The Committee will meet at 10.30 am in Committee Room 4.

1. **The way forward for Scotland's banking, building society and financial services sector** The Committee will take evidence from—

   Jim Watson, Chairman, and Gordon McGuinness, Member, Financial Sector Jobs Task Force;

   Mark Tennant, Industry Deputy Chair, FiSAB;

and then from—

   John Swinney MSP, Cabinet Secretary for Finance and Sustainable Growth, David Wilson, Director of Enterprise, Energy and Tourism, and Dr Gary Gillespie, Deputy Director, Office of the Chief Economic Adviser, Scottish Government.
The papers for this meeting are as follows—

**Agenda item 1**

Note by the clerk EET/S3/10/6/1

Note by SPICe EET/S3/10/6/2

PRIVATE PAPER EET/S3/10/6/3 (P)
The way forward for Scotland’s banking, building society and financial services sector

Background

1. The Committee received a written submission from the Scottish Government in response to the Committee's call for evidence in September 2009.

2. The submission is attached in the annexe to this paper and Members are invited to take it into account in their deliberations when questioning the Cabinet Secretary for Finance and Sustainable Growth.

Stephen Imrie
Clerk to the Committee
February 2010
Q1. What is your view on the cause, nature and impact of the recent difficulties in the financial sector in Scotland?

1. Response: The cause of the difficulties in the financial sector are not restricted to Scotland and are linked to turmoil in global financial markets triggered by the “sub-prime crisis” that hit the USA in August 2007¹.

The sub-prime crisis developed in the wake of interest rate increases in the USA, as many loans to sub-prime borrowers (broadly, those with poor credit histories) proved to be unsustainable in the context of slowing housing market and rising interest rates. In January 2008 a number of international banks reported huge losses following large debt write-downs.

A number of high profile reports have identified the root causes of the difficulties as described above² - in the main these have been seen as low real interest rates, a search for yield by financial institutions, excess liquidity and a misplaced faith in financial innovation (e.g. bonds backed by pools of mortgages with different credit risk profiles - many of which were those from the sub-prime sector as they carried higher yields) all of which led to a culture of over confidence and risk taking. In addition, while regulators across the world had introduced processes to regulate individual institutions within the different sectors of the industry, no-one clearly identified the systemic risks created through a lack of understanding of the impact of risk created in one organisation spreading to others across the globe - and eventually spreading outside of the financial industry to the real economy.

Despite the fact that the UK mortgage market has not experienced anything like the extent of sub-prime lending as has occurred in the USA, the UK financial sector was exposed indirectly in several ways, for example, by holding financial assets that were exposed to the US sub-prime market (i.e. equity in US financial institutions or holdings of securitised assets or derivatives that involved exposure to sub-prime credit) and by holding assets whose value was heavily dependent on US economic prospects in general.

September and October 2008 then saw a re-escalation of the international financial crisis, against a backdrop of an increasingly pronounced economic slowdown and, in the banking sector, weakened balance sheets. Rapidly deteriorating investor confidence led to bankruptcies, unexpected private sector takeovers and government interventions to restore stability to markets and contain overspill to the real economy.


The impact on the structure of Scotland’s financial services industry has been felt mainly in the banking sector with the merger of HBOS with Lloyds TSB (becoming the new Lloyds Banking Group) aided by the UK Government waiving competition rules in the public interest, leaving concerns about the long term competitiveness of the sector in Scotland. Both Lloyds Banking Group and Royal Bank of Scotland have had to participate in schemes administered by the UK Government which have been designed to both stabilise the financial services industry and increase lending with a view to supporting the wider economy to mitigate the effects of recession, resulting in the UK Government owing a substantial share in both banks. In RBS, for example, the UK Government’s voting stake will be capped at 75% however, its economic stake - the value of the government investment as a proportion of the value of all investment - may be higher. In Lloyds Banking Group, the UK Government’s voting stake could be as much as 65% - however the economic stake could be as high as 77%.

On 30 March 2009, Dunfermline Building Society’s wholesale and retail deposits, branches, head office and originated residential mortgages (other than social housing and related deposits) were transferred to the Nationwide Building Society under the terms of the Banking Act 2009. Subsequently, Nationwide successfully bid for Dunfermline’s social housing portfolio which had been held in a bridge bank wholly owned by the Bank of England.

Q2 What evidence do you have on the issue of the availability and cost of credit and what effect have the initiatives undertaken by the banks, government bodies, regulators and others had?

2. Response: Evidence on credit availability and cost of finance is taken from a number of different sources at the UK and where available, at the Scottish level. The data on individual bank lending is largely unpublished and understandably commercially sensitive material so will not be in the public domain. Although there will be references within the media to levels of lending the figures quoted will be released by individual banks on an ad hoc basis and may relate to a designated period of time or a specific client group such as small businesses. The main sources used by the Scottish Government in assessing bank lending credit conditions are;

- Scottish Government Access to Finance Survey 2009 - survey of 1001 SMEs looking at supply, demand and cost of credit and comparing changes between 2007 and 2009
- Bank of England Trends in Lending – monthly UK level assessment
- Bank of England Credit Conditions Survey – quarterly report on UK credit conditions

3 Published on 16th July 2009. Available at: [http://www.scotland.gov.uk/Topics/Economy/access-finance/report](http://www.scotland.gov.uk/Topics/Economy/access-finance/report)
4 Available at: [http://www.bankofengland.co.uk/publications/other/monetary/trendsinlending.htm](http://www.bankofengland.co.uk/publications/other/monetary/trendsinlending.htm)
5 Available at: [http://www.bankofengland.co.uk/publications/other/monetary/creditconditions.htm](http://www.bankofengland.co.uk/publications/other/monetary/creditconditions.htm)

Bank of England Statistical Database – detailed quarterly and monthly data on UK money and lending  


UK Government Treasury Select Committee Report on Mortgage Arrears and Access to Mortgage Finance  

At this time there is no evidence based assessment of the impact of the initiatives introduced in response to the credit crunch. Material is published on the relevant websites of individual bodies on a regular basis, indicating the performance of the initiatives in place.

Q3. What changes can be expected as part of the ongoing and future restructuring plans in the financial services sector within Scotland?

3. Response: At this point it is difficult to accurately gauge what changes will be made to Scotland’s financial services industry. The following issues will, however, impact on decisions:

UK Financial Investments Ltd (UKFI) - an arms length body established by the UK Government to manage its share in the banks, is also responsible for disposing of the UK Government’s investments in a manner consistent with HM Treasury’s stated aims that it should not be a permanent investor, maximising sustainable value for the taxpayer and taking account of risk.

RBS Restructuring: aims to save £2.5 billion per year; the bank to be separated into two arms - with riskier assets and operations grouped together. Overseas business to be cut back, with its operations to be reduced or sold in 36 of the 54 countries it works in. It will restructure as a premier financial institution anchored in the UK - it will "centre on the UK with tighter more focused global operations".

Lloyds Banking Group: the restructure required to combine two large organisations will result in job losses as posts are combined - in its shareholder circular in advance of the acquisition of HBOS, the Lloyds TSB

7 Available at: http://www.bankofengland.co.uk/mfsd/iadb/NewIntermed.asp
8 Subscription only service. Subscription details available at: http://www.cbi.org.uk/n dbs/content.cfm?1802737a45ed3c134205802567060539a0eaa9a3a3bf2b92b6a8023725d00414eb7?OpenDocument
9 Subscription only service.
11 Published 8th August 2009. Available at: http://www.publications.parliament.uk/pa/reports_recent.htm
12 UKFI’s Framework document can be found at: http://www.ukfi.gov.uk/publications/
Board stated it believed it will deliver total annual pre-tax cost savings greater than £1.5 billion by the end of 2011. Announcements by the Group to date have involved changes to both Group Operations and Insurance Division. The group has also announced it will retain the Scottish Widows brand and concentrate pension and investment activity in Scotland - indicating the underlying strength of Scotland’s reputation in financial services.

**EC State Aid:** issues for banks which have received assistance from the UK Government:

- The European Commission (EC) recognises that state intervention has been necessary to secure the future of aided banks and allow businesses continued access to finance.

- Support schemes across all Member States have been deemed compatible with State aid regulations subject to certain conditions, namely that measures are:
  
  - well targeted and proportionate;
  - time limited to address acute crises without creating long term reliability on state funds; and
  - coupled with adequate private sector contributions by way of adequate remuneration for state support.

- It is the view of the EC that aid measures must be followed by restructuring of aided institutions and the financial sector as a whole, to preclude the need for further bailouts. Further, wider regulatory reform and cultural change in financial institutions should be pursued with a view to returning the banks to self-reliance whilst ensuring long term sustainability and protecting the interests of taxpayers and non-aided competitors.

Although Scotland’s banking sector, like banks across the globe, has experienced significant difficulties, this does not present an industry-wide picture and recent announcements of expansion and investment plans by financial services companies have buoyed prospects for the future.

**Q4 - How might these changes affect the business and retail banking market in Scotland, access to project finance, a reduction in competition on the 'high street' for lending, the plans for the retention of functions and 'headquartering' etc and what can the public sector in Scotland do to ensure the best possible result for Scotland?**

4. Response: The ease of access to credit in Scotland, the competitiveness of the retail lending sector, and the distribution of headquarter functions within the UK will depend in the short term on developments in the global financial and economic crisis, and on the success of UK and Scottish Government policy interventions in stabilising the financial system. The financial and economic crises are still unfolding, and there have been no official published reviews of the effectiveness of recent financial market policy interventions.
In the medium- to long-term, access to credit, competitiveness of lending and the distribution of headquarter functions will depend in large part on the actions of UK and European competition authorities, and the impact of future regulatory reform on the structure of the UK financial sector. The evidence below summarises existing proposals from the UK Government, the largest opposition party, the Financial Services Authority and the Bank of England, listed in publication date order.

- House of Commons Treasury Select Committee Report of Sessions: ‘Banking Crisis: regulation and supervision’ – report, together with formal minutes, oral and written evidence;
- Speech by Mervyn King, Governor of the Bank of England: ‘Mansion House Dinner’ – argues for additional regulatory powers for the Bank;
- Financial Services Global Competitiveness Group: ‘UK International Financial Services – The Future’. The report reflects the views of the UK’s financial services leaders. The authoring group was co-chaired by the UK Chancellor Alistair Darling;
- Financial Services Authority Discussion Paper: ‘A Regulatory Response to the global banking crisis’;

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15 Published 8th July 2009. Available at: [http://www.hm-treasury.gov.uk/press_65_09.htm](http://www.hm-treasury.gov.uk/press_65_09.htm)
17 Published 7th May 2009. Available at: [http://www.hm-treasury.gov.uk/ukinternational_financialservices.htm](http://www.hm-treasury.gov.uk/ukinternational_financialservices.htm)
Q5 - What are the current employment levels and skills base in the financial sector in Scotland and how may these change? Additionally, what are the types of jobs that might be expected to be lost as part of any restructuring plans?


The Financial Services Skills Council (FSSC) is an independent, employer-led organisation established in 2004 to provide strategic leadership for education, training and skills development for financial services, and more recently, accountancy and finance, across the UK. It has conducted a range of research on financial services skills issues.21

Skills for Scotland: A Lifelong Skills Strategy sets out the Scottish Government’s ambition for skills, in a lifelong learning context, from cradle to grave.22

In addition, the financial services industry itself has produced proposals for the establishment of a Financial Services Skills Gateway initiative to coordinate the industry’s skills requirements and align these with the corresponding public sector provision. Skills Development Scotland is supporting the establishment of the Gateway.

At this stage, it is difficult to accurately predict what types of jobs might be expected to be lost due to restructuring plans. This is because companies which announce potential redundancies usually do so at the stage of official consultation with employees and their representatives. In many cases, depending on the types of jobs involved, the location of those jobs which are to be lost will not be known until the end of the consultation period and the number of jobs actually lost does not always match the number originally notified as at risk. In the same way, companies announcing the creation of new jobs usually provide a total number expected to be created over a forward period. Company announcements to date have included jobs at risk of redundancy in customer facing branch posts; sales; IT; back office functions and other support jobs as well as managers and senior managers. Individual company announcements will have provided some detail. The Finance Sector Jobs Taskforce is working with financial services employers to better understand the impact on jobs in the industry.

20 The Report is available at: http://www.scotland.gov.uk/Publications/2008/05/20154541/0

21 Available at : http://www.fssc.org.uk/

22 The evidence and performance section of the website is available at: http://www.scotland.gov.uk/Topics/Education/skills-strategy/performance/Q/editmode/on/forceupdate/on
Q6 - How are employment levels in the financial sector in Scotland calculated at present, under what definitions and how do these relate to ONS figures? What changes are required to make employment figures more meaningful and comparable with other financial centres?

6. Response: The Annual Business Inquiry (ABI), an employer survey, is the main source for measuring employment levels in the financial sector. The ABI is carried out by the Office for National Statistics (ONS), and is considered to be the most reliable source for industry level employment.

The ABI asks employers to provide employment numbers, which the ONS classifies into sectors defined by Standard Industrial Classification (SIC) codes. The definition for the financial sector is based on SIC codes 65, 66, and 67 which cover financial intermediation, insurance and pension funding and activities auxiliary to financial intermediation (i.e. security broking and fund management).

The main benefits of the ABI, published by the ONS, are that it covers the whole economy, is comparable regionally, is broadly comparable to GB, and allows analysis of the sub sectors in the industry. The Annual Report on the Strategy for the Financial Services Industry in Scotland uses ABI figures as the source of employment data.

Q7 - What are your views on the current efforts across the public sector in Scotland to respond to the recent difficulties in the financial sector in Scotland and what, if anything, needs to change in the future as the situation develops?

7. Response: A wide range of public sector support is available throughout Scotland for those affected by possible redundancy. In a specific response to the difficulties being faced by our financial services industry, however, the Scottish Government has established a Finance Sector Jobs Taskforce to co-ordinate these public sector efforts in order to ensure maximum levels of employment are retained within the financial services industry - focusing on understanding the needs of the industry as it adjusts to the future structures which will emerge as a result of the current climate. In addition, where restructuring does result in reduction in headcount, the Taskforce will act to achieve the retention of skills within the wider Scottish labour market - by ensuring the promotion of entrepreneurship and self-employment where appropriate, matching transferable skills within the wider economy and enhancing skills and qualifications to meet the needs of alternative employers as well as the future needs of emerging industries and markets. The Taskforce is also a focus for information and analysis on projected changes to the industry to enable full alignment of the current economic development, investment attraction and skills and careers work which is currently being progressed.

The Finance Sector Jobs Taskforce has been established within the current Financial Services Advisory Board (FiSAB) structure, reporting directly to FiSAB. The unique collaborative effort made possible by the FiSAB
partnership of Scottish Government, the wider public sector, Unite the union, Scottish Financial Enterprise and individual financial services companies is continuing to work to ensure the success of this key industry and is meeting more often in light of the current financial climate.

Q8 - Has Scotland’s reputation as a global financial services sector been detrimentally affected by the global crisis and has this been to any greater extent than the problems felt in other financial centres?

8. Response: There is no evidence to suggest that Scotland's reputation has suffered greatly through the global crisis, and anecdotally the further away from Scotland the less perceived the "damage" is. The crisis has, to varying degrees, affected all major global centres and Scotland being an International Financial Services centre is not immune to this. However despite recent events Scotland remains an attractive and highly competitive location for both indigenous and international businesses. Clearly the impact of recent events within the banking sector has had a significant impact on Scotland’s financial services landscape. However, banking only accounts for just over half of the financial services sector in Scotland. We also have real strengths and continued potential for growth in other areas such as asset servicing/fund management, life assurance, insurance and pensions, along with strong robust infrastructure to support the sector.

Q9 - How should Scotland differentiate itself and promote itself as a financial services centre in the future and what steps are being taken by our competitors in this respect?

9. Response: For the second time in four years, Scotland has been named European Region of the Future by the Financial Times fDi (Foreign Direct Investment) magazine. Recent high-profile investments by companies such as Morgan Stanley and JP Morgan were highlighted in the publication. Of the numerous categories by which the prospects for regions were judged, Scotland, which is also currently the Financial Times fDi magazine UK Region of the Future 2007, scored highest in economic performance, overall fDi promotion strategy, quality of life, transport links, IT & telecommunications and human resources. The latter is an area for which Scotland already holds an award as being the best region in Europe. Scottish Enterprise and Scottish Development International (SDI) activity to promote Scotland has seen major investment by international companies directly and indirectly involved in the financial services industry such as BNP Paribas, Morgan Stanley, Tesco, JPMorgan and Shell. By utilising SDI experience and track record in this regard, we need to ensure our key messages of the overall strength in Financial Services are heard. Through its global offices, SDI ensures a clear and co-coordinated message to our key target audience and in 2009 we already have in place a number of events and initiatives to deliver this message. SDI is the lead sponsor at Euro Financial Week in Frankfurt in Germany in November where we will have two keynote speakers to articulate Scotland’s financial services strengths to an audience of CEO's of European Financial Services companies. SDI officials are working closely with Scottish
Financial Enterprise and the Scottish fund management community to participate in a number of events in Asia later in the year.

**Q10 - How can we ensure that the Scottish financial sector continues to retain a global perspective and does not retreat into a purely localised lending regime?**

10. Response: One of the main issues here will be to ensure that we learn lessons from the current crisis to take appropriate steps to mitigate these dangers in the future so that continued commitment to the global economy is attractive to the financial services industry. The recently published report “UK International Financial Services - the future” which is a report by UK financial services leaders to the UK Government, makes the point that future success must be based on partnership between the financial services industry and the wider domestic economy; and between the UK and emerging economies and their financial centres.

In Scotland we have a proven track record of enabling successful partnership working and collaborative effort in a number of key industry sectors - led by the financial services industry through the *Strategy for the Financial Services Industry in Scotland*. This sets out our commitment to partnership, not only within Scotland, but also in influencing policy and decision makers at UK, EU and international levels. SDI will continue to lead our efforts in building partnerships with international financial centres and the Scottish Government will maintain its support for these efforts by ensuring Scotland continues to offer a flexible, open and transparent place to do business.

**Q 11 - Why are “new” banks choosing to establish themselves in Scotland, what is it that is particularly attractive and how can we build on this and attract additional investment into Scotland?**

11. Response: Scotland has always positioned itself as a low risk, lower cost location where companies can take advantage of the existing infrastructure and assistance available to achieve operational cost efficiencies and saving. This gives Scotland an advantage for any financial services company wishing to expand and grow its business here. In 2009, we have already seen investments and expansions from Financial Services companies. In January, BNP Paribas began recruiting 80 new posts, the second tranche of a planned recruitment of 370 jobs in Glasgow, following a successful Regional Selective Assistance (RSA) award in 2008, further cementing the company’s ongoing commitment to Scotland. In February, esure announced the creation of 500 new permanent jobs in Glasgow – the first 250 of which will be recruited over the next 18 months. Esure Chairman Peter Wood cited the local skills base, infrastructure and ‘can-do’ ethic as playing an important part in the decision. In addition, Tesco Personal Finance announced on the 20th August that it is set to create 800 jobs in Glasgow with the opening of a new customer service centre. Once again, the availability of a high quality workforce was cited as a

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23 Published in May 2009. Available at: [http://www.hm-treasury.gov.uk/d/uk_internationalfinancialservices070509.pdf](http://www.hm-treasury.gov.uk/d/uk_internationalfinancialservices070509.pdf)
reason for the decision to come to Scotland. This is in addition to its decision to create 200 new jobs and move its present 250 staff to a new HQ facility in Edinburgh. These decisions and announcements are key testimony that Scotland continues to be an attractive location for Financial Services companies as they wish to grow and be successful from a Scottish base.

The Scottish Government
31 August 2009
Economy, Energy and Transport Committee

Banking Inquiry: additional material supplied in response to Members’ enquiries

Introduction

In the course of the Banking Enquiry some Committee Members have asked SPICe researchers for additional background material. With the agreement of the members concerned this is now presented as a paper to ensure all members have access to this information. The material reflects the nature of the requests and is therefore wide ranging.

Impact of the bail out on the Scottish economy

The NAO Report "Maintaining financial stability across the UK's banking system" is unequivocal in stating that "the Treasury was justified in using taxpayers' money to safeguard savings and stabilise and restore confidence in the financial system". The NAO report makes no reference to benefits specific to Scotland. It appears that no work has been commissioned to assess the impact of the bail out on the Scottish economy.

Support for Scottish banks

The NAO Report has a table in Annex 1 on the nature and scale of the support provided to the banks but does not attempt to allocate costs to individual banks in a comprehensive and consistent manner. The table below summarises information from the NAO report. This shows that the total amount at stake was £753bn of which SPICe estimates £470bn relates to RBS and HBOS.
### Table 1: RBS and HBOS share of total bank bail out

<table>
<thead>
<tr>
<th>Scheme</th>
<th>Total amount at stake</th>
<th>of which RBS and HBOS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Special Liquidity Scheme</td>
<td>£200bn of which £185bn used</td>
<td>say £100bn</td>
</tr>
<tr>
<td>Capital Injections</td>
<td>£78bn</td>
<td>est. £70bn</td>
</tr>
<tr>
<td>Credit Guarantee Scheme</td>
<td>£250bn</td>
<td>say £100bn</td>
</tr>
<tr>
<td>Asset Protection Scheme (all RBS)</td>
<td>up to £200bn</td>
<td>up to £200bn</td>
</tr>
<tr>
<td>Bradford and Bingley and the Financial Services Compensation Scheme</td>
<td>£40bn</td>
<td>nil</td>
</tr>
<tr>
<td>Asset Backed Securities Guarantee Scheme</td>
<td>nil</td>
<td>nil</td>
</tr>
<tr>
<td>Total</td>
<td>£753bn</td>
<td>£470bn</td>
</tr>
</tbody>
</table>

Source: National Audit Office (2009)

### Scale of the bailout of Scottish banks relative to GDP

Scottish GDP in 2008 is estimated at £144bn assuming an 83% geographic share of North Sea oil and gas. Using the figure of £470bn as the amount at stake in bailing out the Scottish banks then this is over 3 times annual Scottish GDP. The comparable figure for the UK, using a figure of £750bn as the amount at stake, is a little over 50% of GDP (£1448bn in 2008).

The latest (Oct 2009) Global Financial Stability Report has revised down the actual and potential write downs of assets held by banks from $4trillion to $3.4trillion. The lower figure is about 6% of forecast global GDP for 2010 on a market exchange basis. It should be noted though that the amount at stake is not necessarily the same as the actual or potential write down of assets held by the banks.

### Net fiscal cost of financial interventions

Table B20 of the 2009 PBR (copied as Table 2 below) sets out the impact of financial interventions on the Central Government Net Cash Requirement (CGNCR) to 2012. This shows a negative cash flow in 2008-09 (£84bn) and 2009-10 (£44bn) but a modest positive cash flow thereafter. The table does not show any significant pay back from the sale of the stakes in RBS and LBG in the period up to March 2012. Significant revenue is likely to be generated when these stakes are sold.
### Table 2: Financial Interventions – Impact on Central Government Net Cash Requirement

<table>
<thead>
<tr>
<th></th>
<th>Outturn 2008-09</th>
<th>Estimate 2009-10</th>
<th>Projections 2010-11</th>
<th>Projections 2011-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net effect of financial interventions</td>
<td>84.0</td>
<td>44.0</td>
<td>-4.5</td>
<td>-3.2</td>
</tr>
<tr>
<td>transactions which also affect net borrowing:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity injections: acquisition of shares</td>
<td>6.1</td>
<td>4.2</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Other equity injections</td>
<td>0.0</td>
<td>1.4</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Depositor compensation</td>
<td>3.8</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Public sector banks: transactions with government *</td>
<td>-0.4</td>
<td>-2.8</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>financial transactions which do not affect net borrowing:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans</td>
<td>20.6</td>
<td>15.0</td>
<td>-4.6</td>
<td>-3.3</td>
</tr>
<tr>
<td>Equity injections (net acquisitions of shares at market prices)</td>
<td>30.8</td>
<td>25.2</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Depositor compensation</td>
<td>23.1</td>
<td>1.1</td>
<td>0.0</td>
<td>0.0</td>
</tr>
</tbody>
</table>

- No fee payments are included in the projections.

Source: HM Treasury (2009b)

Box B4 in the 2009 Pre Budget Report (PBR) (copied below) gives a figure for the net cost of financial interventions of £10bn. This compares with a range of £20-50bn given in the 2009 Budget.
Box B4: The net fiscal cost of financial interventions

At Budget 2009 the Government provisionally estimated that potential losses from the financial interventions might lie within a range of £20 billion to £50 billion. The estimate was set out as a range because of the significant uncertainty over potential outcomes from the interventions at that point. The high end of this range was adopted for fiscal policy purposes as a cautious judgement. It was used to create a measure of PSND including unrealised losses from the financial interventions. This measure was not on a National Accounts basis and was not reported by the ONS.

Exceptional financial market and economic uncertainty has receded since the Budget and, as set out in Chapter 3, significant changes to the APS policy agreement mean the risks to the taxpayer have reduced. Taking these changes into account, the eventual fiscal cost will be determined by a number of factors:

- the eventual net profit or loss on the recapitalisations of RBS and Lloyds. This will depend on the eventual sale price achieved compared to the purchase price. One way to value this is on the basis of current market prices which would point to a cost of £14 billion, net of the value of the Government’s RBS dividend access share. The Government will also have received a total of £0.7 billion in underwriting fees, and this year will receive a £0.3 billion fee for the RBS contingent capital guarantee;
- net payouts under the APS scheme. Based on due diligence of APS assets and the outlook for asset prices and the economy, the central expectation is that net losses on the insured pool of assets will not exceed the revised £60 billion first loss that will fall to RBS. Under the APS the Government will receive fees of £2.5 billion from Lloyds and at least £2.5 billion from RBS; and
- the aggregate costs for all other interventions are expected to be close to zero overall once fees and other income are taken into account. They have been designed to minimise exposure and fair value fees are charged.

At current market prices the net cost of these components would total £8 billion. Any eventual profit or loss will only be realised on the sale of the shares.

Treatment in the public finances and for fiscal policy purposes

With the Government’s exposure now focused on its share holdings and with uncertainty having receded since Budget, it is appropriate to remove the £50 billion provision and move the treatment of financial interventions into line with fiscal aggregates defined on a National Accounts basis and reported by the ONS:

- National Accounts scores a capital grant if the purchase price for equity exceeds the market price on the day of purchase. The value of these capital grants for the purchase of RBS and LBG shares in 2008-09 is £6 billion and in 2009-10 will be around £4 billion, net of the value of the dividend access share. The value in 2009-10 will depend on the share prices on the day of the transactions. These figures will then be fixed as at the day of purchase and will not move subsequently as share prices change in the market; and
- the value of fees to be received this year and so included in the 2009-10 projections totals over £4 billion, but fee receipts estimated to be of a similar value across the forecast period are excluded from the forecast.

As set out in Tables B18 and B19 the equity injections related to the acquisition of shares will increase the measures of net borrowing and net debt excluding the temporary effect of the financial interventions by around £10 billion over two years, representing on a National Accounts basis the treatment of potential losses from the interventions.
Debt interest payments

Table B19 of the 2009 PBR (copied as Table 3 below) shows the effect of financial interventions on the Public Sector Net Debt (PSND).

Table 3: Financial interventions – Impact on Public Sector Net Debt

<table>
<thead>
<tr>
<th></th>
<th>£ Billion</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Outturn 2008-09</td>
</tr>
<tr>
<td>PSND including temporary effects of financial interventions</td>
<td>742.4</td>
</tr>
<tr>
<td>Temporary effects excluded from PSND ex:</td>
<td></td>
</tr>
<tr>
<td>Bank balance sheets (1)</td>
<td>122</td>
</tr>
<tr>
<td>Depositor compensation</td>
<td>9</td>
</tr>
<tr>
<td>Bank of England Schemes</td>
<td>2</td>
</tr>
<tr>
<td>Included in PSND ex:</td>
<td></td>
</tr>
<tr>
<td>Equity injections: acquisitions of shares (2)</td>
<td>6</td>
</tr>
<tr>
<td>Other equity injections</td>
<td>0</td>
</tr>
<tr>
<td>Depositor compensations</td>
<td>4</td>
</tr>
<tr>
<td>Public sector banks: transactions with government (3)</td>
<td>0</td>
</tr>
<tr>
<td>PSND excluding temporary effects of financial interventions</td>
<td>618.8</td>
</tr>
<tr>
<td>Percentage of GDP</td>
<td></td>
</tr>
<tr>
<td>PSND including temporary effects of financial interventions</td>
<td>52.8</td>
</tr>
<tr>
<td>PSND excluding temporary effects of financial interventions</td>
<td>44.0</td>
</tr>
</tbody>
</table>

(1) RBS and Lloyds Banking Group cannot be included until ONS have calculated their specific contributions, this is consistent with ONS’ treatment in Public Sector Finances
(2) Provisional estimate for 2009-10
(3) No fee payments are included in the projections

Source: HM Treasury (2009b)

This table requires some interpretation.

Total PSND including temporary effects of financial interventions is projected to be £941.6bn by end March 2010. Of this £941.6bn, £155bn (130 + 10 + 15) is attributable to the effects of financial interventions of which £12bn (10 + 1 + 4 - 3) is expected to be permanent. This means that by end March 2010 16.5% (155/941.6) of the PSND is attributable to bank bailouts.

Central Government Gross Debt Interest is projected to be £44.4bn in 2010-11 (PBR 2009 Table B15). Therefore the gross interest charges on debt associated with the bank bailouts is 16.5% of £44.4bn or £7.3bn.
**Oversized banking sector**

**Table 4** below shows the ratio of total bank assets of the three largest banks in Ireland and Iceland and the two Scottish banks, expressed as a ratio of the GDP of the respective countries.

<table>
<thead>
<tr>
<th>Ireland</th>
<th>Iceland</th>
<th>Scotland</th>
</tr>
</thead>
<tbody>
<tr>
<td>£bn</td>
<td>ISKbn</td>
<td>£bn</td>
</tr>
<tr>
<td>Bank of Ireland</td>
<td>197</td>
<td>5318</td>
</tr>
<tr>
<td>Allied Irish</td>
<td>182</td>
<td>3058</td>
</tr>
<tr>
<td>Anglo Irish</td>
<td>101</td>
<td>2948</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>480</td>
<td>11,324</td>
</tr>
<tr>
<td><strong>GDP 2008</strong></td>
<td>182</td>
<td>1,476</td>
</tr>
<tr>
<td><strong>Bank assets/GDP</strong></td>
<td>2.6</td>
<td>7.7</td>
</tr>
</tbody>
</table>

This shows that the three largest Irish banks had total assets equivalent to 2.6 times GDP, the three largest Icelandic banks had assets equivalent to 7.7 times GDP and the comparable figure for Scotland, taking just RBS and HBOS, was over 20 times GDP.

**Tax paid by UK banks**

**Table 5** shows the amount of corporation tax paid by the main UK clearing banks in the period 2005-08. As a result of the losses incurred by RBS and HBOS these two banks received tax credits in 2008 i.e. the UK government gave the banks back some of the taxes they had paid in previous years. The net effect is that the total corporation tax paid by the main clearing banks declined by nearly £10bn between 2007 and 2008.

The Pre Budget Report, section B57 states that expected corporation tax revenue in 2009-10 from the financial services sector is "around a third of its 2006-07 peak, at just £3¼ billion".
Table 5: UK Corporation Tax Paid by Main UK Clearing Banks

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
</tr>
<tr>
<td>HBOS</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK Corporation tax</td>
<td>1,442</td>
<td>1,712</td>
<td>1,642</td>
<td>-3,085</td>
</tr>
<tr>
<td>Other tax expenses</td>
<td>104</td>
<td>60</td>
<td>-277</td>
<td>-324</td>
</tr>
<tr>
<td>Overall tax expense</td>
<td>1,546</td>
<td>1,772</td>
<td>1,365</td>
<td>-3,409</td>
</tr>
<tr>
<td>RBS</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK Corporation Tax</td>
<td>2,381</td>
<td>2,756</td>
<td>2,950</td>
<td>-2,316</td>
</tr>
<tr>
<td>Other tax expenses</td>
<td>-3</td>
<td>-67</td>
<td>-906</td>
<td>1,036</td>
</tr>
<tr>
<td>Overall tax expense</td>
<td>2,378</td>
<td>2,689</td>
<td>2,044</td>
<td>-1,280</td>
</tr>
<tr>
<td>BARCLAYS</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK Corporation Tax</td>
<td>1,584</td>
<td>2,141</td>
<td>2,123</td>
<td>1,732</td>
</tr>
<tr>
<td>Other tax expenses</td>
<td>-145</td>
<td>-200</td>
<td>-142</td>
<td>-942</td>
</tr>
<tr>
<td>Overall tax expense</td>
<td>1,439</td>
<td>1,941</td>
<td>1,981</td>
<td>790</td>
</tr>
<tr>
<td>HSBC</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK Corporation Tax</td>
<td>1,119</td>
<td>1,139</td>
<td>1,219</td>
<td>1,244</td>
</tr>
<tr>
<td>Other tax expenses</td>
<td>-292</td>
<td>-161</td>
<td>-452</td>
<td>-401</td>
</tr>
<tr>
<td>Overall tax expense</td>
<td>827</td>
<td>978</td>
<td>767</td>
<td>843</td>
</tr>
<tr>
<td>LLOYDS</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK Corporation tax</td>
<td>862</td>
<td>1,024</td>
<td>763</td>
<td>667</td>
</tr>
<tr>
<td>Other tax expenses</td>
<td>403</td>
<td>341</td>
<td>-84</td>
<td>-705</td>
</tr>
<tr>
<td>Overall tax expense</td>
<td>1,265</td>
<td>1,341</td>
<td>679</td>
<td>-38</td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK Corporation tax</td>
<td>7,388</td>
<td>8,772</td>
<td>8,697</td>
<td>-1,758</td>
</tr>
<tr>
<td>Other tax expenses</td>
<td>67</td>
<td>-27</td>
<td>-1,861</td>
<td>-1,336</td>
</tr>
<tr>
<td>Overall tax expense</td>
<td>7,455</td>
<td>8,721</td>
<td>6,836</td>
<td>-3,094</td>
</tr>
</tbody>
</table>

*“Other tax expenses” is mainly taxes paid in other countries.*

Sources: Company Annual Reports

A press release issued in Feb 2008 by the City of London reported on work done by PricewaterhouseCoopers on taxes paid by the UK financial services sector. PWC estimated that in the year ended March 2007 the sector paid £67.8bn to the UK government in corporation tax, employers national insurance and taxes on the income of employees. The release is available at http://www.cityoflondon.gov.uk/Corporation/media_centre/files2009/FS_tax.htm.


**Bank regulation**

Bank regulation is normally the responsibility of national governments but because of the risk of unfair competition and systemic failure in the banking system there is a need for international co-operation. The lead responsibility for setting standards is taken by the Basel Committee on Banking Supervision, a standing committee of the Bank for International Settlement. There are currently 56 member central banks in the BIS. Further information on the BIS is available at: [http://www.bis.org/about/index.htm](http://www.bis.org/about/index.htm).

The original Basel Capital Accord set down the agreement among G10 central banks to apply common minimum capital standards to their banking industries, to be achieved by end 1992. The agreement has since been updated and is now known as Basel II. Further information on Basel II is available at: [http://www.bis.org/publ/bcbs107.htm](http://www.bis.org/publ/bcbs107.htm).


Appendix 1 is an edited version covering about 20 parameters and a selection of smaller European countries plus the UK.

**Dealing with failed banks**

The mechanisms used for dealing with failed banks differ in the US and UK. In the former, responsibility clearly rests with the Federal Deposit Insurance Corporation (FDIC). In the UK responsibility is shared among the Financial Services Authority (FSA), the Bank of England and HM Treasury.

The FDIC is a United States government corporation created by the Glass-Steagall Act of 1933 to maintain stability and public confidence in the nation's financial system. The FDIC:

- insures bank deposits,
- examines and supervises financial institutions for safety and soundness and consumer protection, and
- manages receiverships.

The FDIC maintains a Deposit Insurance Fund by charging depository institutions an insurance premium. The amount each institution is charged is based both on the balance of insured deposits as well as on the degree of risk the institution poses to the insurance fund.
Since the FDIC was established in 1933, no depositor has ever lost money in FDIC insured funds. In October 2008 the level of deposit insurance was increased from $100,000 to $250,000 per depositor per bank. This is intended to run until December 2013 before reverting to $100,000 for most accounts.

The FDIC also manages the receivership of failed banks. The 2008 Annual Report describes the process as follows.

“Once an institution is closed by its chartering authority...and the FDIC is appointed receiver, it is responsible for resolving the failed bank or savings association. The FDIC has at its disposal and employs a variety of business practices to resolve a failed institution. These business practices typically fall under work associated with the resolution process or the receivership process. Depending on the characteristics of the institution, the FDIC may recommend several of these practices to ensure prompt and smooth payment of deposit insurance to insured depositors, to minimize impact on the Deposit Insurance Fund, and to speed dividend payments to creditors of the failed institution.

“The resolution process involves valuing a failing institution, marketing it, soliciting and accepting bids for the sale of the institution, determining which bid is least costly to the insurance fund, and working with the acquiring institution through the closing process.

“In order to minimize disruption to the local community, the resolution process must be performed quickly and as smoothly as possible. There are two basic resolution methods: purchase and assumption transactions and deposit payoffs. A third resolution option, open bank assistance transactions, generally can only be used in the event the bank’s failure would result in systemic risk.

“The purchase and assumption transaction (P&A) is the most common resolution method used for failing institutions. In a P&A, a healthy institution assumes certain liabilities of the failed institution and purchases certain assets of the failed institution. Since each failing bank situation is different, P&A transactions are structured to create the highest value for the failed institution. Depending on the P&A transaction, the acquirer may either acquire all or only the insured portion of the deposits.

“Deposit payoffs are only executed if a bid for a P&A transaction is not the least costly to the fund or if no bids are received, in which case the FDIC in its corporate capacity as deposit insurer, makes sure that the customers of the failed institution receive the full amount of their insured deposits. The receivership process involves performing the closing functions at the failed institution, liquidating any remaining failed institution assets, and distributing any proceeds of the liquidation to the FDIC and other
creditors of the receivership. In its role as receiver, the FDIC has used a wide variety of strategies and tools to manage and sell retained assets. These include but are not limited to asset sale and/or management agreements, partnership agreements, and securitizations.

“Due to the economic environment, the FDIC experienced a significant increase in the number and size of institution failures as compared to previous years. For the institutions that failed in 2008, the FDIC successfully contacted all known qualified and interested bidders to market these institutions. Additionally, the FDIC marketed approximately 90 percent of the marketable assets of these institutions at the time of failure and made insured funds available to all depositors within one business day of the failure. There were no losses on insured deposits and no appropriated funds were required to pay insured deposits.” (FDIC Annual Report 2008).

Table 6 below provides a comparison of failure activity over the last three years.

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Institutions</td>
<td>0</td>
<td>3</td>
<td>25</td>
</tr>
<tr>
<td>Total assets of failed institutions*</td>
<td>$0</td>
<td>$2.6</td>
<td>$371.9</td>
</tr>
<tr>
<td>Total Deposits of failed institutions*</td>
<td>$0</td>
<td>$2.4</td>
<td>$234.3</td>
</tr>
<tr>
<td>Estimated loss to the DIF</td>
<td>$0</td>
<td>$0.2</td>
<td>$17.9</td>
</tr>
</tbody>
</table>

* Total Assets and Total Deposits data are based upon the last Call Report filed by the institution prior to failure.

During 2008, 25 financial institutions failed. These are listed in the FDIC Annual Report. Details for two of the largest failures are shown below.

**IndyMac Bank, F.S.B.**, Pasadena, California, was closed by the Office of Thrift Supervision (OTS) on July 11, 2008, and the FDIC was named conservator. As conservator, the FDIC operated IndyMac Bank as IndyMac Federal Bank, F.S.B. All the insured deposits and substantially all the assets of IndyMac Bank were transferred to IndyMac Federal. At the time of closure, IndyMac Bank had total assets of $30.7 billion and total deposits of $18.9 billion. The estimated loss to the DIF is approximately $10.7 billion.

**Washington Mutual Bank**, the largest failure in history, was closed by the OTS on September 25, 2008. At the time of closure, Washington Mutual Bank had $307.0 billion in total assets and $188.3 billion in total
deposits. JPMorgan Chase acquired the banking operations of Washington Mutual Bank in a facilitated transaction that fully protected all depositors and caused no loss to the DIF.

By way of contrast the Financial Services Authority 2008-09 Annual Report gives the following description of events surrounding the demise of various financial institutions in the UK.

“When it proved impossible to find market solutions (for failing banks), we have worked with the other members of the Tripartite Authorities to ensure that an orderly resolution was achieved. This often involved partial sale or transfer to other financial services firms to best protect consumer deposits and help maintain stability. We are charged with seeking to facilitate private sector solutions to address potential failing institutions and during the year we were very active in discharging this mandate in a variety of different situations. For example, we used our ‘directed merger’ powers in Section 42 of the Building Societies Act 1986 (BSA 1986) to allow several building society mergers to take place by board resolution rather than members’ vote. Given the uncertain economic climate, this course of action was deemed to be in the best interests of members. In the case of Bradford & Bingley, London Scottish Bank, Dunfermline Building Society and the UK subsidiaries of the Icelandic banks – Heritable Bank plc (Landsbanki) and Kaupthing, Singer and Friedlander (KSF) Ltd (Kaupthing) and the UK branch of Landsbanki (which provided Icesave accounts) – no merger partners or acquirers were available on solely commercial terms. However, the work we did to identify possible private sector solutions was central to identifying potential bidders who subsequently participated in resolution processes.

“We were fully and actively involved in Tripartite discussions which led to the decision in September 2008 that Bradford & Bingley could not continue in its current form. We concluded, having regard to all circumstances that Bradford & Bingley was in breach of its threshold conditions, namely that, the firm’s capital resources and liquidity resources were inadequate in relation to the firm’s activities and that there was no realistic prospect of the situation improving within a reasonable period. Therefore the firm could not continue to operate on a sustainable basis. The government decided to exercise powers to protect savers’ money by selling the saving business to Abbey National plc, a subsidiary of Banco Santander. Bradford & Bingley’s other business, including mortgage and loans, were placed into public ownership in order to move towards a satisfactory long-term solution.

“In November 2008 we decided that London Scottish Bank should be
prevented from accepting further deposits as it no longer met our threshold conditions. It was placed into administration by the Court on the application of its directors. As a result of the bank’s administration, the Financial Services Compensation Scheme (FSCS) was triggered to safeguard retail deposits. The FSCS put arrangements in place to pay back customers and provided further information for customers. Eligible retail depositors were compensated through the FSCS, with the Treasury protecting balances above the current UK deposit limit of £50,000.

“We took steps to address our ongoing concerns over the stability of Dunfermline Building Society. After intensive contact over a number of months between us and Dunfermline to find a workable, private sector solution, in March 2009 the Board of Dunfermline concluded that the Society was unable to continue as a going concern and advised us accordingly. As a result we decided that Dunfermline was likely to fail to meet the adequate resources threshold condition and that there was no other option available that would have enabled Dunfermline to satisfy the threshold conditions. This decision gave rise to the Special Resolution Regime (SRR) being invoked, which is a key component of the Banking Act 2009. After following the process under the SRR an agreement was reached to transfer Dunfermline’s savings business and branch network, most of its residential mortgage and the personal loan businesses to Nationwide Building Society.

“In October 2008 we determined that Heritable and KSF no longer met their threshold conditions and that they were in default for the purposes of the FSCS. The Treasury used powers under the Banking (Special Provisions) Act 2008 to ensure a resolution that preserved financial stability and provided protection and continuity for depositors. Most of Heritable’s retail deposits and KSF’s Edge deposits were transferred to ING Direct. Following due legal process, the remainder of Heritable’s and KSF’s businesses were put into administration.

“In October 2008 we also announced that the UK-based branch of Landsbanki was in default for the purposes of the FSCS. The Treasury guaranteed that all retail depositors with Icesave would receive their money in full through the FSCS and also agreed to finance the reimbursing of deposits above £50,000, which are not covered by either the Icelandic Deposit Guarantee Scheme or the UK’s FSCS.”
The Proposed Merger of RBS and HSBC

The Competition Commission’s report (1982) on the proposed mergers between RBS and Standard Chartered Bank and HSBC describes the main events. Some key excerpts are provided below:

Overview of the takeover attempts and who backed them

“Standard Chartered, having seen press and other indications that Royal Bank Group could become the subject of a bid, made a second informal approach on 29 September 1980, followed the next day by renewed interest on the part of Lloyds. The Royal Bank Group board rejected Lloyds’ overtures once more for the reasons on which it had based its decision in 1979. At the same time, in view of the benefits it foresaw if a merger of Royal Bank Group with Standard Chartered could be achieved, it authorised negotiations with Standard Chartered. During these negotiations Royal Bank Group was in close consultation with the Bank of England and was supported by its knowledge that the Bank of England actively encouraged the proposed merger of Royal Bank Group with Standard Chartered. Agreement was reached and the terms approved by the boards of each of Royal Bank Group and Standard Chartered on 16 March 1981, and on 17 March Standard Chartered’s bid was announced; one Standard Chartered share and 50p in cash was offered for every five Royal Bank Group shares. The offer placed a value of £334 million on Royal Bank Group at the time, and carried the support of the board of Royal Bank Group….

In late March and early April several meetings were held between HSBC and the Bank of England. HSBC told the Bank that it wished to make an offer for Royal Bank Group substantially larger than that made by Standard Chartered, but was told by the Bank that such an offer would not have the Bank's approval. The Chairman of HSBC undertook that HSBC would not proceed with any proposal without informing the Bank. On 6 April the Chairman of HSBC informed the Governor that his board had instructed him to proceed with the offer, and on the same day he told the Chairman of Royal Bank Group the details, which were made public the following day (7 April). Eight HSBC shares were offered for each five Royal Bank Group shares, and there was also a partial cash election. The value of the offer at the time was £498 million. On 6 and 10 April Royal Bank Group discussed the HSBC offer with the Bank of England and learned that the Bank of England strongly disapproved of HSBC's bid for the Royal Bank Group. HSBC and Royal Bank Group discussed the offer and the philosophy behind it on 14 April.

After further discussions with Royal Bank Group, Standard Chartered announced an increased offer on 23 April. This offer again enjoyed the support of Royal Bank Group's board. Shareholders would now receive one Standard Chartered share, 225 pence in floating rate subordinated notes and 220 pence in cash for every five Royal Bank Group shares. This valued
the Royal Bank Group, at the time, at £481 million—some £10 million more than the value, at that time, of the HSBC offer.

Both bids were referred to the Commission on 1 May 1981.”


**Stakeholders views: RBS and Standard Charter**
During the inquiry, the Royal Bank of Scotland and Standard Chartered Bank highlighted several aspects of the HSBC bid which would be detrimental to the business. For example, they submitted that “ownership by HSBC would expose a bank to risks arising from what they saw as inadequacies in the system of prudential supervision of the banking system in Hong Kong, from the position which HSBC occupied in a territory lacking a central bank, and from other considerations which might impair confidence.”

**Stakeholders views: The Bank of England**
“The Bank of England provided written evidence and representatives attended two hearings at which they outlined the reasons for the Bank’s attitude towards the two proposed bids, namely approval of that by Standard Chartered and disapproval of that by HSBC… In the Bank's view the advantages of a merger between Standard Chartered and Royal Bank Group arose from the complementary nature of their businesses.”

**Stakeholders views: Scotland**
Concerns were expressed by organisations, firms and individuals that any merger resulting in foreign ownership would have a detrimental impact on the Scottish economy – particularly as the economy was in a period of recession. For example, “It was argued that there was a significant relationship between poor long-term economic performance and the decline of local decision-making because a regional economy, like that of Scotland, which was dominated by branch plants and subsidiaries was more vulnerable to recession than one that was indigenously based”. According to the Competition Commission “A minority of the submissions from companies and individuals in the financial and industrial sectors saw advantage in enlarging Royal Bank Group and particularly in giving it an international dimension.”

It is likely that these regional issues played a prominent role in the Competition Commission’s decision as they state in their conclusion “We have been impressed by the arguments, summarised in Chapter 10, that the merger of Royal Bank Group with either HSBC or Standard Chartered may be seen as part of a process of economic centralisation which has been seriously damaging to Scotland and to some other regions in the United Kingdom.”

**Competition Commission conclusion**
The Competition Commission recommended that neither merger should be permitted:

“In respect of the proposed merger between Royal Bank Group and Standard Chartered, we find (in paragraphs 12.15 to 12.19) that its effects on career
prospects, initiative and business enterprise in Scotland would be damaging
to the public interest of the United Kingdom as a whole. These adverse effects
outweigh any benefits that we can foresee. We therefore find that the
proposed merger may be expected to operate against the public interest.”

“In respect of the proposed merger between Royal Bank Group and HSBC,
we find not only the adverse effects on Scotland mentioned in paragraph
12.38, but also that transfer of ultimate control of a significant part of the
clearing bank system outside the United Kingdom would have the adverse
effect of opening up possibilities of divergence of interest which would not
otherwise arise (see paragraphs 12.26 to 12.29). We conclude that, taken
together, these effects adverse to the public interest outweigh any benefits
that can be foreseen. We therefore find that this proposed merger also may
be expected to operate against the public interest.”

You may be interested in a subsequent article in The Economist which
criticised this decision – it is attached.

Subsequent developments in merger policy

Later in the same year as the MMC’s report on the proposed RBS mergers,
the Commission recommended against another proposed merger in
Scotland. In this report, the MMC also cited concerns about the merger’s
potential impact on the regional economy as one reason for its
recommendation against the merger. The proposed merger was between
Charter Consolidated PLC and Anderson Strathclyde PLC.[1]

In its comments on public interest, the MMC said:

We conclude that the proposed merger may be expected
to have an adverse effect upon the management
effectiveness and labour relations of Anderson Strathclyde,
and that this would tend to diminish effective competition in
the supply of goods, would be contrary to the interests of
purchasers of goods in the United Kingdom and would not
promote competitive activity by Anderson Strathclyde in
markets outside the United Kingdom. We also conclude
that both because it would affect employment within
Anderson Strathclyde and because it would detract from
the dynamism of business in the region, it may be
expected to have an adverse effect upon employment in a
relatively depressed part of the United Kingdom. These
effects may be expected to operate against the public
interest unless offset by some advantages. (para 9.20)

The MMC report went on to conclude:

The adverse effects which we set out in paragraph 9.20 are
not offset by any advantages which the proposed merger
would confer. Therefore on balance we consider that the merger may be expected to operate against the public interest. The adverse effects arise directly from the proposed merger, and we cannot devise any action which could be taken for the purpose of remedying or preventing them if the merger took place. We therefore recommend that the merger should not be permitted. (para 9.24)


However, the decision to recommend refusal was not unanimous and two members of the MMC distanced themselves from the decision and issued a note of dissent in the MMC’s report, arguing in favour of the merger. At that time, the MMC only had powers to made recommendations to the Secretary of State, who then took the ultimate decision on how to proceed. In an unprecedented move, the Secretary of State decided not to accept the MMC’s majority recommendation and allowed the merger to go ahead.

Commentary suggests that the MMC’s findings in relation to the RBS and Anderson Strathclyde merger proposals were unusual in the emphasis that they placed on regional factors. In an article in the Winter 1985/86 Northern Economic Review, Ian Smith comments on the RBS and Anderson Strathclyde decisions, saying: “These decisions were unique in that for the first time factors other than the level of competition prevailing in the market were taken into account in a decision of the Monopolies and Mergers Commission”[^2]

It would therefore appear that this type of defence was not common prior to 1982. It is difficult to say whether the RBS decision had a particular role in the subsequent change of policy in relation to mergers. Public statements do indicate that the approach was evolving towards one which focused purely on competition in the mid-1980s, but it is difficult to identify an exact cause.

Although the ‘public interest’ test was not formally dropped until the introduction of the Enterprise Act in 2002, the emphasis began shifting clearly towards a specific focus on competition in decisions relating to mergers well before then. In 1984, Norman Tebbit, then Secretary of State for Trade and Industry, issued a statement which became known as the ‘Tebbit doctrine’ in which he stated that his policy would be to make merger references primarily on competition grounds.

The MMC was replaced by the Competition Commission (CC) in 1998, following the Competition Act 1998. The Enterprise Act 2002 gave the CC much greater decision-making and enforcement powers. The Enterprise Act 2002 also replaced the broad-based public interest test with a test based solely on competition. The Act specifies that public interest considerations can only be taken into account in very specific cases involving national security, media plurality and the stability of the UK financial system. In these instances, the Secretary of State for Business Innovation and Skills takes the ultimate decision on whether to clear a merger.
In respect of overseas takeovers of UK electricity companies post-privatisation, many of these were not referred to the relevant competition authorities as they were not considered to have a detrimental effect on competition (because they simply represented the transfer of responsibilities from one group to another). Any referrals have tended to be on other grounds e.g. regulatory matters. Takeovers involving EU companies, would be considered, where appropriate, by the European Commission (depending on the exact scale). As with the CC, the European Commission also focuses on the effect on competition, rather than any regional impact. As such, although there may have been objections or concerns relating to regional impacts, these would not feature in the decision-making relating to the merger. An example would be Iberdrola’s takeover of Scottish Power, which received approval from the European Commission in 2007. Scottish Government Ministers, MSPs from other parties and union representatives met on several occasions with Iberdrola during the takeover negotiations to ensure that concerns relating to the impact on Scotland were taken into account, but such issues would not have featured in the decision-making process at European level.

**Takeover of Midland Bank**

In 1991 Hongkong Bank set up a British registered holding company for the group, called HSBC Holdings. HSBC announced its purchase offer for Midland Bank on 14th April 1992 and on 19th May 1992 the Bank of England issued a statement saying it had no objections to the proposed merger. The statement also said that HSBC Holdings, the holding company of the enlarged group, would have the Bank of England as its lead regulator since its headquarters would be in London. The transfer of headquarters to London from Hong Kong was one of the regulatory requirements imposed by the Bank of England as part of its approval of the acquisition given that Hong Kong does not have a central bank. HSBC stated that the Bank of England did not want a foreign bank owning a major British bank. As such, HSBC’s head office was transferred to London from Hong Kong from 1 January 1993.

The most immediate impact of this transfer was the movement of the HSBC Chairman and headquarter staff to London. Another significant impact of this transfer was that HSBC became resident in Britain for tax purposes as opposed to Hong Kong. Although the HSBC CEO moved back to Hong Kong in 2009, the headquarters remain in the UK and the FSA remains its primary regulator.

**SPICe Research**

05 February 2010
SOURCES


Note: Committee briefing papers are provided by SPICe for the use of Scottish Parliament committees and clerking staff. They provide focused information or respond to specific questions or areas of interest to committees and are not intended to offer comprehensive coverage of a subject area.
# Bank Regulation Database
## Edited Version

<table>
<thead>
<tr>
<th>1. Entry into Banking</th>
<th>Denmark</th>
<th>Iceland</th>
<th>Ireland</th>
<th>Sweden</th>
<th>Switzerland</th>
<th>United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>What body/agency grants commercial banking licenses?</td>
<td>The Danish Financial Supervisory Authority (DFSA)</td>
<td>Financial Supervisory Authority</td>
<td>Irish Financial Services Regulatory Authority</td>
<td>Finansinspektionsen (FI)</td>
<td>Swiss Federal Banking Commission</td>
<td>The Financial Services Authority</td>
</tr>
<tr>
<td>How many commercial banks were there at year end 2005?</td>
<td>161</td>
<td>14</td>
<td>48</td>
<td>31</td>
<td>342</td>
<td>333</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>3. Capital</th>
<th>Denmark</th>
<th>Iceland</th>
<th>Ireland</th>
<th>Sweden</th>
<th>Switzerland</th>
<th>United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>What is the minimum capital to asset ratio requirement?</td>
<td>8.0%</td>
<td>8.0%</td>
<td>8.0%</td>
<td>8.0%</td>
<td>8.0%</td>
<td>8.0%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>4. Activities</th>
<th>Denmark</th>
<th>Iceland</th>
<th>Ireland</th>
<th>Sweden</th>
<th>Switzerland</th>
<th>United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>What are the conditions under which banks can engage in securities activities?</td>
<td>Unrestricted</td>
<td>Permitted</td>
<td>Unrestricted</td>
<td>Unrestricted</td>
<td>Unrestricted</td>
<td>Unrestricted</td>
</tr>
<tr>
<td>What are the conditions under which banks can engage in insurance activities?</td>
<td>Restricted</td>
<td>Permitted</td>
<td>Restricted</td>
<td>Restricted</td>
<td>Prohibited</td>
<td>Unrestricted</td>
</tr>
<tr>
<td>6. Internal Management/Organizational Requirements</td>
<td>Denmark</td>
<td>Iceland</td>
<td>Ireland</td>
<td>Sweden</td>
<td>Switzerland</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>-------------------------------------------------</td>
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<td>----------------</td>
</tr>
<tr>
<td>Can the supervisory authority force a bank to change its internal organizational structure?</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>7. Liquidity &amp; Diversification Requirements</th>
<th>Denmark</th>
<th>Iceland</th>
<th>Ireland</th>
<th>Sweden</th>
<th>Switzerland</th>
<th>United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Are there explicit, verifiable, and quantifiable guidelines regarding asset diversification?</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>What percent of the commercial banking system's assets is funded with deposits?</td>
<td>39.0%</td>
<td>20.4%</td>
<td>66.9%</td>
<td>23.0%</td>
<td>71.1%</td>
<td>55.7%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>9. Provisioning Requirements</th>
<th>Denmark</th>
<th>Iceland</th>
<th>Ireland</th>
<th>Sweden</th>
<th>Switzerland</th>
<th>United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is there a formal definition of a &quot;nonperforming loan&quot;?</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>10. Accounting/Information Disclose Requirements</td>
<td>Denmark</td>
<td>Iceland</td>
<td>Ireland</td>
<td>Sweden</td>
<td>Switzerland</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>-----------------------------------------------</td>
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<td>---------</td>
<td>--------</td>
<td>-------------</td>
<td>----------------</td>
</tr>
<tr>
<td>Are off-balance sheet items disclosed to supervisors?</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Are off-balance sheet items disclosed to the public?</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Must banks disclose their risk management procedures to the public?</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>11. Discipline/ Problem Institutions/ Exit</th>
<th>Denmark</th>
<th>Iceland</th>
<th>Ireland</th>
<th>Sweden</th>
<th>Switzerland</th>
<th>United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>11.3 Can the supervisory agency suspend the directors’ decision to distribute:</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Dividends?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bonuses?</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Not Available</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Management fees?</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Not Available</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Is there a separate bank insolvency law?</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Does the Banking Law establish predetermined levels of solvency deterioration which forces automatic actions?</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>
11.9 Regarding bank restructuring and reorganization, can the supervisory agency or any other government agency do the following:  
11.9.1 Supersede shareholder rights?

<table>
<thead>
<tr>
<th></th>
<th>Denmark</th>
<th>Iceland</th>
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<th>Switzerland</th>
<th>United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank supervisor</td>
<td>Court</td>
<td>Court</td>
<td>Bank supervisor</td>
<td>Court</td>
<td>Bank supervisor and the court</td>
<td>Court</td>
</tr>
</tbody>
</table>

### 12. Supervision

<table>
<thead>
<tr>
<th>What is the supervisory body?</th>
<th>the DFSA</th>
<th>Financial Supervisory Authority</th>
<th>IFSRA</th>
<th>Finansinspektio nen (Fi)</th>
<th>Not Applicable</th>
<th>Financial Services Authority</th>
</tr>
</thead>
<tbody>
<tr>
<td>To whom are the supervisory bodies responsible or accountable?</td>
<td>The Finance Minister or other cabinet level official</td>
<td>The Finance Minister or other cabinet level official</td>
<td>The Finance Minister or other cabinet level official</td>
<td>The Finance Minister or other cabinet level official</td>
<td>A legislative body, such as Parliament or Congress</td>
<td></td>
</tr>
</tbody>
</table>