MONEY BOX

Presenter: PAUL LEWIS

TRANSMISSION: 14th FEBRUARY 2009 12.00-12.30 RADIO 4

LEWIS: Hello. In today's programme, the Chancellor refuses to rule out nationalisation of Lloyds Banking Group after the bank reveals a £10.6 billion loss. Standard Life does a u-turn and says it *will* compensate 97,000 customers who thought their pension funds were safely in cash when they weren't. Campaigners call for the banks to stop helping themselves to money in our current account to pay a debt on a credit card.

DRINKWATER: They take £200 out of my account, which is supposed to be going to my mortgage, so they're now robbing Peter to pay Paul.

LEWIS: And Northern Rock shareholders say they'll appeal after the High Court throws out their claim for more money for their shares after the bank was nationalised.

But first, Valentine's Day. It was a marriage made at a cocktail party: the wedding of Lloyds TSB and HBOS to create the UK's biggest high street bank required a special licence to suspend competition law and a dowry from taxpayers of more than £17 billion. But less than four weeks after the nuptials, the relationship is on the rocks. The bride has discovered her husband has irrecoverable debts of £7 billion. Confidence in the relationship plummeted on Friday. Shares fell by a third, and half the taxpayers' dowry has been lost. Our shares are worth £8 billion less this weekend than they were at the start. That's the same as 2½ pence on income tax. If it's

Valentine's Day, this is perhaps the massacre. Live first to banking analyst Peter Hahn from Cass Business School. Peter, how did this happen?

HAHN: Well that is the big question. Lloyds was a conservative bank, it showed great restraint for a number of years; and for some reason, it just threw it to the wind as HBOS became available and did a quick deal. HBOS of course we all know, but I think it was known in the market, was a bank sort of without brakes, it was the buccaneer's bank. And it's just the strangest thing. We have to wonder what the board at Lloyds Bank was thinking about.

LEWIS: Yes, well I mean presumably they wanted to be the biggest high street bank in Britain and get over the competition law, and so due diligence, as they call it - this rummaging around in the books - just wasn't done properly. And that was admitted by the boss this week in the Parliamentary Committee, wasn't it? He said he took between a fifth and a third of the time he'd normally have liked.

HAHN: Due diligence I think is a very hard concept for most people to understand. It actually means getting your fingers dirty and looking inside the boxes you mention and seeing what really is there. And Lloyds really made the deal without really knowing what it was going to pay - pay meaning take losses from HBOS.

LEWIS: And, briefly, I mean have we all paid for this? Competition law was suspended. The bank I think has a quarter of the market in mortgages and in savings and current accounts. We're seeing now record low returns on savings, mortgages not coming down as much as they might have done. Is that because there are now four high street banks rather than five?

HAHN: Well we're seeing certainly a lot less competition in the marketplace, so we are paying for that. Whether that's because of this merger, I don't really think … That will have an effect over years to come, but that's not the effect right now.

LEWIS: Stay with us, Peter, because also with us is Justin Urquhart Stewart, a director of Seven Investment Management. Justin, we're used to huge losses, bigger subsidies. Still the banks aren't healthy. Is wide-scale nationalisation inevitable?

URQUHART STEWART: It is almost heading that way. If you actually look at what has happened over the past couple of years, we've had a series of strokes in the financial system - Northern Rock, HBOS, Bradford & Bingley, Royal Bank of Scotland and now HBOS again - and the body of the financial system cannot take this constant battering that it's getting and, therefore, action has to be taken in very quick order.

LEWIS: And HBOS, as Peter was saying, taking down with it one of our most conservative and (if you strip out HBOS) still profitable banks - Lloyds.

URQUHART STEWART: And here's the clue because actually what we have done of course is actually mixed up very conservative commercial banking, utility banking - the old-fashioned banking there used to be in the high street.

LEWIS: Just current accounts, credit cards, lending for cars - that kind of thing?

URQUHART STEWART: All of that stuff that we used to associate with Captain Mannering banking. *(Lewis laughs)* And we've mixed that up with, well Peter said there, "buccaneer" banking of the investment banking and merchant banking world, which should be completely separate and the US used to be under their US Glass-Steagall Act.

LEWIS: Yes and they scrapped that, didn't they?

URQUHART STEWART: Scrapped that. And we actually mixed these two poisonous elements together and created a very dangerous cocktail.

LEWIS: So do we have to go back to that?

URQUHART STEWART: I think it's almost inevitable we're going to go back to it.

The question is how we do it and how quickly, and time is running out.

LEWIS: And Peter Hahn, is it nationalisation that could do that for us - we take over the bank, we split it in two, and then we sell it back into the market in a few years time?

HAHN: I think what we need, yes, is we need to close the old books. These banks that have lingering if you will landmines of exposure that keep blowing up, destroying confidence - it has to end, we have to close it. And one of the ways to do that, and frankly probably the *only* way to do it, is to nationalise a bank - create an old RBS, if you will, and a new RBS as an example. There are other countries that may have to do the same thing.

LEWIS: And do you think that's going to happen quickly?

HAHN: I think it's a very painful exercise politically. No country wants to be the first one to nationalise a major bank, but it will happen.

LEWIS: Justin Urquhart Stewart, I mean the Chancellor hasn't ruled it out but hasn't ruled it in. I have to say I spoke to the Treasury this morning. They were sort of steering us away from any thought that the bank would be nationalised this weekend, but is it going to happen soon, do you think?

URQUHART STEWART: I think it must happen quite soon. And it doesn't have to be proper nationalisation, as people know. We could easily suspend the shares but take control. And there is a precedent to this. We've seen it in Sweden before where we saw huge control of the banking operation restructuring and coming back under those different mechanisms of commercial bank and separate investment banks. That's the way it has to restore the mechanism and get banking lending again.

LEWIS: Action soon. Justin Urquhart Stewart, thanks, and Peter Hahn also.

150,000 small shareholders in Northern Rock, which of course *was* nationalised, have lost their court battle to improve the price the Government will pay for their shares following that nationalisation a year ago. They claim the Government has rigged the assessment of the price they should be paid by telling the accountant appointed to work out the value of the shares that he must assume first that the bank got no support from the Government - which of course it did - and that it was insolvent, which would bring the price down considerably. Solicitor David Green has been acting on the small shareholders' behalf and was in court this week. He said he was disappointed, but the judgement in fact wasn't all negative.

GREEN: The court made no order for costs against the small shareholders. It recognised that they were standing up for their rights and it was appropriate that they should be challenging what had happened, so at this point they have no liability to the Government. The court has said that there are compelling reasons why this matter should go to appeal. I think the court appeal will expedite it and therefore we should have another hearing before the summer break, I would have thought, in July.

LEWIS: But the Government and the Bank of England between them made over £50 billion available to Northern Rock. Without that money, it would have gone bust and your shareholders would have got nothing.

GREEN: I think the important point we made to the court was that when you look at that lending - referred to as 'lending of last resort' - it was on very commercial terms, so that the Government was making a profit out of that lending and there was penalty interest applied. We said fine, the Government's in that role and is entitled to have that, but what it can't do is then follow that up by saying well out of the residue, out of the company we'll have 100% of any gain in value of the shares.

LEWIS: And if you ultimately won, what price do you think would be fair for the shares?

GREEN: If these criteria are removed, the value of the shares could be around £4, £5, something of that nature.

LEWIS: That was David Green, the solicitor acting on behalf of the Northern Rock shareholders. If that case is eventually lost, then the valuation will be done under the government rules and our reporter Bob Howard's been trying to find out how the process is going, Bob. *(laughs)* Listening in, it's been quite a struggle. What have you discovered?

HOWARD: Well, Paul, back in September of last year, the Government appointed Andrew Caudwell from the firm BDO Stoy Hayward to value the shares and it's paid him and his team £4.5 million to do so. Five months after his appointment, when I spoke to his office this week, it still couldn't give any indication of when they're going to be in a position to make a valuation. They did tell me the whole process is being divided into seven stages. So far, I've been told, we're still in stages one and two.

LEWIS: Not exactly fast progress, is it? Now the Treasury's paying for this, or I should say you, me and all the listeners are paying for this, Bob, aren't we, out of our taxes? What does the Treasury say?

HOWARD: Well a spokesman said that when they awarded Andrew Caudwell the work, they gave no time limit for when they expected him to hand the valuation over. However, they expected it to be done "expeditiously". When I asked what that meant, they said it meant "months, not years", but the spokesman said the Treasury accepted even so that this process could take more than a year. He also told me that Mr Caudwell wasn't updating the Treasury on his progress because the Government wanted him to act completely independently. So it appears the Government's as in the dark as the Northern Rock shareholders as to when they're going to find out what the shares are worth.

LEWIS: I didn't know expeditiously meant several months. Thanks very much, Bob.

Well live now to Newcastle to talk to Dennis Grainger of the Northern Rock Shareholders Action Group, one of the people involved in the case in court this week. Dennis Grainger, one of the risks shareholders take is that the company they own will go bust and they'll get next to nothing for their shares. That's happened to you, but you still want £4.

GRAINGER: Good afternoon. Yes, I agree that the shareholder who is playing the markets would take a risk. The difference in this case is that government has come along and actually confiscated the assets of a perfectly solvent bank. Can I make the point, if I may, that the taxpayer so far has not actually lost any money with Northern Rock. It gave a loan which, as David Green has just said, is being repaid at a penal rate of interest. It will make a profit from that and the guarantees were never used.

LEWIS: Well we don't know if it will make a profit and £54 billion was made available. I mean that is money from taxpayers and that stopped the bank going bust. You say it was a going concern. I don't think anyone else thought that.

GRAINGER: Well, as it mentions in the Independent today, this was really one of the most solvent banks in the land with a huge capital buffer. It's a good bank and the Government intended to make a profit and I do believe they still will make a profit at the expense of the shareholders.

LEWIS: In the long run. But after all this taxpayers' money has been put up, you now want taxpayers to give you or the shareholders money at £4 to £5 a share according to your lawyer.

GRAINGER: What we're asking for is the valuation of the shares by the Stoy Hayward company to be an independent, fair valuation. We're not asking for any particular value. Certainly there was a book value of around that kind of price - £4 a share. But you know the real issue here is that the Government intends to make a profit and will take all of the upside and make sure the shareholders get nothing, which sounds really unfair to me.

LEWIS: But when we've seen the other banks, the surviving banks … I mean we saw the shares in Lloyds Banking Group down to, what was it, 61 pence on Friday; Barclays I think was just a ha'penny over a pound; RBS was 29 pence I think on

Friday. And yet you're saying shares in a bank that had to be bailed out are worth 4 quid.

GRAINGER: Well I mean you can … there's another angle to this. And I don't want to be alarmist, but you must see that if the Government can get away with confiscating assets and paying no compensation whatsoever, or very little, where does that leave the bigger organisations like RBS and HBOS? These shareholders must be in some disarray at the moment.

LEWIS: Well yes, indeed. And just to confirm. You obviously disagreed with this judgement; you will be appealing against it?

GRAINGER: I will certainly be appealing. And I've interviewed 2,000 people on the streets of Newcastle - small shareholders, yes, I stand alongside with the small shareholders but the big players as well, we're all in it together - but we will be appealing subject to funding. I urge any shareholders who are listening, small shareholders, not to get despondent and pay a donation to help us fight this case.

LEWIS: And Dennis Grainger, just before you go, briefly, you heard Bob's analysis of the independent valuation process. You've been given the opportunity to put your case to the valuer. What do you think of that process briefly?

GRAINGER: Well I think until the result of whether we can remove from him the fettering, the constraints the Government has placed, which we would see as unfair, is there any point in doing a valuation? Let's get this case settled. I would urge the Government to go back and rethink this whole position because this legislation was a panic legislation and is totally unfair.

LEWIS: Dennis Grainger of the Northern Rock Shareholders Action Group, thanks very much.

Standard Life has given into pressure from financial advisers and, I have to say, the media and decided to compensate all 97,000 investors who put their money into its Pension Sterling Fund. The fund was marketed as safe. One document said it was 100% invested in cash, or something similar - though it did have a footnote which backtracked on that a bit. It turned out that 13% was invested in mortgage backed securities as we've said before, the assets at the centre of the credit crunch crisis, though Standard Life says theirs were safe. When we interviewed John Gill from Standard Life four weeks ago, he said compensation was out of the question. But then they changed their minds this week. And Money Box listener Geoff Barrett had money in the Sterling Pension Fund. I asked him his reaction to the news.

BARRETT: I'm delighted that they have had a rethink and changed their mind. And while not wishing to sound churlish, you have to look at the small print. We still don't know exactly how much this compensation package is going to amount to for each customer. One can only hope that we will be back in the position that we would have been. So it's good news, but it's very disappointing to see the sort of behaviour of companies like Standard Life. They shouldn't take their customers for granted. They do look after valuable assets and they should take more care and make sure they keep their customers informed.

LEWIS: Well many financial advisers agreed they should have been kept informed as well. One is Mark Meldon, Director of financial advisers RC Gray and Company Limited.

MELDON: It's been pretty much an inevitable outcome of the current problems with this particular pension fund. The amount of pressure from intermediaries and indeed consumers has been very high and I don't think they really had much of a choice.

LEWIS: Now it's costing them £100 million. They're offering people a free transfer into what they say is a genuine cash fund, their managed cash fund. Is that a move investors should make?

MELDON: If people are looking for complete security, then yes I think they should, but they must remember that no investment is completely safe. And I think the other thing to say about a managed cash fund is that although there are various different deposits with different financial institutions within it, if one of those were to fail, one of the banks failed for example, then the policyholder wouldn't be covered by the Financial Services Compensation Scheme at that particular point.

LEWIS: So although it's a cash fund and a genuinely cash fund in that sense, it could still go down?

MELDON: Yes, although one would hope that that possibility's quite remote.

LEWIS: I suppose though with returns being so low on cash, there is still a management charge, which I'm told is 1% a year, so it is conceivable that the return would be less than the management charge and the value would therefore drop?

MELDON: Quite. Probably the lowest charges you can find with insurance company pension contracts is about half a percent. The average might be 1 to 1.5. And if you're only getting half a percent on your money, for example, you'll make no profit at all in that period.

LEWIS: Standard Life are calling this a cash fund, or a managed cash fund. What's your understanding about where the money actually is?

MELDON: Well my understanding is that most of the money will be held on overnight deposits with various different banks, possibly in Treasury bills which are issued by the Government so they're pretty low risk, and it's about as near to cash that a pension policyholder can get to.

LEWIS: Mark Meldon. Well we wanted to talk to Standard Life, but they wouldn't put anyone up for an interview. They said they've made all their comments through their letter to investors, which will be going out in the next week. So I spoke to Robin Geffen. He's the Managing Director of Neptune Investment Management, and I asked him just what a cash fund should contain.

GEFFEN: When people buy cash funds, they are buying a zero risk asset in their own minds; and that is extremely important, that is the cornerstone of being a cash fund. What people do *not* want is various fictitious types of investments invented by investment bankers with nothing better to do than earn huge fees off them embedded into a plain ordinary cash fund which gives it risk characteristics. Cash should mean cash.

LEWIS: So should it be possible for a financial adviser or indeed just a person in the street to look at the description and think well yes, that's cash, that's safe. It may not go up much, it may not go up at all, but it isn't going to go down.

GEFFEN: The commonsense answer as to what is a cash fund is that it is cash, that it has no risk assets.

LEWIS: So should there be rules about what funds that use the word 'cash' or imply they're cash, what they are invested in?

GEFFEN: Absolutely. Anything that describes itself as a cash fund should be incredibly strictly regulated. People need to be aware that cash funds are often used as part of pension planning, for example. When people approach retirement, they want no risk assets. They exit equity markets, they put their money into cash pending buying an annuity. They do not want any risk whatsoever. They want, as you say, something that might not go up much in the current environment but never goes down.

LEWIS: So would you like to see the regulator, the FSA, actually intervene to control this because at the moment all they seem to be saying is you have to treat customers fairly, your material has to be clear, fair and not misleading? They don't specifically make any rules about how a fund like this is described.

GEFFEN: Well I think that's very worrying, but I think there are two people that should be playing this particular game. There's the Investment Management Association to which we all subscribe. The fact is that in this situation the Investment

Management Association define for the purposes of performance all the characteristics of the different sector, so they could very clearly spell out that cash funds in the cash sector are only allowed to invest in cash. But also I think we would all like to see regulation from the FSA on this too.

LEWIS: Robin Geffen. And I spoke to the Chief Executive of the Investment Management Association who admitted that the present definition for money market funds was “loose”, could include many sorts of assets, but he told Money Box “if people have proposals they want to put forward, we’re glad to look at them”. And we’ve been looking at this for about four weeks now and we’ll be looking at it again - this definition of just what does a cash fund mean.

If you owe money to a company which you can’t afford to pay, then it normally has to go to court to get a deal to structure the payments or force you to pay up. But if you have a loan or credit card debt to a bank and you also have a current or savings account with the same bank, then it simply helps itself to the money from your account. Samantha Washington investigates.

WASHINGTON: It’s legal, it’s established practice, and it’s called the banks’ ‘right of set off’. What this means is if you have your debts like a credit card or a loan with the same bank where you have your current account and you fall behind with your payments on that debt, the bank has a right to simply take the money. This is what happened to self-employed IT consultant from Croydon, John Drinkwater.

DRINKWATER: Right, well what I’ve got here really is the story of what’s been happening on my credit card account recently.

WASHINGTON: After losing a big contract, John fell on hard times. Just before Christmas, he was surprised by what happened with his bank Halifax.

DRINKWATER: Well I have my mortgage and my current account and a credit card with the same bank. And I’ve had some problems financially and went to get some help with the CCCS and they put me under a debt management plan and I’ve been paying £1 a month to all my creditors. Just before Christmas, the bank took £230 out of my current account and used it to pay off some of the debt on my credit card - money which I'd allocated to pay my mortgage at the end of the month.

WASHINGTON: This left John in a tight spot.

DRINKWATER: Well I'm shocked that they could take money out of one account, put it into another without your permission. I didn't realise they could do this sort of thing. All my budgets now are thrown out. I'm now £230 short. They've robbed Peter to pay Paul and left me in a mess.

WASHINGTON: Halifax told us that it had given John notice that his arrangement to make token payments was coming to an end and it made every effort to treat him fairly. It also added it always tries to work with customers in financial difficulty.

CITIZEN'S ADVICE EMPLOYEE: Good afternoon, Citizens Advice. Oh dear, do you want to tell me a bit more about … *(fades)*

WASHINGTON: All banks have a right to do this and Citizens Advice has seen a big increase in cases like John's. Tony Herbert is Social Policy Adviser at Citizens Advice.

HERBERT: We've seen a marked increase in these type of cases - a 25% increase in each of the last 2 years. Now this has a profound impact on our clients, many of whom are on low income, often relying on benefits. We've had cases where clients have had their pension credit or housing benefit taken by the bank, sometimes without any warning whatsoever. And we're calling on the banks to adhere to the Banking Code, to treat their customers fairly and put a stop to this practice.

WASHINGTON: Well that Banking Code is a set of rules that all banks agree to abide by and it recognises the right of set off. But it does make certain requirements of the banks if they choose to do this. Robert Skinner is Chief Executive of the

Banking Code Standards Board.

SKINNER: There's an overarching commitment for lenders to treat people in financial difficulties sympathetically and positively. The right of set off, which is clearly a legal right that banks have, should not be used to the detriment of someone's ability to pay priority creditors - for instance their mortgage or their council tax or indeed utility bills or leave enough for day to day living expenses. They should prefer non-priority creditors.

WASHINGTON: I put the Citizens Advice allegations to Eric Leenders, Executive Director of the body that speaks for the banks: the British Bankers' Association.

LEENDERS: Regrettably things do go wrong and I'm sure that there might be circumstances where mistakes have been made. If those mistakes have been made, the banks take their responsibilities under the Banking Code very seriously, so if you do feel that funds have been transferred inappropriately you take that up with the bank concerned. But it's very important equally that people who are in financial difficulty do talk to their lenders. That's a very important part of helping lenders to understand financial circumstances facing that particular individual.

WASHINGTON: The recommendation from Citizens Advice is for customers in difficulty with debts to seek help straightaway. The organisation also tells all customers in this position to try to open a basic bank account in a different place from where the debts are held. But with mergers creating a smaller number of unconnected banking groups to choose from, this will only get more difficult.

LEWIS: Samantha Washington. And if you have experienced the banks helping themselves to your money, you can let us know through Have Your Say on our website, bbc.co.uk/moneybox. And, Bob, news about the Budget?

HOWARD: That's right. Alistair Darling has announced the 2009 Budget will be held on 22nd April after the Easter recess and more than two weeks after the end of the normal financial year.

LEWIS: Thanks, Bob. Well that's it for today. You can find out more from the Action Line - 0800 044 044 - and our website, bbc.co.uk/moneybox. Lots of things to do there. On Wednesday I'm back with Money Box Live, which this week we're broadcasting live from the Trafford Centre in Manchester. That's part of the BBC's Money Matters Roadshow. Financial experts will be on hand all day from 8 a.m. till 6 p.m. to give advice. Journalists will be there to chat and there'll be lots of broadcasting, including Radio 4's You and Yours and BBC Television's Working Lunch at mid-day, and Money Box Live as usual at 3. You can join us, be in the audience or ask a question. Money Box is back as usual next weekend. Don't forget to sign up for my newsletter - not a blog, but a bit like one. Today reporters Samantha Washington and Bob Howard, producer Lesley McAlpine. I'm Paul Lewis.