



Treasury Committee

Oral evidence: [UK Financial Investments Ltd.](#), HC
726

Tuesday 21 October 2014

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Members present: Mr Andrew Tyrie (Chair); Steve Baker; Jesse Norman; Alok Sharma; John Thurso

Questions 1-103

Witnesses: **James Leigh-Pemberton**, Executive Chairman, UK Financial Investments Ltd; and **Oliver Holbourn**, Head of Capital Markets, UK Financial Investments Ltd, gave evidence.

Q1 Chair: Thank you very much, both of you, for coming in to give evidence this morning. Can I begin by asking you whether you operate at arm's length from the Government, Mr Leigh-Pemberton?

James Leigh-Pemberton: Yes, we do in the sense that our day-to-day operations are determined by us. The UKFI board makes the decisions about how we should be allocating our resources, what we should be doing in order to discharge our mandate, and how we should be planning for the future to carry out the tasks that are set out in the framework document and the investment mandate. I think our experience has been that, when we do that work and its output is presented to our shareholder, in the vast majority of cases that output, after discussion, is accepted and we act on it.

Q2 Chair: Why is this phrase “operating at arm's length” now an endangered species in your annual accounts? You used to have, as a body when you started up, eight references to it, then it dropped to four, then three years ago to three, and then two years ago to two. There is now only one reference left in this document and none at the front of the document, but tucked away much further down. Is this just a coincidence?

James Leigh-Pemberton: I think so. It is not deliberate on our part to exclude it. I think that, in describing our activities, we have—

Q3 Chair: It is not a subconscious reflection of reality?

James Leigh-Pemberton: No, I do not think so because—

Chair: We should not read anything into this at all?

James Leigh-Pemberton: No. Our activities are determined by the framework agreement and by our investment mandate and I think that, certainly the way we read them, they imply a high degree of independence in terms of how we plan our activities and indeed how we execute them.

Q4 Chair: In our latest annual report the section entitled “UKFI’s role as an active and engaged shareholder” is copied word for word from the previous report—

James Leigh-Pemberton: Yes.

Chair: —except for the phrase “arm’s length”. Should we read anything into that?

James Leigh-Pemberton: It is not deliberate. It was not removed—

Chair: It is just an extraordinary coincidence that it has slipped out?

James Leigh-Pemberton: Well, we should take steps perhaps to make sure that it gets put back in because it is not a reflection of any change that has taken place since the publication of the previous annual report.

Q5 Chair: Do you think that the model you are operating is the same model you were operating when Alistair Darling created UKFI at the time of partial nationalisation?

James Leigh-Pemberton: I think that the nature of the activities is different because the balance between transaction, execution and the development of strategies to get the taxpayer’s money back versus stewardship has changed significantly. I imagine we spend less time now on the stewardship aspect of stabilising the banks and more time on the stewardship aspect of enhancing the banks’ investability and more time on the transaction, development and execution side.

Q6 Chair: When Alistair Darling explained to this Committee in 2008 the decisions that he took on 3 November, he made very clear that these firms would be run “at arm’s length from the Government” and that he wanted to do this to ensure that these companies are managed in a commercial way. That is the model, is it not?

James Leigh-Pemberton: Yes.

Chair: That is what people mean by the UKFI model?

James Leigh-Pemberton: Yes.

Q7 Chair: Are you reassuring us that that is still the case and that there has been no change, notwithstanding the evaporation of your commitment in the phrase in your annual report?

James Leigh-Pemberton: Yes, I am. The boards and the management teams of the banks remain absolutely responsible for the formulation of strategy and the execution of that strategy and it is our role, from a stewardship point of view, to act like most other institutional investors; that is to ensure that we are satisfied that that strategy and its execution is devoted to the preservation and enhancement of shareholder value and then to make sure that its execution is carried out on time and in a way that delivers that value.

Q8 Chair: When Sir Mervyn, now Lord King, said that he thought “the whole idea of having a bank that is 82% owned by the taxpayer run at arm’s length from the Government is nonsense”, are you saying he is mistaken?

James Leigh-Pemberton: I am, only in the sense that the model as it is—if we consider the evolution of RBS over the last 18 months—can be made to work. The board of the bank and the management team are engaged in a series of activities that are designed to bolster the bank's capital, shrink and simplify its activities and render it more investable for the principal purpose of developing shareholder value and making it possible to return it to the private sector. It is a model that is working efficiently and satisfactorily at the moment and I think that continuation on this path will mean that we can accelerate the process by which we get the bank back into the private sector, which I think is everybody's objective.

Q9 Chair: I am sure you understand that, in asking these questions, we are not necessarily casting any aspersions on the way you are trying to do your job. Indeed, I think it was the view of this Committee that your predecessor did a particularly good job in very difficult circumstances and no doubt you are trying to play the same set of weak cards. However, you are also flatly contradicting the conclusions of the Parliamentary Commission on Banking Standards, are you not, in coming to the conclusion that you should carry on, given that the Commission felt it would be more sensible to admit reality and reabsorb UKFI into the Treasury?

James Leigh-Pemberton: Yes. My comments are based on one year only of activity at UKFI and my observations of what had gone on before I joined the company, but I think it is worth saying that there have been a number of occasions during the course of the last year where, in my view at least and I think in the view of our board, some of the advice and judgments that we have given have been value-creating for the taxpayer. We have made some recommendations on topics like capital allocation, pace of execution of strategy and so forth that have been perhaps not directly in line with the first instincts of the Chancellor or Treasury colleagues but that we felt were important in the context of ensuring that the strategy was carried out in a way that helped to develop the equity value of the company. My experience is that those recommendations and that advice has been taken.

Secondly, I think it is probably fair to say, as was reflected in the NAO's report both on the sale of Northern Rock and on the first sale of Lloyds—they have not written a report on the second sale—that the availability in-house of the expertise to execute transactions like that is of value to the taxpayer.

Q10 Chair: The allegation will be that it is quite convenient for chancellors to have a buffer to help explain the decisions that they are taking.

James Leigh-Pemberton: As I said, my experience anyway in the last year has been—

Chair: Is that that is an unreasonable description of what they are doing.

James Leigh-Pemberton: Yes. I think, for the most part, things have gone in the other direction; that is, we make suggestions and seek approval to execute them and, for the most part, those suggestions are accepted and we receive that approval.

Chair: I think that is a very helpful piece of evidence.

Q11 Alok Sharma: Could I just explore this whole issue around management governance a little further? You have made the point that you are independent. You have made the point that you are there for preservation of shareholder value and, I assume,

increasing shareholder value. First, was the decision that UKFI took to inform the board of RBS that it would vote against the AGM resolution seeking the approval for bonuses up to 100%, your decision entirely? Secondly, how is that value creating?

James Leigh-Pemberton: We made a recommendation in connection with the 2:1 resolution to be put to RBS shareholders in which we suggested that indeed such a resolution should be put to shareholders and—

Q12 Alok Sharma: Were you ever told by the Treasury or the Chancellor or any Treasury Minister that that was what the Treasury wanted, or was this entirely your decision?

James Leigh-Pemberton: Sorry, just to get the sequence of events, the original recommendation that 2:1 was a good idea was entirely our suggestion, and we made that suggestion because the greater the proportion of variable remuneration in banks the greater the alignment between the remuneration arrangements and the interests of shareholders. As I think has been discussed both by the Parliamentary Commission on Banking Standards and the PRA and indeed the Bank of England, more variable provides better alignment with shareholder interest. It provides more scope for claw-back. It provides more scope for malus. It is more desirable from an alignment point of view. It was on those grounds that we made the recommendation that we did in the context of a possible 2:1 resolution for RBS and the outcome of that was that there was further discussion.

The conclusion was reached that those narrow grounds, which are defined by our mandate, had to be set against considerations arising from the very high level of public interest that there was, and I think remains, in remuneration at RBS, and the fact that RBS had not progressed as far as Lloyds in its recovery or progressed as far as Lloyds in terms of being returned to the private sector. Taking that into account, in order to avoid a major public controversy at a time when the bank was travelling well in terms of the execution of its strategy, it was more appropriate not to put that resolution to shareholders. That was the decision that was made with the agreement of the RBS board and with UKFI and the Chancellor.

Q13 Alok Sharma: What you are telling us is that this was not solely a decision by UKFI?

James Leigh-Pemberton: It was not solely a decision by UKFI, no.

Q14 Alok Sharma: It was a joint decision with other members of the RBS board and the Treasury?

James Leigh-Pemberton: After discussion with all parties.

Q15 Alok Sharma: You talked about enhancing shareholder value. What is the commercial benefit to RBS of restricting bonus payments, especially if they are not in line with the rest of the market and there are issues around staff retention? How did you justify that? At the end of the day, as you said, you are there to create shareholder value and to return a bank to private ownership.

James Leigh-Pemberton: Our starting position on this and the advice that we originally provided acknowledged that it was in shareholders' interests on those narrow commercial grounds that a 2:1 proposal should be put to shareholders. We had to take into account the fact that if there was a material public controversy associated with that proposal it would not be in the interests of RBS reputationally, it would not be in the interests of the company as a whole as it continued to pursue its strategy successfully and that, taking all of those factors into account, it was appropriate not to put that resolution to shareholders.

Q16 Alok Sharma: Going back to this point about paying competitively and staff retention, was there ever a pushback from RBS to say, “If we want to hang on to staff and we want to make sure that we are starting to pay towards the rest to the market perhaps we ought to have this resolution passed”?

James Leigh-Pemberton: Yes. RBS made it clear to us, and we had already reflected this in our advice, that there could be risks to retention and risks to attraction of new employees from them being an outlier in this regard.

Q17 Alok Sharma: In terms of your knowledge, is that the way it has played out?

James Leigh-Pemberton: Yes. We have spent a lot of time with RBS senior management and divisional management just to identify whether this has turned out to be a problem or not. I think one has to be careful about this because these phenomena, in my experience, tend to take quite a long time to manifest themselves, but so far it would appear that there has been no material damage to RBS from a competitive point of view as a result of this. As RBS themselves said at the time, they have of course taken steps to accommodate the 1:1 cap on the one hand and the need to continue to pay as competitively as they can within that constraint on the other. I think they have managed it well so far.

Q18 Alok Sharma: Can I turn towards this whole issue of independence of UKFI from the Treasury? You outlined earlier to the Chairman what you consider the role of UKFI to be to work within the framework. Do you feel that UKFI is independent of the Treasury? Do you need to be independent of the Treasury to work?

James Leigh-Pemberton: The first question: yes, I do. As I said, in our board meetings and in our day-to-day operations we formulate our own strategy and our own book of work, which is based on the requirements of our framework agreement, and we go through processes to set our priorities. We carry out that work and deliver its output and we are left wholly independent in so doing. The output itself we therefore consider to be completely independent and in the vast majority of cases, as I mentioned earlier, we find that that output is accepted by our shareholder, by the Treasury, and we act upon it.

Q19 Alok Sharma: Can you give some examples of where it is not accepted and what the result of that has been in terms of the final decision?

James Leigh-Pemberton: In my experience it is very rare that we get to a point where there is outright conflict.

Q20 Alok Sharma: I am only repeating what you said. I think you implied there are some instances where you do not have that agreement. What I am asking is for you to tell us a couple of those examples and for us to explore what subsequently happens as a result of a disagreement.

James Leigh-Pemberton: I suppose one such example would indeed be that we ourselves submitted some advice in relation to a 2:1 resolution for RBS and there was a different outcome. That was a good example of what I am talking about, which is that it is an iterative process of discussion where all the factors are taken into consideration.

Q21 Alok Sharma: Just going back to the point the Chairman made about the report from the Parliamentary Commission on Banking Standards, which basically said that UKFI is effectively a proxy for the Government. You refute that?

James Leigh-Pemberton: I think the way that I would characterise UKFI is to say that it has a clearly-drawn mandate and the task of its board and its management is to carry out that mandate. I think the way in which one would read its mandate, or the way in which its

mandate should be read and the way that we read its mandate indeed, is that we are independent of Government. We are independent of the Treasury. The Treasury is our shareholder. We are accountable to our shareholder. We are accountable to our shareholder in perhaps the same way as any wholly-owned subsidiary with its own governance organisation is accountable to its shareholder but has its own independent existence as well.

Q22 Alok Sharma: On the point of this RBS bonus, why did you fail to resolve this disagreement, because I know that part of your mandate is to try to make sure that things work smoothly?

James Leigh-Pemberton: As I said, in the end the conclusion that was reached was a conclusion that was accepted by all parties. I think we reached that resolution in the end. In terms of “did things go smoothly”, the outcome was that in excess of 99% of the votes at the RBS AGM were in favour of the remuneration arrangements for 2014. So far there has been, as a result of this, relatively little interruption, almost none, in what has been a pretty successful year in terms of strategy execution for RBS and getting the stock into a more investable condition.

Q23 Alok Sharma: Are you opposed to UKFI being reabsorbed into the Treasury? Some people would see you effectively as a proxy of the Treasury, so you might as well be sitting in the Treasury rather than having a pretence, if I can call it that, of independence.

James Leigh-Pemberton: I think that there would be a loss of benefit were that to happen and the reason I say that is because of the independence of planning and execution that I referred to earlier. I think it is important that there is a body that is focused exclusively on the objective of formulating and realising plans to get the taxpayers’ money back and, because of the size of these transactions, these are complicated operations that need careful planning. In my view, they also need sensitivity to market conditions in order to ensure that each step enhances the prospect for the next one. In other words we have to be very careful in our planning and in our execution to ensure that the disposal programme and the realisation programme carries with it the aura of success. Those are all things that are helpfully carried out by an independent entity that is focused exclusively on that undertaking.

Q24 Chair: That is a very helpful piece of evidence but you will forgive us if we take it at something of a discount since it is very rare indeed for people representing bodies created by the Government to come before us saying, “The sooner we are abolished the better”. I am sure you will appreciate that.

James Leigh-Pemberton: Yes, I understand that.

Q25 Steve Baker: Clearly, it is a very important, high-profile job for exactly the reasons you have just intimated. Could I just drill into part of the exchange you have just had and ask you specifically, when you have these iterative discussions, with whom are you having those discussions?

James Leigh-Pemberton: It depends a lot on what the issue is but they tend to be with Treasury officials in the first instance and, as we lead up to the point of decision or briefings are required when we are requested to do so, those discussions will be with Ministers.

Q26 Steve Baker: When you say “officials” at what level of seniority and do you include special advisers?

James Leigh-Pemberton: Officials at all levels of seniority up to and including Second Permanent Secretary and, from time to time, Permanent Secretary. When we have meetings with Ministers those Ministers will tend to have with them their special advisers.

Q27 Steve Baker: Do you see the special advisers apart from the Ministers?

James Leigh-Pemberton: From time to time, but much more frequently we will have our dialogue with Treasury officials and then with Ministers and special advisers together.

Q28 Steve Baker: Do you see advisers from No. 10?

James Leigh-Pemberton: No.

Q29 Steve Baker: Reflecting on what you have just said, it sounds like you are having an awful lot of meetings at a great many levels throughout the Treasury. How do you structure those meetings so that you maintain the independence that you have emphasised?

James Leigh-Pemberton: As I said, most normally they will be organised in a way where we will present some materials, there will be a discussion about—it depends a lot on what the topic is but most normally we will present materials, there will be a discussion at that meeting about how the project should be taken forward and how we should execute and that is how we do them.

Q30 Steve Baker: Forgive me, I did not mean quite the structure of the meeting within itself but the arrangement of the kinds of meetings that you have. It feels like you are having a large number of meetings. How do you decide what meetings to have, with whom and when?

James Leigh-Pemberton: It is by topic. For example, we will have a regular working-level meeting; topic: disposal of Lloyds' shares.

Q31 Chair: Why do we not take a look at the proposed case study this morning. Tell us how many meetings you had on that?

Steve Baker: On the bonus decision, yes. Who did you meet when in relation to the bonus decision? I have some further questions to try and drill into some of these particular details. What I am trying to get at is to what extent has the Chancellor's view and the view of his special advisers been communicated to you? I am trying to understand this degree of independence.

James Leigh-Pemberton: In that particular case what happened was that we made some proposals. They were communicated to Treasury officials and to the Chancellor. We furnished our advice. We got back some reaction to those and we—

Q32 Chair: This is all taking place in writing at this stage, is it?

James Leigh-Pemberton: Yes. Our proposals were done in writing. We got back some reaction from that. We then had telephone conversations and meetings to discuss the various different aspects and possible consequences of different decisions and then there was a set of discussions towards the end of the whole process that were designed to try to bring all those various considerations to a conclusion that took them all properly into account.

Q33 Steve Baker: I do not think we have quite got to the essence of how many meetings are being had between whom. How often do you meet them?

James Leigh-Pemberton: How often do we meet?

Steve Baker: How often did you meet the Treasury and at what levels in order to get to the decision you reached?

James Leigh-Pemberton: In that particular case in fact, because it was a single issue that was time limited, we did not have an extensive series of meetings. I cannot remember precisely how often we met with Treasury officials but I would say—

Q34 Chair: Perhaps outside this meeting you could go away and take a look at your records and give us a list with a timeline so that we can get a feel for how these contacts are being conducted, at what level, with respect to a specific decision and I would have thought the bonus would be a good one for us to look at.

James Leigh-Pemberton: By all means.

Q35 Steve Baker: Thank you. I would like to come back in a moment to your particular role and the governance implications of it but, just on this theme, the Treasury has the power to compel the board of UKFI to follow a particular course of action. Has that power of direction ever been used?

James Leigh-Pemberton: No, not to the best of my knowledge.

Q36 Steve Baker: Has the Treasury ever threatened to use it?

James Leigh-Pemberton: No. I have no experience of that kind of thing happening.

Q37 Steve Baker: The power requires the board either to comply or resign. Has the existence of the power ever influenced your decision-making with regard to a disagreement with the Treasury?

James Leigh-Pemberton: No. In our board meetings, since I have been involved in the company, I have not had any experience where the decision-making has been dictated by the existence of that possibility.

Q38 Steve Baker: To what extent is your independence compromised or perhaps even enhanced by this tension that you could lose your job over a conflict?

James Leigh-Pemberton: I used the parallel earlier of the board and management team of a wholly-owned subsidiary. It is precisely that role. I think the way I see it and the way the board sees it is that we are 100% owned by a single shareholder. Therefore, we are by definition beholden to them but, given the existence of the framework agreement and our investment mandate, that does not mean that an independent existence and an independent *modus operandi* to carry out the tasks set by the framework agreement is impossible. In fact, far from it. I think the purpose of the organisation in part is to exist with that degree of tension.

Q39 Steve Baker: Let us drill into one of these specific points on tension because since UKFI was founded in 2008 it has had four chief executives and four chairmen. How long can we expect you to stick with it?

James Leigh-Pemberton: I will stay for as long as I am acceptable to our shareholder. I am wholly committed to this job and I perhaps have the advantage of some of my predecessors, unfortunately, of being somewhat older than them, which means that I might have the luxury of being able to stay put, as I said, for as long as I am considered acceptable by our shareholder. In the end they have the right to make these decisions but I am very much committed to staying.

Q40 Steve Baker: You, of course, are executive chairman. The roles were combined in January 2014. Are you confident that you alone are able to effectively take on both the responsibilities of chairman and chief executive?

James Leigh-Pemberton: It is a small company in the sense that the number of people involved is not great. We have 16 full-time employees. We are not complicated in terms of risk management and processes in the sense that we have no capital decisions that we have to make. We have no capital to invest. We have no capital to put at risk. We have an operational framework that we must adhere to with great care but I think that, given all of that, it is possible for the board to be constructed with an executive chairman. We have taken steps to ensure that we have the right kind of governance balance. We have refreshed our board and we will be putting arrangements in place to have a senior independent director so that all the non-executives will have somebody other than me that they can go to and who can exert some authority over the proceedings of the board.

Q41 Steve Baker: I think the points you have made about UKFI itself, of course, are well made but surely the scale of the investment that you are managing means it is critical that the governance arrangements are just so. When I look at the UK Governance Code, "There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision." It goes on, "The roles of the chairman and chief executive should not be exercised by the same individual." I have worked for start-ups with an executive chairman, which seems fine, and I think the arguments you have extended apply in those circumstances. Can you see that there is a degree of weakness to those arguments given the scale of the investment in the banks that the taxpayer has made?

James Leigh-Pemberton: I do not think the validity or not of the arguments relating to how UKFI operates is proportional to the absolute value of the assets under its management. In short, the complexity of our operations and the difficulties of staying on top of them and making sure that all our directors have a good line of sight into how the company conducts its affairs, those things are not determined by the absolute value of our holding in RBS. I think we would be doing the same things and operating in the same way if we owned 10% of RBS or if we owned, as we do, 81% of RBS.

Q42 Steve Baker: Of course your influence is very different, isn't it?

James Leigh-Pemberton: That is absolutely correct, but it does not alter the fact that we would still be going about our operations in the same way.

Q43 Steve Baker: My constituents will be acutely concerned about the outcomes that you achieve. This far into the job, how do you see yourself personally doing in terms of delivering for the taxpayer?

James Leigh-Pemberton: In the last year we have realised in excess of £7 billion from the transactions that have been completed by UKFI and I think, therefore, we have accomplished what we are charged to do by our framework agreement in that respect. Secondly, it is probably fair to say that we have been very active on the stewardship side and the progress that has been made at both RBS and at Lloyds in terms of moving towards the point at which the taxpayer's money can be returned in full has been quite rapid during the course of this year. We have made a large disposal, just recently announced from UKAR, of a portfolio of part-priced mortgages, which has accelerated what was already a good rate of rundown of their balance sheet. As long as we have in

sight the mandate set out in our framework agreement and as long as we have the means by which we can carry out those tasks then I think we will be able to make good progress.

Q44 Steve Baker: You particularly mentioned stewardship and I think earlier in your evidence you said you are spending more time on stewardship now than perhaps in the past. Of course, one of the acutely sensitive issues is remuneration within the banks and we just this moment touched on the degree of influence that you have as a shareholder of such scale. Can I just draw your attention to a speech—I think it was only yesterday so you may not have seen it—by Jon Cunliffe at the Bank of England. Did you see it?

James Leigh-Pemberton: I did, yes.

Q45 Steve Baker: Thank you. One of the things he said is, “Another driver of low returns on assets and equity is the fact that banks’ pay bill has not adjusted to the smaller returns banks are now earning.” I will not read the whole section since you have seen it but, just for the record, he pointed out that shareholders have gone from getting 60 cents for every dollar in pay for staff to getting 25 cents per dollar, and that is globally, “Across the big UK banks in 2013 the fraction had fallen to just 2%, i.e. to 2 pence per pound paid to staff.” Just very specifically on this issue of stewardship, what are you doing to ensure that remuneration within the banks adjusts to correct this trend?

James Leigh-Pemberton: We have a very active engagement with both banks’ remuneration committees and in fact last year, in respect of the 2013 performance year, it was precisely this topic with both of them that informed a lot of our discussion. I think Sir Jon’s speech refers to a number of factors that have led to this, one of them being specifically the very significant conduct charges, which has obviously reduced statutory profits, which then result in the 2 cents per dollar outcome because of the significant charges below the line to the statutory profits from PPI and the like. We had a very specific conversation with both banks on that topic because statutory profit is a very important measure for us as well as the operating profit and the impact of those losses were reflected in reductions in the banks’ bonus pools from the levels that were originally proposed for that very reason.

I think it is also worth saying that there is a second aspect to what Sir Jon said in his speech yesterday, which is that one of the reasons why this has happened is that the adjustment in wholesale banking—and especially in what he refers to as the FICC area, which has a high concentration of very highly-paid risk-taking traders—there has been a very bad coincidence of falling returns on equity in those areas because of higher capital charges and not enough adjustment to the pay levels of those particularly highly-paid individuals, which has been a material contributor to the phenomena that you described. I think one of the strategic decisions that has been taken by both Lloyds and RBS is indeed to shrink, meaningfully, their level of exposures to those areas of wholesale banking precisely because the returns on equity, after all charges including the costs of employing the people who are able to run those businesses satisfactorily, are not satisfactory.

There are two ways in which I think this has been reflected in our stewardship. The first is direct drive into the size of bonus pools but the second is in our discussions about capital allocation and strategy at the banks.

Q46 Steve Baker: We all sit here answering to a public who will still be very angry that they have bailed out banks that now seem to be delivering a low return to shareholders, where remuneration is still very high by the standards of the rest of the country. What will

you say, very simply, to our constituents who will still be very angry about what has happened to the banks and the levels of remuneration?

James Leigh-Pemberton: I would say the process of getting their money back has started and we intend that it should continue, that the process of reducing significantly the absolute amounts of compensation that are paid by these banks remains intact, and the downward trend in the pay bills at RBS and Lloyds is something that we intend to pay careful attention to in the future.

Q47 Steve Baker: Forgive me because I am conscious that I have taken a lot of time. I just want to wrap up a couple of more things. Looking at your objectives, where do you see, among your priorities, and what do you think will be the most challenging areas for you?

James Leigh-Pemberton: Our priorities now are to continue the process of realisations. Our biggest challenge is to be able to do so at a pace and in a size that means that we can make real progress, particularly in the context of the fact that we are very much dependent on market conditions and being able to pick the right moment to effect these realisations, because they are in absolute terms very large sums of money. I have put this within two categories. That is our first, returning the taxpayers' money.

Our second is to work with the banks so that the relationship between the improvement of the experience of the customers of the banks and shareholder value is as embedded as possible inside both of the banks where we have shareholdings.

Q48 Steve Baker: I feel I should give way but, if I may, I would like to ask one last question, which is this. You have not published any specific targets alongside your objectives so how should the public and Parliament gauge your success?

James Leigh-Pemberton: Quantitative targets are very difficult for us to identify for the reasons that I described earlier. We cannot ignore market conditions and their variability and if we think about how receptive markets might have been to selling £4 billion worth of Lloyds' stock at various different points during this calendar year, for example, they have varied enormously. From our standpoint, the most effective means of measuring this is through the mechanisms of the National Audit Office and their determination as to whether we have delivered value for money and whether we have done it on a timely basis for the taxpayer.

Q49 Jesse Norman: Just to pick up a point Mr Baker raised on bonuses, Mr Leigh-Pemberton, what you have said, summarising Jon Cunliffe's talk yesterday, is that the bonuses paid in the banks are resistant to fines; they do not come out of the bonus pool in the sense that they get charged their reduced profit and then out of that bonuses are paid. The second thing you said is that they are resistant to capital charges. Have I understood what you said right?

James Leigh-Pemberton: No, I am sorry if I gave that impression. I did not mean to. I think in fact the reverse. What I was trying to say is that the relationship between the size of bonus pool and the charge to the operating profit line arising from conduct charges is a close relationship in our mind. To be more blunt, the way we think about it is this. The monies paid to the FCA or to anybody who has levied these fines are effectively coming straight out of shareholder value. They are a direct diminution to TNAV and to earnings. Therefore, whichever multiple you use to value the stock, whether it is a multiple of both or whether it is a multiple of earnings, it has an impact on the stock price. What that means in its turn, therefore, is that from our standpoint our value is diminished by those fines and

we want the cost of those fines to be met to the greatest extent possible out of bonuses paid to staff rather than coming straight out of our pocket.

Q50 Jesse Norman: I am very glad to hear that. Thank you. That was an unequivocal, pleasingly straightforward statement. You are going after these guys to make sure that that happens as much as possible, where you increase the percentage full stop?

James Leigh-Pemberton: As much as possible. Unfortunately, given the size of some of these fines, as a practical matter of fact it cannot happen on a like-for-like basis, clearly, but the principle is a very important principle for us. It has a direct impact on the capacity of these banks to pay dividends, which has a direct impact on the marketability of the shares, which in its turn has a direct impact on our ability to discharge our mandate.

Q51 Jesse Norman: These guys sold the PPI, in many cases, and they should be paying for them.

James Leigh-Pemberton: These organisations did. The issue becomes complicated because of the question of legacy conduct charges and current management and how the burden should be shared. The fundamental principle, which I think you have already seen it reflected in public statements that have been made both by the chairman and the chief executive of Lloyds Bank, that it is the task of remuneration committees to look closely at the impact of these conduct charges and how they are then reflected in remuneration is one that we are very focused on.

Q52 Jesse Norman: Just to be clear, it is not just the person who may have done the mis-selling. It goes up the management chain to the people who are responsible for that, so that senior management is being penalised at least as much pro rata as the people they supervised?

James Leigh-Pemberton: There is evidence of that in the history of the RBS wholesale banking bonus pool. There is direct evidence of that.

Q53 Jesse Norman: Just for the avoidance of doubt, it would not just apply to retail selling scandals. It would also apply to things like the LIBOR fixing fines and those kinds of things.

James Leigh-Pemberton: As it did in concrete terms in the case of RBS in the past, yes.

Q54 Jesse Norman: That is helpful. Am I right in thinking that what stops you from exercising as much influence as you might like is a worry about people just jumping ship and taking a lot of the profitability of the institutions with them? It is the nature of the jobs market for some of these high-priced individuals. Is that a concern for you?

James Leigh-Pemberton: It is a concern and I think it is important to emphasise that it is not just in the wholesale investment banking area that that is the case. We are particularly concerned by the demand and the potential imbalance of supply and demand for talent in areas like risk, compliance, product control and other areas of treasury and perhaps, more than ever now, in systems and IT.

Q55 Jesse Norman: You would like to be being tougher on bonuses that are still way out of whack but you can't because of the particular nature of the employment markets for these functions?

James Leigh-Pemberton: That is correct, with particular focus on these hotspot areas.

Q56 Jesse Norman: You cannot co-ordinate with other banks because that would be a cartel in the labour market, but you can certainly try to recruit them to your way of thinking.

James Leigh-Pemberton: Yes.

Q57 Jesse Norman: That is helpful. Do you think the big banks are being run in the interest of their shareholders at all?

James Leigh-Pemberton: I think it is increasingly the case right now.

Chair: That was a skilful reply, that one, if I may say so.

Jesse Norman: That sounds like a “no, but we are working on it”.

James Leigh-Pemberton: I was just going to say that I think the numbers evidence underpinning what Sir Jon Cunliffe had to say yesterday, those are the numbers.

Q58 Jesse Norman: “No, but we are working on it” is an accurate summary of what you are saying?

James Leigh-Pemberton: I think there has been a significant improvement and the evidence of that can be seen in how much interest we hear—and I will say a word about this in a moment—is being expressed to us now by other institutional investors in RBS, for example, and the fact that we have been able to make disposals in Lloyds. These are very sizeable disposals in Lloyds. These are evidence now that, certainly in those banks anyway, a focus on delivering shareholder value and running the business for shareholders is a priority.

Q59 Jesse Norman: We have spent a fair amount of time on bonuses. Let me ask you about something else. Obviously, there has been a lot of public concern about mistreatment of business customers by RBS in the GRG division. What conversations have you had with RBS on this?

James Leigh-Pemberton: We have had very extensive conversations with them, starting with the basic principle that every recommendation of Sir Andrew Large’s report should be implemented and then, very much in line with what I was discussing earlier, going through a process of ensuring that they are understanding how those steps are being executed and understanding what the impact is in terms of growth of their market share in SMEs and, therefore, growth in shareholder value.

Q60 Jesse Norman: They have given you reassurances on those fronts, have they?

James Leigh-Pemberton: Yes. There has been a very significant restructuring of how they go about both SME coverage and, in particular, how they go about working with companies that do get into financial difficulty. That has been reorganised completely.

Q61 Jesse Norman: I saw Derek Sach, who headed up GRG, has left. Was that a result of these accusations?

James Leigh-Pemberton: I do not know the answer to that question, but he has left.

Q62 Jesse Norman: You will have read the evidence that Mr Sach and Mr Sullivan, the deputy CEO, gave to us on the issue of GRG. What did you make of Mr Sullivan’s and Mr Sach’s claim that GRG was not a profit centre?

James Leigh-Pemberton: We are absolutely clear that GRG was a profit centre in the sense that a profit centre was defined by Sir Andrew Large.

Chair: That is the standard definition and which is well understood throughout the banking industry, just to be clear.

James Leigh-Pemberton: I would say so. However, it is fair to say that the larger question of “was GRG managed in a way that was deliberately focused on disadvantaging clients and customers of the bank for the purposes of creating advantage for the bank”, that is a question that can only be answered when the FCA’s report on the matter is finished. We have to await the outcome of that report before we can reach—

Q63 Jesse Norman: Just to remind ourselves what happened, “Chair: I am going to ask the same question again. In forming that judgment is GRG acting as a profit centre or a cost centre?” “A cost centre.” “Then GRG is not, as is commonly supposed, a profit centre?” “It is absolutely not a profit centre.” “In the bank?” “In the bank, absolutely not.” “Absolutely, unequivocally I am saying that this is a cost centre.” “It has always done for the period we have under review?” “Correct.” It sounds like Mr Sullivan does not have the foggiest clue what a profit centre is. How can he be running the bank if he does not know what a profit centre is?

James Leigh-Pemberton: Mr Sullivan is also leaving RBS and, as I said, there has been a complete reorganisation of GRG. We have obviously had sight of the public correspondence between Mr Sullivan and the Chairman of this Committee and I think there is probably little that we can add to the record as is.

Q64 Jesse Norman: Did it point in your mind to a wider concern about standards and culture and management of the bank?

James Leigh-Pemberton: I think the changes that have been made in the whole of the SME area in terms of simplification and new lines of accountability, all things that Ross McEwan has put in place in the relatively short time that he has been in post, those changes have been designed to take fully into account everything that was said in Sir Andrew Large’s report. I do believe that the RBS board and management have been responsive to the issues that were raised and they have put in place arrangements that, on the evidence to date anyway, appear to be working.

Q65 Jesse Norman: Chairman, with your indulgence I would like to just continue a little bit on the RBS privatisation. Would that be okay? Thank you.

Mr Leigh-Pemberton, when you appeared before us last time you said there had been little progress on the privatisation of RBS. You were waiting for news that would inform advice and your views. Are you closer to having a plan for the privatisation?

James Leigh-Pemberton: I am going to ask Oli, if I may, who is Head of Capital Markets and looks after these exits, to say a few words about that but, just by way introduction perhaps, I would say yes we are closer. I mentioned earlier that there is a higher level of investor interest than we were experiencing this time last year. The capitalisation of the bank has improved and so on, but there are other issues that have to be taken into account and that will need the passage of time. Oli, I do not know if you would like to add anything.

Oliver Holbourn: As you said, James, we continue to spend a lot of time thinking about it. I think if you speak to institutional investors they would tell you that Ross has made very good progress this year in terms of trying to make RBS a simpler, better bank, but I think there are still a number of issues on which we would like more clarity before we feel that

we could deliver a good outcome for the taxpayer. I do not think there is a single issue that needs to be dealt with but I think we need more clarity around conduct and litigation and we probably need more clarity as well around the future shape of the corporate and institutional business before we think we will be able to deliver a good outcome.

Q66 Jesse Norman: Who is responsible for the development of such a plan within your organisation? Is that your responsibility, Mr Holbourn?

Oliver Holbourn: Yes, it is.

Q67 Jesse Norman: When you are looking at the rather better financial results we have had recently, I do not think we are in a polar period now. Are you expecting these results to continue, that positive trend to continue?

Oliver Holbourn: I think it is very difficult to say at this point because there are a number of outstanding issues that need to be dealt with, in particular on the conduct and litigation side where the sizes of some of those issues are unknown and at this stage unknowable. We are hopeful, as James has said, that Ross's strategy, which has made it and is making it a simpler and better bank, means that the performance will continue to deliver good results.

Q68 Jesse Norman: There have been reports that you have been approached about selling smaller stakes in RBS. Are those true?

Oliver Holbourn: From time to time we have been called by institutional investors who have told us that RBS is becoming a simpler, better bank and they were more interested now than they were in the past in investing in the company. I think the issue with RBS is that our stake is incredibly large and, therefore, we would have to think very carefully whether selling smaller blocks of shares would deliver a good outcome for the taxpayer in our desire to try and dispose of all of the RBS shares on some sensible timeline.

Q69 Jesse Norman: Mr Leigh-Pemberton, you obviously have an enormous amount of experience in the equity capital markets, I think I am right in saying both at Warburg and at Credit Suisse. Is that right?

James Leigh-Pemberton: Yes, that is right.

Q70 Jesse Norman: Have you institutionally done an assessment of the privatisation of Royal Mail?

James Leigh-Pemberton: We have paid a lot of attention to the NAO report and to everything that has been written and said about the Royal Mail in order to learn whatever lessons could be learned from the Royal Mail, yes.

Q71 Jesse Norman: But you ran some privatisations, I seem to recall, in the 1990s that were conducted a hell of a lot more effectively and efficiently than that one.

James Leigh-Pemberton: Yes. The circumstances then were very different and for us now at UKFI the most important thing for us is to say what is the read across from Royal Mail, if any? We need to study this case and we need to make sure that any lessons that should be learned from the Royal Mail IPO are brought to bear in how we conduct our sales.

Q72 Jesse Norman: What was your assessment? What was, in fact, your technical assessment of the Royal Mail?

James Leigh-Pemberton: I do not think I have very much to add to what the National Audit Office said. The National Audit Office did an absolutely exhaustive investigation

and a detailed report and, as I said, I think they had the benefit of a much greater level of examination than us on the outside.

Q73 Jesse Norman: Let us just take a more technical issue. Take the technology of book building that was developed in the 1990s and early 2000s. That appears to have been forgotten. The quality of the book as built, sadly, unusual entity and unusual market conditions, but still it would seem to have been extraordinarily badly handled from that point of view by the advisers; bad advice given to the Government. You do not demur from that? You are not disagreeing with me?

James Leigh-Pemberton: I do not think I have a lot more to add than what the NAO concluded on the Royal Mail.

Q74 Jesse Norman: You will include a retail offering on the RBS when it does come public, will you?

James Leigh-Pemberton: I think that depends a lot on market conditions. As I think I have mentioned here before when I appeared in front of this Committee last year, the inclusion of retail has the benefit of enabling a larger size than would otherwise be achievable and, having regard to what Oli has just said earlier, the absolute size of our holding, I think that we absolutely must have it on the list of possibilities as a means of reducing our holding.

Q75 Jesse Norman: That is interesting. A final question on Lloyds. They fired eight of their traders in connection with the LIBOR and repo rate manipulation scandals. What conversations have you had with Lloyds about that? Are you satisfied that they have taken adequate measures compared to the size of the problem they face?

James Leigh-Pemberton: We did have conversations with them both before and after the FCA's findings were published and the thrust of those conversations were that the notion of accountability is extremely important to us as shareholders because, if you come back to some of the earlier discussions, it is extremely important reputationally and reputational issues have a direct relationship to shareholder value. Therefore, we expected that there would be a thorough review and an uncompromising approach to the findings of that review. We are satisfied that Lloyds have taken the right approach and that all the persons who were involved who should be dismissed have been dismissed. I know they did a very thorough, careful review and they looked at it from a number of different aspects.

I think we are also satisfied with the fact that such clawback as they can contractually impose they have imposed in respect of bonus payments that have been made in the past. I do not think this whole process is yet complete because, as we mentioned earlier, we will need to have a discussion with the remuneration committee in the context of the full year performance of Lloyds as to how the various different aspects of Lloyds' full-year performance, including these fines, are reflected in the overall size of bonus pool.

Q76 Jesse Norman: Are you surprised there are no Opposition Members of the Treasury Committee here for this meeting on such an important topic?

Chair: I do not think you need to answer that.

James Leigh-Pemberton: I am not sure.

Q77 Alok Sharma: Just a very quick point on transition plans for RBS. Am I right in thinking that you have retained JP Morgan to provide advice on this? Is that right?

Oliver Holbourn: JP Morgan is our current privatisation strategy adviser. That is correct.

Q78 Alok Sharma: Could you tell me how often you meet with JP Morgan to discuss specifically the potential privatisation of RBS and when they do turn up to these meetings do they come with a PowerPoint presentation telling you what the potential institutional investor appetite is in RBS and at what price and all the rest of it?

Oliver Holbourn: I should think in the last month we have either met or spoken with them on the topic of the RBS privatisation in excess of five times. I would say that each meeting is different. I would say that we do a lot of our own work internally on what we think fair value for RBS could be now and in the future. We put our thoughts usually on paper internally as to what we think future disposal strategies could be. We then discuss those with JP Morgan and, more often than not, they will go away and also write their own thoughts separate to our document and then we will meet and discuss and that process will continue to iterate.

Q79 Alok Sharma: Are you seeing increased interest from institutional investors in a potential privatisation of RBS?

Oliver Holbourn: We are definitely seeing more interest from institutional investors in investing in RBS. I do not want to mislead the Committee. I think it is healthy signs of improvement rather than massive scale interest that we are seeing at the moment.

Q80 John Thurso: Can I turn to the third of your business, UK Asset Resolution, and pick up where I left off last year? Was it a hospital pass or a nice little earner to give you the job of looking after the home buy help scheme?

James Leigh-Pemberton: I do not think it was a hospital pass. I think it is entirely appropriate that UKFI should be on the board of UKAR and, given the people and the skill sets that we have inside the company, that we should also be focused on getting the taxpayers' money back as quickly as possible and reducing the risk that we have on the—

Q81 John Thurso: The particular question was on the Help to Buy scheme, which you may remember we had a discussion about.

James Leigh-Pemberton: I beg your pardon. The Help to Buy scheme is definitely not a hospital pass. There are 13 people at UKAR Corporate Services involved in the administration of Help to Buy. It is no difficulty or burden, but it is also not a good little earner because the services of UKAR Corporate Services are charged out at cost to HMG. It is not a profit-making activity, but it is not material either.

Q82 John Thurso: Can I return to the wider question then? UKAR has its own chairman, chief executive and board, although you appoint one or two of the non-executives. What value does UKFI add to UKAR?

James Leigh-Pemberton: The model that is referred to in our framework agreement, which I think is a very good way of describing it, is that the governance relationship is like the relationship between a private equity investor and a portfolio company. That is, the portfolio company has its own board responsible for the formulation of strategy and the execution of that strategy and holding the executive team to account for the delivery of that strategy. We have representation on the board, so we have that line of sight and we have that means of influencing the deliberation of that strategy.

There is a second aspect of value that UKFI can bring to bear, which is just to take a step back and, like any concerned shareholder, we say to ourselves, "Is the board at UKAR

thinking about all of the means by which we can reduce this risk, shrink the balance sheet and get the taxpayers' money back and is this being pursued at the correct pace and are the risks as well as the returns associated with doing this being properly taken into account?" That is perhaps a one-step distant, slightly more strategic way of thinking about things.

Q83 John Thurso: What is your conclusion on those questions that you put to them?

James Leigh-Pemberton: I think we are fortunate to have a very strong management team in UKAR and a tight and well-organised company. The pace at which the balance sheet has been shrinking and the Government loan being repaid has been a pretty good pace over the last 18 months. I certainly do not think that UKAR have left any stone unturned in terms of trying to keep that pace up and the recent sale of mortgages I think is very good evidence of that.

Q84 John Thurso: I wanted to ask you about that. Obviously it is made up of the two different Northern Rock and B&B, but if you take them together you have about £6 billion of equity. I first asked about the equity in that at least four years ago, I think it was, and it was about £1 billion at that time. There has been a substantial increase in shareholder equity, which from my reading of the balance sheet comes almost entirely from retained earnings.

James Leigh-Pemberton: That is right, yes.

Q85 John Thurso: It now has a very comfortable capital buffer. A relatively small number of mortgages, about £2.7 billion I think, was sold. Why not sell the whole thing?

James Leigh-Pemberton: The size of the UKAR balance sheet, the consolidated Bradford & Bingley and NRAM balance sheets means that, I think, a transfer of ownership of equity of the whole thing without leaving the Government funding in place would be very difficult. In other words, to raise from the private sector the £37 billion to £38 billion of term funding, which is currently a critical part of the liability side of the balance sheet of UKAR, in a single transaction would be extremely challenging. If the whole of UKAR were to be sold to somebody, I think we would find ourselves in a position where the equity was transferred but some or all of the Government funding on the liability side of the balance sheet would need to stay in place just because it could not be found all in one go at the same time from the private sector. It is quite a challenging proposition to have 100% of the equity and, therefore, control owned by one party but funding provided by the public sector.

Q86 John Thurso: A critical point would be that you would need to ensure, in any sale that took place—you could look at doing just B&B or just Northern Rock or whatever, which would roughly halve it, but the key principle would be that you would have to have commercial funding of the liabilities to make it worthwhile?

James Leigh-Pemberton: Or put differently, that the degree of control that we as a shareholder could continue to exercise was proportional to the amount of capital that there is at risk; even if it is not equity capital, was nevertheless proportional to the amount of capital at risk, in the form of the funding that constitutes such a big part of the liability side of the balance sheet.

Q87 John Thurso: I cannot remember if it was the 15-month period or the 12-month period, but last year there was a repayment of about £2.5 billion to the Government of which £1.9 billion was loan repayments roughly, I think, and something like £500 million or thereabouts was interest charges, fees and all the rest of it. Are those fees equivalent to what

the commercial cost of that capital would be? Is the Government subsidising or is the Government earning more? Is it a good investment for the Government?

James Leigh-Pemberton: They were set at commercial rates. The FSCS facility which provides a significant proportion of funding to the Bradford & Bingley balance sheet is on preferential terms to the borrower. So the taxpayer is benefiting at the moment from that.

Q88 John Thurso: If one was being absolutist about it and if you wanted the Government to get rid of it, there would need to probably be an increase in cost on that capital?

James Leigh-Pemberton: Yes, possibly. If the funding were to be replaced with private sector funding, overall I think the cost of funding would go up.

Q89 John Thurso: Have you ever looked at the idea of keeping it as it is but removing some of the Treasury's burden on the funding to see if some of the debt side could be placed in the market?

James Leigh-Pemberton: Yes. As well as thinking a lot about the asset side of the balance sheet and disposal of mortgages, the range of options in terms of liability management is constantly under consideration. In fact, there has been a recent announcement by the EU that allows for a bit more flexibility in liability management in terms of how we might treat some of the subordinated debt in the balance sheet. These topics are always under consideration.

Q90 John Thurso: I am not asking you to say what is right or wrong. I am merely seeking to see what options there are, but most of the conversations around UKFI revolve around RBS and Lloyds for very obvious reasons of scale and so forth, but the third leg of your business, which is UKAR, has quite considerable potential to be something that might be resolved on a shorter timescale if the Government felt that that was something it might like to see happen and you were to look at that. We are not asking whether it is good or bad. I am saying it is a possibility.

James Leigh-Pemberton: It is a possibility, although that too is highly dependent on market conditions. The third party appetite to buy different categories of mortgages varies a lot from time to time and I think we also have to be very mindful of the fact that there is a high concentration on the consolidated UKAR balance sheet both of Buy to Let and of, relatively speaking, lower yielding assets, business that was written at rates which today would be perceived to be below market. Those are also factors that I think we must always take into account when assessing the value for money achievable by the different options that are UKAR's disposal to shrink its balance sheet.

Q91 John Thurso: One other area, and I suppose this comes back to governance, is the Better Together mortgages that were part of Northern Rock—the old 125%. A number of people have re-mortgaged the mortgage bit but get left with the personal loan bit and it is reputed that they are paying 13% on that, which of course is pretty punitive.

James Leigh-Pemberton: Yes.

Q92 John Thurso: To what extent do you look at that and the way that is handled, thinking of the broader requirements of Government to be fair with people?

James Leigh-Pemberton: We do and treating customers fairly is a key corporate priority for the UKAR board on which we are represented. They measure it carefully and I think they perform well. The FCA, who regulate UKAR, are satisfied with UKAR's procedures, systems and controls relating to treating customers fairly. In connection with the Better

Together, the contractual terms of those loans unfortunately are what they are. I expect that in most cases there is a fairly straightforward calculation that can be made. Is it more advantageous to refinance the mortgage and the unsecured loan or is it more advantageous to refinance the mortgage and leave the unsecured loan outstanding? On a customer-by-customer basis, they have to determine whether that is appropriate and what action they should be taking.

Q93 John Thurso: Did the £14.5 million set aside in the balance sheet for PPI claims come as a surprise and do you expect more?

James Leigh-Pemberton: I am afraid it did not come as a surprise. I do not think it is ever possible in the case of any of the three banks, which includes UKAR, to say there will be no more in this conduct area, but in the case of UKAR it is something that the company keeps under very close surveillance and the level of provision that was made is satisfactory and appropriate.

Q94 Chair: Can I take you back to some answers you were giving and exchanges you had with Jesse Norman about fines and bonuses? One of the central themes of the Parliamentary Commission on Banking Standards' conclusions was that banks needed to make much more effort to try and identify individual responsibility in advance for specific tasks in banks, both at the highest levels through a new and much more focused senior management regime and lower down through the introduction of something that is now called certification. Have you taken a close look at those proposals?

James Leigh-Pemberton: Yes. We have certainly taken a very close look at the proposed senior persons regime.

Q95 Chair: I am not asking you whether you took a look at what the Government and particularly regulators subsequently came forward with. I am just asking you whether you took a look at the Commission's proposals.

James Leigh-Pemberton: I am afraid only in the form in which they have been brought forward by regulators, because that is how it impacts our portfolio companies.

Q96 Chair: Of course, there is quite a gap between what the regulators have come forward with in a number of places and what the Commission originally intended. Perhaps outside this meeting it might be helpful to examine that.

James Leigh-Pemberton: Certainly.

Q97 Chair: The reason I raise all this is you were saying you were trying to find ways of clawing back as much as possible in a number of cases, but isn't the much more important task to be in a position contractually to not pay money by turning deferral into malus?

James Leigh-Pemberton: Yes, absolutely. As I mentioned earlier, I think that for as long as deferral periods are there you can just turn it off but even post-deferral, post-vesting, we are quite keen on the idea in order that our interests are properly aligned and we do not have this direct deduction to the P&L. We are quite keen on the idea that post-vesting, post expiry of deferral, there should still be scope for clawback.

Q98 Chair: Don't you think that should only be in the most serious cases? After all, this money has been paid out. It might have been spent.

James Leigh-Pemberton: If it transpires that the recipients of these monies have been—

Chair: Subject to enforcement action.

James Leigh-Pemberton: Yes, for example.

Chair: Egregious misconduct.

James Leigh-Pemberton: Yes.

Q99 Chair: That is what the Banking Commission recommended. The reason I go through all these issues in some detail is that they look simple but in fact they are quite complex to implement and a good deal of thought needs to go into them. When I discussed them with a senior person at RBS I discovered they were unaware of the proposals and, in fact, as he put it, “We are a long way away from working out who can add risk to our balance sheet in the firm”. That strikes me as very concerning, that we are still in a position where we do not know who these people are.

James Leigh-Pemberton: We would agree with that. The process of simplification inside RBS and the lines of accountability is a priority for the board, I think. It is certainly a priority for Ross. It is work in progress. It is not finished.

Q100 Chair: I think the most revealing evidence is often inadvertent and you did come out with one remark that I wrote down immediately, which was “running the business”, which means banks, “in the interests of shareholders is now a priority”, which speaks volumes about the way these institutions have been run in the past, don’t you think?

James Leigh-Pemberton: Yes. There was a time in the past where one would often hear it said that it was better to be an employee of one of these banks than it was to be a shareholder from a financial point of view.

Chair: That certainly seems to be true.

James Leigh-Pemberton: In the early part of the 2000s one often heard that said. As it happened at that time, because of the amounts of liquidity and the amounts of leverage that the banks were operating, it was possible for both parties to do okay, exactly as pointed out by Sir Jon Cunliffe yesterday. I suppose the point that I was trying to make is there is now a better balance in the way in which, certainly at Lloyds and RBS, things are being run. There is now a much better balance than was the case then, at that time, between the benefits to shareholders and the benefits to employees, which is in part the consequence just of the very material change in regulation that has taken place in the intervening period. That is the major driver of it.

Q101 Chair: I am sure you understand we have concentrated on the degree to which you are operating at arm’s length for some time in this hearing, not least because that is absolutely crucial to your reason for existing.

James Leigh-Pemberton: Yes.

Chair: As I said, inadvertent evidence is often the most forceful and the fact that this has more or less disappeared from your annual report does strike us as inadvertently significant and, indeed, I do not think you used the word but you described it inadvertent. We would be very grateful for that detail of exchanges that can act as an illustration for us of the degree to which you are being run yourselves by a third party in different parts of the Government. Before I make one final point, Steve Baker wants to come in with a quick rejoinder.

Q102 Steve Baker: As I just listened to you talk about the point that it was once said it was better to be an employee than a shareholder, I wondered: do you recognise in your work that many of the issues that you are dealing with day to day go to the heart of whether people have faith in a market economy?

James Leigh-Pemberton: Perhaps we recognise that many of the issues that we deal with day to day go to the heart of whether the customers of the banks are satisfied with the way the banks conduct their business. I think that at Lloyds and RBS and, as we were discussing earlier, at UKAR there is a very high degree of attention now on conduct and delivering to the customer the service that the customer requires. We are conscious that the relationship between doing those things correctly and shareholder value and, therefore, the taxpayer getting their money back, is a close relationship, and we do pay attention to that, yes.

Q103 Chair: I think you would agree that the most effective force for good conduct is and should be the restoration of competition in the banking sector where there is clearly not enough, something we have not discussed much today.

James Leigh-Pemberton: Yes.

Chair: You are between a rock and a hard place at UKFI. We understand that and we understand that you are doing your best in those difficult circumstances. It is a thankless task. We are very grateful to you for doing that job on behalf of the shareholders, which is the UK population.

James Leigh-Pemberton: Thank you.

Chair: We recognise that you are engaged in a big clear-up operation after some appalling decisions, one that is going to carry on for some time. Thank you very much for coming in to give evidence this morning.