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MONEY BOX

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LEWIS: Hello. In today's programme, after a more extraordinary week than anyone can remember, are we out of the financial wood or in the eye of the storm? Lloyds TSB will take over its high street rival, Halifax Bank of Scotland, to create the UK's biggest bank. Will we all suffer from a lack of competition? The collapse of a bank in America and the emergency rescue of HBOS makes many wonder about the safety of their money. We explain the rules. And after a week of turmoil, what will happen now to mortgage and savings rates? Finally, the government admits it will save £300 million from Britain's poorest pensioners when rules change in two weeks time.

Well there were times this week when it seemed like the end of banking as we know it. On Monday, the American investment bank, Lehman Brothers, founded when cowboys roamed the Wild West, went bust; another venerable name, Merrill Lynch, disappeared into Bank of America; and AIG, once the biggest insurance company in the world, was nationalised by the United States government; then on Wednesday, a run on the shares of our own Halifax Bank of Scotland led to an emergency rescue take-over by Lloyds TSB. But none of this stopped the fall in share prices. They plunged again on Thursday, so that night the US government said it would buy the toxic debt the banks had been playing pass the parcel with at a cost to US taxpayers of … Well no-one knows, but probably hundreds of billions of dollars. On Friday, share prices rose in London by a record 8.8%. Well with me is Justin Urquhart Stewart of Seven Investment Management. And if Justin's here, there must be a crisis or have been one. *(Urquhart Stewart laughs)* Have you seen anything like this, Justin?

URQUHART STEWART: Not on this scale and not this combination of issues. If you want to see a rise like that, then of course just after the '87 crash we saw one not quite as big. But a combination of issues of market trauma, banking failure like this is unprecedented.

LEWIS: It has been threatening for a year though. I mean we've been talking about the credit crunch for, what, 13 months now. Why did it happen this week?

URQUHART STEWART: Well when you actually look at the combination of issues that have come together, and certainly one or two people - I can even talk about my own chief investment officer talking about Merrill Lynch, a year,18 months ago - saying, given the circumstances, some of these giants may well fall. So a combination of issues coming together really then made their lack of trust in banking lead to this fall.

LEWIS: Now in the press people have been blaming what's called "short selling" - selling shares you don't own in the hope the price will fall and you can then buy them back and make a profit. Was that part of the problem?

URQUHART STEWART: No, not really. We know the number of shares are actually being borrowed in order to carry out that mechanism and it was actually relatively small. No, what you saw was a huge crisis of confidence which ran around the market with the general phrase being, "Who's next?" And that's actually what was going on.

LEWIS: But one of the things that undoubtedly has caused it are these things called derivatives, obscure named things like collateralised debt obligations, which I think everybody now admits they probably didn't understand in the first place. Are those now going to disappear from the banking system?

URQUHART STEWART: Yes, you're now going to see a change of era in banking. The old investment banking based on these derivatives frankly will not be sustainable in this new era. I believe we're actually going to go back to another era of almost

Quaker banking, of simpler banking where credit is going to be tighter, you're going to have to have deposits in order to obtain things, and the control is going to be back to almost the days of well probably the sort of bank manager like Captain Mainwaring except in a dog collar.

LEWIS: Okay, well we'll stick with banks for a bit. Stay with us, Justin. And, as I said, as shares in Halifax Bank of Scotland plunged and fears for its solvency grew, Lloyds TSB rode in on what we might call Black Horse Wednesday to buy it for £12.2 billion and that was a quarter of what it was worth a year ago. And this will create a high street mega bank with 35% of current accounts, 29% of the mortgage market and more than £300 billion of our cash savings, and a quarter of personal loans and a fifth of credit cards bunged in as well. Now normally such a banking bohemeth would not be allowed, but the government decided it would overrule competition restrictions and allow it to go ahead. We're also joined by Jonathan Charley who's Vice President of the banking division at the consultancy EDS. Jonathan Charley, was HBOS really in such trouble it had to be saved, or was this the government or the regulator panicking?

CHARLEY: Well certainly the share price was under attack, as Justin mentioned, and it was getting lower and lower and I think there was a great deal of concern as to where it was actually going to stop. But in terms of if you look at it in a rational way as a business, and on the evidence that was there, it wasn't in as much trouble as certainly the share price seemed to reflect.

LEWIS: And now that Lloyds TSB has … well it hasn't bought it but it's going to buy it, will it have trouble itself? Is it buying something that isn't as secure as it might be?

CHARLEY: Well certainly Lloyds TSB is going to have to increase its capital because obviously it's buying a much larger bank than itself. And whilst Lloyds TSB at the size it was was very well capitalised, it will need to go out and get more capital. The question is how much is actually out there in terms of the exposure that HBOS had.

LEWIS: Yes because we don't really know that, I suppose. But there's no question about the safety of the joint bank. It is going to be a huge bank on the high street, isn't it?

CHARLEY: Absolutely. You've just rattled through a number of the strengths it's got there and the number of branches it's got out there, the amount of savings it's got. It is a very large bank once it's brought together.

LEWIS: And you mentioned raising capital and it's also going to save costs. I think it's saying it's got to save a billion pounds by 2011. They employ over 75,000 people each, these banks. Some people are going to go, aren't they?

CHARLEY: Well the opportunity to dramatically reduce cost is definitely there. The challenge is how quickly you can do it because it's very simple to say well you've got two branches on a high street, so therefore let's close one, but actually you then need to pay to provide the means for the Halifax customers to use a Lloyds branch and that's much more complicated than it sounds.

LEWIS: Shareholders are going to get a vote in this though. Do you think there's any chance that they'll vote against it?

CHARLEY: I certainly think there'll be quite a bit of noise from the institutional investors, but I don't think they've got much prospect of turning this over.

LEWIS: Justin Urquhart Stewart, do you think HBOS was really in such trouble it had to be bought by Lloyds?

URQUHART STEWART: No, I don't, because actually when you looked at the trading on the day, as Jonathan was saying HBOS was still a perfectly good bank. Yes of course there were risks there, as there are with all banks, but the trading was getting very erratic indeed and under those circumstances and although there were some trading firewalls put in to try and calm things down, what you would expect is actually the shares to be suspended in both Lloyds TSB and HBOS to allow a period of cooling off. And if that had happened for a couple of days, well we've seen a market recovery, or they could have found another solution such as a lifeboat to be able to support the issue; and that way you still have a perfectly good job, not upset the monopolies issue and of course save those jobs.

LEWIS: So this was unnecessary. I mean one reason why shares rose by this record amount in London on Friday was because the American government announced that they are going to set up a fund to buy all this junk debt that we've been talking about for the last year, these collateralised debt obligations, with taxpayers' money. That's going to cost hundreds of billions of pounds. Jonathan Charley, is that going to sort out the banks? Is it going to settle them down?

CHARLEY: I think what it will give is a period of calm, but of course at the end of the day someone's going to have to pay for that support that's been provided to the banks.

LEWIS: But isn't the problem, Justin, that the banks have stopped trusting each other? They've been passing on this debt and misleading each other, maybe lying about what was in it. Are we going to get back to a period of trust?

URQUHART STEWART: Well the key issue here is if they can actually take out the poisonous debt and actually put it into this new bank, this sort of manure bank or whatever it's going to be called, then hopefully the key issue that all the banks have to look at is particularly in America getting those high prices down to a value which they know then is real, so when they are lending to one another and their clients they've got a tangible asset at the end of it. Until you can actually establish the value of those assets, they won't trust each other.

LEWIS: Justin Urquhart Stewart and Jonathan Charley, thanks very much for that.

Well the news of the takeover of HBOS by Lloyds TSB and those other rumours of other institutions in trouble and indeed one American bank actually going out of business have led many Money Box listeners to ask is their money in the bank safe? Events of the last year have shown that government here won't let a UK high street bank go under, but if one did the Financial Services Compensation Scheme comes into play. I asked Jonathan Clark, its Director of Claims, how much was covered.

CLARK: £35,000 is our limit for payment. That's for each authorisation and it's one limit for one person.

LEWIS: And what about joint accounts?

CLARK: With joint accounts, we assume that the money in the joint accounts will be split, so if there are two account holders then the compensation limit applies to each individual.

LEWIS: Now you said "for each authorisation". What do you mean by that?

CLARK: Well each company that takes deposits has an authorisation from the Financial Services Authority and that may apply across several brands or several businesses.

LEWIS: And what about people who have a mortgage and savings with the same institution? Are their savings still protected?

CLARK: Obviously we do have to take into account any debts or any loans that are available to be offset against savings. So for example if you had savings of £2,000 and a loan of £500, then the compensation available would be around £1500.

LEWIS: It does get confusing though, doesn't it? On our phone-in Money Box Live on Monday people were very confused about subsidiaries, about companies that were banks that might be owned by another bank. I mean if you have savings in Halifax and Birmingham Midshires, which are both owned by HBOS, you only get one lot of compensation, don't you?

CLARK: The key thing here is to understand how the banks have chosen to organise their businesses and seek their authorisations. If the banks are part of a group and the group's only got one authorisation, the consumer would qualify for a compensation up to the single limit no matter how many accounts they hold. So I think the issue is to seek confirmation from your bank to understand how they're operating their business and what that might mean for you.

LEWIS: And, presumably, now that Lloyds TSB is taking over Halifax Bank of Scotland, Nationwide we know is going to take over Cheshire and Derbyshire Building Societies, that really means there are going to be fewer institutions that you can spread your money among.

CLARK: Probably early days to comment on the mergers and it wouldn't be for me to do so. But certainly I think for consumers who are interested, it's a matter of understanding how those banks are going to organise themselves going forward and the authorisations that they're going to take up.

LEWIS: Don't you think it would be helpful though if the compensation scheme produced its own guide, a little table showing who owns whom or who is jointly authorised with who?

CLARK: I think what we try to do is make sure that consumers are aware of what our limits are and provide as much information as we possibly can on those limits. For the vast majority of depositors, the compensation scheme provides a good level of compensation. For those who are concerned, I think it's always best to speak to the bank concerned.

LEWIS: Jonathan Clark.

Well the FSCS maybe won't publish a list of connected banks, but Money Box's Bob Howard's here. Bob, with this join up of Lloyds TSB and Halifax Bank of Scotland, they'll have a third of the savings market. What protection will you get?

HOWARD: Well, Paul, this is complicated. For example, Lloyds TSB is the provider for people saving with Cheltenham & Gloucester and Bank of Scotland is the provider for people saving with the AA, Birmingham Midshires, Halifax, Intelligent Finance and Saga. But, as we've just heard, you only get £35,000 guaranteed per branded account if each brand is separately authorised by the Financial Services Authority, so at the moment if you have an account with Lloyds TSB and Cheltenham & Gloucester, if you have one with Lloyds TSB *and* Cheltenham & Gloucester, the total sum of your savings which are protected is limited to £35,000 because both brands are authorised by the FSA under the name of Lloyds TSB. And if you're a saver with the brands provided by Bank of Scotland, again the total sum of your savings which are protected is limited to £35,000 because all of these brands are authorised by the FSA under the single name of Bank of Scotland. What we don't know is whether Bank of Scotland and Lloyds TSB will continue to be separately authorised by the FSA once the takeover is complete. If they're not and they're authorised under just one name, then the limit if you had savings in an account with all of these eight brands would still be a total of £35,000.

LEWIS: Well thanks for that, Bob. We're still getting emails about that very subject as you speak. What about other recent takeovers - if you have savings with Derbyshire and Cheshire Building Societies, for example, or Alliance & Leicester?

HOWARD: Well, Paul, Nationwide told me at the moment Derbyshire and Cheshire Building Societies continue to be authorised separately, but that will change when they formally become part of Nationwide in December. Alliance & Leicester, which is being bought by the Spanish bank Santander, is also currently separately authorised and the bank told me yesterday there are no plans to change this.

LEWIS: Thanks Bob. And of course if you save with National Savings and Investments or Northern Rock, your money is protected by the government without limit. And, as I said earlier, I think it's very unlikely the government would let a UK bank or building society go bust.

There have been calls for the radical reform of this complicated Deposit Protection

Scheme and some have come from Lord David Lipsey, Chairman of the Financial Services Consumer Panel. I asked him what changes were needed.

LIPSEY: I would like to see the compensation limits got rid of actually. The thing is while there are limits to compensation, there is always the risk that people will think their money is at risk, go off down to their bank or whatever institution it is, queue up and cause the kind of chaotic scenes we saw at Northern Rock. Now Northern Rock shows that if an institution, major institution goes under, the authorities have to compensate everybody in full anyway, so why not say so upfront and prevent these problems arising in the first place?

LEWIS: One of the problems that listeners identified to us is that because there is a limit, they want to know where that limit applies; and with more banks joining up, that's becoming more difficult.

LIPSEY: Yes, I think that does have to be very clear. In fact I think the whole scheme has to be clearer because there are some Byzantine complexities to it at the moment, which mean that it's very difficult to know precisely and exactly where you stand.

LEWIS: So what change would you like to see there? I mean if there's no limit, of course it doesn't matter, does it? But if there is to be a limit of any sort, should it apply to each bank or to each account or to each brand? How would it work?

LIPSEY: Well at the moment the limit is per bank. We'd like to see it per brand, so if you have a Halifax account, a Bank of Scotland account, both of them would be covered up to £35,000, rising to £50,000 under the present proposals. Because I think if people find that they have two accounts within an institution with no idea whatsoever that it was one institution they were investing with and then didn't get their money back, there would be uproar.

LEWIS: David Lipsey. And the government is considering changes to the scheme and will make an announcement in the autumn. Meanwhile, you can have your say on our website on how your cash savings should be protected. That's at bbc.co.uk/moneybox.

Well, as we heard earlier, the new Lloyds TSB HBOS will take a major share of retail banking in the UK, and what impact will that and indeed all these other problems in the world have on savings and mortgages? Rob Clifford is Managing Director of the mortgage broker Mortgage Force. Rob Clifford, we've been seeing mortgage rates easing down over the last few weeks. What's happening now? What are you expecting to happen next week, week after?

CLIFFORD: I think it's very likely that we'll see mortgage rates increase, I'm afraid to say. We saw it happening during last week and we're going to see more of it in the next two weeks, I'm quite certain of that.

LEWIS: So the sort of slight ray of hope that mortgage rates are coming down is over. Certainly some of the newspapers are suggesting they're going to go up quite strongly.

CLIFFORD: That's right. I mean the swap rates that tend to influence the rates offered to consumers got to the dizzy heights of 6½% in June, so recovered and got more attractive in recent weeks, but then closed yesterday at 5.53 up from the day before. So we will see lenders increase rates and we saw some increases on Monday and Wednesday. And I think we'll see fees increase too, lenders charging much higher fees for the products they launch.

LEWIS: Yes because those make it very difficult to work out. I mean they really are interest in advance, aren't they, let's be honest about it? But it makes it very hard to compare deals.

CLIFFORD: It does. For folk with larger mortgages, very often paying a higher fee to achieve a lower rate, it's still worth doing; but you're right to point out that fees can alter the overall cost considerably. We saw some examples last week of arrangement fees of £700, rising to £2,500, so consumers really have to look at fees very carefully.

LEWIS: And on the Lloyds HBOS deal - do you think now it's going to be this mega bank on the high street, that's going to reduce competition and that will tend to let prices rise as well?

CLIFFORD: There's always that risk, Paul. After all, HBOS was operating five mortgage brands. C&G was part of Lloyds and I think it's inevitable that some of those brands will disappear. The number of mortgage products available will reduce and that can cause consumer detriment in the long run.

LEWIS: Rob Clifford, Chief Executive of Mortgage Force, thanks. Well also with us is Andrew Haggar from the financial website Moneynet. Andrew, looking at savings now, Lloyds and HBOS, how do they compare in the market?

HAGGAR: I think when you look at it, there's three separate levels. Lloyds is the least competitive. Then you'll see Halifax, slightly better with rates. But the very best is Birmingham Midshires, one of the brands within the HBOS group.

LEWIS: So when it becomes one combined group, which may well be called Lloyds for all we know, we could see things shading downwards?

HAGGAR: That could well be the situation we see. I mean if they decide to take a more steady, sort of cautious approach that they have done in the past, then yeah I can see yes some of these rates being toned down.

LEWIS: And of course because they will be so dominant, as we've just discussed, there'll be less competition from others. Do you think that's also going to be a factor?

HAGGAR: Obviously there will be slightly less choice, but I think you've got to bear in mind that overseas providers are still giving our banks and building societies a good run for their money. Icesave, ICICI, Firstsave, those sort of people. They operate through direct channels and have lower overheads and do offer much better rates at the moment.

LEWIS: I suppose though with banks still needing to raise money from us because they still don't trust each other like they used to do, that's going to tend to keep rates - the best rates anyway - fairly high, isn't it?

HAGGAR: That's right. And I guess with a new super bank, it depends on their requirement for funds. You know if they can't borrow easily from the money markets, they may have to keep their deposit rates high to get the money in through the doors of their branches.

LEWIS: And if people do want to be active consumers moving their money round, what sort of rates should they be looking at?

HAGGAR: I mean it depends. If you're looking for a fixed rate bond, then you should be looking for over 7% and Icesave will offer you 7.06%, ICICI 7.2. If it's a cash ISA, then you need to be looking for over 6¼ and both Barclays and Principality Building Society will offer you that.

LEWIS: And even instant access savings accounts are doing quite well, aren't they?

HAGGAR: Yeah. I mean Birmingham Midshires does very well on that one - 6.33; and you can get up to say 6.55 with the Kaupthing Edge. So it's still best to shop around.

LEWIS: We're all going to have to keep an eye on our money. Andrew Haggar from Moneynet, thanks very much indeed.

The government is set to save hundreds of millions of pounds from some of the poorest pensioners in the country by cutting the length of time it backdates new claims for means tested benefits. At the moment Pension Credit, council tax benefit and housing benefit are all backdated 12 months from the date of the claim, but anyone who makes a claim from Monday 6th October - two weeks away- will only get 3 months backdating, costing them on average £1600 each. The change was announced as part of a wider shake-up, which will automatically treat a claim for pension credit as a claim for other benefits as well. Now the government says that will mean 20,000 extra claims every year, but Sally West from Age Concern says cutting the backdating will have a bad effect on many older people.

WEST: Although we support some of the changes that are being introduced because they will improve the system for older people, we are very concerned that the government is going ahead with reducing the backdating. We know that there's a lot of older people who aren't claiming the benefits that they're due and sometimes put off claiming or don't realise they can claim for many, many months. And I think particularly people who perhaps have disabilities or difficulty filling in forms are going to be affected quite badly by these changes.

LEWIS: Well Pensions Minister Mike O'Brien made the changes. I asked him why.

O'BRIEN: What we wanted to do was find the funding, the extra funding which we needed to introduce this automatic payment with one phonecall so that you get the lot, and we believe that this will lift by 2010 about 50,000 pensioners out of poverty as a result and that's why we did it.

LEWIS: So you're quite openly saying that you're paying for the extra cost of getting these extra claims by cutting the backdating paid to those who *do* claim?

O'BRIEN: If we reduce the backdating from 1 year to 3 months, we can cover the cost at least for a period of time, so that what you are able to do is cover the increases in numbers of pensioners who will benefit as a result of this. What it's doing is better targeting the money we already had to help people out much more effectively because what they'll get instead of you know a big lump sum at the start is £4,400 on average a year extra, which is quite a significant amount of improvement in their income.

LEWIS: Yes, but what it means is that everybody who claims will lose money and the average loss will be something round about £1600, so the average loss of everybody is paying for the benefits for the few.

O'BRIEN: Well what we're doing effectively, and you know let me be perfectly straightforward about this, is better targeting the resources. And the answer to that is, yes, I'd rather that people had an ongoing good income over many years than have a big lump sum at the start. But the real help is lifting 50,000 pensioners out of poverty and that's why I've done it.

LEWIS: But in the early years, the three years over which the government plans, this is going to save you a lot of money, isn't it? I mean on your own figures, next year, 2009-10, this will save £125 million.

O'BRIEN: But, as you know Paul, when the Treasury looks at this - and I had to go to the Treasury and argue for this change - we had to convince them that although this was going to cost government a lot over the long-term, this change would have a short-term benefit but the real benefit here is that people who are not sending in forms to their local authorities, not getting that housing benefit, not getting that council tax benefit, won't have to send it in any more. They will get that benefit.

LEWIS: Isn't the real problem though that you rely at the heart of your policy for older people on means tested benefits, which never reach everybody who's entitled to them? Why can't you just abandon that and pay this benefit automatically to everyone?

O'BRIEN: The only money we can pay essentially to pensioners is money that we raise from taxation. And, yes, I would like to pay pensioners vast sums of money, but frankly the taxpayer doesn't want to pay that and remember, many pensioners are also taxpayers. There's a balance always to be struck here and means testing is there because what we want to do is have the basic state pension but also say there are some people on such low incomes that we need to give them that extra bit of help and therefore we have to test whether or not they are on those low incomes or not and then target the extra funding at them.

LEWIS: Mike O'Brien. And people aged 60 or more who find it hard to manage have just two weeks to get their claim in under those old backdating rules. Call 0800

991234. 0800 991234.

And that's it for today. You can find out more from our website, bbc.co.uk/moneybox. There you can download a podcast; have your say on savings protection, as many of you are - detailed questions coming in; give us your ideas; and every Wednesday you can see an update of the week's financial headlines. Gosh, some of you are even blaming the press for these problems. In this week's In Business, which goes out after this programme on Sunday evening, Peter Day examines how risk is managed in the gambling industry. Can banks and financial services firms learn from casinos? Vincent Duggleby's here on Monday, Money Box Live, questions on pensions. Back next weekend with me. The editor of Money Box is Stephen Chilcott. I'm Paul Lewis.