset Protection Scheme].[63]

However, offsetting the actual and potential costs associated with the Government's involvement are fees, interest payments and loan repayments.

Asset Protection Scheme

The Asset Protection Scheme ("APS") was identified by the Treasury as one of the two "key elements on which the final net cost [of Government intervention] will depend", the other being the recapitalisation of RBS and Lloyds.[64]

The APS was announced by the Chancellor in January 2009, when he informed the House of:

> a new scheme under which the Treasury will insure certain bank assets, for a commercial fee, against losses on banks' existing loans. The purpose of the protection is to allow the expansion of lending, so the pricing has to be fair and reflect all our objectives. The banks' problems stem from uncertainty about the value of their assets, and faced with that uncertainty, individual banks are reluctant to lend to businesses and companies. This reduces the banks' exposure to risks and will give them the room that they need to lend more. We will insist on the highest international standards of public disclosure and transparency in the operation of the scheme. Countries all over the world are considering similar proposals, and we will work with them to take action together.[65]

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[62] "Bailed-out bank stakes cost UK £3.2bn a year, JP Morgan says", FT Alphaville, 2 June 2010

[63] National Audit Office, Maintaining financial stability across the United Kingdom's banking system, December 2009, p5, para 4

[64] HM Treasury, Budget 2010, March 2010, 2009-10 HC 451, p213, box C4

[65] HC Deb 19 January 2009 c485

The Treasury published further details of the nature of the APS,[66] and further details were announced in February 2009:

> **Overview of the Scheme**
>
> Under the Scheme, in return for a fee, the Treasury will provide to each participating institution protection against credit losses incurred on one or more portfolios of defined assets to the extent that credit losses exceed a "first loss" amount to be borne by the institution. The Scheme aims to target those assets where there is the greatest amount of uncertainty about their future performance.
>
> The Treasury protection will cover 90 per cent. of the credit losses which exceed this "first loss" amount, with each participating institution retaining a further residual exposure of 10 per cent. of any credit losses exceeding this amount. Both the "first loss" amount and the residual exposure provide an appropriate incentive for participating institutions to endeavour to keep losses to a minimum on those assets included in the Scheme.[67]

The first participant in the APS was RBS, and the Treasury announced an "agreement in principle" with RBS covering participation in the APS and a capital injection, with the following proposed terms:

- RBS intends to participate in the Scheme in respect of £325 billion of assets;
- RBS will pay a participation fee of £6.5 billion to the Treasury in capital;
- The agreement would see RBS bear a first loss of up to £19.5 billion;
- RBS would make 2009 lending commitments totalling £25 billion.[68]

In early March 2009, an agreement in principle was also reached with Lloyds, with the following proposed terms:

- Lloyds will place £260bn of assets into the Asset Protection Scheme, focusing on those assets where there is the greatest degree of uncertainty about their future performance.
- Lloyds will pay a participation fee of £15.6 billion to the Treasury in capital
- The agreement will mean that in the event of a loss, Lloyds will bear a first loss amount after existing impairments of up to £25 billion.
- Lloyds will make additional lending commitments totalling £3bn of mortgage lending and £11bn of business lending over the next 12 months. A similar lending commitment has been made in respect of the subsequent 12 months but this will be reviewed to ensure it reflects economic circumstances at that time.[69]

The Treasury added that:

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[66] HM Treasury, Statement on the Government's Asset protection scheme, press release 07/09, 19 January 2009
[67] HM Treasury, Statement on the Government's Asset Protection Scheme, press release 18/09, 26 February 2009
[68] HM Treasury, Asset Protection Scheme and increased lending, press release 19/09, 26 February 2009
[69] HM Treasury, Asset Protection Scheme - agreement with Lloyds, press release 23/09, 7 March 2009

> implementation of the Asset Protection Scheme will be subject to further due diligence by the Treasury and its advisers, execution of legally binding documentation, satisfaction of the application criteria and asset eligibility criteria of the Scheme, and satisfaction of applicable conditions precedent to accession to the Scheme including regulatory, state aid and shareholder approvals.[70]

The Treasury announced the conclusion of discussions with RBS regarding their participation in the Government's APS in November 2009.

RBS decided it would be covered by the APS, although the Treasury said that it would do so "under revised terms that improve incentives and deliver better risk-sharing with the private sector". Under the final agreement involves, these terms were:

> - A larger first loss to RBS than agreed in February – the first loss to be borne by RBS has increased from £42bn to £60bn;
> - A smaller pool of insured assets – reduced from £325bn to £282bn based on their balance sheet at end 2008;
> - A capital injection by the Government of £25.5bn — equal to the £25.5bn total capital commitment announced in February, which comprised £13bn in upfront capital, £6bn of capital to be drawn at the option of RBS and £6.5bn in a fee taken as capital;
> - A fee to the Government to be paid annually at £0.7bn for the first three years, followed by £0.5bn a year for the life of the scheme – compared to the up-front fee of £6.5bn paid in shares agreed in February;
> - Removing the undertaking, agreed by RBS in February, to forego for up to five years certain tax losses and allowances. This was estimated at a value of £9-11bn in RBS' most recent accounts.
>
> [...]
>
> The Government has also agreed that RBS will pay a minimum exit fee when it leaves the APS. The minimum fee will be the largest of either:
>
> - £2.5bn, or
> - 10% of the actual regulatory capital relief received by RBS while it was in the APS
>
> This fee will be less any fees already paid. Exit would need to be approved by the FSA.[71]

By November 2009, stock markets had recovered strongly (although credit markets remained vulnerable), and while significant doubts remained, the most serious concerns about the banking sector had been allayed. This improvement in conditions allowed banks to raise capital through, for example, rights issues; Lloyds successfully raised £13.5 billion through a rights issue in November 2009.

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[70] HM Treasury, Asset Protection Scheme - agreement with Lloyds, press release 23/09, 7 March 2009
[71] HM Treasury, Implementation of Financial Stability Measures for Lloyds Banking Group and Royal Bank of Scotland, press release 99/09, 3 November 2009

As a result, Lloyds decided it did not need to participate in the APS. Although it had not been formally in the APS, it had benefited from "implicit protection" by agreeing in principle to be covered by the APS; as a result, Lloyds paid the Government a fee of £2.5 billion.[72]

Asset Protection Agency
The Treasury established the Asset Protection Agency ("APA"), an executive agency of the Treasury. The APA was established in the summer of 2009, and formally launched in December 2009 in order to run the APS.

The APA said that:

> The principal function of the APA is to operate the APS on behalf of HM Treasury. The main tasks that this involves are:
>
> - Monitoring the management of assets in the scheme and, where necessary, intervening in the management of those assets
> - Reviewing and approving significant decisions, such as disposals and restructurings in relation to APS assets
> - Verifying the losses on covered assets to enable the APS to make appropriate payments
> - Forecasting future losses under the APS to enable HM Treasury to predict any fiscal impact
>
> In addition, the APA may be required to provide advice to HM Treasury on other aspects of its business.[73]

The APA's Chief Executive is the Permanent Secretary to the Treasury, Sir Nicholas McPherson.

At the time of the Budget 2010, the Government reported that

> Under the APS the Government has now received fees totalling £3.9 billion and will receive at least a further £1.1 billion from RBS. Based on the APA's assessment of the assets the central expectation remains that there will be a net benefit to the taxpayer of at least £5 billion from the scheme (taking account of the £60 billion first loss, fees and recoveries).[74]

Other measures to support the financial sector

As noted above, the Government has stated that, in regard to the other measures it has taken to support the financial sector, they are "not expected to have a material cost to the taxpayer after fees, other income and recoveries are taken into account".[75]

In the Budget 2010 Red Book, the Treasury provided an update on the cost of these measures. In addition to the repayment and recovery of financial support provided to protect retail depositors (see section 3.2), the Treasury estimated the following:

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[72] HM Treasury, Implementation of Financial Stability Measures for Lloyds Banking Group and Royal Bank of Scotland, press release 99/09, 3 November 2009
[73] Asset Protection Agency, About the Asset Protection Agency, website
[74] HM Treasury, Budget 2010, March 2010, 2009-10 HC 451, p213, box C4
[75] HM Treasury, Budget 2010, March 2010, 2009-10 HC 451, p213, box C4

- losses suffered by the Bank of England on the Special Liquidity Scheme (SLS) (HM Treasury has indemnified the Bank of England for any such losses). However given the high quality of collateral required by the Bank of England and the amount of collateral pledged (£287 billion nominal value of securities against £185 billion of nominal Treasury bills) losses are considered unlikely; and

- fees received and payouts under the Credit Guarantee Scheme (CGS). Losses would occur under the CGS only in the event that a financial institution which had participated in the scheme went into administration and insufficient recoveries were available to pay back creditors.[76]

3.5 Ready reckoner of the impact of direct support

Given the average share price and the size of the Government's holding in RBS and Lloyds is known, it is possible to calculate a "ready reckoner" of the cost or benefit to the taxpayer of its shareholding in the two banks for a given share price.

The ready reckoner also takes accounts of fees already paid by each of the two banks (e.g. APS participation and exit fees) as reported by UKFI; as of March 2010, these were £305 million for RBS, and £2.876 billion for Lloyds.

Allowing for these fees, the net average share prices paid by the Treasury for its holdings in RBS and Lloyds are, respectively, 49.9p and 63.2p.[77]

However, the ready reckoner does not take account of the estimated financing cost of the borrowing required to purchase the stakes in RBS and Lloyds (see section 3.3).

Tables for the ready reckoners can be found in Annex A, but as a rule of thumb, for a 1p change in the share price, the value of the Government's holdings changes by:

- about £910 million in the case of RBS;

- about £280 million in the case of Lloyds.

[76] HM Treasury, Budget 2010, March 2010, 2009-10 HC 451, p213, box C4
[77] UK Financial Investments Limited, Update on UKFI Market Investments, March 2010, pp4–5

4 Plans to relinquish the government's direct support

4.1 The position of the former Labour Government

As noted above, the former Government made it clear that it did not intend to indefinitely continue to provide direct support to the banks, saying that it would "not be a permanent investor in UK financial institutions and will over time seek to dispose of the investments in an orderly way, through sale, redemption, buy-back or other means".[78]

In his Budget 2010 statement, the then Chancellor told the House "We will sell our shares in RBS and Lloyds, as well as Northern Rock, in a way that maximises value for the taxpayer and recoups the money we have invested. We intend to get all taxpayers' money back".[79]

4.2 Conservative proposals – "People's bank bonus"

In February 2010, the then shadow (now current) Chancellor, George Osborne, stated that, as the Chancellor, he intended to sell the Government's holdings in Lloyds and RBS to the public, giving a "special offer to all people" and comparing the sell-off to the "Tell Sid" advertising campaign used when British Gas was privatised in the 1980s.

> Cheap shares would be offered to small investors when the government's £70 billion stake in Royal Bank of Scotland and Lloyds Banking Group is sold, George Osborne, the shadow chancellor, said last night.
>
> While the shares are currently trading 30% below what the Treasury paid for them, City analysts expect the market will recover and a sell-off could begin within three years.
>
> While the details of the Tory plan are still being drawn up, it is expected that people would be offered shares worth between a few hundred and a few thousand pounds at a discount on the market price. The shares would be offered through the Isa scheme, so any dividends and capital gains would be tax-free. Even cheaper deals would be offered to young people and families on low incomes. There could also be special discounts for parents saving for their children.
>
> The scale of the bank sell-off would dwarf Margaret Thatcher's 1980s privatisations of British Telecom and British Gas. Osborne said: "To get a large public offer off the ground like British Gas and British Telecom you want to make a special offer to all people.
>
> "But there were back then, and there can be in the future, special ways of targeting particular groups of people.
>
> "It fits in with an argument you have seen made within the Conservative family in the past few years about 'recapitalising the poor'. We will look at special offers, discounted share sales and the like."
>
> [...]
>
> Osborne's big idea is that millions of ordinary families will be offered cheap shares in these banks when the government stakes, worth more than £70 billion, are eventually sold.

[78] HM Treasury, New company to manage Government's shareholding in banks, press release 114/08, 3 November 2008

[79] HC Deb 24 March 2010 c250

"The bankers have had their bonuses. We want a people's bank bonus for the people's money that was put into these organisations," he said.

The Conservatives hope this is the policy equivalent of the "killer app" — a plan that has the potential to transform their electoral prospects.

Osborne has long been wrestling with the problem of how to offer a positive vision to voters, against a backdrop of deep public spending cuts, likely tax rises and a possible return to recession. His new bank sale plan is a conscious echo of Margaret Thatcher's vote-winning privatisations of British Gas and British Telecom.

"It will be like the public offerings of shares such as the Tell Sid campaign of the mid-Eighties," he said. "All individuals in our society will have a chance to own some shares in the future of these banks."[80]

While Mr Osborne did not suggest a timescale for the possible sale, the *Financial Times* subsequently reported (prior to the General Election) that:

George Osborne, shadow chancellor, wants to make quick progress in selling its stakes in Lloyds Banking Group and Royal Bank of Scotland, with the aim of realising billions of pounds of potential profit before an election in 2014-15.

[...]

Mr Osborne has suggested to City figures he is eyeing a sale of some of its 70 per cent stake in RBS in 2012. "There is no timetable," an aide to Mr Osborne said. "But we will do it as early as possible to get a good price."[81]

4.3 Liberal Democrat proposals

In contrast, before the 2010 General Election, the Liberal Democrats position was that there was "no hurry" to sell the Government's holdings in the four banks, as set out by Vince Cable, then Liberal Democrat Shadow Chancellor in a speech in February 2010:

The semi-nationalised banks (and nationalised Northern Rock) sit an uneasy, semi-competitive, relationship with private banks and mutuals. One issue, as yet unresolved, is the future of the publicly owned banks. While the Liberal Democrats have no fundamental ideological opposition to selling the taxpayer stakes in the nationalised and semi nationalised banks – indeed we support re-privatisation – there is no hurry and every reason to show patience. UKFI now believes that it will be a state shareholder for at least five years. Experience in Korea, Sweden, Israel and in the US would lead us to believe that the optimal time frame for disposal of nationalised or semi-nationalised assets is probably close to 10 years. That is the time needed to sort out and restructure banks, manage bad assets and restore normal, safe lending. That is why Mr Osborne's proposal for a quick sell off of bank shares to retail buyers is such a bad idea. It almost guarantees that the taxpayer will not get value for money.

[...]

The break up and restructuring of the banks, particularly in the semi-nationalised sector, provides an opportunity to launch and capitalise a range of institutions: another reason for avoiding a quick sell off.[82]

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[80] "Tories offer bank shares for all as poll lead dives" and "Tories' 'killer app': a bank bonus for all; Election The shadow chancellor tells Jonathan Oliver of his plan to let people buy cheap shares in RBS and Lloyds", *The Sunday Times*, 21 February 2010

[81] "Tories plan early sale of state bank stakes", Financial Times, 11 April 2010

4.4 Coalition Government's plans

Following the formation of the coalition Government, its programme for partnership government document, *The Coalition: our programme for government*, did not specifically address the possible sale of the Government's direct support for the four banks, but stated that:

> We want the banking system to serve business, not the other way round. We will bring forward detailed proposals to foster diversity in financial services, promote mutuals and create a more competitive banking industry.
>
> [...]
>
> We will take steps to reduce systemic risk in the banking system and will establish an independent commission to investigate the complex issue of separating retail and investment banking in a sustainable way; while recognising that this will take time to get right, the commission will be given an initial time frame of one year to report.[83]

The *Guardian* reported in May 2010 that executives at RBS had implied to financial analysts that the coalition Government's planned reviews of the banking sector could delay any sale of all or part of its shareholding in the bank and perhaps, by association, Lloyds:

> **George Osborne's plans to sell stakes in RBS and Lloyds hit by banking review**
>
> *Coalition government's year-long probe into splitting up banks pushes back chancellor's proposal for a 'tell Sid' style sell-off*
>
> George Osborne's hopes of a "Tell Sid"-style privatisation of Royal Bank of Scotland and Lloyds Banking Group have been dashed by the government's pledge to launch a year-long investigation into splitting up the banks.
>
> Senior RBS executives have told the City that there is little chance of a quick sale of the bank's shares because of the commission the chancellor is setting up and his promise to launch a competition review of the banking sector.
>
> Bruce van Saun, finance director at RBS, has conceded to City analysts that a sale of any stake will be pushed back by the investigations.
>
> Analysts at Bank of America Merrill Lynch said last week that van Saun had left them with the impression that he thought it unlikely the government would proceed with plans to break up the banks because the uncertainty caused by the review would prohibit share sales.[84]

To date, no announcement has been made on the possible timing or scale of taxpayers' shares in RBS or Lloyds.

4.5 Preparations for the possible privatisation of Northern Rock plc

As noted above the Government nationalised both Northern Rock, and Bradford and Bingley banks as a result of the credit crunch. In the Budget 2010 "Red Book", the Government said:

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[82] Liberal Democrats, Vince Cable sets out the Liberal Democrat plan for the banking sector, 23 February 2010
[83] Cabinet Office, The Coalition: our programme for Government – Banking, website
[84] "George Osborne's plans to sell stakes in RBS and Lloyds hit by banking review", *The Guardian*, 23 May 2010

> **The Government today announces its intention to integrate two of its wholly owned companies, NRAM [Northern Rock Asset Management][85] and Bradford & Bingley plc, under a single holding company.** The integrated business will be committed to providing excellent customer service, leading arrears management and efficient operations. Both companies will remain as separate legal entities under the new holding company, each with its own balance sheet liabilities and Government support arrangements. The Government believes this is the optimal solution to maximise value for the taxpayer and to create a solid platform for the orderly management of both companies' mortgage books.[86]

In addition, the previous Government announced the removal of the unlimited guarantee on retail deposits in Northern Rock on 24 February 2010[87] (which came into force three months later), which the then Government said represented an "important milestone ... in Northern Rock's return to independent, commercial strength".[88]

This has increased speculation that the Government is planning to sell off the "good part" of Northern Rock, although Northern Rock Asset Management and Bradford and Bingley are not expected to be sold for several years as their mortgage books are wound down:

> **Northern Rock and Bradford & Bingley to merge**
>
> Britain's two fully nationalised banks are to be merged to cut costs and recover funds for taxpayers as their mortgage books are wound down.
>
> Northern Rock Asset Management (NRAM), the bad bank that was spun out of the nationalised lender at the start of the year, and Bradford & Bingley will be brought together under a single holding company in the coming months. No deadline was given as it will be "an extensive process".
>
> Bringing the two banks under common management and common platforms has been widely expected since B&B was taken into public ownership in September 2008. Earlier this year, Richard Pym, chairman of B&B, was appointed chairman of NRAM as well, hinting at the plan ahead.
>
> All the good assets have been separated out of both banks, leaving NRAM with toxic 125pc loans and B&B with buy-to-let mortgages. Northern Rock's "good bank", which holds £10bn of performing mortgages, £19bn of deposits and 76 branches, is expected to be put up for sale later this year. B&B's deposits and branches were sold to Santander.
>
> The combined "bad" bank is expected to remain nationalised for decades. Northern Rock has said the mortgage book will take about 20 years to run down. The banks have received more than £40bn in Government loans to keep them going that will be repaid as their books run down.
>
> Keith Morgan, who is managing the nationalised banks for the taxpayer at UK Financial Investments, said: "We believe that bringing [B&B and NRAM] together under a single

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[85] On 1 January 2010, the former Northern Rock bank was split into Northern Rock and Northern Rock Asset Management (NRAM); NRAM has the back book of mortgages. See HM Treasury, Treasury confirms 1 January restructuring of Northern Rock, press release 116/09, 8 December 2009

[86] HM Treasury, Budget 2010, March 2010, 2009-10 HC 451, p45, para 3.63

[87] HM Treasury, Northern Rock takes another step towards independence, press release 20/10, 24 February 2010

[88] BBC News, "Northern Rock 100% savings protection guarantee ends", 24 May 2010

holding company with a common management team is the natural outcome and the right solution to maximise value for the taxpayer."[89]

[89] Daily Telegraph, Northern Rock and Bradford & Bingley to merge, 25 March 2010

ANNEX A

Ready Reckoners: Cost/benefit to the taxpayer of its holdings in RBS and Lloyds for a range of possible share prices

Share price (p)		Benefit (+) or cost (-)* (£ billion)		
		Royal Bank of Scotland		Lloyds Banking Group
100		45.4		10.2
95		40.9		8.8
90		36.3		7.4
85		31.8		6.0
80		27.3		4.6
75		22.8		3.3
70		18.2		1.9
65		13.7		0.5
60		9.2		-0.9
55		4.6		-2.3
50		0.3		-3.6
45		-4.4		-5.0
40		-9.0		-6.4
35		-13.5		-7.8
30		-18.0		-9.2
25		-22.6		-10.5
20		-27.1		-11.9
15		-31.6		-13.3
10		-36.2		-14.7
5		-40.7		-16.1

* benefits and costs are based on the share price relative to the average investment per share price net of fees (as of March 2010) which was 49.9p for RBS and 63.2p for Lloyds.

Due to rounding errors in the underlying data (number of shares and average share price), the above calculations might be prone to a small margin of error.