House of Commons

Treasury Committee

Oral evidence: UK Financial Investments annual report and accounts 2015-16, HC 829

Wednesday 16 November 2016

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Watch the meeting

Members present: Mr Andrew Tyrie (Chair); Mr Steve Baker; Kit Malthouse, George Kerevan, Chris Philp, John Mann

Questions 1-107

Witnesses

I: James Leigh-Pemberton, Chairman; Oliver Holbourn, Chief Executive, UK Financial Investments Ltd

HOUSE OF COMMONS

Examination of Witnesses

James Leigh-Pemberton, Chairman; Oliver Holbourn, Chief Executive, UK Financial Investments Ltd

Q1 **Chair:** Thank you very much for coming to see us this afternoon. UKFI is a very interesting institution. I know I have asked you the question that I am about to ask you before and, indeed, I have given you notice that it is coming today as well. Of course, whenever I have been asked a question many times and given the same answer, by the time I have given it four or five times I have become convinced it must be right, even if when I first gave it I was not so sure. I will be interested to see whether we get the same answer to the same question I asked at the beginning of the last hearing we had. Why should UKFI exist?

***James Leigh-Pemberton*:** We believe that there are a number of reasons. First, a commercial approach to the management of the assets that we have responsibility for and to the execution of transactions that we do is highly desirable. The transactions themselves are large and, by definition, quite complicated. Secondly, a commercial approach to our stewardship and management is in the interests of the tax-payer. Thirdly, because our mission is clearly defined by our framework document and our investment mandate, it is possible for the company to attract people with a high level of commercial experience and skills from the private sector. We believe that that is of value to our shareholder and it is of particular value now in the context of the announcement of the creation of UKGI and the fact that we have become a wholly-owned subsidiary of UKGI.

Q2 **Chair:** Why can the Treasury not buy in that advice, in the way that it has bought in advice on privatisations and management of similar organisations over the last 30 years?

***James Leigh-Pemberton*:** You can do that on a from-time-to-time basis. There is another advantage—

Q3 **Chair:** Sorry to interrupt, but it is a bit more than that, isn't it? They have a permanent relationship with a number of organisations, if they feel they have something that needs managing.

***James Leigh-Pemberton*:** Yes, and they can avail themselves of those resources. The point that I was trying to make was that having the expertise consistently available in-house at a reasonable price provides continuity, consistency and immediate availability of this expertise in a way that is overall beneficial. It is also fair to say that one of the functions that we believe we have is to get the best out of the external advisers. In other words, the private sector expertise, as I mentioned earlier, can be brought to bear to check, to ensure that we have seen right into the advice that is being provided by those external providers and to get the best out of them, by asking the right questions and ensuring they are focused on the right issues.

Q4 **Chair:** You have said they are at "a reasonable price." Do we get top advice on the cheap, then?

***James Leigh-Pemberton*:** It costs HM Treasury about £2.4 million in administrative and management costs per annum for UKFI to exist. In the end, it is a subjective judgment whether, given the size of the portfolio of assets and the value at risk, that is good value or not. As an asset management fee, for example, expressed as a percentage of the assets under management, it is pretty good value.

Q5 **Chair:** Is not the better comparator bringing you in-house, absorbing this organisation into the Treasury and ending this rather peculiar apparent arm's-length arrangement, which many observers would say flatters to deceive?

***James Leigh-Pemberton*:** Were that to be the case, certain of the things I mentioned before would be lost. I believe, if UKFI were subsumed into the Treasury, it would be more difficult to attract the private sector outside talent than would otherwise be the case.

Q6 **Chair:** Even as specialist advisers on fixed-term contracts?

***James Leigh-Pemberton*:** Yes, because the independent, commercial focus of our mandate gives to those people who come from the outside a clearly-defined role, which is primarily commercial and not policy-driven in its activity. That is an attractive role to those who are coming from the commercial world and probably intend to go back to the commercial world.

Q7 **Chair:** As you know, the Parliamentary Commission on Banking Standards and this Committee in the last Parliament recommended that you be absorbed into the Treasury and that we end this fig-leaf—I think that was the word used by the Parliamentary Commission—arrangement, where you appear to be offering independent advice and justification for decisions that are often being taken by the Chancellor. Is that a picture that you recognise or is that a slight caricature?

***James Leigh-Pemberton*:** I do not recognise it, because it is not really my view, or our view, of what happens every day at UKFI. We have to think of it as a process that works slightly the other way round. We have our mandate defined by the framework document. We do the work to discharge that mandate, and that work produces advice and recommendations, which we then send to Ministers for their approval. To use commercial parlance, both the stewardship initiatives and the disposal transactions themselves are originated by us as a result of our standalone, independent activity, framed by our framework document. They are then approved by Ministers, but the history of our major stewardship initiatives and all the transactions that we have completed is that they have been originated by us, go through our approval process, are signed off by our board and then advice is sent to Ministers accordingly.

Q8 **John Mann:** Are you going to be around for another five years or more?

James Leigh-Pemberton**:** I was recently asked this question at the Public Accounts Committee, and in the end I said that it would probably be somewhere around five years, yes.

Q9 **John Mann:** Quangos have always got away with justifying their existence and their lengths into the future. When will we be able to see exactly the advice that you have given that the Chancellor of the day rejected in relation to timing, value and volume of sales? Obviously, that is currently commercially confidential.

James Leigh-Pemberton**:** Yes, although with respect to the past I think I can say now that I do not think there has been an instance where that has taken place: where we have originated in the way I described a possible disposal transaction and our advice has been rejected.

Q10 **John Mann:** So it is entirely you calling the shots on all matters.

James Leigh-Pemberton**:** As I said, we originate; we do our work; we keep our eyes on market conditions; we interact with investors; we read all the materials required to make sure that we understand what is going on in markets; we check carefully the evidence for the recommendations that we will make. Those are all taken through an approval process with our board but at the end our framework documents provides that those recommendations have to be approved by Ministers before we go into action. I do not think it would be right to say that we call the shots because the final approval is a Minister's approval. The recommendations that are made to Ministers are originated by us and go through our approval processes. They are the product of our work.

Q11 **John Mann:** And you never liaise with Treasury officials or Ministers through that process.

James Leigh-Pemberton**:** Yes, we do. We certainly do. As our work evolves, we do keep our shareholder informed of our work. Particularly with the larger projects, there are joint HM Treasury and UKFI governance arrangements. As the project is evolving, our work is kept under review by our shareholder, but, as I said, these transactions are originated by us and executed by us.

Q12 **John Mann:** It is a pretty damming statement that you made: that Treasury officials are not as good as you at getting the best out of external advisers, considering they also employ external advisers to advise; that you ask the best questions and, therefore, you ask better questions than they are capable of asking; that you can see right into the advice and therefore, by definition, they can see less well into advice. That is pretty damning condemnation of the Treasury.

James Leigh-Pemberton**:** It is a question of the degree to which the Treasury decides to allocate its resources to those competences.

Q13 **John Mann:** If they had the right resources allocated, there is no reason that they would not have equal competences, is there?

James Leigh-Pemberton**:** That is probably absolutely right.

Q14 **John Mann:** That is not what you said in answer to the Chair. You said, "Intrinsically, we are better at getting the best out of external advisers. We are better at seeing right into the advice. We are better at asking the best questions." You are putting yourselves up on a pedestal compared to the Treasury.

James Leigh-Pemberton**:** I do not think it is a comparison; it is simply a statement that that is what we are there to do. We should be better because that is what we are there to do.

Q15 **John Mann:** It is a comparison, because you are qualifying it as being better in justifying your existence. You are now denying that.

James Leigh-Pemberton**:** No, I am not.

Q16 **John Mann:** You are either worth being separated out and being paid, and you are better; or there is no difference. Therefore, equally, if there is no difference where Treasury has the right resource, which is what you are now saying, then you might as well not exist. Bring it in–house.

James Leigh-Pemberton**:** To be clear, as things currently stand today, it is our role to provide that corporate finance expertise in relation to the assets and interventions that were required in 2008. In a similar way, it is UKGI's role to provide that corporate finance expertise across the whole of Government. Were it to be the case that our shareholder decided that it wished to do that in-house, one of the things that we have learned from the existence of UKFI is that steps should be taken to acquire the same level of expertise that is currently embedded in UKGI and UKFI inside the house at HM Treasury.

Q17 **John Mann:** We can probably agree on that, but you are now reeling back totally from what you said in answer to the Chair. I would just make that observation. When you were suggesting that you were the best this was, in fact, a classic quango justification. If the right people, with the right skills, were employed inside the Treasury, frankly, the only difference it would make is that, if things went wrong, Chancellors would not have someone else to put the finger at and say, "They got it wrong, not me."

James Leigh-Pemberton**:** There is a very important proviso in what you said, which is if the "right people are employed" at the Treasury. I said to the Chair that I feel strongly that the independent commercial remit that we have is a very important means of ensuring that the right level of expertise can be attracted into UKFI. There is a difference between working for a commercially oriented organisation, established in the way that UKFI is established, and being an employee of HM Treasury. One of the most important tasks that we have is to ensure that we have the right mix of capability and talent inside UKFI. This is a personal view, but I am not certain that, as things currently stand, it would be so easy to recruit that external talent to be full-time employees in HM Treasury as it currently is to recruit that kind of external talent into UKFI.

Q18 **John Mann:** All I can say is that I am bewildered at the concept that someone's CV would be more enhanced by saying "I work for UKFI", as opposed to "I was a top adviser working for the Treasury" on the same matters. I find that a little surprising.

***James Leigh-Pemberton*:** For the sake of correctness, I am not saying that either. There is a difference between an independent, focused, commercially oriented organisation and being an employee in a Government Department. That difference is an important contributory factor in enabling us to attract the kind of capability that we think is important to allow UKFI to discharge its mandate.

Q19 **Chair:** I think we have got the point: you are saying that the quality of advice is improved because of the terms of engagement that have been set by the Government. We are saying that carries the price of the fig-leaf problem that we set out and discussed, in some detail, in the PCBS and the Committee in the last Parliament. That is the discussion we are having now. I would hope that our scepticism is not read by you personally or your organisation as a judgment of individuals in the organisation, who may be doing an outstanding job. It is about the relationship and the value of the relationship.

***James Leigh-Pemberton*:** We have obviously seen the correspondence between yourself, Chairman, and the NAO Comptroller and Auditor General in relation to the proposed inquiry the NAO should undertake on, among other things, our stewardship of RBS and the independence of the advice that we have provided. We look forward to working with the NAO, as they would like us to do so, in relation to that inquiry, because that will go some way into getting a third pair of eyes on to this topic, which will hopefully illuminate the debate.

Chair: Do one or the other, and it will be helpful to see what comes.

Q20 **Stephen Hammond:** Good afternoon. Mr Leigh-Pemberton, in response to a question in front of this Committee a couple of years ago, you said, "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." You had just become executive chairman. That situation has now changed. Can you explain to us the reasons for the change and why that logic has been changed?

***James Leigh-Pemberton*:** What I said then remains true now. UKFI is the same size and has the same operational platform. In the period since, between then and now, some things have changed. We have developed. Our people internally have developed; they have made progress, as should be the case in any healthy organisation that is doing well. Ollie has taken on an increasing level of responsibility as a result of first one promotion and now a second. It is entirely natural in an organisation that is working well that people should develop and take on additional responsibility. The decision that the board made, which our shareholder agreed with, that Ollie should become chief executive and I should become chairman also has the effect of normalising our governance arrangements and making them look more conventional. This is a reflection of the development of the capabilities of our team and that development enabling a more normal governance structure to be put in place.

Q21 **Stephen Hammond:** In the development of your team, given the rationale that you say is still valid, would it not have been normal for Mr Holbourn to have become executive chairman, on that line of logic?

***James Leigh-Pemberton*:** That was a decision for the board. As I set out in our annual report, we have been extremely busy. There is quite enough for all of us to keep ourselves occupied. The decision of our board was that we would like to keep the team intact in terms of the number of people that we have and, as I say, to make the changes that are entirely appropriate, given the development of the capabilities inside the firm.

Q22 **Stephen Hammond:** In response to my first question, you spoke about normalising the governance structure, but the UK governance code explicitly says that someone who has been chief executive should not go on to be chairman of an organisation. Can you say why in normalising the governance structure you have not chosen to follow the governance code?

***James Leigh-Pemberton*:** When I arrived I was, very briefly, chief executive, only because Robin Budenberg was still in post as chairman. That was for a handover period. The only post that I have held here for any meaningful length of time was the post of executive chairman.

Q23 **Stephen Hammond:** Executive chairman is effectively CEO.

***James Leigh-Pemberton*:** Yes, but the corporate governance code is designed to ensure that the chairman of the board is sufficiently independent from the management team to be able to exercise oversight over them. That was already a responsibility of mine as executive chairman.

Q24 **Stephen Hammond:** Has the senior independent director, Mr Remnant, agreed with the current arrangements?

***James Leigh-Pemberton*:** Yes, he has.

Q25 **Stephen Hammond:** And he has set that out.

***James Leigh-Pemberton*:** Yes. We had a board meeting to review all this. The board agreed and that is recorded in our board minutes.

Q26 **Stephen Hammond:** Given that it is a relatively small organisation is there not some impact, in term of the lessening of his role as the senior independent director, by you being the chairman?

***James Leigh-Pemberton*:** No, not really. Part of the reason why we created that role was to accommodate the possibility, for example, that I was unable to carry out my duties. It was to ensure that there was a proper performance review of my role, carried out by a member of the board but an independent director. Philip's key duties are, first, to step into my shoes in the event that I cannot carry out my duties any more, at least for the interim; and secondly to ensure that my performance is subject to proper review and scrutiny. Those two central duties of Philip, as the senior independent director, remain the same.

Q27 **Stephen Hammond:** Could you also set out the accountability structures of the UKFI board and UKGI board for the management of your organisation?

***James Leigh-Pemberton*:** Yes. Under the arrangements that have recently come into force, we the UKFI board report up to the UKGI board. We do that on a quarterly basis. They are our parent company now, under the new corporate structure. We are answerable in the first instance to the UKGI board, and then, ultimately, to our shareholder, which is HM Treasury. The reporting line goes therefore to the UKGI board in the first instance and to HM Treasury in the ultimate instance. The corporate structure of UKFI remains intact for the time being. Our board meets monthly, and all the processes associated with the running of the company are the same now as they were prior to the merger, save that our reporting line has changed.

Coming back to the previous conversation, we are in the business of trying to make ourselves redundant in due course. We want to run down these assets on a timely basis and we have to recognise that we are engaged in the management of a portfolio of securities that is in run-off. In due course, when the level of activity in UKFI and the scale of assets under management shrink to the appropriate level, there will be another change in our governance and organisational structure.

Q28 **Stephen Hammond:** That brings it back more or less to the Chair's and Mr Mann's questions. Given the accountability structures that you have just outlined, that it is a relatively small company and that you are in run-off, what is the point of UKFI being there now? Why is it not just a unit of UKGI?

***James Leigh-Pemberton*:** Because the scale of what were are doing at the moment requires dedicated resource and a high level of attention on a daily basis. These transactions, some of them recently completed in the summer and some currently in progress, are not trivial undertakings.

Q29 **Stephen Hammond:** No, I understand that point, but you have outlined a management accountability where, frankly, UKFI board appears to be just a throughput up to the UKGI board. All I am saying is, dedicated though the management may be, you could take the UKFI board out of the loop, put the unit inside UKGI and have them reporting to the UKGI board.

***James Leigh-Pemberton*:** As I said, for the time being it is a question of scale and the focus that is required. In due course that is the intention, but we have concluded—as, indeed, has the UKGI board—that for the time being the scale of the operations that we undertake and so forth require the level of focus that is afforded by this corporate structure.

Q30 **Stephen Hammond:** That begs my last question: at what stage do you think the scale will such that that structure change needs to happen?

***James Leigh-Pemberton*:** It is difficult to say precisely. I apologise, as I think this is going to sound glib, but we will know it when we see it. It is very hard to say precisely, but it will be measured by the amount of activity that there is, on a daily basis, inside our group. There is currently a very significant amount of activity for various different reasons, because of the things that we have in hand at the moment. Over time, that will diminish, as these transactions complete. We will be able to recognise that phenomenon as it begins to materialise. We will make a recommendation at that point to the UKGI board that the time has come for this corporate structure to be collapsed into UKGI.

Q31 **Chair:** You were created by Alistair Darling to, among other things, give the public confidence that the Government do not meddle with these companies, but there has been quite a bit of meddling, has there not, over the years? Take remuneration, for example.

***James Leigh-Pemberton*:** We discussed before that there has been—

Q32 **Chair:** Use your own word, other than "meddling", and we can short-circuit this discussion.

***James Leigh-Pemberton*:** A strategic review of RBS was conducted by the HMT in 2013, and that was conducted by HM Treasury with a lot of input from UKFI but, nevertheless, it was conducted by HM Treasury, as the majority investor. There was an occasion on which we made a recommendation in relation to remuneration, which was not agreed by Ministers. We made that recommendation on commercial grounds and we have been over that ground in this Committee. That related to the 2:1 bonus cap at RBS.

Q33 **Chair:** I am looking for your word for "meddling": "interference", "engagement".

***James Leigh-Pemberton*:** If I think of the way our company functions every day, again, I fear I am going to come back to the point that when, as a shareholder, we feel that we need to make our views known to the board and management of RBS, it is actually UKFI that tends to identify those occasions and to make the recommendation as to how we should do it. In the same way as the transactions are originated by us, the stewardship is conducted by us on a daily basis. You may want to say something about this, because you are now running our monthly engagement with the management team and so forth.

Q34 **Chair:** I do not want to stop you saying something. By all means do so in just a second. I do not doubt that on a day-to-day basis you are allowed to get on with your job. What interests me is when it matters to the Treasury or politicians that you may not be allowed to get on with your job.

James Leigh-Pemberton: The level of coincidence between what is commercially the right thing to do and the agreement with that course of action by Ministers has, at least in my experience, been extremely high. Put differently, we are allowed to get on with our day-to-day work. We do so in a way that ensures that Treasury and Ministers are informed at what we consider to be the key moments, but we are allowed to get on with our day-to-day work. The degree of meddling or interference with the day-to-day management of the banks is extremely low, because our mandate specifically provides that the board and the management of the banks should be free to run those entities commercially.

Q35 **Chair:** There is some meddling. As you say, the day-to-day meddling is low, but there is some, isn't there?

James Leigh-Pemberton: On the interventions by Government as a large shareholder, there have been only two material instances that I can think of since the creation of UKFI. The first was the strategic review. The second was the 2:1 bonus cap.

Chair: Mr Holbourn, I cut you off before you could start. If there is something you would like to add, please do.

Oliver Holbourn: I do not have anything to add on that topic, Chairman. I agree with James that we are allowed to get on with our job and, generally speaking, the banks are allowed to get on with theirs. We concern ourselves, as our mandate says, with the strategic issues at hand rather than day-to-day operations.

Q36 **Mr Rees-Mogg:** Gentlemen, good afternoon. I am going to be continuing on this theme. As long as the Government know they own 72% of RBS, they are inclined, when it is politically sensitive, to intervene, because, effectively, the electorate expects that, doesn't it? They cannot just pretend they do not know anything about it and it is not their responsibility.

James Leigh-Pemberton: That is right. That does not mean, however, that this is a regular occurrence. Part of our role is to ensure that, to the greatest extent possible, what is provided for in our mandate, which is that the board and management should be free to run the banks on a commercial basis, remains the case. It is the norm. That is normal.

Mr Rees-Mogg: If RBS decided to close half its branches and move its headquarters to London, then it would become quite a hot political issue.

James Leigh-Pemberton: Quite possibly. However, I do not think that necessarily means, if that were in the commercial interests of the bank, or in interests of the bank as a whole, its customers and its long-term sustainability, that it would not happen. There are many occasions on which commercial organisations with no government shareholding make decisions that are of political interest, and that political interest is reflected then in a high level of public debate. It does not necessarily mean that those decisions do not get made.

Q37 **Mr Rees-Mogg:** However, it would be easier if the 72% came down. How and when do you think that is going to happen?

Oliver Holbourn: It is very difficult to tell you when we will be able to restart selling shares in RBS. As you know, we made our first sale nearly 16 or 17 months ago. There are really two big issues that investors in particular want more clarity on now, before they will be willing to buy shares in sufficient size such that it makes sense and we are able to continue that reduction of shareholding. Those two issues are the RMBS litigation in the United States and the situation with Williams & Glyn. As the Chancellor has said on the fringes of the IMF, and we have provided advice on this, the sensible thing to do is to wait until those two issues are out of the way.

Q38 **Mr Rees-Mogg:** Is that because there is an unwillingness to buy the shares, or are you unwilling to sell at current levels?

Oliver Holbourn: Maybe the best way to explain this is to talk you through how our process works. First of all, we undertake a valuation of the banks—we have talked to this Committee before about how we do that—and whether there is sufficient certainty on the current and future prospects of the business such that we can put a reasonable valuation on RBS. At this point in time, given those two particular issues, we feel it is very difficult to get enough comfort that we can put a reasonable valuation range on RBS with a reasonably solid set of bookends to say, "Okay, now that we know what we think it is worth, let us assess whether we can sell a block of shares." That is stage one. I do not think we can do stage one at the moment. Stage two is whether investors are interested enough in buying shares.

Q39 **Mr Rees-Mogg:** Can we stay on stage one for a moment? My profession is as an investment manager. Is it not always true that you cannot come up with a value of a share that is absolutely solid and bookended? The value of the share is what the market is willing to pay for it.

Oliver Holbourn: I would beg to differ. There are market expectations of what a company is worth. There are also fundamental valuations that one can undertake. One can never be absolutely certain, but, as an investment manager, one would always want a sufficient degree of certainty that what one is buying or selling is worth between X and Y. Because we do not know the size of the RMBS fine, it is very difficult to determine with certainty what the equity of RBS is worth at this point.

Q40 **Mr Rees-Mogg:** It is hard to determine whether it is worth more or less than the market price, but that does not mean that it is not worth the market price. The market is taking into consideration what the size of the fine will be.

Oliver Holbourn: The market is giving it due regard, but it has no idea what the size of the fine will be.

Q41 **Mr Rees-Mogg:** No, but there could be a shock that it is higher and there could be a surprise that it is lower. That would have an effect on the share price. The share price is taking into account current information.

Oliver Holbourn: Yes, based on the liquidity of the shares. Based on our mandate, which is to get good and fair value for the tax payer, we do not feel that there is sufficient certainty around certain parameters of the RBS equity story for us be able to sit here in front of you and say, "We think this is fair value between X and Y."

Q42 **Mr Rees-Mogg:** Are you influenced in this by the cost price at which the Government entered?

Oliver Holbourn: We are absolutely not influenced by that.

Q43 **Mr Rees-Mogg:** Your first sale was very political, as I am sure you remember. The Government had to defend the book loss that they were taking on the sale.

Oliver Holbourn: We do not take the in price into our calculations when we are assessing whether we should sell shares and what the shares are worth.

Q44 **Mr Rees-Mogg:** When you sold 16 months ago or whenever it was, was it not just as true then that Williams & Glyn had not been sorted out and the US fine had not been established? Why were you able to make a decision on those two uncertain variables then, if you are not able to do it now?

Oliver Holbourn: First of all, those are not the only two variables that are important.

Mr Rees-Mogg: There are always variables in any investment decision.

Oliver Holbourn: Absolutely. If we look at what has changed since we first sold shares at 330p, at that point in time there was quite a lot of market interest in self-help and banking restructuring stories. That has changed. The market, at least until perhaps the last week, has been much more interested in those companies that can pay solid, steady dividends, and RBS is not yet able to do that.

The second thing that has changed is that Williams & Glyn was not really a focus, frankly, for the market when we undertook the sale; nor, at that point in time, had it been determined that there was a block on RBS returning capital. That was something that the PRA subsequently decided. In relation to the litigation fines, you are right. They were outstanding at the point in time. There was an expectation that they would be resolved a lot more quickly. When we assessed the outcomes that the market was pricing in, we felt at the time that it was pricing in some fairly benign outcomes in relation to that fine.

The other thing that has changed is obviously the outlook for monetary policy and the yield curve, which has made it more difficult for banks to earn money. As a result of all those things that have changed since we sold shares at 330p, we are now back, unfortunately, in wait and see mode until those issues are resolved.

Q45 **Mr Rees-Mogg:** Do those issues not just make the shares less valuable? If you are making your decision today on the value of the company, rather than speculatively on what it may be worth if things change, then if there are any buyers—and I know that is the second bit you want to go onto—you should be looking at this as a realistic price. Nothing you have said argues for the price going back to 330p.

Oliver Holbourn: That is right. I am saying that, to be able to forecast what you think the present is worth, we have to be able to forecast the future with some degree of certainty. Currently, we are not able to do that.

Mr Rees-Mogg: You can never do that. We had the Governor of the Bank of England in yesterday who admitted that, even with the enormous wisdom of the Court of the Bank of England and the MPC, they cannot forecast.

Oliver Holbourn: We are not saying that the forecasts are necessarily going to be right, but at this point in time we cannot even undertake that forecasting exercise.

Q46 **Mr Rees-Mogg:** It seems to be a constant argument for doing nothing and not selling the shares. The only reason that overrides it is the one you absolutely insist is not the one: that you are at a book loss, and an even bigger book loss than you were a year ago.

Oliver Holbourn: As I said, if we had had any regard to the in price, then we would not have recommended to the Chancellor, initially in the summer of 2014 and then onwards, that we were starting to see a set of market conditions and circumstances where we could value RBS with sufficient certainty that we could start selling shares. I can categorically tell you that we do not consider the in price in any decisions that we make.

James Leigh-Pemberton: One has to also see this in the round. There is range of possible outcomes in relation to the DOJ. The fine might be $5 billion. It might be $12 billion. Based on what was said to Deutsche Bank, it could be more. The direct drive impact of that number on book value, and particularly surplus capital, is almost a penny for penny impact on the share price. For precisely the same reasons as we are grappling with what a sensible exit point is in terms of price, the stock market and investors generally speaking are grappling with the question of what a sensible entry point is. At present, if you asked UKFI for its judgment on how deep the demand is for RBS today given the uncertainty, we would say it is not deep enough to enable a sale in any meaningful size.

Q47 **Mr Rees-Mogg:** That is very important. If you cannot sell in meaningful size, then you cannot do an offer. It depends on the price.

James Leigh-Pemberton: Given that range of potential outcomes, even at a significantly discounted price there is still risk on the buy side that they are making a major error in terms of entry point.

Mr Rees-Mogg: That is what investment managers do every day.

James Leigh-Pemberton: That is correct. Goodness knows, if you look at overall levels of activity and price performance in the banking sector, they do not have to. Until only six trading days ago, the overall level of interest in financials was at a remarkably low level.

Q48 **Mr Rees-Mogg:** Sometimes a big offer triggers interest. The fact of an offer and an opportunity makes people look at an area that they have not been looking at, and the marketing power of the City to get behind an issue can be very important.

Oliver Holbourn: Our views are informed by engaging with institutional investors on a regular basis. That is part of our activities. You would think that everyone, as you say, knows that we are a seller and own 71.5%. If there was interest we would see it, hear it and feel it. Honestly, all I can tell you is that, certainly over the past few months, the level of interest for RBS shares, or even to take an RBS investment decision to their investment committee, given the uncertainty, is low.

Q49 **Mr Rees-Mogg:** Only for a very naïve fund manager, because if you went round the City and said, "Do you want to buy a great slug of RBS shares?" they would say, "No, of course not; I am not really interested at the moment", because they want the price to go down. The people being consulted never say, "We want a much higher price and then we would buy lots." I have been on the other end of these conversations. The broker rings up and says, "We are bringing a stock to the market. Do you think this is the right price?" and you try to bat it away and get the price down.

***Oliver Holbourn*:** First, these are not broker-to-broker conversations and we do not go out to lots of investors at a single point in time; we go out during the course of the year. These are very large sales; in the scale of European capital markets, they are larger than most. When we did the Lloyds transactions and the RBS transactions, both through our engagement with investors and through our advisers' engagement, we knew that the demand for the shares was there and we knew that it was there at a price that, with reference to the market price, would represent good value for the taxpayer. I agree fund managers are not always going to give you their best view first off as to what price they will pay, which is why the operation of the book-building mechanism is there, to ensure that they pay the best possible price when we have established that there is enough interest to do a meaningful sale.

Q50 **Mr Rees-Mogg:** Would you consider a public offer to the general public, or, as with Lloyds, is that very much off the cards?

***Oliver Holbourn*:** A retail offer has always been part of our potential toolkit, but there are a couple of points worth mentioning to the Committee. One is that the nature of, particularly, a large-scale public offer is such that it needs many months' worth of preparation. Therefore, it is probably better suited to market conditions that are relatively benign, but it is part of our toolkit, so it is possible in the future.

Q51 **Mr Rees-Mogg:** Can I move on to the Williams & Glyn issue, briefly? Why do you think Lloyds was able to sort out TSB and RBS could not sort out Williams & Glyn? Is it all down to the IT or more complex underlying problems?

***Oliver Holbourn*:** By way of background—and this is not to try to avoid the question, but just to be clear—this was a state aid decision made in 2008 that RBS needed to divest of this business. That agreement remains in place and it is important that they meet those conditions. The key difference operationally between TSB and Williams & Glyn is that TSB always sat on a different operational system from Lloyds. Therefore, it was much more of a corporate carve-out than it was a technology carve-out. Williams & Glyn is fully integrated on the RBS IT platform and it is therefore much more difficult, first of all, for them to separate it and, secondly, and as importantly, for somebody else to receive those customers in a way that makes sure the customer journey is good, right and proper and that RBS manages to achieve reasonable value for that.

***James Leigh-Pemberton*:** One could also describe it in terms of the product suite. The Williams & Glyn carve-out represents a vertical slice of the entire product suite of the RBS Group, and that is a range of product that is far broader than current accounts and mortgages in TSB.

Q52 **Mr Rees-Mogg:** Was it a mistake of RBS to do a more complex carve-out, because at the point it was making the decision it could have decided to do a simple carve-out of current accounts and mortgages?

***James Leigh-Pemberton*:** It was not necessarily a mistake by RBS, because the terms of the carve-out were defined by the agreement with the Commission and the specific competition area that that state aid requirement was designed to address was concentration in the SME area, so that full product suite was imposed upon them.

Q53 **Mr Rees-Mogg:** Which TSB did not have to worry about, since it was almost entirely personal customers.

James Leigh-Pemberton: Personal current accounts and mortgage business, primarily.

Q54 **Mr Rees-Mogg:** Do you think it will be possible to get an extension from the Commission, because it looks as if the deadline is going to be very hard to meet now?

Q55 ***Oliver Holbourn***: There was already an extension renegotiated in 2013. RBS have recently commented that they are unlikely to be able to meet the deadline and, therefore, discussions will take place between the Commission, RBS and HMT during the course of the next few months to ascertain the best way forward. RBS have said that they remain in discussion with a number of potential acquirers and we will just have to see how the situation plays out.

Q56 **Mr Rees-Mogg:** As the major shareholder, what role are you playing in this? Are you facilitating discussions between RBS and the Treasury? Are you putting pressure on the management to come up with new ideas? Are you suggesting to them that they look at a different type of carve-out? What is your role?

Oliver Holbourn: Our engagement is with RBS, to understand, through the conversations that they have been having with the parties and also potential other options, what the shareholder value impacts of this disposal are on the bank and, therefore, our shareholding. To date, the divestment has cost approximately £1.5 billion, so we are focused on the shareholder value aspects of the transaction.

Q57 **Mr Rees-Mogg:** Is that £1.5 billion now wasted or is that money that could still have a beneficial outcome?

Oliver Holbourn: That is money that has, to date, been spent on the divestment of Williams & Glyn and it is money that has gone.

Q58 **Kit Malthouse:** Chair, can I just draw the Committee's attention to the fact that the companies that I founded both have business dealings with RBS and Lloyds?

Should you have sold more RBS in 2014?

Oliver Holbourn: If we had been able to sell more shares than we did at the time at the same price, we would have done so, but the demand was not there to do so. We achieved a 2.3% discount to the market price, which, in the context of precedents, was tight.

Q59 **Kit Malthouse:** It looks now like you should have given a bigger discount, right? Volume is a product of discount.

***James Leigh-Pemberton*:** It is, up to a certain limit. Ollie has been through it, no doubt, and I too have been through it in the past. If you go out to market with a very large placing at a big discount, you run the risk that there is a perception that the only means of moving the stock is by incentive in the form of price, rather than that there is a coherent equity story that is reasonable for people to buy.

Q60 **Kit Malthouse:** In the end, though, volume is always a product of price.

***James Leigh-Pemberton*:** Yes, but it is not infinite. There is finite capacity in the marketplace. There is only a certain amount of money available in these overnight book builds.

Q61 **Kit Malthouse:** I understand that. The alternative scenario to the very rational one you have put is to say, "We sold some at 330p and 240p; crikey, the price is now 209p. We are looking a bit like we got caught; we might as well gamble on the future."

James Leigh-Pemberton: Us, as sellers?

Kit Malthouse: Yes. I know you say you cannot get a valuation, given market conditions, but the alternative scenario is to say you are keeping your fingers crossed, hoping that everything goes well in these two decisions—Williams & Glyn and the other—and that the price goes back up.

***James Leigh-Pemberton*:** There are two things. First, to come back to the placing, there is a pivot point in these very large offerings where a price reduction will cease to have the effect of enabling a larger size to be placed. In fact, it will have the effect of even diminishing your call size.

Q62 **Kit Malthouse:** This is the skill of the companies that are acting for you, right? The first in gets the biggest discount and the next in gets less. There is a way of managing demand as you go through.

***James Leigh-Pemberton*:** Yes, but those are exactly the types of analyses that we are there to do, to ensure that we do not have the kind of accident that I just referred to. It is extremely easy for someone to walk in and say, "At 7% down we could move 5 billion, and down 2.3% we will sell 2.1 billion". There are many cases in the past where that theoretically correct statement has been proven to be wrong, and when these things go wrong they go wrong in a major way. They also have a material impact on the feasibility of subsequent disposals.

In relation to the question of whether we are sitting here, waiting for things to get better, our mandate provides that we should be able to affirm that the price we are realising in any transaction represents good or at least fair value. That fair value is determined by our assessment, discounted to PV, of the current and future prospects of the bank. To come back to our earlier discussion, it is, at the moment, exceptionally difficult to make that present value calculation, because of the range of outcomes.

Q63 **Kit Malthouse:** No, I heard your previous answer. Effectively, the taxpayers are having to gamble that everything turns out okay, because if it does not, if the fine goes against us and the Williams & Glyn thing collapses, the share price is going to go even further south.

***James Leigh-Pemberton*:** That is an imaginable outcome. It is possible. The second part of the equation, in terms of making disposals, is that there should be demand. As we mentioned earlier, for financial institutions as a whole, until six trading days ago, demand for equity was hard to come by. You can see it in the price action since September of last year. It has been hard to come by.

Q64 **Kit Malthouse:** Moving on to Lloyds, given that the Chancellor has chosen to exclude the public from buying the shares on your advice, who will you be selling them to?

***Oliver Holbourn*:** It is probably worth outlining the way the trading plan works. We give discretion to a broker, in this case Morgan Stanley, and they sell shares into the market in an orderly way, over time—so small parcels of shares every day. Anyone who wants to buy shares in the market is able to buy them. If a retail investor has a broker with a relationship with Morgan Stanley, they are able to buy those shares. We are selling them to all market participants that Morgan Stanley, based on a set of parameters that we have set them, are able to sell them to. We do not get the names or have any information on the identity of the shares that are sold, as a result of client confidentiality reasons.

Q65 **Kit Malthouse:** With Morgan Stanley distributing them they are more likely to go to institutional investors. Why would you not just distribute them directly through retail brokers? You could have had applications by a variety of retail brokers to take allocations, which they could then distribute to the public, rather than Morgan Stanley taking one great big slug and, presumably, one great big fee.

***James Leigh-Pemberton*:** If you look at the average daily volume traded in Lloyds and the breakdown of the category of those who are doing business in it, it is absolutely regular that in the top three most active houses in the stock on any given day there will be one to three of the major retail broking houses. There are in excess of 3 million individual shareholders in Lloyds. It is actively traded by individuals every day and that is reflected in the market shares of the retail brokers, so the phenomenon that you are describing is going on, on a daily basis, in any event.

Q66 **Kit Malthouse:** I understand that, but that will also largely be to people who are already existing investors in the stock market. The people I am concerned about are the people who paid the most for the bailout of Lloyds, who will be largely excluded. The fact that there is no retail offer as there was with the Post Office, even though institutions did better out of that than the public, means that my grandparents, were they alive, cannot put their 900 quid or whatever they might think into Lloyds. They can go and buy some shares, but the attraction of a retail offer is that it gets people who would not otherwise have any dealings with a stockbroker to buy shares.

***James Leigh-Pemberton*:** It does so, but by offering incentives. One point we should have in mind when thinking about this is that all taxpayers put money in to the rescue of Lloyds or the recapitalisation of Lloyds. Not all taxpayers, by definition, will benefit from participating in the discounts and other incentives that would distinguish a formal public offering from buying the shares in the ordinary way in the market every day.

There is another point in all this, which is important, and that is Ollie's point about the length of time that it takes to prepare for this. When this was originally considered, we were operating in a set of market conditions that was completely different from those that we have at the moment and where you could make a case for saying that there was a reasonably benign outlook and a planning period that would allow you to consider this kind of an operation. Today, the levels of volatility have gone up significantly. It is difficult, over a six to nine-month planning period, to say with any degree of certainty whether you could get value at the point of execution, so there is also a value to the taxpayer point in two ways, which needs to be taken into account, in terms of the best available method in today's environment for disposing of the shares.

Q67 **Kit Malthouse:** You can understand, though. I have had two constituents write to me, frankly, resenting the fact that they have been barred from buying RBS and effectively barred from buying—

***James Leigh-Pemberton*:** They could buy them tomorrow.

Q68 **Kit Malthouse:** They can go and buy them in the market, but the point is they do not have access to the discounts that you would be giving to Goldman Sachs or Merrill Lynch.

***James Leigh-Pemberton*:** We are not giving any discounts in the trading plan. The stock gets sold at the prevailing market price. That is one of the principal purposes of the trading plan. It is designed to enable shares to be sold at a moment in time and at a price point that is a reflection of the appetite of the natural buyer.

Q69 **Kit Malthouse:** Then I do not understand why you need Morgan Stanley. Why would you not go directly to retail brokers?

James Leigh-Pemberton: We have to appoint a single broker.

Q70 **Kit Malthouse:** Why?

James Leigh-Pemberton: A mandate has to be given to—

Q71 **Kit Malthouse:** Why could you not choose six, one in each of the regions? There are lots of regional brokers.

***Oliver Holbourn*:** There is a very important point here, which is that it would only be practicable to have one broker operating at any one point in the market. To maintain an orderly market, you would have to have one broker in the market at any one time. It would not be the right thing to do to have multiple brokers operating on behalf of one seller at any point in time in the market, because you would not be able to ascertain what, if any, price pressure you were having on the market. That is not possible.

The other thing about the trading plan is that it enables us to trade through periods where otherwise we may not be able to trade. In other words, similar to a corporate buyback, where a company goes into a closed period and is not able to deal in its own shares, we have given discretion to Morgan Stanley under a set of parameters that enables us to trade and sell shares at good prices over a prolonged period. If we wanted to have a process whereby one broker went to another broker and went to another broker, that would mean reinstituting that entire process, which takes two to three weeks; and, if we were in a company closed period or we were in possession of other information that meant that we were not able to sell, then we would have to stop selling shares. Practically speaking, therefore, to get best value for the taxpayer, it is the best outcome to have one broker for a prolonged period of time.

The other point I would make is that, when you are executing a trading plan, you want a broker who has access to the broadest range of market participants that you possibly can. That is not just selling to retail investors, because that is one portion of the market; on any day in Lloyds it is probably between 5% and 10% of the market. We do a procurement process with a great number of banks and we choose the bank that we think has best access to the market in a way that will least impact the price over a prolonged period of time.

Sorry for the long answer, but that is why.

Q72 **Kit Malthouse:** No, that is all right. I understand what you are saying, but you understand people's frustration. As you say, there is 5% to 10%, so that means 90%-odd of these shares are going to end up in the hands of Goldman Sachs, Merrill Lynch, Credit Suisse and all the rest of it.

***Oliver Holbourn*:** None of the shares will end up with any of the banks. The shares are sold to market participants every single day.

Q73 **Kit Malthouse:** Would it be possible to give Morgan Stanley a mandate that says there has to be a retail tranche every day? In the old days of the stock market, every flotation had to have a retail tranche to ensure that the private investor got access to these things.

***James Leigh-Pemberton*:** There was a reason for that, because that access was not available. Take a platform like TD Waterhouse. Today, for those who want to buy listed ordinary shares, there are many low-cost means of access. Different platforms operate at different cost levels for different levels of service, but there are low-cost platforms that give the person who is on that platform access to all quoted stock.

The fundamental principle is that, if anybody wants to buy Lloyds shares as an individual, in almost any size, they can do so today. Yes, there are costs, because you have to have market access through a platform or through a broker, but those costs are quite small. I absolutely accept that in so doing you have to pay the market price, not a discounted price. However, in this current market environment it is our view, and it was the advice that we gave, that that is the best means of achieving best value for the taxpayer, in particular because in this volatile market environment the structure of the trading plan provides that the taxpayer is protected on the downside. There is a stop point below which no sales can be made, but it is fully exposed to 100% of the upside. In a volatile market environment, that is the most effective means of realising best value for the taxpayer.

Q74 **Kit Malthouse:** It just does not feel to me as if there is ever going to be a retail offer. There always seems to be a reason why not. Here we are, and I think you are saying a couple of years to resolve these things, so we will be 10 years on and there will not have been any chance for those people who do not participate to start to participate in it. Can you see the prospect of there ever being a retail offer?

***James Leigh-Pemberton*:** As Ollie said and we have said before here, it is absolutely part of the toolkit that we think about regularly when we are thinking about how to dispose of these shares. However, a very particular set of circumstances would be required to enable a successful retail offer to be undertaken: namely, a period during which, first, we could effect the preparation and, secondly, we could be sure of getting value at the end of that preparatory period.

Q75 **Chair:** There is overwhelming support from this side of the table for you to consider this as carefully as you possibly can; you have already said you are doing so. Perhaps you would take the thought away, give it very careful consideration and drop us a line about the scope, the problem for doing so and the limits to doing so. We might take it from there, either orally or in writing, because there is a good deal of public interest about this, as you can imagine, and a good deal of interest in this Committee.

Q76 **George Kerevan:** Good afternoon, gentlemen. The FCA and RBS have agreed to a redress scheme for customers caught up in the GRG affair and RBS is offering an initial £400 million as part of that redress scheme. I wonder what views you have inputted to the board of the bank on that redress scheme and how it could proceed.

***James Leigh-Pemberton*:** Since the Andrew Large report into RBS's SME activities, which is now some two and a half years ago, and the subsequent Clifford Chance report and the appointment of Promontory and Mazars to do a skilled persons report, we have had a continuous discussion with RBS, much less about the specifics of the company-by-company activity of GRG, but rather about the measures that they have put in place to prevent the repetition of anything of this sort in the future. We did not, therefore, have any specific input into the determination of the size of the amount that has been put aside to provide redress to customers.

Q77 **George Kerevan:** Given that the redress scheme is not finalised and there are ongoing discussions between RBS and FCA, do you have a view on the shape, scale and form of redress, given it will have an impact on the share price?

***James Leigh-Pemberton*:** This is a conduct matter, where I understand that there has been a high level of dialogue and co-operation between the FCA and the management and board of RBS. The figure that has been made public by RBS's announcement was referred to in the FCA's simultaneous announcement, and the FCA said that they agreed with and approved the announcement that RBS had made.

Q78 **George Kerevan:** With respect, the redress scheme is not approved.

***James Leigh-Pemberton*:** Sorry, I think they approved the contents of the announcement; that is what they said. That is all I was saying. Put differently, we, as a shareholder, do not have any regulatory powers. We do not have any intervention powers equivalent to those of the FCA in matters like this.

Q79 **George Kerevan:** I appreciate that. That is not what I am asking. As a quasi-institutional shareholder, there is a very significant issue, which could lead to further litigation, in that the companies involved in the redress process feel that £400 million is much less than the final outcome. It has an impact on shareholder value, which is your locus.

***James Leigh-Pemberton*:** Yes, certainly.

George Kerevan: I am just probing the degree to which you have been talking to the RBS board and the degree to which you are involved in approving the redress scheme or at least give your views on the scale and structure of the redress scheme.

***James Leigh-Pemberton*:** As I said, we have been much more focused on the improvement in RBS's policies, procedures and culture to prevent this from happening. We have not been consulted or given any approval on the size of this redress scheme. Obviously, we are aware of the potential impact on shareholder value of, first, that provision and, secondly, the possibility that there could be further litigation. That has been widely reported in the press. However, this is a decision that will have been made by the board of RBS in the full knowledge and full acknowledgement of the shortcomings that were exhibited by RBS. It is not really a decision for us. We do not have that full knowledge. We certainly have not been in any kind of dialogue with the FCA on this topic.

This is one of those cases where the decision has to be made by the board and management of RBS rather than by the shareholders.

Q80 **George Kerevan:** Let me give you some context. If you read the litigation and investigation section of the half-yearly report from RBS, there are 38 separate investigations or potential areas of litigation. That has a profound impact, potentially, on shareholder value and your ability to sell the shares. It is a strategic issue; it is not just a conduct issue. Let me put it another way. Of those 38 potential flashpoints, which do you think are the ones that we should be looking at and taking into consideration as the most important, with a potential impact on shareholder value?

***James Leigh-Pemberton*:** The most important of those, as I mentioned earlier, is RMBS. I want to make this absolutely clear. I said earlier that the market has speculated on a size for the fine of between $5 million and $12 million. That is market speculation. That is not, just to be completely clear, a view that we hold at UKFI. We do not have any certainty on what the size of that is. That is the most material. That section on litigation risk refers also to potential litigation in the context of a shareholder suit in relation to the rights issue prospectus of early 2008.

GRG is a material matter and, in our regular meetings with RBS, we are keen to understand how all these items are progressing; I will ask Ollie to say some more about that. We cannot judge, as a shareholder, whether the provisions that they have made in relation to GRG are right. That has to be a decision for the audit committee, the risk committee and the board overall.

Q81 **George Kerevan:** I will move on to another issue, which is obviously a matter of public interest at the moment: the robustness of IT systems in retail banks. In recent days, we have seen the attack on Tesco Bank. Since that attack, have you had discussions with the management of Lloyds or RBS on what lessons can be drawn and the state of play of their IT system security?

***James Leigh-Pemberton*:** Yes, we have.

***Oliver Holbourn*:** It is probably a little too early to draw the lessons, because everyone is trying to figure out exactly what happened in that situation. Whether we call it IT or cybersecurity, or whatever it is, we know it is a top risk at both banks, which the boards of both RBS and Lloyds are very focused on. In fact, they have changed some of the personnel on the boards in recent years to focus on this specific issue. RBS said, in 2015, they were going to spend £3.5 billion of investment spend on technology in 2015 through 2017, of which £1.6 billion is on strength and sustainability. Lloyds have an annual spend of in excess of £2 billion and they also have a separate digital arm.

Any CEO of any big bank would say that it is very difficult to sit in front of anyone and say that the systems are impenetrable. They have to put in place a range of issues, working with Government, with law enforcement, with branch colleagues. RBS, for example, last year did some of what they call "ethical phishing" with colleagues. They sent out emails to branch colleagues to see whether they would get a response, so that they can then understand what the risks to the organisation are on a day-to-day basis.

The final point I will make on the Tesco incident is that Tesco ceased being reliant on RBS systems back in 2012, so there is no legacy impact or read-across there, but it is a very difficult issue. They are spending a lot of money, but it does not mean they are going to get perfect outcomes.

Q82 **George Kerevan:** Okay, so you are concerned; there have been discussions; more money is being invested, but what steps have you taken to analyse how much needs to be invested? As our surrogate institutional shareholder, you cannot just stop at the level of more money being invested. Is enough money being invested by Lloyds and RBS, from your point of view, in cybersecurity?

***Oliver Holbourn*:** That is a really good question.

George Kerevan: That is why I asked it.

***Oliver Holbourn*:** It is an incredibly difficult judgment to take and it is not just specifically on IT. A lot of this spend is rolled up in wider investment plans. The truth is, in particular at RBS, we talk to the head technology gentleman, Simon McNamara, and he talks us through the level of resilience that has been achieved in their systems. Lloyds, last year, for example, had the best availability of systems throughout the year. That is the only way that we will learn that they are investing enough. The truth is that we cannot say for certain, but we think the sums of money being input are sensible and proportionate.

Q83 **George Kerevan:** Do you have independent IT advice separate from the banks?

***Oliver Holbourn*:** The board takes separate IT advice. Obviously, it is a whole company issue, not just a board issue. Both boards have people on them with specific backgrounds in IT. We do not have separate cybersecurity advice, no.

Q84 **George Kerevan:** How do you know that the information you are getting from the banks is correct, then?

***Oliver Holbourn*:** The decision as to whether they are investing enough in information technology is a decision that the bank has to take. That is a decision the board has to take. The board, if it needs to, will seek advice on what it is able to take, but we do not take separate advice on the amount of IT spend.

Q85 **George Kerevan:** Do you think that the attack on Tesco has had a material impact on Tesco's share value? If it has and you are telling me that you do not take any independent advice on the efficacy or robustness of the investment by two banks that you own or are a substantial shareholder of, then is there not a lacuna in your knowledge?

James Leigh-Pemberton**:** To answer the first question, it is probably a little too early to say. This is a bit like what happened with TalkTalk. As ever, the critical question for any customer-facing business is more what the reputational damage is, the extent to which the franchise has been affected. As it happens, if you look at the stock price and the operating performance at TalkTalk, there seems to be some evidence that, yes, there was some damage, but it was not material damage, at least from a share price point of view. In Tesco, it is probably too early to say.

I very much take your point that we are dependent on the management team and the board for their analysis of the steps that they are taking to improve their cybersecurity. Our task, as a shareholder, is to focus on the extent to which that is being done, the resource that the bank has to challenge itself satisfactorily and whether there is sufficient expertise, especially at board level, in exactly the same way as you need to have risk expertise, audit committee expertise and capable people on the remuneration committee.

We rely on those people, as a shareholder, to do their job correctly and we try to make sure that that is being done correctly; so too at board level. Both of the listed investee banks have elevated this matter to the board. They have both strengthened the board through appointments that allow proper board-level challenge to the executive in relation to these matters, by acquiring a very high level of expertise in this area. It is through that mechanism primarily that we, as a shareholder, have to exercise our pressure. It has to be done through the mechanism of the board rather than directly, as in all the other measures of risk and return in the banks.

Q86 **George Kerevan:** I have one final question, which arose from earlier contributions you made. There is an overlap in the board membership of UKFI and UKGI. Does that not lead to conflicts of interest or certainly unclarity about who is responsible for what, particularly as you have a couple of non-exec directors at UKFI level who are also on the new UKGI? In a sense, who are they delivering the independent advice to, at which level? It is also important to note that UKGI has the Treasury director who is represented on the board, so, in a sense, your argument that you are at arm's length is being eroded by this interim structure that you have.

James Leigh-Pemberton**:** Turning to the second question first, we also have on our board a Treasury-nominated director. Kirstin Baker is nominated by HMT and she is not independent in that regard. The rest of our board is independent. Similarly, with respect to the UKGI board, there is an HMT-nominated representative, who is not independent. The rest of the board is independent from the shareholder in that regard.

That is very normal. I think I have said in this Committee before that the parallel I draw is that the board of UKFI and, indeed, the board of UKGI in its relationship with its shareholder, HM Treasury, is a little like the board of a wholly-owned subsidiary of a parent company. It has one shareholder that it is answerable to. It is highly likely that that board will have on it representation from that one shareholder, but the directors also have the responsibility to carry out the duties of the company as defined by its ultimate shareholder. That is exactly what the situation is with respect to the Treasury representation on the UKGI board and, indeed, the UKFI board.

With respect to the governance arrangements between UKGI and UKFI, yes, there is overlap. There are two NEDs on the UKGI board who are also NEDs of UKFI. That, again, is a reflection of that similar arrangement, and I think it is considered desirable by the UKGI board that it should be able to exercise its shareholder duties on UKFI through both its ownership under the corporate structure and also through governance.

Q87 **Chair:** Mr Holbourn, I was surprised by your reply to George Kerevan's earlier question about whether there was enough IT investment going on. Your reply was that it was an incredibly difficult judgment to take. We have just had a succession of failures, apparent cybercrimes and demonstrations of a lack of resilience. The list is just endless and the reputational risk from all this is pretty large. Have you discussed with the regulators whether they think the IT systems are up to snuff?

***Oliver Holbourn*:** Our role as a large shareholder does not extend to a discussion with the regulator on cybersecurity or IT matters.

Q88 **Chair:** Do you attend the board?

***Oliver Holbourn*:** Of RBS and Lloyds? No, we do not attend the board.

Q89 **Chair:** And you do not get reports back of board meetings.

***Oliver Holbourn*:** No, we do not get reports back of board meetings unless there are circumstances where the banks ask to share the information with us through our information protocols.

Q90 **Chair:** Okay. George Kerevan also asked about the scale of the losses from conduct fines. There is an extraordinary passage, which I am sure you are aware of, in the accounts. I will not read it all out, but, in a nutshell, it says it is not possible to determine whether any loss is probable or to estimate reliably the amount of any loss, either as a direct consequence of the relevant proceedings and investigations or as a result of adverse impacts or restrictions on RBS's reputation.

By the way, I have only reached the first proper comma, and then it goes in similar vein for about eight lines, which is basically them saying they do not have a clue what the contingent liabilities on the balance sheet are. Have you given some thought to that and do you not think it might be depressing the share price? It is back to the questions that Kit was asking and Jacob also alluded to.

***Oliver Holbourn*:** RBS would welcome some clarity on these issues, but a number of them are not within their gift. In particular, in relation to the Department of Justice, under accounting rules the loss has to be estimable and probable. On the balance sheet, as at Q3, they have approximately £7.7 billion worth of provisions at the moment for conduct and litigation, but they have not taken anything for the DOJ because they simply do not know what the number is and there is no way of estimating it. We have tried, other people have tried and there are obviously estimates, which are, at best, guesses in the market as to what it is, but you are right. It is kind of an overhang, for want of a better word, on the price.

Q91 **Chair:** Have you tried to take a view on when we will have a clearer picture?

***Oliver Holbourn*:** Yes. In our management discussions with RBS, we discuss it very, very regularly with them.

Q92 **Chair:** What answer do you get to that question, because that could have a considerable bearing on the date at which we might be able to do some serious selling?

***Oliver Holbourn*:** I am afraid the answer is exactly the same one as Sir Howard gave in his comments publicly on Sunday.

Q93 **Chris Philp:** Let me continue on the theme of the US fines. Clearly, these fines will pretty much directly impact the value realised by the UK taxpayer, as you said. Some people have commented that the US government have levied fines on European businesses—BP, for example, the UK business—and European financial institutions that are disproportionate compared to the offence and when compared to similar fines levied on US banks that had much larger US operations. Is that a view that you share?

***James Leigh-Pemberton*:** I do not think we really have a view on the topic. These numbers can be made to fit whatever view you would like to express. There are so many different component parts, so I do not think we have a view on that. We have never done any work on the comparative analysis between the fines levied on banks from one jurisdiction or another in the United States, so we do not have the data and we have not done any analysis in a way that would allow us to take a properly formed view.

Q94 **Chris Philp:** Given that your mandate is to optimise value for the UK taxpayer, is that not analysis that you should do and if you find, as I suspect you would, that UK and European firms are being disproportionately penalised by US regulators—in this case transferring value directly from the UK taxpayer to the US taxpayer—should you not then be lobbying our UK Government to take this up with their American counterparts to get them to cease and desist from this apparent victimisation of European businesses?

James Leigh-Pemberton**:** Our work here to protect and enhance value for the taxpayer is focused entirely on ensuring that RBS are seeking the best possible settlement. Each of these settlements is very specific to a whole raft of different things and in the case of RBS it will be, no doubt, a function of how much underwriting they did, how much distribution they did and whether they were involved in origination. Some of the US banks were involved in origination; some were not. What was the precise nature of the offences that have been identified and that are the subject of litigation? They are different bank by bank. Take, by way of example, the fine that was levied on BNP in relation to its failure to comply with know your customer and money laundering requirements. In the findings that the DOJ published, this was a reflection, I think, of the precise detail of what they were alleged to have done.

Q95 **Chris Philp:** I am not asking you to dig over the embers of every fine the DOJ have ever levied. What I am saying is that you have told us this afternoon, quite correctly, that these fines, which could be in the billions, possibly mid-single figure billions, maybe higher, will have a very material impact on the UK taxpayer. As a responsible custodian of the UK taxpayers' money, should you not be engaging with the UK Government to make sure that we bring to bear diplomatic pressure on the US Government to make sure that they behave in a manner that is reasonable and proportionate, in order to protect UK taxpayers' interests? Is that not exactly what, as the custodian of those interests, you should be doing?

James Leigh-Pemberton**:** To the extent of our capability to do it with the resources that we have in-house inside UKFI, we have.

Q96 **Chris Philp:** Good. In that case, what conversations have you had with the Foreign Office in order to press this point?

James Leigh-Pemberton**:** As I said, to the extent of our capability, we have had conversations with our Treasury colleagues. We do not have diplomatic skills. We do not have the capability to execute in this area.

Q97 **Chris Philp:** No, but the Foreign Office obviously does.

James Leigh-Pemberton**:** Yes, so we have had conversations with our Treasury colleagues and we have made precisely this point: that this is a material item in terms of both the timetable and the value realisable in any disposal programme relating to RBS.

Q98 **Chris Philp:** Sorry to cut across you, but there is going to be a division quite soon, which means we will have to go and vote. What response did you receive from the Treasury when you raised that point?

James Leigh-Pemberton**:** They said, "We are highly mindful of this. We have our own channels for discussing these items and we will do that. We have means by which we can engage with colleagues elsewhere in

Government and we will do that. We have taken your point and you will have to leave it with us".

Q99 **Chris Philp:** How long ago was that conversation?

***James Leigh-Pemberton*:** They are continual. This is a point that we continuously make.

Q100 **Chris Philp:** Have you had any feedback to suggest that they have taken action as a consequence of you raising this point, as opposed to merely telling you they have taken your point?

***James Leigh-Pemberton*:** We have not had anything specific back from our colleagues, but they have said, "Yes, we have done that" and we have spoken to those who we believe can give us the best possible guidance as to how this case should be made. However, in the end, this is a matter of negotiation, which RBS and its legal advisers must have with their opposite numbers in the relevant part of the DOJ.

Q101 **Chris Philp:** It is, but it is also a matter of critical national interest and, therefore, in my view, it is appropriate for the UK Government to exert pressure as well. Can I suggest that you press the Treasury to give you feedback on this issue, and could I further suggest that you also raise this issue with the Foreign Office, which is clearly primarily responsible for intergovernmental relations?

***James Leigh-Pemberton*:** As I said, our shareholder is HM Treasury. HM Treasury is acutely conscious of the impact of this litigation on the value realisable and the timetable for realising this value. It is an area that falls outside the expertise of UKFI to go further than that. We are there to do stewardship and to execute transactions here.

Q102 **Chris Philp:** I am not asking you to personally go and lobby the DOJ. What I am asking you to do is actively and energetically engage with the machinery of the UK Government to make sure that they are doing those things. It is good that you have raised it with the Treasury, but you need to go further. You need to actively chase them for follow up, to make sure they have done something on the point. You should also raise it directly with the Foreign Office. I can provide their phone number, if that would be of any assistance to you, given your team is very small and may not be able to look it up themselves.

Chair: I can have a word with Nigel Farage.

Chris Philp: I think I have made the point. Moving on, clearly it would be helpful, in a similar vein, to make sure that RBS is as successful as it can be. I note that its tier 1 common equity stands currently at 15%, which is higher than the 13% target. It is also higher than the UK average, which is around 12%. Clearly, if you run with higher tier 1 common equity ratios, your return on equity and, therefore, the equity value in the bank are lower than they would be otherwise. Do you concur with that analysis and do you believe that the regulators should be looking at giving RBS a bit of an easier ride when it comes to their apparently rather high levels of tier 1 common equity?

***James Leigh-Pemberton*:** The CET1 equity at RBS is high. We take the view that it is prudent that it should be so, in light of the conversation that we have just been having. There are uncertainties in relation to the liabilities that RBS face, which could have a direct impact on the amount of capital that they hold. Therefore, in our view, as a shareholder, it is prudent to be running a higher level of CET1, not on a continuous basis—and RBS have referred to a 13% target level as being the appropriate level in the medium term—but at this juncture and against the backdrop of the things that have been mentioned here today: the contingent liabilities, which have yet to be finally crystallised, as a result of pending litigation in relation to legacy items.

***Oliver Holbourn*:** There are also other regulatory developments, which will impact their core equity tier 1: Basel IV, wherever that lands; IFRS 9. It is not just the contingent liabilities; it is the future development of the regulatory environment, which could bring that number down.

Q103 **Chris Philp:** It sounds like you have a certain measure of engagement with RBS management, as I would expect for a major shareholder. What is your view and what view have you expressed to management on the fact that they are looking to shrink their balance sheet? I am speaking from memory, so please correct me if I am wrong, but I think their gross balance sheet is currently about £800 billion and they are looking to shrink it to something like £600 billion. Can you comment on whether you support that strategy and if you think that will create or destroy value for the British taxpayer? Were those numbers roughly right, by the way?

***Oliver Holbourn*:** Roughly. We look at it on a risk-weighted basis, which is the relevant metric for CET1. Basically, they have £185 billion worth of risk-weighted assets in core and £50 billion of risk-weighted assets in non-core, i.e. divisions that, hopefully, by 2019 they will be out of. The short answer to your question is yes, we agree with their strategy; yes, we think they are doing the right thing. Broadly, that is trying to allocate the capital to businesses where they have a competitive advantage, where their customers want advice and products and where they can generate a return on capital above the cost of capital. We think it is the right thing for them to do.

Q104 **Chris Philp:** Clearly, RBS is an institution that is fairly central to the functioning of the UK economy. It is obviously a very large bank; lots of businesses and consumers depend on it for banking services and credit, in particular. They have expressed a view to me that they would be a more dynamic organisation, an organisation better able to serve the interests of this country's economy if they were fully in private ownership, without the hand of the state on their shoulder, no matter how lightly you may lay that hand. First, would you agree with that analysis? If you do, do you not think we should, therefore, be looking to expedite the return of RBS to private ownership?

***James Leigh-Pemberton*:** Yes, I agree with both those things, but as ever there are trade-offs and there are important considerations that have to be taken into account to deliver that outcome in the best possible way. The fact that we are there at all as UKFI, speaking for myself, would tend to suggest that I agree with both of your fundamental contentions. It is right that the ownership should be returned to the private sector at the earliest possible opportunity, but it is also right that it should be done in a way that does not compromise receiving fair value for the securities that we currently own.

Q105 **Chris Philp:** I understand the point about fair value, which colleagues have raised. The Government has been a shareholder in RBS for something like eight years now. I understand you do not want to dispose of an asset in a distressed situation or in a time of market turmoil, which clearly prevailed in 2008, 2009, 2010 and possibly even a bit later, but eight years is nearly a decade. It is a very long time and I would have thought that there would have arisen a time during that eight-year period when an orderly disposal might have been achieved. You are asking the Committee to believe that at no stage during that eight-year period were market conditions benign enough to effect an orderly disposal. I find that hard to believe, given eight years is awfully long time.

***James Leigh-Pemberton*:** I do not think it is that alone. We have to understand what the scale has been of the restructuring just to put RBS into a place where its business is stable and its returns are predictable. A very significant proportion of that eight-year period has been spent going from the largest bank in the world, with balance sheet footings of £1.3 trillion, to where we are today. It is a long and time-consuming process to do that. It went through a series of phases. There was a period of interruption as well in the form of the euro crisis, which had a major impact on investor perception of banks.

The scale of the strategic refocus in Lloyds was smaller; the result is that it reached the end stage quicker and the disposal process could start earlier. The simple fact is, unfortunately, with respect to RBS, the scale of the reorganisation, which is still continuing, has been so large and it has taken a very long time. We are now halfway through a five-year restructuring, which is intended to leave the bank in its final end state. We are halfway through and that restructuring programme is on target and on time. I hope that we are coming towards the end of the period during which there is insufficient investor certainty as to what they are buying, so that we can find demand in the market and sell the shares.

Q106 **Chris Philp:** Let me conclude by saying I concur with the comments that Mr Rees-Mogg made earlier. There are clearly uncertainties in RBS. There are uncertainties in any business and I accept that the uncertainties are larger in RBS than for other businesses. Nonetheless, the market will take a view of those uncertainties and the market's view of those uncertainties is not necessarily any better or worse informed than your view. Clearly, it would be possible to transact at a price the market will pay and the market will price in the uncertainties to its offer. If you were minded to make a disposal in the coming 12 months, you would be able to do so at a market value and there is no reason to suppose that would not be fair value, unless you think your understanding of true value is better than the market's understanding of true value. That may be the case and, if it is, perhaps you could tell us.

James Leigh-Pemberton**:** I come back to the question that was asked in relation to the original sale, which is simply to say there will be times when the market is pricing risk in a different way, either more aggressively or more defensively than is a reflection of how it fairly should be priced. That is what happens. In those circumstances, that is when we will either decide to go forward, if it is pricing risk more aggressively, or decide not to make disposals.

Q107 **Chris Philp:** Crucially, therefore, you might sell before these uncertainties have been resolved if you think the market's view of those uncertainties moves in your favour.

James Leigh-Pemberton**:** At the right price point relative to our assessment of what the possible outcomes are, yes, we would. If we thought that the taxpayer was being rewarded adequately for the current and future prospects of the bank, yes, we would. It is very difficult in the present circumstances to imagine how that could be so, because precisely our uncertainty is also afflicting the buyers. That is really the fundamental point we are trying to make.

Chris Philp: Thank you, and do please press that fines point.

Chair: Thank you very much for coming to give evidence to us this afternoon. We have picked up a few things and you can see there is a good deal of interest and some pointers for the direction of Parliament's thinking on this. We look forward to receiving your letter on one point as well. Thank you very much indeed.