Treasury Committee

Oral evidence: UK Financial Investments Ltd, HC 824

Tuesday 12 November 2013

Ordered by the House of Commons to be published on 12 November 2013.

Watch the meeting

Members present: Mr Andrew Tyrie (Chair), Mark Garnier Andrea Leadsom, Mr Andrew Love, Mr Pat McFadden, Mr Brooks Newmark, Jesse Norman, Mr David Ruffley, John Thurso

Questions [1-153]

Witnesses: **Robin Budenberg**, Chairman, UK Financial Investments Ltd, and **James Leigh-Pemberton**, Executive Chairman designate, UK Financial Investments Ltd, gave evidence.

Q1 Chair: Good morning. Thank you very much for coming to give evidence today. We have quite a bit of ground to cover. Mr Budenberg, do you ever take instructions from the Government?

Robin Budenberg: No.

Q2 Chair: What do you think that Sir Nicholas Macpherson meant when he said, in evidence to the Public Accounts Committee, "They have a clear remit but they are also people of the world who are willing to take the odd instruction"?

Robin Budenberg: I think he was referring in that instance to the Northern Rock Foundation, because that was a hearing about the sale of Northern Rock where we were asked whether we would include as a potential part of the proposals that the purchasers made the inclusion of some form of allowance for the Northern Rock Foundation. We made it clear to purchasers in our assessment of those bids that we would not take account of that allowance in terms of the value assessment that we reached.

Q3 Chair: There was not an instruction.

Robin Budenberg: I do not think it affected our value-for-money remit because we made it absolutely clear to purchasers that we would not take account of those allowances in terms of the assessment of their bids.

Q4 Chair: Justifying the permanent secretary's conclusion does sound quite close to an instruction.

Robin Budenberg: I think we would be criticised by other people if we were not to include something that was clearly for the benefit of a group of people who had previously received benefits from Northern Rock.

Q5 Chair: Well, that is the benefit of the decision. I am just looking at the way the decision is taken, rather than whether it is the right one.

Robin Budenberg: Yes. The Northern Rock Foundation was an issue that we discussed very long and very hard—what was the right way of dealing with it? I think that was the right outcome.

Q6 Chair: Again, that is not quite on the point that I am asking: who is really running this policy?

Robin Budenberg: Well, I think we are talking about a very narrow issue there.

Q7 Chair: But that is what you have to do, isn't it, to find out what is going on?

Robin Budenberg: Yes, but I feel very comfortable that that was the right outcome. We knew that we had an issue that we had to deal with. If we simply ignored it and said we will not suggest to anyone that they should make an allowance for the Northern Rock Foundation, I do not think that would have been the right outcome.

Q8 Chair: Your mandate is to manage investments commercially with robust institutional arrangements for keeping UKFI at arm's length from Government. I am quoting almost exactly from the July 2010 annual report and accounts. You were already in post at that time, weren't you?

Robin Budenberg: Yes.

Q9 Chair: Can you point to a decision whereby you protected the company's commercial interests with which the Government disagreed?

Robin Budenberg: I think that the Chancellor has made it clear that he feels that he should be representing the interests of the taxpayer in the future direction of the banks. That means that part of our role is to make sure that we feel comfortable that the views that he takes are consistent with the commercial best interests of the banks. It is clear that he takes a very active interest in certain issues and, to come to your question, remuneration is a very clear example of that.

Q10 Chair: Where you have overruled the Chancellor.

Robin Budenberg: I would not say we have overruled the Chancellor. What I would say is that he comes at things, naturally, from a different point of view than a pure commercial point of view would be.

Q11 Chair: You are saying you saw him off.

Robin Budenberg: I would say that he accepted our arguments and we ended up with outcomes, broadly speaking, where the banks could continue to operate on a commercial basis and the remuneration results were sustainable externally.

Q12 Chair: Is it incorrect, therefore, as there have been many press reports making clear, that the Chancellor secured an agreement that a target would be set for SME lending in relation to Mr Horta-Osório's bonus?

Robin Budenberg: Again, when we were looking at arrangements for Mr Horta-Osório's bonus, as I have said to this Committee before, it was important that the Chancellor was supportive of those arrangements. I felt it was perfectly appropriate in the context of the commercial interests of the bank and, indeed, the board felt the same.

Q13 Chair: That is not the same, though, is it? That is not saying you felt it was consistent with your role that this should occur. It is not the same as what I am asking you: did the initiative for that proposal come from you or the Chancellor?

Robin Budenberg: I would say that we were very keen when recruiting António Horta-Osório to make sure that he was going to be the sort of chief executive who was going to support the UK economy because Lloyds is such an important factor in that and SME lending is a key part of that. There are a wide range of measures that get taken into account in a bonus and in long-term incentive plans. As I say, the issue of SME lending was something that the Chancellor was very focused on and it seemed like a good outcome.

Q14 Chair: But it was an outcome that was not influenced by the Chancellor. It was an outcome that you decided upon and you are giving it to me as an example of something where you resisted pressure to come to another decision.

Robin Budenberg: No. I would say that I would have resisted pressure to insert something in Mr Horta-Osório's bonus that I felt was inconsistent with the bank's ability to operate commercially. I did not find that that was inconsistent with it.

Q15 Chair: I am trying to get to the point of whether there were proposals made to you by the Government that you rejected in the commercial interest of the bank?

Robin Budenberg: Yes.

Q16 Chair: What were they?

Robin Budenberg: There were suggestions that bonuses were far lower than what I considered to be commercially sustainable. Sorry, I would say "arguments" rather than proposals.

Q17 Chair: Is that true in the Stephen Hester case?

Robin Budenberg: If you are talking about the Stephen Hester case back in 2010, I do not think that is the case because, again as I have discussed with this Committee before, I had a sense of where Philip Hampton and the board were coming out in their assessment of what level of bonus should be paid to Stephen Hester. I felt that that was appropriate and consistent with something that would be acceptable to the Government.

Q18 Chair: The framework document between the Government and UKFI also gives UKFI the objective of financial stability and competition, doesn't it?

Robin Budenberg: Yes.

Q19 **Chair:** Competition—working out how to get competitors into the market you are trying to make money from—is scarcely a commercial activity, is it? Wasn't it Adam Smith who said that when two or three businessmen are gathered together, the conversation generally turns to a conspiracy against the consumer?

Robin Budenberg: I do not know. I think the competition mandate was particularly attached to the disposal of our stakes in the banks and, in particular, were we to dispose of one of the banks, for example, it would be important, as we did with Northern Rock, to judge the competition element of that as part of that process.

Q20 **Chair:** But it is not trying to increase the competition of the bank for which you are responsible against the other banks. This objective of competition you have is competition of the whole market, isn't it?

Robin Budenberg: Yes and, as I say, particularly in relation to how we dispose of the stakes in the banks.

Q21 **Chair:** Which is not normally an objective of a commercial bank?

Robin Budenberg: No.

Q22 **Chair:** When you are trying to sell something, you are just trying to get the money, aren't you?

Robin Budenberg: Again, in this Committee we had quite substantial discussions around that with Northern Rock. As it turns out, we were able to achieve the value objectives and, I think, a good outcome for British banking.

Q23 **Chair:** Your clear mandate to manage the investments commercially needs quite a bit of qualification, doesn't it? You are not running it commercially.

Robin Budenberg: I believe that we make sure that the banks are able to act in what they consider to be the commercial best interests of their shareholders.

Q24 **Chair:** As you know—this is no reflection on your personal performance and I want to make that clear—the Banking Commission recommended that UKFI's function be reabsorbed into the Treasury. One of the arguments that has been put to us by a number of people, I think including you and also Jim O'Neill, was that UKFI also plays a role in addition to that strict mandate role, which is the provision of commercial, technical and market expertise that is not readily available to the Treasury. That is correct, isn't it?

Robin Budenberg: Yes.

Q25 **Chair:** Do you think it would be perfectly possible for you to be able to perform that function within the Treasury?

Robin Budenberg: First, I would say that advisory function is very much a side element of what we do.

Q26 Chair: By which you mean not crucial to your function at all.

Robin Budenberg: No, it is not, but fundamentally I do not agree, as you would expect me not to agree. The reason is that the fact that we have an independent mandate, which as you say is reasonably clear, in which we are responsible to our board and to this Committee, and which the boards of both banks are aware of and hold us accountable to, means that we have a much more fundamental determination to achieve that outcome than if we were simply people who worked within the Treasury and ultimately who worked to the Chancellor. With that role, if we felt that the Chancellor was insisting on interfering in the way in which the bank is run against the commercial interests of the banks, I think we can stand up to that, and in a way that we could not as part of the Treasury.

Q27 Chair: Going back to my earlier question, can you cite an example of when you have stood up to the Treasury? The only one we managed to find was, "Well, I did not accept a number of proposals for sharper cuts in bonuses." Why then, when there were all these press reports suggesting that you had done the opposite—that in fact the Chancellor had secured objectives of reducing bonuses—did you not act to protect the perceived independence of your institution and clarify what had really happened publicly?

Robin Budenberg: I do not believe that the best way of persuading the stakeholders that we have is to make too much noise about those sorts of things in public. If we told the world what we say to the boards of both banks, I do not think that would be the best way of persuading the banks of our points of view; similarly, across the full range of our stakeholders.

Q28 Chair: Is the message you are sending us, "We may not look independent—indeed we may look a bit of a pushover on occasion, judging by some of the press reports of which that is one—but behind the scenes we are made of tungsten steel"?

Robin Budenberg: Yes, I think broadly that is the message we are trying to get across.

Q29 Chair: "Trust us, we are getting it right, but we cannot disclose how."

Robin Budenberg: No, I genuinely believe we are getting it right. You say that there is only one example. To be honest, I have only been given a chance to give one example. I think we do much the same—

Chair: I apologise.

Robin Budenberg: No, it is fine.

Q30 Chair: If you think of more after this hearing, perhaps you would jot them down for us.

Robin Budenberg: I can think of them now if you would like.

Chair: Or now.

Robin Budenberg: Another one, for example, is Citizens Bank in the US, which is a part of RBS that we have always felt is not fundamental to the core of RBS and the Chancellor has always felt it difficult to justify why any capital contributed by the UK taxpayer should be devoted to Citizens rather than to the UK. Our view has always been that we need to give Citizens time to recover in terms of its financial performance and in terms of the market environment in the US, and now is an appropriate time to commence that process.

Q31 Chair: You resisted Government attempts to offload Citizens successfully for a period of a couple of years.

Robin Budenberg: We always felt that the ultimate disposal of Citizens was the right outcome.

Q32 Chair: I have understood the point you are making—you have to wait for the US market to recover so you can get a decent price. The question I am asking you is: over what period did you resist these pressures?

Robin Budenberg: Again, I would not describe them as pressures. This was a view of the Chancellor. We persuaded him that that was not the right view and he accepted that.

Chair: You have played a very straight bat so far. I am extremely impressed, Mr Budenberg. I am going to pass the questioning over to David Ruffley.

Q33 Mr Ruffley: Mr Budenberg, the mortgage guarantee element of Help to Buy is available only at the start through the RBS and Lloyds Banking Group brands. Why is it that the two partly state-owned banks are leading in this? Why are they the first to participate in this scheme?

Robin Budenberg: I think it is right that RBS and Lloyds, as the people who have used the goodwill and the money of the UK taxpayer, are at the forefront of contributing to these sorts of schemes. As it happens, while we would have asked about what their position was on that scheme in our regular meetings with them, without any instruction from us—in fact without any discussion with us—they unilaterally decided that they wanted to be at the forefront. I think that is a really good outcome.

Q34 Mr Ruffley: They were the initiators in saying they wanted to be the first two banks to participate in the scheme?

Robin Budenberg: Certainly, as far as I am aware, yes.

Q35 Mr Ruffley: That is helpful. Were they given, to your knowledge, privileged access to the scheme's design to entice them to participate, for instance?

Robin Budenberg: Not that I am aware of, no.

Mr Ruffley: Not that you are aware of.

Robin Budenberg: I have read and I do know that Mr Horta-Osório had input into the scheme. Again, I think that is appropriate.

Q36 Mr Ruffley: Were you aware of any discussions that the Chancellor or any Treasury Ministers, or any senior officials at the Treasury, had with either of the two partly state-owned banks about being the first two participants in the Help to Buy mortgage guarantee scheme?

Robin Budenberg: No.

Mr Ruffley: You are not aware.

Robin Budenberg: No.

Q37 Mr Ruffley: That is helpful.

Could I turn to remuneration? In the report, you speak of how your organisation has worked with the boards of both institutions: "To ensure that pay is aligned with the interests of shareholders and is appropriately focused on long-term performance". Could you give examples of the changes to remuneration practice that have been achieving a longer-term focus that you at UKFI have put forward?

Robin Budenberg: Yes. First of all, we have made sure that the banks are at the forefront of, and go well beyond, what the FSA[1] requires in terms of deferral. The Parliamentary Commission's report on deferral quite rightly emphasises the importance of that. We were anyway pressing for deferral periods to be longer than they are at the moment and, indeed, for the long-term investment plans to be longer term than they are at the moment. I think that Lloyds and RBS are both seen as frontrunners in terms of those sorts of structures.

Q38 Mr Ruffley: You will be aware the Parliamentary Commission was also rather keen on provisions in remuneration clauses with senior executives that said that a future employer could not buy out deferred remuneration. Is that now standard practice in the case of Lloyds Banking Group and RBS Banking Group's contracts with their senior executives? That is quite radical. I just wonder how radical you are.

Robin Budenberg: I think we were absolutely in agreement with that, James and I.

Q39 Mr Ruffley: No, the question is not whether you are in agreement. Have you succeeded in persuading the boards to introduce clauses going forward that would prevent or put restrictions on future employers of these executives buying them out?

Robin Budenberg: The two routes that were identified by the Parliamentary Commission require help from the other bank to which it goes. The answer is, no, we have not, but I think we would definitely strongly support that and seek to do whatever we could. I think the Commission was absolutely right to identify this as a difficult issue, which we came across earlier this year.

Q40 Mr Ruffley: You are satisfied that RBS and Lloyds Banking Group have the best remuneration practice among the major UK banks.

Robin Budenberg: I am sure there are individual elements that could be improved and should be improved, but I do believe that they are at the forefront of international best practice, yes.

Q41 Mr Ruffley: Could I ask you, Mr Budenberg, why did Stephen Hester leave RBS early?

Robin Budenberg: Our view, which we put to the board, and I should emphasise this was a decision of the board, was that—

Mr Ruffley: Sorry, which board are we talking about?

Robin Budenberg: The board of RBS, and we obviously discussed it with our own board. Our view was that it made sense to have a new chief executive in place before RBS returned fully to the private sector. Given that, our view was that it would be better to make that change sooner rather than later.

Q42 Mr Ruffley: Did you speak to the Chancellor or any Treasury Ministers about that?

[1] Note by witness: Regulatory oversight for and authority over bank remuneration now lies with the Prudential Regulation Authority (PRA) following the FSA's split into the PRA and FCA.

Robin Budenberg: We did, but I would say that we spoke first to the board, to the chairman of the board, and to the senior independent director of the board.

Q43 **Mr Ruffley:** Was this something that the chairman and the senior independent director at RBS were going to do, or was it something you put in their mind? Were they already thinking about it, or did you put it in their mind?

Robin Budenberg: I think they were clearly thinking about what the right timing on management succession was. All boards do think that.

Q44 **Mr Ruffley:** Do you think your advice was decisive in pushing them?

Robin Budenberg: I think it was certainly important in terms of acceleration, yes.

Q45 **Mr Ruffley:** You think your intervention was decisive in accelerating a decision that the RBS board were already mulling over.

Robin Budenberg: They were mulling over it, yes.

Q46 **Mr Ruffley:** Finally, Mr Budenberg, the issue—I am sure you have been following it with bated breath—of Project Verde, the Co-op attempt to buy the Lloyds branches and the Verde assets. We had Rev. Flowers joining us a few days ago and he made great play of the fact that he was talking to lots of politicians. In fact, he could not stop talking about the politicians he or his colleagues at the Co-op board were talking to. In relation to the Lloyds assets, on the subject of Project Verde, did you at any stage recommend to the chairman or chief executive of Lloyds Banking Group that your preferred disposal would be to the Co-op rather than to any other bidder?

Robin Budenberg: No.

Q47 **Mr Ruffley:** You did not have any discussions at all about the Lloyds Banking assets that were the subject of the disposal.

Robin Budenberg: Absolutely we did.

Q48 **Mr Ruffley:** Why not?

Robin Budenberg: Sorry, we did have discussions and our focus was on relative value and optionality.

Q49 **Mr Ruffley:** Did you proffer any advice before the bidding process started or during the bidding process as to who your preferred purchaser might be?

Robin Budenberg: No, I think where we really got involved—

Mr Ruffley: You did not.

Robin Budenberg: No. Where we really got involved was when there were two rival bids, one from NBNK and one from the Co-op. We met Lloyds and discussed with them their assessment of the relative values of the two options, and we also talked with them about fallback options.

Q50 **Mr Ruffley:** In those conversations or discussions, did you express a view as to which of the two bids—the NBNK bid and the Co-op bid—were better from a commercial point of view?

Robin Budenberg: I think we focused on value. Part of it was we did feel that the—

Q51 **Mr Ruffley:** You were using value as the metric. How were you defining value exactly?

Robin Budenberg: I think it is value and certainty. Whenever you are going through a process like that—

Mr Ruffley: Value and uncertainty.

Robin Budenberg: And certainty.

Q52 **Mr Ruffley:** Is that code for saying that NBNK did not have any track record or any banking licence, and therefore the advice you gave was to go with the Co-op?

Robin Budenberg: Again, we did not give advice. We listened to what their views were. Had we disagreed with those views, we would have made our views clear, but we did not disagree with those views.

Q53 **Mr Ruffley:** You were going with the Lloyds Banking Group board on their preferred course of action?

Robin Budenberg: Yes.

Mr Ruffley: That is very helpful. Thank you.

Q54 **Mr Newmark:** I am going to keep focusing on Robin—

Robin Budenberg: Yes, that is fine.

Mr Newmark: —although I want to ask James some questions. I appreciate he has only just joined, so I do not want to put him on the spot. I do not want to keep him bored either, so I will figure out something to ask him.

Robin Budenberg: I do not think he will have a problem.

Mr Newmark: I will ask him some future things in a minute. The independent review of lending practice by Sir Andrew Large has exposed some serious shortcomings in RBS's approach towards its small business customers, both new and old. This is directed to Robin. Were you aware prior to the publication of the Large review in November this year that RBS had serious problems with respect to its small firm lending practices?

Robin Budenberg: This has been a constant or a consistent source of disagreement as to whether RBS was trying to lend to smaller companies and not able to, or whether it was withholding lending from smaller companies.

Q55 **Mr Newmark:** But were you aware?

Robin Budenberg: We were aware this was an issue.

Mr Newmark: You were aware.

Robin Budenberg: It was something that we discussed with Stephen Hester on a regular basis. We also had regular discussions with the individual in charge of that area and I spent some time in branches and talking with customers.

Q56 Mr Newmark: You said you were aware before the report came out, so I guess my question is: since when were you aware of the scope and need for significant improvement in your lending practices to small businesses? Going back how far? Was it as soon as you got your legs under the desk?

Robin Budenberg: This has been a growing issue, if I am honest; certainly over the last two or three years.

Q57 Mr Newmark: Has the awareness come from the public in general, your customers or from the Government? I am trying to understand where your awareness came from.

Robin Budenberg: I think from everyone, if I am honest.

Q58 Mr Newmark: Why did UKFI allow such a situation to persist? What action, if any, did you take to try to improve the situation, having become aware of it?

Robin Budenberg: It is important to look at what the Large review says. It says that RBS intended to increase the level of its lending to SMEs.

Q59 Mr Newmark: Did you speak to Andrew Large about his—

Robin Budenberg: Yes, and when the full report comes out, which it still has not, we intend to follow up on that as well. RBS intended to lend more than it ended up lending and it made the capital available to do that. It failed to achieve that lending, which frankly is a disappointment to us as shareholders because we see SME lending as a very attractive business for RBS. I think what the report says is that it failed to do that because, first of all, its natural market share is somewhere between 25% and 30% of this market.

Q60 Mr Newmark: Don't you think, though, given this is a bit of reverse engineering in the way you are thinking, it is natural that you look backwards and think, "We should have," or if Sir Andrew Large is saying, "You should have"? But, at the time, there was huge financial distress in the market. There was huge financial distress with the bank and the order of priority seemed to be shore up deposits and really to focus on risk management, and lending seemed to become a distant third. That seemed to be one of the conclusions, but surely when an institution is in deep financial distress, you want to shore up your balance sheet a bit and focus on the risk management aspects, having made huge errors previously, perhaps on the risk management side.

Robin Budenberg: That is exactly what happened. RBS—

Mr Newmark: That seemed to be a criticism that Sir Andrew made, but surely that is what one would expect—

Robin Budenberg: I did not think it was a criticism. I think he was—

Q61 Mr Newmark: Was he wrong to criticise that?

Robin Budenberg: I do not think he was criticising. I think he was simply saying that if you focus on the right people to lend to and restrict lending to those people when before you were not, and if you are focusing on gaining deposits, as you say, as crucial to your balance sheet, and if you have an organisation where responsibility for SMEs is split between a number of different areas because you have a non-core area but it is trying to wind it down, that is not a good backdrop to achieve the objective that RBS set itself to increase lending. Your points are exactly right and they are the reasons that Andrew Large puts for failing. He also points out that there are a significant number of areas where RBS needs fundamentally to improve its approach. I think the fact that the new management team instigated this review and have committed to implement it in full is a great opportunity for RBS to push forward in this area.

Q62 Mr Newmark: He talks about the importance of growing gross lending to SMEs and enhancing services for your SME customers, but he also says that part of the remit should be to support economic recovery. Isn't your duty to your shareholders effectively, which is taxpayers? Normally, if you were not owned by taxpayers, you would say, "In my duty to my shareholders I have to focus on my core customers, which are SMEs and so on, and I have to be careful with how I lend and who I lend to and so on." It would not even occur to you to be thinking, "Gosh, I must be supporting economic recovery as well." Your shareholders today benefit from that tax recovery and are shareholders in the traditional sense. Do you think he is right to add that third thing to his objectives? Perhaps James can answer that.

Robin Budenberg: I would say that what the Large review found was that RBS continues to lend in line with its normal market share of relationships, but I think what RBS also had a duty to the taxpayer to do was to put its balance sheet back in order and that involved getting its loan to deposit ratio back towards 100%, where every bank should be.

Q63 Mr Newmark: Right, I totally agree with you. I am going to ask James. Do you think part of your remit as you go forward as chief executive should be to support economic recovery?

James Leigh-Pemberton: I think that it is reasonable, given the scale of taxpayer support for RBS, that due regard is paid to the overall economic welfare of the country, but "due regard" is the operative phrase. I do not see, in fact, that the recommendations of the Large review, which as Robin said are going to be adopted in whole—the management team have said they are going to adopt them in whole—as listed, as you have just read them out, are contradictory to the achievement of value for shareholders. An increase in SME lending and a reorganisation of the means by which that client segment is served and covered by RBS, as Robin said, in our view is good for the shareholders because this is a business in which RBS enjoys a competitive advantage and which generates satisfactory returns for shareholders.

Q64 Mr Newmark: Historically, there were incredibly bad decisions from your credit officers internally in some of the lending that went on. Now that you are on the right side with the balance sheet, you have some cash sitting there and you want to lend, and indeed you are feeling pressured to lend by your shareholders—i.e. taxpayers, and all of us here who represent those taxpayers, all of whom have lots of SMEs in their constituencies. There is a cry for more lending, more credit and so on, but you want to maintain the discipline on the credit side. How do you deal with that, or how are you going to deal with that contradiction of getting a little bit more discipline on the credit side yet fulfil the needs of the shareholders who are all our constituents saying, "You are not lending enough. You are not lending enough. We need more capital"?

James Leigh-Pemberton: I think in the Andrew Large report there are recommendations about the decision-making process both in terms of the organisational structure to serve this client segment and how people should be provided with the skills and wherewithal to make it easier for them—firstly to make good credit decisions and, secondly, to go through the process of lending. Those recommendations are there.

Q65 Mr Newmark: I am assuming you have now had a chance to look at your management team. Are the senior credit officers who were there when some of these bad decisions were made still there, or have they moved on? Do you have a new team of senior credit officers going forward so that you do not perhaps fall into the same trap again?

Robin Budenberg: I think it is very important that they are not "our" credit officers.

Mr Newmark: I appreciate that, but you have oversight with your role.

Robin Budenberg: We have oversight, and what the Andrew Large review says is that a lot of progress has been made with those credit officers, but significant further learning and education will improve things.

Q66 Mr Newmark: One last thing is that you have a lot of financially distressed customers. As an MP, I hear a lot of noise from some of those in terms of bad treatment by RBS, and that when they fall into distress, there seems to be a lack of understanding, sympathy and good handling. Certainly that is my perception as an MP. Is that perception wrong? Why is that wrong and how can we perhaps bridge the gap between what we are hearing from our constituents and what you are trying to achieve in the long run? You do not want to toss out all your customers, obviously.

Robin Budenberg: I think inevitably in difficult situations—and these are difficult situations—people tend not to agree and they tend to be inflammatory situations. Equally, you hear much more about those situations than the many thousands of situations that are resolved perfectly amicably. That is again something that Andrew Large outlined and suggested that there should be some form of inquiry into the more difficult areas to work out exactly—

Mr Newmark: Or a more sympathetic appeals process, perhaps.

Robin Budenberg: Yes.

Q67 Jesse Norman: Just very quickly, Mr Budenberg, to pick up one point from earlier, when Lloyds briefed you on the bids for their branches from the Co-op and NBNK, did they show you the memo that NBNK had written to the board outlining their concerns about the Co-op?

Robin Budenberg: No.

Q68 Jesse Norman: Do you find it odd in retrospect that this completely damning—and, as it proved, accurate—memo covering issues of capital management systems should not have been shown to you since it was so material on the bid?

Robin Budenberg: Lloyds did make us aware that there were challenges that the Co-op had to go through in order to achieve PRA consent for its bid and to allow it to proceed. To that extent, broadly we were aware that there were challenges, but I think at that stage people felt those challenges were achievable—difficult, but achievable.

Q69 Jesse Norman: I put on record that I find that remarkable behaviour by the Lloyds board.

I want to turn to the issue of LIBOR: $3.5 billion worth of fines so far to the industry; RBS so far fined £87.5 million and $475 million—enormously expensive. The first question, Mr Budenberg, is: what was UKFI's response to the FCA's findings about LIBOR manipulation at RBS?

Robin Budenberg: Well, obviously we read them very carefully. We discussed them with the management and with the board. The vast majority of these issues predated the current management's involvement.

Q70 Jesse Norman: How did management make an accurate assessment of the level of concern and the level of liability?

Robin Budenberg: It was difficult for them to do that until the outcome of the inquiry, but I think where we felt that current management had not performed as well as they could have done was in relation to addressing the issues when alerted to them by the authorities.

Q71 Jesse Norman: Have you, as UKFI, made any independent assessment of RBS's systems and controls relating to LIBOR and the prevention of LIBOR manipulation?

Robin Budenberg: No.

Q72 Jesse Norman: Do you think you should have done?

Robin Budenberg: I think it is very difficult for us to go on to a trading floor and get into the level of detail that an organisation such as the FCA—

Q73 Jesse Norman: You could commission someone to come in and look at it to get an independent view, and to see whether you trusted the systems that you were being told were good.

Robin Budenberg: We have always been aware—we have been open with this Committee—that the systems at RBS that were inherited by the previous management left a lot to be desired. We have always said that this will be a long-term issue. Our job is to make sure that we keep talking with the people involved in risk at RBS, in particular, to make sure that they feel that they are on top of the job.

Q74 Jesse Norman: Have you asked the boards of RBS or Lloyds whether any further manipulation of benchmarks is going to be discovered within their organisations?

Robin Budenberg: We have asked them where they feel their exposures are and there are a range of different regulatory issues that are pending. It is clear that there are going to be—

Q75 Jesse Norman: We know about forex. What are the other ones they are worried about?

Robin Budenberg: I think the mortgage trading has been identified as a potential issue. We have seen at JP Morgan that that has been a significant potential liability.

Q76 Jesse Norman: Have they shared with you any extent of potential liabilities they have estimated?

Robin Budenberg: I do not think they have. In something like forex, it is very difficult for them to estimate what their potential exposure could be because ultimately they do not know what the regulators know.

Q77 Jesse Norman: They are in the hole for nearly £100 million on LIBOR. I would not expect you to tell us what they think their liability is, but I would expect you to tell me that they had

had some frank discussions with you that they could be out half a billion dollars or whatever it is on these things—a substantial chunk of their capital.

Robin Budenberg: Again, I think that is very difficult on forex because I do not think anyone has a clear view yet what the potential liabilities in that area could be.

Q78 Jesse Norman: Are there no issues from your point of view in terms of provisioning or providing against these liabilities, which obviously are not just restricted to forex and mortgages?

Robin Budenberg: No, I think that has been a fundamental part of the discussions that the board of RBS has been having with the PRA and which resulted in the capital actions that were announced two weeks ago. It is clear that the PRA is rightly concerned, as is the board of RBS, about these potential liabilities and that caused them to take the actions that they did to make sure that their balance sheet was in a fit state to cope with these sorts of liabilities.

Q79 Jesse Norman: Mr Leigh-Pemberton, you are obviously a man of enormous experience in the capital markets and the advisory world in your previous career. Do you share the widespread concerns that there may have been systematic manipulation of indices not merely in the forex markets, but in the oil and metal markets, and the other commodities markets—swap rates and areas like that?

James Leigh-Pemberton: The evidence in each of those areas that any of those things have taken place is only slowly beginning to emerge. It is obviously something about which the whole industry has to be concerned and therefore I think the answer to your question is: yes, I do share everybody else’s concerns. It is a matter of great concern.

Q80 Jesse Norman: When you take the helm, can we take it from you that you will be instituting pretty rigorous investigations, to the extent they are not already being conducted, within Lloyds and RBS and their subsidiaries as to the level to which they may have been involved in these manipulations?

James Leigh-Pemberton: Yes. To be fair, that has already started in both organisations in the sense that as soon as the news of this began to emerge—I think it has been made public in both cases that they have commenced—as I think would be the case with any commercial organisation, they have immediately commenced internal investigation to determine the degree to which their organisations were in any way involved in those sorts of activities. Based on my previous experience, I think that is a very normal way of reacting to that kind of news. One’s immediate reaction is to say if that has been going on—if that has been happening out there in the marketplace—it is important that we should attend to the question of whether it has been happening here. I think in both of those organisations that has taken place.

Q81 Jesse Norman: We can take it from you, can we, that in the new era of Leigh-Pemberton there will be a pretty fingertip understanding, to the extent that is possible, or information from them to you as to what the potential liabilities are and how they are proposing to provide for them?

James Leigh-Pemberton: I think it is a very important part of UKFI’s stewardship role that we should be aware of all items that could have a material impact on the capital and, therefore, earnings capability.

Q82 Jesse Norman: That is a yes.

James Leigh-Pemberton: That is a yes.

Q83 Jesse Norman: Can you understand why we as the Treasury Committee are nervous about the taxpayer looking at a potential £1 billion additional capital hole in these balance sheets if they prove to be heavily involved?

James Leigh-Pemberton: Yes, I understand that. I will just go back, if I may, to what Robin said earlier, namely that the capital planning process for all major banks that are regulated by the PRA should incorporate and will incorporate, I think, the best estimate of what those liabilities are in order that from time to time the capital adequacy of any of the banks regulated by the PRA is sufficient.

Q84 Jesse Norman: Yes. It will also need to include, of course, a further estimate as to the extent to which regulators take flight and demand higher capital from their side over and above any actual capital needs the banks may have from the losses.

James Leigh-Pemberton: Yes. As evidenced in a different regime in a different country only a few days ago, incremental capital for operating risk has to be taken into account as well.

Q85 Jesse Norman: Thank you. That feels like a slightly different emphasis than the one we have had in the past few years. Could you outline very briefly any other areas—just based on your initial experience of UKFI, and the reading and thinking you have done about it—where you would expect your leadership to have a slightly different emphasis or a different style about it?

James Leigh-Pemberton: I think only that we want to organise ourselves to reflect the tasks that we anticipate over the coming years. Therefore, the reason why we have organised ourselves to have an investment analysis team that will be focusing on the stewardship questions on the one hand, and a capital markets team to focus on the design, implementation and execution of sales of shares on the other, is a reflection of what I think together we expect will be the principal functions of UKFI in the future.

Jesse Norman: Thank you very much.

Q86 Chair: It might be helpful if you could remind people watching this hearing how many staff you have to perform these functions. After all, these are quite large jobs that are being discussed here.

James Leigh-Pemberton: There are 13 of us.

Q87 Chair: How many employees are there in RBS?

James Leigh-Pemberton: In excess of 100,000 worldwide.

Robin Budenberg: 150,000, yes.

Chair: I think it is important that we get a feel for the scale of the task that you are being given.

James Leigh-Pemberton: Perhaps I could just add that we are giving active consideration to adding one more to that headcount to help in the completion of those tasks.

Chair: I hope he is a good chap—*[Interruption.]* Or woman.

Q88 John Thurso: Mr Leigh-Pemberton, may I ask you about the asset resolution business, UKAR? I know you have been in post for only a relatively short time, but what are your impressions of that business?

James Leigh-Pemberton: My first impressions are that it has a clearly defined mission, which is to release over time the monies that have been made available by Government to fund the books of assets that are managed in UKAR. At present, that objective is being achieved a little bit ahead of what was originally budgeted in terms of timing to deliver that outcome. That process needs to continue and the focus of UKAR needs to be precisely on the continued efficient running down, and allowing to run off, of the book of assets so that the Government funding is periodically released back to the Government and effectively the taxpayer is repaid.

Q89 John Thurso: It is quite a nice little earner, isn't it?

James Leigh-Pemberton: Yes, it is making profits.

Q90 John Thurso: The shareholder funds between 2011 and 2012 went up from £4.6 billion to £5.2 billion. It is selling off loans at a profit.

James Leigh-Pemberton: Yes.

John Thurso: It is lowering the loan impairment losses. It is really quite a good news story.

James Leigh-Pemberton: Yes, the financial performance of the company has been pretty satisfactory.

Q91 John Thurso: Would you expect it to go on generating those surplus shareholder funds at roughly the same rate as it goes through?

James Leigh-Pemberton: It must be the case that in due course that starts to decline. As the stock of lending declines, if the cost base does not decline at the same rate, which is very difficult to achieve—to keep the costs coming down at precisely the same rate as the stock of lending declines—the margins, or the operating income, will start to come down both in absolute terms and in relative terms. As the stock of lending comes down, the operating income will slowly start to decline.

Q92 John Thurso: Over the period of the rundown, one could expect to see the equity part of that—the shareholder funds—keeping pace for a while to come?

James Leigh-Pemberton: Continuing to grow but, as I said, I think by definition they will grow at a lower absolute level.

Q93 John Thurso: It will tail off, yes. UKAR is the amalgamation of B&B and Northern Rock Asset Management. Are we still able to note where the equity is as between B&B assets and as between NRAM assets?

Robin Budenberg: Yes.

James Leigh-Pemberton: I cannot answer that question I am afraid.

Robin Budenberg: They are operated as a single entity, but the two sets of accounts are kept separate.

Q94 John Thurso: When this is all over, will we be able to say this is the equity generated, quite apart from the repayment of loans to the Government and the fees?

Robin Budenberg: Yes.

Q95 John Thurso: I notice the interest rate has gone up and more fees are being paid. At the end of it, will we know what the equity position is?

Robin Budenberg: I believe that. It may be that at some stage in the future it makes more sense to combine these two in a more fundamental way, but certainly at the moment you can keep a track of that. As you know, we released a document a year ago setting out what we expected the returns to be, including the sale of Northern Rock and the two bad banks. Broadly speaking, we are still on track in relation to that.

Q96 John Thurso: One question on the past, which comes from December 2012. UKAR announced that remediation was required in respect of a segment of NRAM Consumer Credit Act regulated loans incurring an exceptional cost of £271 million. Can you explain what that was about?

Robin Budenberg: Yes. When the Consumer Credit Act came in in 2008, it introduced certain requirements for what had to be included on statements. One of those requirements was that you have to set out what the original value of the loan was—not necessarily what the current value of the loan was, but what the original value of the loan was. Obviously, at that stage, Northern Rock was in a pretty chaotic state and, unfortunately, they did not follow through on that properly. The regulations state that if you do not include that information on the statements, effectively you cannot charge interest on that loan. That is the outcome, which is very unfortunate.

Q97 John Thurso: Deloitte reviewed that. Did they come up with anything? You asked Deloitte to review that.

Robin Budenberg: Yes and, as you know, we have published the report. They were quite clear that these issues emanated from the old Northern Rock and there was nothing that current management could have done about that. There were opportunities during the period where if somebody had been really sharp, they could have picked it up, but this is an incredibly complex process. UKAR is going through a massive process of literally going physically through millions of bits of documents to work out whether there are other issues. I was interested to see that the OFT wrote to a number of firms the other day asking them, as a result of problems identified at Northern Rock, and I believe at Barclays, to do the same thing.

Q98 John Thurso: Still talking about UKAR, going back to the question of its administration of the Help to Buy scheme—I am not sure whether this is past or future. Whoever thinks it is right to answer, chip in.

Robin Budenberg: I think it is both, isn't it?

John Thurso: UKAR has been asked to administer the scheme, but has no profit from it and incurs no cost. Is that correct?

Robin Budenberg: Correct, yes.

Q99 John Thurso: It is just a management vehicle that the Treasury has used. Is that something you sought, or was it just imposed on you by the Treasury?

Robin Budenberg: When the Treasury was setting up the scheme, it obviously was looking at different ways of administering it. I think it is clearly an area that is in the skill set that UKAR has. As James mentioned earlier, UKAR is in the process of running down its people because the ambit of its operations is reducing. Therefore, I think it felt that it would be a good use of those skills, but there was a very serious discussion at the board of UKAR because, quite rightly, one or two of the non-execs were very focused on whether this would distract UKAR from its main objective, which is as James has outlined. The arrangements that are being put in place satisfied the board that that would not be the case. There is a special purpose vehicle that is completely separate.

Q100 John Thurso: It is a pretty complex scheme in many respects and it strikes me, looking at it from the outside, that it will require quite a lot of management to get it right. Of course, the CEO of UKAR is the accounting officer for it, so there is now a direct report from him to the Treasury on these matters. With giving out figures in advance, getting money in, and then reconciling at the end, given the success of UKAR doing its core business, this has, surely, the potential to be a pretty monumental distraction if it does not all go to plan.

Robin Budenberg: I think it is a perfectly fair point. As I say, it was one that was a great focus of board discussion and I am sure that James will make sure that Chris Fox, who represents us on that board—

Q101 John Thurso: It would be something you might expect us to come back to over the next year or two to find out how you are getting on—whether it has turned out to be a hospital pass or a nice little earner, or whatever it might be.

James Leigh-Pemberton: By all means.

John Thurso: Lovely, thank you.

Q102 Mark Garnier: Mr Budenberg, can I turn to the good bank-bad bank debate in RBS? Would you give us an idea of what your role was in the review of the good bank-bad bank split?

Robin Budenberg: We gave advice to the Treasury team working on this around what we saw as the shareholder value implications.

Q103 Mark Garnier: That was it.

Robin Budenberg: That was the focus, yes.

Q104 Mark Garnier: Not in terms of the management of the business—whether it was a good idea or bad idea—just simply a numerical calculation.

Robin Budenberg: I think all those things go into shareholder value. If it is a good idea, it tends to be positive for shareholder value.

Q105 Mark Garnier: What was your conclusion?

Robin Budenberg: Our conclusion is very consistent with the conclusion set out in the Treasury review document. The non-core assets of RBS have reduced from over £250 billion down to £50 billion. They are continuing to reduce at a substantial rate. I think our concern was that separating those out into a separate entity would not have a substantial beneficial effect and might involve the risk of taking people’s eye off the main ball, which is realising value for them.

Q106 Mark Garnier: Your input was specifically on shareholder value.

Robin Budenberg: That is correct.

Q107 Mark Garnier: Not the wider economic value of tidying up the balance sheet of RBS.

Robin Budenberg: Again, I think the tidying up of the balance sheet of RBS is absolutely about value. Where we did not have an input was in terms of assessing the economic impact of creating a separate bad bank and in assessing the implications on the nation's finances of whatever backing would be required to support that bad bank, even if it was not in the form of new money.

Q108 Mark Garnier: Is that because you were not asked, or was it because you did not feel that it was your place to give a view on that?

Robin Budenberg: I do not think either it is our place, or that we would be particularly well positioned to do that. I do not think we claim to be economists.

Q109 Mark Garnier: No, fair enough. The internal bad bank has 5% of the funded balance sheet yet absorbs 20% of the capital, and that is clearly not a very good position to be in.

Robin Budenberg: No.

Mark Garnier: Could you give us an idea of how that has changed with the internal bad bank, or has it not changed at all? If it has not changed at all, would it not reinforce why there is still an argument for having an external bad bank or, indeed, moving this bad loan book into the UK Asset Resolution? Mr Leigh-Pemberton, you were nodding furiously there.

Robin Budenberg: It is past and future here today. Why don't I start and ask James to add something? I think the bad bank review in itself was a very good thing because it allowed an independent person, BlackRock, to go through all the assets on the balance sheet. It is important to note that they found that RBS had done a good job with those—I do not think I would call them bad assets—non-core assets, that they were properly marked in the balance sheet, and that RBS's views on future values were consistent with, and indeed, in some cases, less positive than BlackRock's. I think that was a good thing. It also allowed everyone to identify the fact that there were, as you say, a relatively small number of assets, which came not just from the non-core bank but from the core bank, that tie up an awful lot of capital. The creation of the internal bad bank and the strict disciplines over running down the bad bank may clearly have had some value implications upfront, but will be extremely positive in terms of the discipline of releasing that capital and removing these assets from the balance sheet.

James Leigh-Pemberton: I was going to say very much what Robin said. I suppose I could just add that a reasonable proportion of the pool of assets in the new bad bank have come from the core, rather than all of them coming from non-core. There is a recategorisation that is taking place, and that recategorisation revolves around the very high capital intensity assets and particularly those that have a high degree of capital consumption in a stress. These are where severe tail risk is concentrated. The elimination, the sale and the runoff of those assets, therefore, has the impact of the reduction of tail risk but, very importantly also, when they have gone, the need to hold that stress buffer of capital against them also goes. Therefore, there is scope for capital release arising out of this composition of the bad bank promptly.

Q110 Mark Garnier: Can I just be clear? By isolating this into a ring-fenced entity within RBS, am I right in thinking it does not change the implication on the balance sheet until such time as those assets have been sold off? Is that right?

James Leigh-Pemberton: That is correct. Well, in accounting terms, by accelerating the timetable for their disposal and recategorising some of the assets from being assets held to maturity to becoming assets now held for sale, there is an accounting adjustment that needs to be made upfront to take the impairments associated with those assets now rather than taking them over time. In near-term balance sheet terms, there is an impact to the tangible book value of the bank resulting from taking those impairments now rather than later.

Q111 Mark Garnier: Thank you very much. That was very clear. Can I turn back to the debate that went on about whether an external bad bank should be created or not? There were one or two arguments that were put forward that you could not create an external bad bank without privatising the minorities, or I suppose nationalise the minorities, to take out that 17% of shareholders. Did you buy that argument, Mr Budenberg? Did you agree with that when you were looking at the ways of doing this and the shareholder value? Was it necessary to take out the minorities in order to have this set up?

Robin Budenberg: No, I think it could have been done without taking out the minorities, but creating the bad bank would have required the consent of those minorities acting as a group, if you like, and one of the issues that the report highlighted was that gaining that consent might have caused some degree of value leakage for the Government.

Q112 Mark Garnier: A final question from me. The share price has fallen 10% since the announcement. Do you have any thoughts about that? Is the market giving fair value to RBS on the back of this news? Mr Leigh-Pemberton, you are nodding.

James Leigh-Pemberton: Because of the downward adjustment to book value that I referred to earlier, and because of the requirement that was announced as part of the new plan for more tier 1 capital, the near-term valuation of the bank, if valued on a price to book basis, should come down to adjust for that reduction in book value, a near-term reduction in book value. And I think also that the effect of more capital for the same earnings in the near term should inevitably cause the share price to adjust downwards. These are the impacts today as the plan has laid out and as was explained so clearly by RBS management on the Friday of the announcement. The roll forward and returns on both tangible equity and capital will rise as a result of the execution of this plan.

Q113 Mark Garnier: Have the long-term prospects of the bank significantly improved as a result of this, though? Is the share price just reflecting the immediate valuation as opposed to the longer-term prospects?

James Leigh-Pemberton: That is our view.

Mark Garnier: That is your view. Thank you very much.

Robin Budenberg: But it is important, as James says, that if you do require more capital in a business for the same earnings, it has an impact on value. I think that has been a very fundamental impact for banks over the last four years. You might argue that the capital that banks are quite rightly required to maintain have in many business areas doubled, and if you double the amount of capital for the same amount of earnings, the consequences are clear.

Q114 Mark Garnier: Is that more of a Basel III argument?

Robin Budenberg: Yes, and I am not saying it is the wrong thing or anything like that. I just think it should be part of the context at which—

Q115 Mark Garnier: But that is fully at the price now, isn't it? The price of banks are now reflecting all of that.

Robin Budenberg: Yes, totally.

Q116 Chair: Back on the point, Mr Leigh-Pemberton, where you said offloading the tail risk releases capital on the balance sheet. Isn't the counter-argument that these large tail-risk assets are often the ones that the market turns out to be undervaluing—that it is putting at too high a discount now—and that holding them to runoff tends to generate a better long-term return for the owner, which in this case is, in fact mostly, the taxpayer? Have you done any analysis, or seen any analysis of previous bank rescues, with respect to that point?

James Leigh-Pemberton: While I have been at UKFI in the last two weeks we have looked at an overall analysis of the potential losses associated with the acceleration of the removal of the tail risk, and there are some. They are set out in the RBS management presentation, but I think those—

Q117 Chair: Are you talking about the published presentation?

James Leigh-Pemberton: Yes, the presentation that was made on Friday 1 November. That is the trade-off, the certainty associated with the elimination of the tail risk and the possibility of capital release arising from that is the benefit, and there is the risk of profit and loss impact. Well, there is the risk of loss relative to holding them, but for as long as they are being held, there is a cost of capital. As RBS management explained, there is the cost of capital associated with holding them and the cost of that capital is extremely high because of the very high capital intensity of the assets in question.

Q118 Chair: That is the point you made earlier, which I understand, but I was making the point about an analysis of bank rescues with respect to large tail-risk run-offs.

James Leigh-Pemberton: I have not been party to any such analysis since I have been at UKFI.

Q119 Chair: Has UKFI done any work on that, Mr Budenberg, since you have your team of half a dozen people working non-stop on this issue?

Robin Budenberg: I think it does come out of this analysis. I think it is the offset. I think the regulators feel that sort of asset is a very difficult asset for banks like ours to own and therefore inevitably they focus, as James says, capital buffers on those assets, which make it uneconomic for the banks to wait and wait for the things to come out. It is much easier for somebody like UKAR just to hold on to assets and make the profits from it. They are completely different types of assets, but I think it is a deliberate policy of the PRA to discourage banks from holding those sorts of assets with significant tail risk, and I think we all understand why.

Chair: It might be worth considering taking a look at previous bank rescues with respect to that.

Q120 Mr Love: I want to come again to that point in a different way, but let me just ask you first: were the issues that you were asked to comment on in the RBS review about the choices of an internal bad bank or an external bad bank, or were you allowed to comment particularly in relation to the acceleration of the sell-off of those assets? In other words, could you have argued for the status quo with a different set of core and non-core assets in the bank? I accept that there is a change and that you seem to be in favour of that change, but were you allowed to argue that selling off the assets at an accelerated rate might have a negative impact on shareholder value and the benefits for the taxpayer?

Robin Budenberg: There was an active discussion about how much and how fast the assets should be run down. I would again say that the PRA was actively engaged in that discussion and that, ultimately, I think the PRA felt that the balance that was achieved was a reasonable balance between the board's wish to maintain value and not, as the Chairman says, to throw away value, and their wish to remove tail risk from RBS. It was an active debate in which we participated, but ultimately it was something that the PRA and the board decided between themselves.

Q121 Mr Love: Let me come back to the question that has consumed the last two contributions. The RBS interim management statement published on 1 November says: "The internal bad bank is expected to be capital accretive and neutral for shareholder value, taking account of the benefits of a material reduction in the credit risk profile of the group". Do you support that statement and what did you ask RBS to do to justify its claim that it would be neutral for shareholder value?

James Leigh-Pemberton: First of all, yes, we support the proposition that it is capital accretive and, secondly, if so, that is one of the drivers of neutrality for shareholder value, because the release of capital is a means by which the return on tangible equity and an increase in earnings can be achieved. I think the analysis that we saw and which we were able to discuss demonstrated that those two things are the case.

Q122 Mr Love: But we have a very definite view of what likely losses will be in the fourth quarter as a result of the change—it has been estimated at £4 billion to £4.5 billion. What estimates did they make of the benefits to the credit risk profile of the group? How did they justify that this would turn out to be neutral at the end of the day, or are we accepting a bold statement without any figures? You suggested earlier that there were no figures given to you to justify any of these claims. Did you take it on trust?

James Leigh-Pemberton: No. We were provided with analysis of the build-up of the capital accretion. We were provided with an analysis of the likely losses over the lifetime of those assets and the comparison between those losses and the losses that would be taken as a result of an accelerated disposal. Just to come back to the point about the £4 billion or so, those are impairments that are already provided for in the capital base of RBS and that are accelerated as a result of the recategorisation of these assets from assets held to maturity to assets held for sale.

Q123 Mr Love: Let me come on to the Government's report, which stated: "UKFI will engage closely with the board and management to oversee the development and implementation of the internal bad bank". Will there be a tension there between your natural desire to slow down the process in order to maintain shareholder value and the needs of the objectives set for the internal bad bank to speed up the process to get rid of these assets?

James Leigh-Pemberton: We do not anticipate that there will be any such tension. The plan, as it is, is a plan that UKFI fully supports, so—

Q124 Mr Love: Let me take a specific issue that was mentioned earlier on—Citizens Bank. It is now suggested that that will be brought forward to next year. The evidence, for what it is worth, suggests that that will have a direct hit on the amount that is raised from an IPO. What will you be arguing as UKFI in relation to Citizens Bank?

James Leigh-Pemberton: We will obviously want to pay close attention to the means by which the IPO is effected to make sure that it does deliver best value, but the overriding objective associated with that disposal is to meet the new capital requirements for RBS. It is to generate capital through the sale so that the core equity tier 1 capital of the bank hits the targets that its current capital plan—embedded in its plan—requires. As Robin said, the timing now for the IPO is probably much better in terms of creating shareholder value than it would have been had these steps been taken two or three years ago.

Q125 Mr Love: The Chancellor set out three objectives, two of which accord with those objectives of the UKFI. He added to that a third objective, which was to support the economy. That is not one of your objectives. The argument will be used continuously that we have to sacrifice shareholder value in order to support the economy. What role does the UKFI have in those circumstances?

Robin Budenberg: It is the role of a bank to support the economy and to make profits out of supporting that economy. The discussion we had earlier about lending to SMEs is a good example of that and our role is to make sure that the Chancellor or the Government do not force the banks to do things for the good of the economy that are contrary to their commercial interests. Indeed, if they were to do that, the directors, who have a fiduciary duty to all their shareholders, would also have a serious problem with that. There is a balance that we need to achieve, but equally I think both our banks recognise that they need to be particularly sensitive to these issues, given the history with the taxpayer, and they also feel that that is a sensible thing for them to do from a shareholder point of view. We have seen that Lloyds is seen to be a responsible part of contributing to the economy and I think that is good for it, for the perception of it and for its shareholders' perception of it. RBS very much wants to do exactly the same thing.

Q126 Mr Love: Let me come on to the dividend access share. It has been suggested that this needs to be sold so that dividends can start to be paid by RBS. There are negotiations currently ongoing. What role does UKFI play in those negotiations?

Robin Budenberg: We have in the past carried out valuations—we have employed Deutsche Bank to carry out the valuations on our behalf—of the dividend access share, but this is fundamentally a discussion. We have valuation input into that discussion, but fundamentally it is something between the company, the Treasury and the European Commission, as the dividend access share was a key part of the European Commission's settlement with RBS.

Q127 Mr Love: There have been all sorts of leaks about the value of the dividend access share. What is your estimate? It has been suggested than £1.5 billion—

Robin Budenberg: I would not want to add to any leaks.

Q128 Mr Love: There is a significant difference between the book value at £4.2 billion and the ballpark figure, if I can use that as an alternative ballpark figure. Is this is concern of UKFI? Are you speaking up at this stage? What is your role in that mix of discussions that are ongoing about what to do about the dividend access share?

Robin Budenberg: Without making any leaks, the value of the dividend access share in March this year we put at £1.5 billion and the difference between that and £3.1 billion fundamentally reflects the difference in the situation today versus what it was expected to be four years ago. People would have expected dividends to be getting paid by now, and the reality is that has not happened, so a dividend access share that creates a share in a dividend paid by the bank is inevitably going to be less valuable than it was.

It is in all our interests that that dividend access share is dealt with because I do not think it is possible to privatise this bank fully without shareholders feeling they are able to participate equally in dividends. *[Interruption.]*

Chair: By the way, I have tried to get these bells indicating the beginning of business in the Chamber silenced—unsuccessfully. I have been told it will cost well in excess of six figures to turn a bell off in three rooms, but there we are. Sorry.

Q129 Mr Love: Let me ask you a last question, which leads on from the comments you have just made. You are suggesting that selling the dividend access shares will speed privatisation. Will the internal bad bank proposition that has just been agreed help to speed privatisation, and what is your current estimate of when they can start to go to the market on the sale of RBS shares?

James Leigh-Pemberton: To answer the second question first, it is very difficult to say, and it is probably too early to say with any precision when there will be sufficient investor demand to enable a sizeable sale to be undertaken. The new chief executive of the Royal Bank of Scotland will make a presentation about his detailed strategy in February. That is a crucial part of the investment case and then the implementation of that strategy will also be a very important part of building the investment case. There are a lot of indefinites and therefore it is very early to say.

With respect to the first question, there are certain issues in relation to RBS that absolutely have to be tackled as a precursor to successful reprivatisation: sufficient capital; a strategic focus on businesses in which they enjoy competitive advantage and higher returns; and the normalisation of the capital structure in the way that Robin has tried. We can say the new plan will enable privatisation at least on the timetable that would have been achieved otherwise and perhaps with scope to act a little bit faster.

Chair: This is the last question, Andy, and a quick reply, please.

Q130 Mr Love: Yes. How do you weigh in the balance the twin objectives of getting the best shareholder value from RBS and privatising it more quickly? How do you decide?

Chair: In a word.

Robin Budenberg: It is a good question. You just have to get the right balance that protects the interests of the taxpayer both as the holder of the dividend access share and the holder of 80% of the ordinary shares[2] of the company. Ultimately, you have to look at technical evaluation of the dividend access share but, as we have always said, it is difficult to get precision around what something as unusual as that is worth.

Chair: That will be a big job for Mr Leigh-Pemberton in the months ahead.

[2] Note by witness: Mr Budenberg gave a shorthand response when speaking of ‘ordinary shares’, which is referring to ‘economic ownership’ in this instance.

Q131 Mr McFadden: I want to stay on this track. Can I start with you, Mr Budenberg? You said in the opening exchange with the Chairman that there had been one or two occasions when you had a difference of view with the Chancellor on various things. You mentioned, for example, the exit from Citizens as being one of those. Have you had any differences of view with the Chancellor or any Treasury Ministers in the past couple of years about the timing of reprivatisation of RBS?

Robin Budenberg: No, because I do not think there has been any time in the past two years where the reprivatisation of RBS has been a serious prospect.

Q132 Mr McFadden: Can I turn to you, Mr Leigh-Pemberton, because I want to go to the future now? What are the implications for the timing of the sale of the bank of the series of announcements on 1 November about RBS? Do they make any difference, or do they make it more likely to be earlier than we would otherwise have thought?

James Leigh-Pemberton: As I mentioned earlier, I think our assessment is that the measures announced on 1 November mean that reprivatisation can take place at least on the same timetable as would have prevailed had they not been announced, with the possibility that if markets are good and the plan is executed completely, and on time, the reprivatisation could be accelerated as a result of those measures.

Q133 Mr McFadden: Can you tell us what JP Morgan is doing for you on reprivatisation?

James Leigh-Pemberton: JP Morgan was acting as privatisation adviser and the focus of its activity has been giving UKFI advice in relation to Lloyds.

Q134 Mr McFadden: Are they working on timing or strategy on RBS reprivatisation?

James Leigh-Pemberton: We have not yet started because, as I said, we have to wait just to see what the presentation in February tells us about the shape of the investment case, and that will inform our advice and our views on the likely timetable.

Q135 Mr McFadden: So far its role has been restricted to Lloyds?

James Leigh-Pemberton: During the couple of weeks that I have been there, all the discussions have been about Lloyds, but Robin—

Robin Budenberg: And before, yes.

James Leigh-Pemberton: And before.

Q136 Mr McFadden: Is the entry price a key criterion for reprivatisation, or is that something that is not top of your thinking? By that, I mean the price the taxpayer paid for the bailout.

James Leigh-Pemberton: It is one of the things that we have in our mind and we will have to have in our mind in future when thinking about possible sales. I would say that our mandate is always to think about whether the potential opportunity is there to realise value for money in all the circumstances that prevail at the time. Therefore, we also have to think about, and make recommendations in relation to, whether the prevailing share price in our view reflects fair value for either of the banks at that time. Certainly the work that I have seen since I arrived in relation to the decision making around the Lloyds sale was substantially focused on the question—and never mind the share price and the in price—of whether the current stock price reflects fairly the prospects and therefore whether, by disposing of it today at this price point, we would be getting full value for those prospects. That is an important part of our analysis of when it is appropriate to make a recommendation.

Q137 Mr McFadden: But should the taxpayer be thinking, "We at least want back what we put in," or is your advice to the taxpayer, "That is not the way to think about it, because in these circumstances you have to let bygones be bygones and think about the situation today"?

James Leigh-Pemberton: As I said, it is one of the things that it is difficult not to take into account, but it cannot be the only consideration because when we make our recommendations and provide our advice, we also have to provide it in the context of whether there is an opportunity to realise fair value or more than fair value, given everything that we know about the current and future prospects of either of the banks.

Q138 Mr McFadden: Can I ask you a final question about the potential form of the sale? This is a massive holding that the state has in RBS. Is this likely to be a trade sale to institutions, or will the public be offered at least some of these shares as, for example, in the recent Royal Mail privatisation?

James Leigh-Pemberton: The timing and the format of any sale of RBS is going to be dependent on an enormous number of factors—the equity story, the valuation of the shares, the overall market conditions—but it is certainly the case that given the size of the disposal programme, if an opportunity were to present itself that enabled a sale to be made to retail investors alongside a sale to institutional investors, that is certainly one way of achieving size in any major share disposal. That is a topic that we have already started giving some thought to, just in terms of the structure of how best to achieve that, and we will continue to do that work so that we are in a position, if the appropriate opportunity does present itself, to be able to effect such a sale.

Mr McFadden: Mr Budenberg, do you want to add anything about past work on these issues?

Robin Budenberg: No.

Mr McFadden: Thank you.

Q139 Andrea Leadsom: Good morning. It does seem to me that UKFI has been neither fish nor fowl. Mr Leigh-Pemberton, could you tell us why you want to do this job? UKFI is not an activist shareholder. It is very clear from your responses that you do not feel incredibly empowered, such as to look into, as Mr Norman said, the issues around the potential for rigging other benchmarks and so on. You are quite passive in the sense that you are not out there looking for trouble and looking for where things can go wrong. On the other hand, you are also not empowered to have a strategy for recouping the taxpayer their money so, as you have just said to Mr McFadden, it is up in the air and retail investors will be invited in only if the opportunity presents itself. In other words, you are not going out looking for it. Do you have a vision for UKFI and, if so, what is it, and could you explain why you wanted to do this job?

James Leigh-Pemberton: Yes. I think the vision for UKFI is that the independent stewardship role that Robin described earlier is very important for the purposes of ensuring that shareholder value is preserved and created. It takes a number of forms, but that continued discussion with the boards and the management teams of the banks and with the board of UKAR does have the capacity to enable good decisions to be made in the interests of the preservation and creation of shareholder value. That is the first part.

The second part is that I do believe that—the evidence of Robin and his colleagues' activities suggests that this is the case—there is significant value that can be brought to bear by the application of the expertise that is available in UKFI in the choosing of the moment to sell shares, and then in the detailed execution to ensure that value for money is delivered.

Q140 Andrea Leadsom: Excuse me, but that is not a unique expertise, is it? There are placings that go on all day, every day. We have just had a very successful placing of Royal Mail that did not require UKFI to manage it. What is the unique advantage of UKFI over just having a Government Department keeping an eye on it? Very specifically, for example, are the problems with NatWest/RBS' systems now resolved? Have you taken steps to ensure that the breakdown of their payments systems cannot ever possibly happen again? Have those investments been made or is that something that could happen again tomorrow, or is it not your problem?

James Leigh-Pemberton: To start with the question, "Is the expertise available elsewhere?", the expertise can be hired from the outside. To ensure that the very high standards that are required, certainly from my perspective, of a public sector entity to ensure that value for money is achieved is a very important role that UKFI can play in the design and implementation of the share sales.

Q141 Andrea Leadsom: Are you saying that you have not hired any external advisers because you have all the expertise in house to do a placement?

James Leigh-Pemberton: No, we have hired them and—

Q142 Andrea Leadsom: Did you get a better deal than the Royal Mail, for example? Is there any evidence that you have achieved better value for money?

James Leigh-Pemberton: I believe that the price of securing that external expertise was very low. First, we were able to secure those services for almost a nominal consideration. Secondly, I believe that the after-market performance of the Lloyds Bank stock in the days following the sale, and from the sale until now, is indicative of the fact that the after-market was orderly but that full value was extracted from our shares, from the Government shares, at the point where the sale was made. The share price has hovered around the sale price, which I think is a very satisfactory outcome for a secondary offering of shares.

Q143 Andrea Leadsom: In reference to my first question about whether the NatWest/RBS systems can go wrong again, has that been resolved? Are you satisfied that you can never again have 13 million customers unable to check their balances or make any payments for two weeks—in fact, in some cases, up to a month?

James Leigh-Pemberton: Could I ask Robin to answer?

Robin Budenberg: It was clearly an extremely unsatisfactory state of affairs.

Q144 Andrea Leadsom: They are taxpayers, aren't they?

Robin Budenberg: It was an extremely unsatisfactory state of affairs and Stephen Hester was clearly very aware of that and took—

Q145 Andrea Leadsom: You said in 2012, Mr Budenberg, in the UKFI accounts: "There will need to be a full investigation into the causes of the recent major technical disruption in NatWest, RBS and Ulster Bank”. That was in the 2011 to 2012 UKFI account. Have you seen that full report and are you happy that it is now resolved?

Robin Budenberg: I understand that the FCA is coming out with its own report in relation to that.

Q146 Andrea Leadsom: So two years later?

Robin Budenberg: I think that systems are a very difficult thing. As I said earlier, the management of RBS inherited a dysfunctional set of IT systems and it has been an enormous and prolonged process getting them back into shape.

Q147 Andrea Leadsom: Are they now in shape? Can you assure the Treasury Committee that such an out could not happen again?

Robin Budenberg: I cannot assure the Treasury Committee of that.

Q148 Andrea Leadsom: Do you see it as part of UKFI’s job to ensure that an existential risk like that isn’t looming?

Robin Budenberg: Absolutely. On the definition of an activist shareholder, I think we spend much more time, for example, talking to Ross McEwan about what he is going to do about his systems than any other shareholder would. If you ask the boards of both Lloyds and RBS, they would consider that we are extremely activist shareholders. What we are not meant to do is run the banks on a day-to-day basis, so there is a clear distinction in the role of an activist shareholder and the management of the banks.

Q149 Andrea Leadsom: Absolutely, but you would say you are an activist shareholder. Have you been so?

Robin Budenberg: Yes.

Q150 Andrea Leadsom: Can you assure us that the systems issue is now resolved?

Robin Budenberg: If you ask Ross McEwan whether he could assure you of that, he would be a brave man to say so, and I am not brave enough to say that. I believe that there is a lower chance of it happening now than there was before, definitely.

Q151 Andrea Leadsom: Going back, Mr Leigh-Pemberton, to the issue of the sales of particularly Lloyds’ shares, you have said you are very pleased with the execution of that. Can you tell us what your strategy is for future sales? Is it going to be in the region of 6% parcels again? Do you expect to offload a much greater percentage of the taxpayers’ shareholding in future? Do you anticipate you would like to see distribution to retail investors? What is your vision for that future progress?

James Leigh-Pemberton: As I remarked earlier in the context of RBS, it is very difficult at this point to say for certain what the precise timing and format of any sale might be because the interplay of overall market conditions, the equity story associated with Lloyds Bank, the momentum in its earnings and the prospect for dividend payment—all those things—has to be taken into consideration at the same time to determine what is the right way to sell and the right time for a recommendation for the next sale. In order for us to carry out our mandate correctly, what we have to do is to be in a position to incorporate all the alternatives you mentioned so that we are ready to operate in any one of those formats—another institutional offering; an institutional offering alongside a retail offering; or some form of retail offering on its own. We have to be in a position to be able to execute through any one of those mechanisms, and the decision about the timing and the best way to effect a sale will just be a reflection of the market conditions at the time.

Q152 Andrea Leadsom: Would you see your responsibility as merely to effect a market transaction without any consideration of, for example, the merits of a broader retail investor offering, or the risks perhaps of a foreign funds management placement, versus long-term UK investors perhaps investing for pension funds and so on? You do not give any consideration to the quality and tenure of the likely holders of the stock; this is just a market transaction.

James Leigh-Pemberton: We have to give very careful consideration to those questions and, certainly based on conversations with my new colleagues, I understand that an enormous amount of care was devoted to determining how the allocations should be made on precisely those sorts of criteria and how they should be made in the context of the last Lloyds sale. Our overriding objective is to achieve best value for money at any one point in time when a sale is to be made, but all those factors that you have mentioned must be taken into account when we are effecting a sale.

Indeed, to come back to one of the questions that was asked previously, I see that preservation of competition is part of our mandate to incorporate precisely this question—ensuring that the shares are distributed in a way that does not cause any consolidation of the competitive position in the UK banking market.

Robin Budenberg: I would like to give a practical example of exactly that issue. When we were going through the exercise of building the book of demand for the Lloyds shares, we split investors into long-term investors and short-term investors. It was a pretty blanket approach, but it is a reasonable approach. When we came to assessing the final book of demand, it would have been possible for us to price the sale at 75.5p rather than 75p, but our view was, given the different allocation that would have happened by pricing it at 75.5p, where a lot of the long-term investors dropped out of the book, that it was right in terms of our need to show that we were responsible sellers who sell to the right people—and do not just sell to the highest bidder and cause dislocation in the market afterwards—that we should price the issue at 75p. That is what we did. When the National Audit Office reports, you will see the details of that and I think that was a good example.

Andrea Leadsom: Thank you.

Q153 Chair: Mr Budenberg, you are leaving at the end of the year, so this is your last appearance before us, at least in your current role. You have done a great public service in this job, answering our questions directly and with a considerable grip on the detail. Your job has required some bravery from time to time—you mentioned bravery in an earlier answer—as well as a bit of diplomacy to avoid getting caught in a lot of crossfire. It has been a thankless task, I expect, but I would like to thank you on behalf of this Committee and Parliament for the work you have put in and to wish you well in whatever you do in the future.

Robin Budenberg: I am very grateful, and I have to say that I think this Committee does—I can say this now—a really good job in terms of holding people like us to account. That is not always comfortable, but it is necessary.

Chair: Well, you are still alive. Thank you very much indeed