



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

3 November 2008

The Rt Hon John McFall MP
Chairman
Treasury Committee
7 Millbank
House of Commons
London
SW1P 3JA

Dear John

1. I am writing to update you on the financial stability measures that I announced to the House on 8 and 13 October.
2. As you know, following detailed discussions with the major UK banks and the largest building society, I announced the initial implementation of these measures, including that the Government would be underwriting capital investments for RBS and, upon successful merger, HBOS and Lloyds TSB, totalling £37 billion. All three institutions subscribing to the Government's bank recapitalisation fund will be seeking shareholder approval for raising their capital levels before the end of the year. The Government will then take shareholdings in these banks on the terms agreed on 13 October, subject to claw back by existing shareholders or take up by new shareholders of the ordinary shares and, in the case of HBOS and Lloyds TSB, to the merger going ahead. If for any reason the merger between HBOS and Lloyds TSB does not go ahead, the FSA would need to re-assess both banks to determine the extent to which each would need to recapitalise.
3. As I said on 13 October, the Government's investments will be managed on a commercial basis by an arm's-length company, "UK Financial Investments Limited" (UKFI), wholly owned by the Government. Its overarching objective will be to protect and create value for the taxpayer as shareholder with due regard to the maintenance of financial stability and to act in a way that promotes competition. This includes:
 - maximising sustainable value for the taxpayer, taking account of risk;



- maintaining financial stability by having due regard to the impact of its value realisation decisions; and
 - promoting competition in a way that is consistent with a UK financial services industry that operates to the benefit of consumers and respects the commercial decisions of the financial institutions.
4. UKFI will manage the Government's shareholdings in financial institutions subscribing to the bank recapitalisation fund announced on 8 October. Consistent with the agreements reached with the companies, UKFI will work with the Boards to strengthen their membership through the appointment of suitably qualified, independent non-executives. Final decisions will be taken by the relevant company Boards. In addition, the Government wholly owns Northern Rock plc and Bradford & Bingley plc and, in due course, the Government intends UKFI will also manage these investments on its behalf. All these companies will continue to have their own independent Boards and management teams, determining their own strategies.
 5. UKFI will work to ensure management incentivisation based on long-term value maximisation, which attracts and retains high quality management and which minimises the potential for rewarding failure. UKFI will also oversee the conditions attached to subscribing to the Government's recapitalisation fund, including maintaining, over the next three years, the availability and active marketing of competitively-priced lending to home owners and small businesses at 2007 levels.
 6. The Government will not be a permanent investor in UK financial institutions and will over time seek to dispose of the investments in an orderly way, through sale, redemption, buy-back or other means, in accordance with the UKFI's objectives.
 7. The governance of UKFI will be consistent with the Government's intention to manage its investments on a commercial and arm's-length basis and not intervene in day-to-day management decisions. There will be seven members of the Board, comprising a private sector Chair, three further non-executive private sector members and a Chief Executive. Two senior Government officials will sit on the Board: one from HM Treasury and one from the Shareholder Executive.



8. In order to ensure that the Company can be operational in good time to manage investments made by the recapitalisation fund, we have informed the Commissioner for Public Appointments that we believe it is in the national economic interest for the appointment of the Chair and Chief Executive to be accelerated. I am pleased that Sir Philip Hampton has agreed to become the UKFI's first Chair, and that John Kingman has been appointed as UKFI's Chief Executive. Both will be taking up their positions shortly. The remaining private sector board members will be recruited expeditiously. These roles will be filled by individuals of relevant commercial skill and experience to enable UKFI to best meet the objectives set out above.
9. The Board will be accountable to the Government and, through me, to Parliament for the delivery of its objectives. Annual reports on UKFI's performance will be laid before Parliament and the Chair and Chief Executive will be available to scrutiny by the relevant Parliamentary committees. In due course, the Government will publish a full framework agreement setting out the details of the UKFI's relationship with the Government. We have remained in close contact with the European Commission regarding the implementation of the bank recapitalisation fund, which authorised the fund under the state aid rules on 14 October.
10. On 13 October, alongside my own announcement, the Debt Management Office published the arrangements for operating the credit guarantee scheme, which has now been operating as intended for two weeks. The scheme's objective is to restore confidence in the inter-bank money market by providing credit guarantees to banks to refinance their maturing unsecured debt as it falls due. The guarantees are priced to reward taxpayers for the risk they take on and, by controlling the total size of the scheme and the term of guaranteed debt, taxpayer exposure to banking sector risk is limited. The contingent liabilities taken on through the scheme will be reported to Parliament through the usual Winter and Summer Supplementary Estimates process.
11. In addition to the recapitalisation fund and the credit guarantee scheme, as the Prime Minister and I have said, it is important that all lenders do everything they can to support homeowners and small business during this period of financial market turbulence. Last week, the Secretary of State for Business and I met a range of banks to discuss the steps they can and should take to help borrowers struggling with mortgage payments, and to strengthen their arrangements for supporting small



business. We will continue discussions with the industry on these issues and will shortly publish proposals for monitoring information on lending to homeowners and small businesses.

12. Finally, the UK continues to lead international efforts to bring stability to the financial system. Many other countries have now adopted similar measures to those that the Government announced on 8 October and in the next two weeks the Prime Minister, other Ministers and I will discuss measures to ensure financial stability in both the short and long term with our European and global counterparts, including at ECOFIN in Brussels tomorrow; an extraordinary Informal European Council, again in Brussels, on 7 November; a G20 Finance Ministers' meeting in Brazil on 8-9 November; and an extraordinary G20 Heads' and Finance Ministers' Summit in the USA on 15 November.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'A. Darling'.

ALISTAIR DARLING