HOUSE OF COMMONS

ORAL EVIDENCE

TAKEN BEFORE THE

TREASURY COMMITTEE

PROJECT VERDE

TUESDAY 19 NOVEMBER 2013

DAVID ANDERSON

Evidence heard in Public Questions 979 - 1093

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Oral Evidence

Taken before the Treasury Committee

on Tuesday 19 November 2013

Members present:

Mr Andrew Tyrie (Chair)
Stewart Hosie
Andrea Leadsom
Mr Pat McFadden
Mr George Mudie
Mr Brooks Newmark
Jesse Norman
Teresa Pearce
Mr David Ruffley
John Thurso

Examination of Witness

Witness: **David Anderson**, former Chief Executive, Co-operative Financial Services, gave evidence.

Q979 Chair: Thank you very much for coming to give evidence this morning on this inquiry, which seems to throw up surprises every time we ask a few straightforward questions. I am going to begin with a straightforward question, which is, why did you leave when you did?

David Anderson: I left the group at the time of the merger with Britannia, and clearly there can only be one chief executive in a merged organisation. I had actually made it plain to the group board that I would continue as CEO—assuming they wanted me—if the merger did not take place. But it was my call during the conversations with Britannia that, if this was a merger of equals, and it was very likely that the Co-operative Group would want to appoint the chairman of the bank, that it was likely that Britannia would need to have senior executive representation, probably the chief executive, not least because they had to mobilise their staff to get members to vote in favour of the merger. So I made it clear I was prepared to step aside if that was the best thing for the transaction. I believed strongly enough in the transaction to do that.

Q980 Chair: So you did not feel put out?

David Anderson: To be honest, my thinking at the time was—

Chair: You were expecting it.

David Anderson: Yes, I was expecting it. It was better for the group for me to step out as part of the transaction; it was going to be better for the group in the long term than for me to stay and the transaction not to happen. So I was not put out, no.

Q981 Chair: You thought Mr Richardson was the right man for the job?

David Anderson: I did.

Q982 Chair: Therefore, you would agree with the evidence that we heard from Mr Flowers on that point?

David Anderson: I don't recall Mr Flowers saying anything about Mr Richardson's fitness for the job, I'm sorry, Chairman.

Q983 Chair: He did discuss the senior appointments that were made in a room in Shanghai, if you recall.

David Anderson: Right. The—

Chair: I do not know whether you have read his evidence. Perhaps I will not waste the Committee's time by going through it all. Basically, you are saying that the correct decision was taken for the mutual.

David Anderson: I believe so.

Q984 Chair: Clearly, things have gone disastrously wrong. Do you think that you share any of the blame for that and, if so, which part?

David Anderson: To be clear, I was responsible for initiating the talks with Britannia about merger, so that is very clearly my responsibility. It was in keeping with the Co-op Bank Group board strategy at the time. Merging with a building society had been discussed; approaching building societies had been discussed. I set that in train. I was part of the evaluation of Britannia, so very clearly I have a role in that. What I think also influenced the downfall were a lot of things that happened after the merger, including problems that arose in both Britannia books and Co-operative Bank books, including significant management stretch created by merging the financial services business into the group, bidding for the Verde assets, and also difficulties that arose from changes in accounting procedures and regulatory views of capital. As ever, when something goes so disastrously wrong, it tends to be a series of things that come together to create the outcome rather than one thing.

Q985 Chair: You did not mention PPI there among the things that went wrong. There is £300 million, perhaps £400 million of provisioning there from PPI mis-selling. Who is responsible for that?

David Anderson: I did refer to problems that arose from the Co-operative Bank, and I was referring in that case to both PPI and to the IT write-offs that arose.

Chair: Fair enough.

David Anderson: As far as the PPI provisions are concerned, which I think now approach £300 million, the bulk of that selling took place in the early 2000s. When I arrived in the bank in 2005, my discussion with the board was that strategically the bank was too dependent on unsecured lending and the associated incomes, which included PPI. Although PPI continued to be sold on my watch, the numbers were something like 37,000 in the first year, for half of which I was there; 20,000 the next year; 11,000 the year after that. So we very severely ramped it down. In May 2007 we conducted some research, because obviously there was massive regulatory interest in PPI. We realised that there had been things to put right. We mailed 2,200 customers, 660 replied and we found nine cases out of that sample of inappropriate selling. So I do not believe on my watch there was systemic PPI mis-selling, and the numbers of cases that took place during my watch, compared with the provisions, lead me to think that it must have been significantly more historic. I have not seen the details of those provisions because I have not been in the bank for four years.

Q986 Chair: Have you asked the question how many of those cases that you reviewed at that time have subsequently been identified as possible cases for compensation?

David Anderson: I do not have any access to the bank to ask that question now.

Q987 Chair: What we have found is that the banks' view of what is deserving—I am talking about the banks collectively—and the regulator's view often diverge about that, dramatically. As we saw in the evidence we took from Lloyds, for example.

David Anderson: Yes. I think what is absolutely crystal clear is that, even in those cases that we considered to be fine, there probably was not enough evidence retained to prove now that there was suitable advice given to the customer. Under the new rules that came in in 2005—the COBS rules—we did choose to go an advised route. In 2006 we removed the financial incentives for selling PPI from staff, and in 2007 we introduced new ones that were based about service and customer care.

Q988 Chair: If we go hunting for it, are we going to find in the minutes statements by you making it clear that you wanted to bring PPI sales to an end, that you were worried about them, that you thought that there was mis-selling?

David Anderson: No, you will not find statements that I thought that there was mis-selling. I think in about 2007—

Q989 Chair: I am now just asking for something that supports the statement that you were ramping the sales down from the period you took over in 2005.

David Anderson: Okay. The numbers that I have just quoted are taken from the Co-op's submission to the Parliamentary Commission on Banking Standards from October 2010. I did not have any access to those numbers from anywhere else, to be honest, so not surprisingly I was keen to try to find some evidence and I found those numbers in that. There were board discussions about PPI. I can remember one elected member being particularly concerned about it. I also had it raised with me at a Co-op regional board meeting in Huddersfield that I attended, and personally I was concerned. I was a newcomer to the organisation. I wanted to make sure we were doing it right. I specifically went into the call centre and listened to PPI calls.

Q990 Chair: So who was responsible for the PPI mis-selling in your view, in the Co-op? Who was driving the policy?

David Anderson: The vast bulk of the unsecured lending in PPI was sold in the early 2000s before I arrived in the bank, so it is difficult for me to say who was responsible for it at that time. Obviously, ultimately, the bank board, the CEO would be responsible.

Q991 John Thurso: Good morning, Mr Anderson.

David Anderson: Good morning.

John Thurso: Can we go back to the origins of the Britannia transaction? Neville Richardson testified that the first contact came from you to him, and I think you have just confirmed that.

David Anderson: It did.

Q992 John Thurso: Can you take me through why it was you made that call, and what was behind the decision to go and talk to him?

David Anderson: Yes. We had been reviewing the strategy for the Co-op's financial services businesses all together—I was CEO for the insurance businesses as well as for the bank—and we had looked at the investments that were needed. We had looked at the continuingly high cost base for the bank and we knew that we had to make very significant investments. We really did not have the distribution reach in order to get a return on those investments, so if we were to make those investments we had to do something. Our plan was twofold. We had a kind of more organic view, which is, "Let's work with the food retail business in the Co-op". We opened branches in food stores and so on to try to develop that, but that was slow-urn and unproven. At the same time the Butterfill Act was becoming law, which for the first time allowed one species of mutual to merge with another. We were very interested in that and the board formed the view that it gave us the opportunity to be involved in consolidation in the building society sector.

I think the board minutes for May 2006 record the fact that I am going to a building society conference to make contacts, and obviously I was previously CEO at the Yorkshire Building Society, I knew virtually all the building society chief executives, I knew the sector well. So Britannia was seen as a very complementary fit in terms of distribution reach—the 254 branches—the expertise in mortgages and savings that would help take the bank away from the over-dependence of unsecured lending, which I described earlier, and give us scale to make the investment in IT that we needed.

Q993 John Thurso: It would be fair to say that with your board you had conducted a fairly rigorous, strategic analysis of the Co-op Bank and seen some fairly significant potential future weaknesses going forward, and identified consolidation as the strategic answer to that. Would that be an accurate summary?

David Anderson: One possible strategic answer, not the only strategic answer. Because those sorts of mergers can never be guaranteed, it was one thread that would be pursued if it became available. The main thrust was the organic route that we could control ourselves.

Q994 John Thurso: When you made contact with Neville Richardson, that was with the complete knowledge and full support of your board?

David Anderson: There was knowledge I would talk to building societies. I would say my first conversation with Neville was probably before it was mentioned. I would have talked to the chairman about it within days of it happening, if not the next day—to be honest, I do not completely recall—and it would have been discussed at the next board meeting. It was then quite a slow burn because that first contact was made, I think, in May 2008 and it was July 2009 before the transaction completed. It was towards the end of the summer before any serious discussions took place. I met the Britannia chairman with my chairman—well, I had one more conversation with Neville, and then we met together with our chairmen. Then each organisation set up a small executive team to talk to each other.

Q995 John Thurso: Did it surprise you at all that Britannia was so receptive to your approaches?

David Anderson: Only to the extent of a natural caution. In the sense that, if you ask a question like that and get a positive response immediately, you would naturally think, "Oh, why would that be?" But as we talked, in fairness, my analysis of their situation was that they would be facing some of the challenges that I knew other societies faced, and the attractions of us as a partner seemed to me to be quite clear for them.

Q996 John Thurso: At what point in the discussions with Neville Richardson did you start to decide—the two of you—that this was a deal you wanted to take back to your respective boards?

David Anderson: I would say the chronology was about September or something like that. The Co-op have kindly let me review the board minutes for 2008 so, as far as I could see, October 2008 was the first substantive discussion in the Co-op Financial Services boardroom about the merger. There had been mentions before then but not a proper case discussion.

Q997 John Thurso: In answer to one of the questions the Chairman put to you, you testified that when you left it was your analysis that, as the Co-op was going to have a chairman, Britannia should have the chief executive—which is a very normal thing in a merger, so I completely understand that—but also that you thought it was in the best interests that Neville Richardson take that forward. You said that going ahead with the deal with him was much better for the Co-op than not going ahead with you carrying on, which I think was not a criticism of yourself but rather an endorsement of your views on the deal. With hindsight, looking back, do you still take that view or have you considered what elements you might do differently?

David Anderson: Obviously, in view of events, I have agonised over that. I believe that the businesses, together, need not necessarily have led to the difficulties that we see now. I believe that they could have been managed in a successful way and that, separately, both the businesses would have had their own challenges. Obviously it is very difficult to unravel four years of history and try to work that out. So I cannot say, yes, one was obviously right and one was not.

Q998 John Thurso: Could I ask you a final question? Looking back, would it be fair to say that the need of the Co-op to do a deal was equally important as the need of Britannia to do a deal, so this was a merger in which both sides felt it was a good thing to do a deal?

David Anderson: I genuinely believe that to be the case. We always discussed it as a merger of equals, and there was no other narrative going on.

Q999 Andrea Leadsom: Good morning, Mr Anderson.

David Anderson: Good morning.

Andrea Leadsom: This is astonishing timing. You have just said that your first talks were in October 2008, at the height of the financial crisis. Does it not strike you—in hindsight or at the time—that that was a bizarre moment to begin the talk about a merger of two equally successful mutual companies?

David Anderson: The merger conversation had started in May, but I take the general point. We were already in crisis by then and we were evaluating where we were in that crisis. Clearly, we would not have gone into a transaction without being able to look very, very closely at the position that the other business was in. At that point, based on reported results, both businesses were doing quite well through this crisis.

Q1000 Andrea Leadsom: But did you recognise that you were in the middle of a financial crisis that was about leverage and the potential for bank loans to be severely impaired by that crisis?

David Anderson: Most definitely. We were the clearing bank for Northern Rock, so at the end of 2007 we had seen very clearly what happens when those things go wrong, and it was a constant discussion around risk in the business as you would expect it to be.

Q1001 Andrea Leadsom: So why on earth would you take the risk of merging with another mutual at that point when, surely, there could not have been a riskier time to undertake a merger with another organisation that you did not know intimately?

David Anderson: Because, on the basis of the work we were able to do, we formed the view that the risk of the two organisations together was less than the risk of each separately and less than the risk of our organisation separately. There are minuted comments in the board that that was the conclusion that was reached. We had very full due diligence on the Britannia. We had advisers who had reached the conclusion that there was significant value to the Co-op in the deal. We could see a business case that produced very significant cost synergies that effectively were going to improve the condition of the combined, because that improved the collective profitability. At that time Britannia had stronger tier 1 capital than the Co-op. We knew the regulator had just conducted a review of its capital position. We knew it had passed the stress tests from the regulator. So, yes, looking back I can see that it looks as though it was a strange time, but we knew that at the time and we tried to take all the possible steps to take that into account.

Q1002 Andrea Leadsom: Presumably you read the report in the *Financial Times*, of 18 October 2008, saying that Britannia's profits had dropped by about 40% and that their arrears and provisioning were going up. Did that not make you worry, as a previously healthy entity, that actually you might be combining with the unknown at a time of absolute crisis never before seen in the markets? Did it not seem to you that that was a very high-risk strategy? What was your assessment of the reports in the *FT* at the time?

David Anderson: We were clearly able to look very closely at the trends in the Britannia books. We analysed those in great detail, so I knew a lot more detail than appeared in the newspaper. Our own loan book at the time was also getting worse—everybody's loan book at the time was getting worse—but we assessed that their capital position, combined with ours, put us in a better position than we were in on our own with all the other factors associated with merging.

Q1003 Andrea Leadsom: One director of the Co-op Bank said at the time, "Perhaps Britannia needs this a little bit more than we do". Were you aware of that view?

David Anderson: No.

Q1004 Andrea Leadsom: Do you understand what was meant by it?

David Anderson: That question was asked in our board room quite clearly, in the sense that—as I answered in response to Mr Thurso—if you get a "yes" to a question like, "Are you interested in merging?" you need to be extremely cautious about why you have got a "yes". So we were very keen to make sure that we understood what we were getting into. We asked KPMG to look at 10 different aspects of the Co-op's books. In fact the commercial loan book appears now to be the source of most of the provisions for losses. Losses as yet have not really arisen. But the provisions had no arrears in it at the time, save for two cases of tenants that had gone bad. From memory, one was MFI and the other one—forgive me, I have forgotten for a moment, but there were virtually no arrears in that loan book at that time.

Q1005 Andrea Leadsom: So was there any encouragement whatsoever, from the Government or the regulator, for this merger to go ahead? Was there any view expressed in your understanding?

David Anderson: There was healthy scepticism from the regulator, who put us through very, very detailed capital planning calculations over an extended period, at times to the frustration of the team when we were kept being asked to run another set of stress numbers through the books. There was no encouragement from political figures directly to me.

Q1006 Andrea Leadsom: My last question. Whose interest was this merger in? You must surely have recognised at the time that it was an extraordinarily high-risk thing to do, at a moment of unprecedented crisis in the markets, to merge two entities where clearly the direction of travel for the banking sector was only going one way. Whose interests was it in?

David Anderson: We firmly believed it to be in the interests of the members of the Co-op who owned the financial services business. That was the analysis that we reached. It was the analysis that the advisers reached, and in fairness it was the conclusion that the Treasury reached three years, later because this is the post-legislative assessment of the Building Societies (Funding) and Mutual Societies (Transfers) Act, which was the Butterfill Act. It was done in October 2012. To quote what the Economic Secretary put before Parliament, "The success of the merger resulted in a strongly capitalised mutual business with the scale to offer its customers and members a full range of financial services products that are ethical, mutual and co-operative". So for some considerable time afterwards, this did not look like a daft thing to do.

Q1007 Andrea Leadsom: So, with hindsight, do you still consider that that decision was the right decision, and is it just events since then that have led to a strange situation?

David Anderson: Clearly, it has not turned out as well as we would have wanted, and it has contributed to the situation that has arisen in the bank. I do not believe that on its own it has created the situation, and I—

Q1008 Chair: So it was the right decision in hindsight?

David Anderson: I believe it was the right decision to take at the time with the information that we had, and I cannot really say now what the full consequences were. Apart from anything else, I have not been on the inside of the Co-op's books for four years so I do not know what has been done and not done to manage that situation.

Q1009 Teresa Pearce: Good morning.

David Anderson: Good morning.

Teresa Pearce: I would like to talk a little bit about the merger and the financial advice you received. We have heard that the Co-op's auditors are KPMG.

David Anderson: That is correct.

Teresa Pearce: The Britannia's auditors were PwC and JP Morgan were the financial advisers on the transaction. Is that—

David Anderson: To the Co-op, yes.

Q1010 Teresa Pearce: Yes. That is correct. However, when Reverend Flowers appeared before us we asked him about the due diligence on the merger. He said there were three due diligence reports, the first by Deloitte and the second two by KPMG. Could you tell us who did the due diligence?

David Anderson: The bulk of the due diligence was done by KPMG. There was an initial process pre-January. There was an extra report prepared by Deloitte that, as far as I recall, was for the benefit of the trustees of the Co-operative Group pension scheme. It was designed to assess whether the covenant of the banking group, as a contributor to the funding of the pension scheme, was strengthened or weakened as a result of the transaction. Deloitte's conclusion was that the covenant of the bank was unaffected. It basically says it has not changed. It says it is neither better nor worse.

Q1011 Teresa Pearce: So Deloittes did an asset due diligence?

David Anderson: Deloittes did an overview piece for one particular group.

Teresa Pearce: For one particular area.

David Anderson: KPMG did due diligence over 10 headings that we gave them to look into.

Q1012 Teresa Pearce: Right. So who scoped that due diligence?

David Anderson: We did.

Teresa Pearce: But when you say "we"—

David Anderson: The team within the Co-op Bank that was overseeing the merger, me and three senior colleagues.

Q1013 Teresa Pearce: It was scoped by yourselves.

David Anderson: Yes.

Teresa Pearce: When you buy a house, you have a valuation survey or a full structural. Was this a full structural due diligence or was it a valuation due diligence?

David Anderson: I think it was a full structural. It was described by JP Morgan as a significantly more complete piece of due diligence than they would normally see in a transaction between PLCs. There is a board minute to that effect. That is not just my view. Clearly it was their view as well.

Q1014 Teresa Pearce: Do you have any recollection of how much you paid for that advice?

David Anderson: I do not recall exactly.

Chair: I am sure it was a lot.

David Anderson: It would be in the hundreds of thousands of pounds, I would think, but probably not the millions.

Q1015 Teresa Pearce: KPMG as your auditors and the KPMG team that did the due diligence—were they completely separate?

David Anderson: It was a separate team. The benefit of having the auditors business do it was that, clearly, they could give us a very good insight as to whether there were differences in accounting policies between the two businesses that might lead you to end up with a different profit figure that you would want to understand.

Q1016 Teresa Pearce: This belt-and-braces due diligence that KPMG did, which cost a lot of money—what were the conclusions of the work?

David Anderson: The report that I have recall of basically provided an assessment of the underlying trends in the different components of the business. So it went across things like taxation, provisioning, accounting policies, equality of the loan books, the trends in arrears. There were 10 topics of that nature, and I have a list of them. If you would like me to look for them, I have it just to hand.

Teresa Pearce: Perhaps you can send it to us later.

David Anderson: Okay. I will do that. I have a list of the 10 topics. It was a full piece of work. There was significantly less time pressure on this deal than is often the case because, at the time the due diligence was going on, the legislation to allow us to complete it was not complete. The statutory instruments that had to be laid before Parliament to implement the Butterfill Act—which was the Private Member's Bill that allowed the transaction—still had not been laid at that point. So, although we were already doing due diligence and talking to the regulator, there was no certainty at the end of 2008 that the transaction could proceed because the legislation did not really exist to permit it.

Q1017 Teresa Pearce: When the due diligence report came back to the Co-op and you all reviewed it, apart from this one piece of work by Deloitte's on the pension fund, did you instruct any further work, any drill-down?

David Anderson: With the big drill-down in the loan book that eventually seems to have turned out—forgive me for using that expression, because I do not know where the current provisions have come from except what I have seen reported, but it would appear to be the commercial loans in Britannia—the due diligence of that was followed up by our own team within the Co-op. In my view, this was a very, very experienced risk team, who we relied upon to put all our own corporate loans on the book, who were the people that reviewed the criteria that we used, and we sent them to look at the major loans in that Britannia book and the—

Q1018 Teresa Pearce: So when you got the due diligence back, you then sent your own risk team in to look at that aspect?

David Anderson: That is correct.

Q1019 Teresa Pearce: Did you look at any other aspects or was it just that aspect that concerned you?

David Anderson: No, we looked at other aspects. KPMG had not looked at the commercial book in great detail. We did that for ourselves. Other aspects that particularly concerned us were the nature of the securitisations, whether those held good to keep the assets away from the balance sheet and what the risks were associated with those; the nature of the intermediarial lending in the mortgage book, which was originated through Platform; and the nature of the risk that was being created by the property company that Britannia was setting up, called Illius, which they were putting some repossessed properties into, which was something that I had seen done in the early 1990s in the building society. So there were a lot of other areas that were followed up in great detail. As I said, we had time to do this because the time scale from start to finish was quite long.

Q1020 Teresa Pearce: Given what we now know, do you think there was too much reliance put on your financial advisers by the board?

David Anderson: No, we made the decision. The board made the decision. It was our responsibility. Clearly you are influenced by the advisers. There is no point in having them if you are not influenced by the advisers. We were influenced by the regulatory assessments. We were influenced by the advisers who were telling us this was a compelling transaction. We were influenced by the fact that reputable firms were involved at all stages, but we made the decision.

Q1021 Chair: Can I follow up one point you made there? You said that you sent your own team in to do the key due diligence on the quality of the loan book.

David Anderson: The detailed due diligence on the commercial loan book.

Chair: Yes, and also on the securitisation, so—

David Anderson: No, I think that was largely done by KPMG.

Chair: That was KPMG?

David Anderson: Yes.

Q1022 Chair: I see. On the due diligence on the commercial loan book, you sent in your own team, who at that time you had confidence in. But they did get it very wrong, didn't they? A lot of that stuff turned out to be poor-quality.

David Anderson: It was clear to us from what they reported that there were some parts of that loan book that were appraised differently than we would have appraised them. Specifically, their limit to an individual counterparty was greater and the concentration in some sectors was greater. There were some risks that they identified. We evaluated those as being acceptable in the context of the whole transaction. I think we were able to make £680 million-worth of fair value provisions against Britannia loans at the time of the transaction. That looked like a pretty solid insurance policy against problems that may arise in different parts of the book. From memory, about £300 million of that was for the commercial book and about £300 million of it was in the mortgage book. So we had been able to put significant protection in place.

Chair: I think Brooks Newmark has a few more questions in this very area.

Mr Newmark: Yes. Thank you for treading on my territory, Mr Chairman.

Chair: Opening it up for you, Brooks.

Q1023 Mr Newmark: There are about £970 million of loan impairments, of which roughly £560 million were distressed Britannia assets, and I think about £410 million were Co-operative distressed assets. In line with this, do you believe the significant impairments of the former Britannia assets raise questions over your advisers' professional skills judgment?

David Anderson: I assume those numbers are across the 2012 year-end and the half-year of 2013 that you are talking about.

Mr Newmark: Yes.

David Anderson: I do not, no, because I believe that they looked at them in the context of the economics at the time. They stressed them in accordance with various things. Obviously the exact environment that occurred was not the one that we looked at, and the performance has been significantly worse. On their own, would those £550 million of impairments have brought down the bank? Definitely not, and I think I am correct in saying, from what I can see in the accounts, that only about £80 million has so far been written off, so the rest of it is loans that are impaired in the future. The reason that that suddenly leapt up in 2012 was a change in the accounting policy. If you look at the way that bad debts were provisioned for in the bank accounts in the years after the merger, there was—

Q1024 Mr Newmark: The change of policy was brought about by what, then?

David Anderson: I believe it was brought about by intervention by the regulator. I do not know that because I wasn't there. But they started impairing at 30 days in the accounts instead of at 90 days. The very existence of loans means you get a funnel; loans start going a little bit bad, and then some of them correct themselves, but there is a funnel like that down to loans going bad. Moving from 90 days to 30 days would have produced a massive spike in provisions, and that is clearly an accounting policy that changes for the accounts at the end of 2012. I do not believe that the bank would have done that of its own accord, but I don't know.

Q1025 Mr Newmark: What you are saying is that effectively the money was well worth spending on your advisers, because the stress testing they did on the balance sheet and the assets and everything, even with the benefit of hindsight, was sort of satisfactory?

David Anderson: I believe, yes. I accept that that may sound a ridiculous comment in view of where the bank is now. I do not think it would have been reasonable at the time to expect them to have identified all the things that have come together to create the situation that the bank is in now, and realistically—

Q1026 Mr Newmark: But don't forget, this is not like 2008 or 2009, when effectively a catastrophic event took place, and therefore, I am not trying to second-guess. Due diligence was perhaps done in 2006, 2007 or early 2008 on what a balance sheet was like. This was effectively after a catastrophic financial event happened. You send in your advisers. The advisers do their stress testing on those assets, and the impairment of those assets, and still they really got it wrong. It is not that a massive event suddenly happened that they could not have predicted. The event had already happened.

David Anderson: £550 million of impairments sounds a lot. The net assets of Britannia at the merger were £1.6 billion, and the bank did not pay for those net assets. The synergy benefits that the bank reports from 2010 onwards are £50 million a year. So there is a benefit coming through on the other side, and the gap between those provisions and those benefits—

Q1027 Mr Newmark: Yes, but that is 10%. The synergy benefits are still 10% of the distressed assets that you were acquiring.

David Anderson: But they will be there every year.

Mr Newmark: That is still quite a long payback.

David Anderson: It is a long payback, but it is not enough to bring down the bank, is my point. I fully accept that the deal turned out to be not as attractive as we thought it was going to be. Do not let me attempt to give the wrong impression. It clearly did not, but I do not believe it brought down the bank.

Q1028 Mr Newmark: All right. This is my last question, and I do not want to put words into your mouth. What is your view now of, first, the advice that you received, and, secondly, the advisers on both sides of the table, that is KPMG and PwC, who I guess were the auditors of Britannia—

David Anderson: Correct.

Mr Newmark:—and JP Morgan and Citi who were the advisers?

David Anderson: I honestly believe they did the job we could have expected them to do at the time.

Q1029 Mr Newmark: You are happy. No criticism at all, then? I mean, fair enough, if that is what you believe.

David Anderson: No, I believe that.

Q1030 Mr McFadden: Just to finish on this issue of the advisers, we have had a lot of witnesses—past and present—from the Co-op in the last month or so on this inquiry. One of the features has been the structure of the Co-op Group—the fact that it is a mutual, it is owned by its members, it has this big executive committee and so on. Did the professional advisers take any account of the Co-op's specific model or did they give their advice as though you were just another high street bank?

David Anderson: There was significant cognisance of the co-operative model, because we considered the value for the members and the potential dilution of the dividend stream for members. So there was very clear understanding of who the owners were and what their interests were. There was a constant dialogue going on at the time about the capital position and our ability to raise more capital relative to other people. That was part of the board dialogue. I cannot specifically recall whether that was raised by the advisers or whether that was our own dialogue, but they would have been involved in that. They were in the conversations.

Q1031 Mr McFadden: Do you see what I am trying to drive at? Do you think KPMG understood and shaped their advice around the structure of a co-op that is owned by its members in a different way from, say, another high street bank that is owned by its shareholders?

David Anderson: I think it is important to understand the nature of what KPMG were asked to do. They were asked to investigate the books and to go into enormous detail in the areas that I have described. They were not asked to give a view as to whether this transaction was a good deal or not. That was the role of JP Morgan. They were the advisers. KPMG's role was much more of a research type than valuation.

Q1032 Mr McFadden: Perhaps I have mentioned the wrong advisers, then. Did JP Morgan understand the specific nature of a co-op and how that was different?

David Anderson: Yes.

Q1033 Mr McFadden: You believe they did. I want to talk to you a little bit about the wider implications of this for the mutual model. I will read out a quote: "Owing to the damage done by the credit crunch, people have been crying out for a new way of doing business with a financial organisation of substance that truly has their interests at heart". You will recognise that.

David Anderson: I do recognise the quote. That is why I smiled. That was my quote.

Q1034 Mr McFadden: Yes, that is your quote. Where do you think the collapse of the bank has left the mutual model in financial services?

David Anderson: As I said before, a whole series of events have come together to cause that collapse. Some of it you would have to ascribe to governance issues. I think that in every sector there are businesses that do well and businesses that make mistakes, and I think it is clear that in this case mistakes have been made. I fundamentally disagree with anyone who says that undermines the financial mutual model. I agree with the comments that Nationwide made when they announced their results this week. It is fair to say that the Co-op as a mutual bank was in a different position to raise capital from, for example, business societies going forward, and that was something that they were in discussion with, I think, the Treasury about. I am not sure. But they were trying to redress that position and get a specific way. It is a particular issue for co-operative banks in the UK that does not apply to co-operative banks in Europe. I believe that successful mutuals are a big part and an important part of our financial landscape and will continue to be so.

Q1035 Mr McFadden: Is it your view that the lessons that we learn from this inquiry should be focused purely on the Co-op Bank and the mistakes that it made—we have talked about Britannia, PPI, the Verde issue, the IT and all these things—and that there is no read-across to other mutuals in the financial sector?

David Anderson: Any time things go wrong there is always a read-across for every other organisation, but I do not think there is a read-across about the constitutional status. I think the lessons would probably apply to a proprietary bank just as much as they would apply to a mutual.

Q1036 Mr McFadden: The Co-op marketed itself as being different. To go back to your quote, that is what you were driving at—the Co-op said it was different. But the mistakes that it made were exactly the same as other banks—bad commercial loans, mis-selling of PPI, self-certified mortgages. You could go to many of the banks that toppled over in a financial crisis and it would be the same set of issues that caused big financial holes. In reality, how different was the Co-op Bank if it made exactly the same mistakes as other banks that got into trouble?

David Anderson: I think any bank that is in commercial lending is going to have some bad debts, so it is difficult to be different in that respect. I think the Co-op Bank owed an especial duty of care in the products it sold to its customers. I know everyone connected with the bank is deeply disappointed that the bank is caught up in that. I think the bank was fundamentally different in two ways. One was that it regularly turned down a large amount of business from particular types of counterparties that its customers said they did not want it to deal with—the armament sector, for example. That was very clearly a policy defined by the members that was delivered by the bank that made it different. So there were some key differences.

Q1037 Mr McFadden: Can that kind of thing survive in a structure where hedge funds are calling the shots rather than the Co-op's members?

David Anderson: The bank needed to make a profit when it was run for itself. The hedge funds still need to make a profit. If the hedge funds remove that plank of the Co-op's operation—the attempt to be more ethical—then they risk undoing what the bank stands for. I cannot say whether they will or they will not, or what commercial model they see. I am not party to that thinking.

Q1038 Mr McFadden: This is my last question. Richard Pym, the new chairman of the Co-op Bank, has stated that the new management team, "are planning to rebuild the bank into what it always should have been, and indeed, what it used to be". That implies that the Co-op Bank had moved away from its mutual roots, moved away from the values that ought to have been driving it. Do you accept that?

David Anderson: No, I don't believe I do accept that. The bank always strived to be that. I don't question the motivation of the people involved or what they were trying to do at any time, I really don't.

Q1039 Mr Mudie: Carrying on from where Pat was, as I see it, the mutual model means two things. One is that they get most of their money from their customers, and that is their base. Their customers accept, because of the model, that they are not in it for great profit, great returns. They expect a low yield. So that then affects the type of behaviour you can get involved in. But isn't the lesson of the Co-op—apart from the fact that serious mistakes were made—that Alliance and Leicester, Northern Rock and others who moved away from the mutual got caught up in high salaries for top staff and riskier markets in search of a higher yield, which led to destruction, whereas the mutual model is one of modest yields and less risky business? You seem to epitomise to me a very good mutual or building society individual—very, very careful, very, very sensible, and not with the idea that the business has great profits and you have to be on any bandwagon that will deliver money.

David Anderson: I do not know quite how to answer that, Mr Mudie.

Mr Mudie: Do your best.

David Anderson: I believe that building societies that have stayed closer to their traditional approach have remained more secure, and I believe that has turned out to be the best model. That is evident from those that now remain societies and from what happened to the societies that demutualised and chose a more leveraged model. So I think I agree with the statement you made.

Q1040 Mr Mudie: A second tiny question. Do you not think that the Co-op, apart from mistakes, was moving inexorably to a field where they were doing things that they might not have done—as Pym says, they should have been doing them and had done in past years—and then got into very dangerous territory that was almost inexorably going to lead to what happened to the other building societies that took the same path, and—

David Anderson: No, I do not. I beg your pardon; I didn't mean to interrupt.

Mr Mudie: No, go on.

David Anderson: I do not believe there was an inexorable path. There was a significant change in the balance sheet because of the merger with Britannia, but the activities that had been undertaken in Britannia were severely curtailed under the bank's ownership. In a sense, those assets came with the deal, but there was not an idea that that was the business model going forward. There was an expectation that they could be managed successfully. It turned out to be incorrect, clearly.

Q1041 Mr Ruffley: Good morning, Mr Anderson. Turning your mind to the due diligence that KPMG and JP Morgan did on the Britannia balance sheet, what did they draw most attention to, to you and the rest of the board? What were they most worried about?

David Anderson: The highest-risk areas were seen in the intermediary mortgage area and the securitised assets, so the nature of the transactions that had been done to take things away from the balance sheet and whether those were robust.

Q1042 Mr Ruffley: Did the board have a discussion about that?

David Anderson: Yes.

Q1043 Mr Ruffley: It is after your time, but the financial statements for 2012, as we know, state that Co-op Bank's impairment losses were concentrated in commercial real estate exposures, which originate predominantly from the Britannia business. What do you make of that statement?

David Anderson: Clearly there were more loans emerging from that relatively small part of the Britannia book than you would have expected. The total actual pure commercial lending from Britannia at the time of the merger was £2.2 billion. The whole book was just over £3 billion, but some of it was residential development and some of it was housing associations, which were relatively low-risk. But the pure commercial was a relatively small book, which as I have said KPMG reported as having almost no arrears at the time of the merger. It was also a book that was not recently lent. Most of it was quite well established. It had been put on the books over a four or five year period, so there was not a big surge in new things. At that time it would have been pretty hard to envisage that that was going to be the source of most of the problems, and we felt that that was closer to the lending that we did as a bank and we could better understand that. That is why we focused the advisers on things that we did not do as a bank, which were the sub-prime, the intermediary lending and the securitisations, of which we had significantly less experience on our team. As it turns out, those things have performed probably better or at least in line with the expectation at the time.

Q1044 Mr Ruffley: I want to ask some questions about the economic assumptions. Lehman went down in September 2008, and this deal was put to bed in summer 2009. It seems to me the that whole world—anyone who is a sentient human being—understood that the world had changed. Can you tell me what advice you recall your professional advisers, in particular JP Morgan, giving you on the future UK economic outlook post-Lehman?

David Anderson: Sorry, I am just trying to—

Mr Ruffley: It is incredibly material, isn't it, to what subsequently happened?

David Anderson: I do not remember a specific economic forecast discussion. What I do remember is discussions about different types of economic stress that the assets had been subjected to, such as variants on interest rates, variants on levels of house price falls and asset price devaluation. They were then worked through, and they said, "Well, if there is a 50% fall in house prices, the book will look like this. If there is an X% move in interest rates the book will look like this". They were not saying, "Here is one projection". The basis of the illustration of the book was a series of scenarios.

Q1045 Mr Ruffley: Which would have been done anyway, in good economic times or bad economic times. That stress testing is bog-standard.

David Anderson: The stresses were not bog-standard. The stresses went to 60% house price falls.

Q1046 Mr Ruffley: No, the stress test was something that would be done in the normal course of events, but there is a distinction between that and what the economic outlook was forecast to be by your advisers. That was very material to the catastrophe that befell Co-op Financial Services, was it not, Mr Anderson?

David Anderson: The economic outlook produced the loan losses that have occurred. It did not produce all the other things that, in my view, produced that catastrophic result. I have tried to be consistent on that. The loan losses were worse than we expected. The economic outlook was worse than anybody expected. We were working off stresses off the Treasury projections for the economy at the time, and honestly I cannot recall what those were. I cannot go through that line by line for you.

Q1047 Mr Ruffley: I am sure other colleagues will want to pick up on that. On the negative fair value adjustments that you took, it was £867 million against the Britannia loan book. Is that figure correct?

David Anderson: I do not recognise that figure. I think—

Mr Ruffley: It is in the 2009 financial statements.

David Anderson: I recall the figure against the loan book being something like £680 million. There were some other elements about interest rate fair value adjustments that were valuing securities which had a different rate from the market rate. I think against the loan book the figure was in the 600s, but it was a big number.

Q1048 Mr Ruffley: Who calculated that figure?

David Anderson: That would have been calculated by KPMG, because there is a very prescribed accounting approach to assessing what the fair values need to be on the merger, and it—

Q1049 Mr Ruffley: Was that discussed by the Co-op Financial Services board?

David Anderson: Yes, in great detail.

Mr Ruffley: So it was minuted.

David Anderson: Not just the board but the audit committee of the group, the group board and in fact the Co-op Bank risk committee. So there was a lot of committee and group discussion about these fair values and the risks associated with them, and whether or not even the existence of them suggested that this loan book was in trouble. Obviously at the time you could not fair-value the Co-op book. Because of the nature of the transaction, you can only fair-value the book that is being acquired, and that was—

Q1050 Mr Ruffley: No, absolutely, and the bigger the negative fair value adjustment the greater protection to your profit, which would obviate the need to take bigger impairments, so—

David Anderson: Our motivation at the time was to try to make that as big as we possibly could in accordance with the rules that existed.

Q1051 Mr Ruffley: But would you say that you were insufficiently conservative in arriving at that number?

David Anderson: I think we were as conservative as we were allowed to be by the auditors at the time.

Q1052 Mr Ruffley: Oh, so in coming to this figure you were very much led by KPMG. They gave you a figure, you discussed it, and they said it was—

David Anderson: No, we calculated the figure and they made an assessment as to whether they thought the calculation was in keeping with the accounting regulations that were in force at the time. They did not calculate the figure or profess it. Our financial team would have done it.

Q1053 Mr Ruffley: They blessed it?

David Anderson: Yes, they would have needed to for the merger accounts.

Q1054 Mr Ruffley: Yes. A final question, Chairman. In terms of the fair value adjustment, what proportion of that figure was to protect the bank against credit losses on the loan book and how much of it related to other variables, for instance the economic outlook and the outlook for interest rates in that economic forward look, there being a distinction between the two?

David Anderson: Yes, absolutely, my recollection is that there was around £300 million related to the commercial loan books, about £300 million related to the residential mortgage books and the remainder was about interest rate fair values.

Mr Ruffley: That is very helpful. Thank you.

Q1055 Chair: I want to come back to one comment you made a moment ago, that you were working off Treasury projections for growth. You were basically saying, therefore, that the message you were getting from the Government was that there was going to be a strong rebound, and you were using that as your base case.

David Anderson: No, there was a base case. I do not recall that "strong rebound" is a correct reflection of what we were being told at any other time. I think—

Q1056 Chair: I have the figures in front of me here—

David Anderson: Okay. I do not have those figures.

Chair: I have just been given them, and they show a forecast in the March 2009 budget for a very sharp rebound in GDP to well above trend growth.

David Anderson: Our figures would have been from the end of 2008 rather than March 2009, because—

Chair: It is from the Autumn Statement.

David Anderson: I guess so.

Q1057 Jesse Norman: Mr Anderson, you have said that KPMG, Deloitte's and JP Morgan advised you on the transaction. Could you give the names of the individuals who were leading those teams at each institution?

David Anderson: I believe it would be Tim Wise at JP Morgan and Simon Walker at KPMG. I did not meet the Deloitte team as they were working for the pension trustees rather than for the bank per se.

Q1058 Jesse Norman: Right. Thank you very much. Focusing on the impaired elements of the Britannia balance sheet, we have heard from Barry Tootell that there was particular failure and areas of risk based on the self-certified mortgage books—which I think you have mentioned—and also the distressed books received from General Motors, or GMAC. Can you just talk about the nature of those assets?

David Anderson: The GMAC loans were part of an origination deal that other lenders had been involved in as well. So GMAC originated the loans and then Britannia took them on to their book. By their very nature, they were less rigorous in the credit standards than the basic Britannia mortgage lending, so there was less proof of income, higher loan to values—that sort of thing.

Q1059 Jesse Norman: So these are car lease receivables that have been repackaged by GMAC and sold as an asset to Britannia.

David Anderson: I cannot answer that question.

Q1060 Jesse Norman: But that is how they come to be in the Britannia balance sheet, is that right?

David Anderson: I am not sure that they—

Jesse Norman: Britannia is not in the business of originating auto receivables.

David Anderson: I am not entirely sure they were car lease receivables, but the rest—

Q1061 Jesse Norman: But they were receivables, is that right?

David Anderson: They are receivables, yes.

Q1062 Jesse Norman: Right. But you did not look at what kinds of receivables they were?

David Anderson: The team would have done at the time, yes. I just do not recall that level of detail.

Q1063 Jesse Norman: How much did you in fact embed yourself in these different asset classes to satisfy yourself that they were as they had been represented to you?

David Anderson: I would be having almost daily discussions with the team involved, in the sense that we worked in an open-plan office. Barry Tootell was leading the due diligence, my desk was as far away from his as you are from me now, and he would be having a constant discussion with people over a prolonged period about what we were finding in Britannia.

Q1064 Jesse Norman: We know these things are very duff assets, and yet you seem unable to tell me what the character of this particular class of assets was.

David Anderson: Those assets have performed in line with the expectation that we had for them at the time, so the impairments that we made against them and the fair value is, broadly speaking, not off the Richter scale.

Q1065 Jesse Norman: So was Barry Tootell wrong to say that there were particular areas of risk in that area?

David Anderson: No, that is what we thought at the time. That is why we focused the due diligence in those areas. I think his answer was about why KPMG focused there and not on the commercial book. As I understand it, it is the commercial book that has since been the cause of the big problem, not those assets.

Q1066 Jesse Norman: Right. I understand. So you should have been more focused on the nature of the commercial book, and KPMG were not focusing on the commercial book.

David Anderson: No, the commercial book had no loans in it and we sent our own specialists in to assess it. Clearly, the performance of that book has not turned out as we would like. Could we have seen that at the time? I do not know. It carried on performing well for another three years. It had been audited by PwC for years before the merger. It was audited by KPMG for years after the merger apparently without deteriorating dramatically. It had been reviewed by the regulator. It had been reported on to credit rating agencies. Perhaps we should have seen what they didn't. We did not have to take the risk, and the core of this is that question.

Q1067 Jesse Norman: You made a commercial judgment about the quality of those assets—

David Anderson: We did.

Jesse Norman: —and they turned out to be much worse than you thought?

David Anderson: Yes. But I do not believe they turned out to be bad enough to bring down the bank.

Q1068 Jesse Norman: You have described the due diligence as an outstanding exercise and—

David Anderson: JP Morgan made that assessment.

Jesse Norman: JP Morgan made that point, and then I am sure it was of great satisfaction to the auditors to have that noted in the board minutes. You do not think it is like the case when the fellow says, "The operation was a complete success but the patient died"?

David Anderson: No.

Q1069 Jesse Norman: So it is a highly accomplished piece of due diligence that ends up with a £900 million hole in the balance sheet.

David Anderson: The £900 million is not connected with the due diligence. The £550 million write-off is connected with the due diligence. The fact that there were some write-offs is inevitable. So far only £80 million of those loans are actually losses, and £550 million on its own would not have created the problems that the bank has now. Clearly the loan book was considerably worse than we thought it was going to be. I would not represent it any other way, but I do not believe that it was sufficient to cause the situation that the bank now finds itself in.

Q1070 Jesse Norman: When you were working at the Co-operative, did you find yourself in any tension with Peter Marks?

David Anderson: No, not especially. I did not report to Peter Marks when I was in the Co-operative. I reported to the chairman of the Co-operative Financial Services business.

Q1071 Jesse Norman: So how would you characterise the relationships?

David Anderson: Normal business relationships. There were some things that we wanted to try to achieve together. We were both keen to get the financial services business more integrated with the group because, as I mentioned earlier, we saw an opportunity to work with the retail business and we launched joint stores.

Q1072 Jesse Norman: He was not driving change within the bank in any way.

David Anderson: No, he was not a member of the bank board at that time. The group finance director was a member of the bank board but the group chief executive was not, and we were driving the strategic agenda in the financial services businesses. When I say "we" I mean the Co-operative Financial Services team.

Q1073 Jesse Norman: As you look back at the committees that you attended while you were there, and the enormous numbers of people, in and around the bank, who in fact knew nothing about banking but were there because of the Co-operative's own structure, do you feel that the politics of the Co-operative was in some way defective?

David Anderson: Do you mean the democratic structure rather than the politics? I mean basically the—

Jesse Norman: Both areas. I am interested in the structure of it and whether that was effective, and I am interested in whether or not it bred a kind of internal politicking that was contrary to the best interests of the bank and mutual members.

David Anderson: I do not believe that that existed at all in the banking board, because we had external professional non-executive directors. In addition to group board democratically elected members, we had five professional non-executive directors on the bank board. That made the boardroom feel like other boardrooms in which I have been involved, to be honest. The group board was different. It had two constituencies. It had its elected members from the democracy, and it also had the chief executives of the largest independent co-operatives, because they had a say in the group as well. That did sometimes create tensions in that boardroom, because there were effectively two groups in there. We did not have that issue in the bank.

Q1074 Jesse Norman: The factionism of the group did not extend to the bank?

David Anderson: No.

Q1075 Stewart Hosie: Mr Anderson, at the time of the takeover, what discussions did you have with the FSA regarding Britannia?

David Anderson: I would have had quite regular discussions with our supervisory team for the bank and then one or two conversations with more senior FSA people. There were some things that the FSA had to help us with in order for the transaction to proceed. For example, PIBS, permanent interest bearing shares—which were part of tier 1 capital in Britannia—did not count as tier 1 capital in the Co-op Bank. That was a significant barrier to keeping the capital ratio where we wanted it to be. The capital was the same the day before as the day after but it had a different treatment in the bank's accounts. We agreed with the FSA eventually that they would view that capital in the same way as they had done before. So there was that type of nitty-gritty dialogue going on around the—

Q1076 Stewart Hosie: That is clearly a very specific technical point, but I understand why you raise it. In terms of the meetings, you said you met with the supervisory team and occasionally with more senior people. On the senior people, how many times would you and your senior management team have met with senior people in the FSA?

David Anderson: Personally, I think I can recall two or three meetings with senior FSA people during the course of the merger discussions. I know that, on an almost weekly basis throughout this period, the senior bank executives who were involved with the transaction were having conversations with the regulator, and probably on a daily basis at times.

Q1077 Stewart Hosie: That is really helpful. So the FSA were absolutely aware and familiar as this process of merger developed?

David Anderson: Definitely.

Q1078 Stewart Hosie: Who in particular did you meet at the FSA?

David Anderson: The bank's team, so our own supervisory team, was headed by somebody called Steve Riding. The more senior people who I think I met would have been Simon Green, who was one layer above normal supervisory activity, and I think the most senior person I met was called Clive Adams. I cannot tell you what his exact position was. I do not recall.

Q1079 Stewart Hosie: But you were happy enough that the people within the FSA were the right level of people for this merger?

David Anderson: There was no question that there was enormous regulatory involvement, because this type of transaction, by its very nature, had not happened before because we were using a new Act of Parliament. There was no reference point from previous transactions, so they had to be very, very closely involved. I would go as far as to say that I think it is likely that they were involved in helping to shape statutory instruments that went before Parliament, so that they fulfilled the requirements that they had from a regulatory purpose. So there was enormously close involvement.

Q1080 Stewart Hosie: I appreciate that. In terms of the nitty-gritty, then, what did they say to you or your team regarding the Britannia merger? Did they encourage it? Did they see the merger as a rescue, for example?

David Anderson: No. There was never any discussion of rescue from anybody that I was connected with or spoke to about the merger. I think it is fair to say they neither encouraged it nor discouraged it. My impression was that they were keen to make sure that we understood the risks. They were keen to make sure that we had done significant capital stress testing, and at times caused us frustration by asking for different stress tests, but they were not saying, "Yes, do this" or "Do not do this".

Q1081 Stewart Hosie: In terms of them wanting to make sure you understood the risks, did they ever express any concerns to you about the acquisition of the Britannia assets or even asset classes within the total Britannia book?

David Anderson: "Concern" is an interesting word. I am sure there would have been conversations about, "We need to be sure both sides have done the due diligence properly", those sorts of things. It was not concern in the sense of, "Do you know what you are doing?"

Q1082 Stewart Hosie: Just on that point, what would the FSA have had to say to you in order for you to say, "Hold on a minute, we are going down the wrong route here?" How large a warning would they have had to give?

David Anderson: That is a very speculative kind of question and I cannot say.

Stewart Hosie: I appreciate that.

David Anderson: Clearly if they had said, "No, we do not believe there is sufficient capital for this to take place", or "We believe that the risks associated with this set of loans under your ownership are great", or "We believe that you have miscalculated". I mean, I'm sure we were showing them all kinds of numbers, so they would have been looking at those numbers. If they had raised concerns about those numbers, then that would clearly have been very important to us. We were not relying on the FSA to make this decision. This was our decision.

Q1083 Stewart Hosie: That is what I was going to ask. Are you sure the FSA were not saying these things? Because in all of the hearings we have had with core people, the impression that I have had is that the enthusiasm and determination to do this deal almost at any cost was incredibly strong. Could the determination to see this through have blinded people to some of the warnings that may have been given?

David Anderson: Or could it be that the attractions that were clear for both parties in the merger were sufficient for the regulator to be enthusiastic as well? Remember, our analysis showed that the combined entity was safer than either on its own. So if you were the regulator, that would be attractive.

Q1084 Stewart Hosie: Let me ask one final question. Apart from the issue of capital, which I understand, did the FSA attach any conditions to its approval for the merger, other than making sure that statutory requirements were met?

David Anderson: Not that I recall, no.

Q1085 Stewart Hosie: In hindsight, do you not think that is a bit odd given what has happened since, or is it the same answer ain relation to the professional advice—that it was as good as it could have been at the time?

David Anderson: It had not occurred to me that they might attach conditions, so it is not a question I thought about. They could have had conditions about governance structures or perhaps raising capital levels to a different level, or those sorts of things. There was nothing of that type raised.

Stewart Hosie: Okay. Thank you very much indeed.

Q1086 Chair: Bringing all these strands together, in particular, you have stressed that you do not think that the impairments on the property book were enough to bring down the bank. In your view, what really did all but destroy the Co-op?

David Anderson: I said at the beginning tha I believe it is a combination of things. Clearly the £550 million write-off is unhelpful. Clearly the management—

Q1087 Chair: It is a bit more than that, to be fair. It is a bit more than that. Wouldn't you like to think of something a bit stronger than that, or a bit more accurate?

David Anderson: I do not believe on its own it would have brought down the bank, and I have made that—

Chair: I think you have.

David Anderson: But obviously it did not help. I believe the management distraction associated with the Verde bid was significant, and I had some experience of that directly as chair of the Reclaim Fund. Members of the Committee may know I am chairman of a wholly owned subsidiary of the Co-op, which is the Reclaim Fund, which is a banking utility to look after unclaimed assets. We had Co-op directors on there who were missing board meetings because of the pressure that they had to the point where, at the end of 2011, I asked for a different set of people to be put on to that board. So there was clear management stretch going on with everything they were trying to do. There were other big write-offs. We have talked about those on PPI and the IT. I believe the IT write-off was directly associated with the Project Verde bid, in the sense that the project was on track at the time of the merger. According to Mr Richardson it was on track at the time of his departure, but once you have chosen to use the Lloyds banking systems then clearly it becomes of no use. So that £300 million was a direct result of the Verde transaction. I think there were another £100 million of costs associated with Verde, so that bid clearly had a very big impact.

I also believe that the attempt to merge the bank into the group at that time probably had a very big impact. I think that is germane because quite senior teams across the bank that had all had to throw their hat in a ring for a job in the Co-op relatively recently, before the merger, then had to do it again when we merged with Britannia as we brought the businesses together. They then had to do it again because of Project Unity within the group, and then they were going to have to do it again for Lloyds Bank. Fundamentally, I cannot believe that that led to a sustained enthusiastic team. It just does not make any sense. I was not involved, but that is an outside view, so I believe that would have had a big impact.

Then at the end of this process there is a big accounting change that creates a big loss in the books, and then there is a change in capital requirement that creates a bigger shortfall, presumably, than would have been there otherwise, so—

Q1088 Chair: Well, that is a response to these problems, isn't it?

David Anderson: But imposing that at a time when all the other things have happened, in a hurry, seems to me to be guaranteed to bring a downfall. I accept we are then slightly into chicken and egg.

Chair: Yes, we are.

David Anderson: But I do think all those things together are pretty hard to withstand. How often in failures is that what you see? That it is actually—

Q1089 Chair: You have £300 million of PPI in there—perhaps it is more than that—which you feel was already on the books before you arrived, and for which you are not responsible. You feel that the property mis-valuation in the Britannia deal, the underestimation of the impairments, was reasonable. I think that was the word you used earlier.

David Anderson: I do. I don't recall it as reasonable, but it was much bigger than anyone would have wanted it to be.

Chair: Yes, but not—

David Anderson: I do not believe on its own it would have brought down the bank, but you put it together with £300 million of PPI and £300 million of IT and £100 million of costs. The thing about those other costs is that they are genuine losses that have gone. The loan book is still a provision. Those loans have not actually gone yet.

Q1090 Chair: Provisions are provisions. This is a bank.

David Anderson: But the money is still there.

Chair: Well, the provisions are provisions. This is a bank. The provisions are extremely important, crucial tools for bank management and safety.

David Anderson: I agree.

Q1091 Chair: What I am trying to get to is: what proportion of this you do feel yourself to be personally responsible for? While you are thinking about that question, perhaps I can just say we have had a stream of people before us, and the Banking Commission spent nearly a year with a stream of people before it, saying, "Well, it was all the general responsibility of somebody, of a group, but it wasn't any individual's responsibility". Individual responsibility was missing whenever we went looking for it. Nobody was prepared to take any. What I am asking you is whether you feel any personal responsibility for any specific parts of these things that have contributed to the severe weakness of the Co-op, and if so which?

David Anderson: I have made it clear that I feel as though I am responsible for initiating the merger of Britannia and overseeing the process by which that was evaluated. I do not believe the other elements of the problem can be associated with my tenure, in the sense that they happened after I left or before I started.

Q1092 Chair: You do not think that the team that you sent in to go looking for those impairments let you down? It was in 2009, remember, when commercial property was falling off a cliff.

David Anderson: They were looking at it early in 2009, the end of 2008. No, I do not believe they let me down.

Q1093 Chair: It was falling off a cliff actually from earlier than 2008.

David Anderson: I believe that they did—

Chair: Just to be clear—I am sorry to interrupt you—the correction in the property market began in 2007, didn't it?

David Anderson: Yes, there is no doubt we were already seeing this growing through 2008, as were Britannia. I do not believe that that team let me down, in the sense that I believe they did as good a job as could have been done at the time, with great care and with the right motives. I think at the heart of all this there is nobody involved in that part of the story for whom this created any personal benefit. Quite the opposite, in the sense that most of the people involved were going to be putting their own jobs on the line if they found in favour of going ahead with this deal. So I do not think there were any perverse incentives going on. I think they were acting for the right motives and did as good a job as they could.

Chair: Thank you very much for giving evidence to us this morning. We are very grateful to you for your direct answers to the questions you have been asked.