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Financial Stability Measures

The Government announced on the 3rd November the proposals for Lloyds Bank and Royal Bank of Scotland under the headline "Implementation of Financial Stability Measures". The phrase "financial stability" is now apparently used as a catch-all phrase to justify whatever measures the Government cares to promote. The banks themselves also made complementary regulatory news announcements at the same time.

These were heralded by some sections of the media as the "break-up" of these banks although that is rather simplistic a view. In essence both banks are having to downsize considerably to meet European Commission dictates on "state-aid" and associated competition issues.

In the case of Lloyds, this means that the original Government waiver of UK competition law to enable and encourage the merger with HBOS to take place can now be seen for what it was. Namely an illegal act promoted by either an ignorant or duplicitous Treasury. Shareholders were encouraged to vote for the merger when, as was said at the time by several commentators, it was very questionable whether the resulting dominant position of the enlarged bank would be allowed to stand for long.

It is of course also now made plain that the Government is not allowing UKFI (the holding company they set up to hold their stakes in banks) to manage their stakes in these banks on an "arms-length" commercial basis as originally suggested. They are using their substantial control of these banks and the powers of the FSA to dictate the banking sector landscape in terms of the number of banks in the UK marketplace, and their lending policies.

The level of interference in the case of RBS is evidenced by a report in the Daily Telegraph that said the Government is demanding that it should have the power to force the sale of assets covered by the APS scheme or "manage" the loans concerned. RBS is disputing this.

The share price of Lloyds rose on the announcements, but that of RBS fell.

The RBS Proposals

The RBS announcement confirmed the key terms of the Asset Protection Scheme where their "toxic assets" are insured by the Government. RBS will now take the first £60bn of losses themselves rather than the previously proposed figure of £42bn. The pool of insured assets will reduce to £282bn.

The fees associated with this “insurance” and the additional capital to be supplied are complex with the former comprising a mix of up-front fees and annual fees. Some £25bn of additional capital will be provided by the Government which will increase the economic interest of the Government in the company to 84% (but the ordinary share interest will stay at 70%).

RBS may consider ways to reduce the £25bn from the Government by raising capital from other sources over the next few weeks.

Additional Commitments

The company has also had to agree, as part of this deal, to:

- Maintain it’s commitments to lending as previously agreed.
- A “Customer Charter” for small businesses and transparency on charges.
- Limitations on bonus payments to staff.
- “Behavioural” commitments - a truly Orwellian phrase but it means such limitations as not appearing higher than number 5 in global debt league tables.

Also the company is required to downsize substantially by making a number of disposals over the next four years including parts of its branch network, RBS Insurance, Global Merchant Services and its interest in RBS Sempra Commodities. In total 318 UK branches will be disposed of including the RBS ones in England/Wales and Natwest branches in Scotland.

No Dividends

One of the “behavioural measures” is that there will be no dividends on hybrid capital instruments (including preference and B shares) for a two year period. No mention is made of dividends on ordinary shares, but presumably there won’t be any of those either.

Capital Ratios

The announcement gives details of the current and resulting Core Tier 1 Capital ratios. At 30th June 2009, this figure was 6.4%. With the APS in place this is calculated by RBS to be 11.1% on a “proforma” basis - much higher than other similar UK banks.

There seems no obvious justification for this and the APS could well be seen as an unnecessary scheme which simply enables the Government to take greater control of the company. There is no clear justification given in the announcements for the necessity of this scheme and in respect of the “insurance cover” allegedly being provided, the figure is so large that if RBS had to claim for the full amount it is doubtful the Government would have the resources to pay it. We are considering some of the legal issues involved here.

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