

## **Howard Reed – what the “nationalisation” means**

Formerly chief economist at IPPR. 6 months ago started new economic consultancy, Landman Economics, working on various progressive issues.

### **Key points on the nationalisation**

#### ***Technical details of the part-nationalisation***

##### **Shares**

For RBS, the govt has agreed to invest up to £15bn in ordinary shares and £5bn of preference shares to 're-capitalise' the bank – i.e. to provide it with enough extra capital to meet its financial obligations. This gives the govt a maximum 63% stake in RBS.

RBS is currently attempting to raise £15 billion of share capital via private investors. The govt has agreed to underwrite this issue at 66.5 pence per share– i.e. it will make up the gap between whatever RBS manages to raise on the open market (which could be limited in current economic circumstances) and £15 billion. The £5 billion of preference shares is a fixed amount. So in practice the govt's stake could be less than 63 per cent at the end of the day – but it is likely to be close to 63 per cent, as there is unlikely to be substantial amounts of private investment in the shares at the offer price.

To give some idea of how much this capitalisation means to RBS:

RBS's total stock market value on 15.10.07 - £42 billion

RBS's total smv on 10.10.08 - £12 billion

For Lloyds TSB and HBOS an additional £17bn of capital has been made available, again in the form of underwritten purchases of shares. This will give the govt an approx 44 percent stake.

Only two banks with major high street operations in the UK – HSBC and Barclays – remain in fully private hands.

##### **Dividend policy**

Under the original terms of the bail-out the banks cannot pay dividends while the govt owns preference shares in them. RBS has £5bn of preference shares, which pay a 12 percent annual interest rate and cannot be repaid for 5 years.

However, the banks may be able to restart dividend payments in 2010 if they can demonstrate that their capital positions are robust and may be able to repay preference shares early by mutual agreement with govt.

## **Terms of the deal**

Dividend payouts: (at present) banned until at least 2010 – although this may be relaxed.

Limits on executive remuneration. No bonuses will be paid to directors in 2008. Any bonuses for 2009 will be in stock and linked to long-term growth in the bank.

The govt is appointing non-executive directors (but not executive directors. The difference is that NEDs attend board meetings and contribute to strategy but are not involved in day-to-day company decision making).

The bailout plan contains a requirement for the banks to restore lending (presumably mortgage plus commercial sector lending) to 2007 levels within 3 years from now. It's not clear, however, what the regulatory mechanism is to achieve this, or what sanctions the govt intends to use if the target isn't achieved. If demand for credit is low (e.g. in an economic slump) it could be impossible to meet this target anyhow, even at low interest rates.

The Treasury says that “the shareholdings [in RBS and other banks] will be managed on a fully commercial basis by an arms-length body – with a precisely defined remit – to act in the interests of taxpayers.” (Parliamentary statement by Alistair Darling, 13<sup>th</sup> October.) This was confirmed in an interview the *Guardian* conducted with City minister Lord Myners for today's issue:

“Myners reveals a new agency is likely to be created similar to the Shareholder Executive set up in 2003 to oversee government stakes in businesses such as the Tote, Channel Four and the Met Office. It is not clear whether Northern Rock will be under the new agency.”

A report in the FT of Oct 13<sup>th</sup> suggested that the new RBS chief executive (Stephen Hester) is planning to review the bank's strategy “from first principles” - with more UK-based operation and less international commitments.

## **How long?**

At the moment no-one can really see. The conditions of the bailout deal suggest anything between 2 and 5 years but the govt will not want to sell these assets at a loss, so will probably just hold until it can sell them at a profit. In a statement to HoC last week Alistair Darling said “the long-term future of UK banks lies in the private sector. We will aim to sell the public share in the participating banks as soon as feasibly possible.”

## **Re-organisation?**

The merger of HBOS group and Lloyds TSB group, which was already being planned before the part-nationalisation, is set to go ahead. So far there have been no

announcements about merging RBS with any of the other nationalised or part-nationalised banks although we have no real idea at present what kind of business strategy any of these banks will pursue. A prolonged and severe contraction in the commercial lending and mortgage market could put all these banks at risk as independent entities. This means that we could be looking at Lloyds-TSB-HBOS-RBS-Northern Rock & Bingley somewhere down the line (or something with a more manageable name).

### ***Wider regulatory implications?***

The chairman of the FSA, Adair Turner, has called for a totally new approach to bank regulation- “wiping the slate clean” - in view of the failure of the previous regulatory framework. A 'heavier touch' regulation, costing more, with higher-paid people employed. Details have yet to emerge, however.

Q: Why does share price affect available capital?

Value of shares is not direct measure of capital, but a lot of RBS' capital is tied up in investments – and other shares have gone down. The lower the stock market and housing market, the harder it is for RBS to make investments.

Q: Restoring lending: is it just mortgages and small businesses or general?

Mandelson has talked about encouraging small business sector. Nothing specific in the deal on small business – but being used for political expediency, to demonstrate that government is working for small businesses.

Q: Who sets the terms?

The Treasury, consulting with FSA. And in conjunction with Number 10.

Q: Are terms subject to review?

Yes, because a lot of the small print hasn't been set yet. Key numbers (amount of cash being put in) not likely to change in near future. But depends on what happens in the economy + the market now.

Only 2008 and 2009 set in the deal – most of the rest still open.

Q: When are shares being issued?

Next month or so. 6 weeks after initial bailout.

Q: When arms-length management company to be set up?

Not clear yet – over next few months. They'll probably do a temporary management structure, then do the long-term one alongside reform of FSA etc. Its terms of reference will be absolutely key.

Q: And non-exec directors?

Also unclear – but likely to be around the same time.

Government had lots of influence on appointment of Hester – they consulted with Treasury.

Q: Who will non-execs be?

We will know who they are. Don't know how much media profile etc they will have. It won't be civil servants, but will be someone with government approval – probably city people known to be sympathetic to the government.