



House of Commons
Treasury Committee

Reporting contingent liabilities to Parliament

Fifth Report of Session 2009–10

Report, together with formal minutes, oral and written evidence

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The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of HM Treasury, HM Revenue & Customs and associated public bodies.

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The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at www.parliament.uk/treascom.

A list of Reports of the Committee in the current Parliament is at the back of this volume.

Committee staff

The current staff of the Committee are Eve Samson (Clerk), Andrew Griffiths (Second Clerk and Clerk of the Sub-Committee), Adam Wales, Jay Sheth, Helen Jackson and Aliya Saied (Committee Specialists), Phil Jones (Senior Committee Assistant), Caroline McElwee (Committee Assistant), Gabrielle Henderson (Committee Support Assistant) and Laura Humble (Media Officer).

Contacts

All correspondence should be addressed to the Clerks of the Treasury Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5769; the Committee's email address is treascom@parliament.uk.

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Reporting contingent liabilities to Parliament

1. On 24 November 2009 the Treasury Committee was to take evidence from the Governor of the Bank of England on the Bank's November inflation report. However, immediately before that hearing the Governor wrote to the Chairman to alert the Committee to the fact that:

In exceptional circumstances, as part of its central banking functions, the Bank acts as 'lender of last resort' to financial institutions in difficulty in order to prevent a loss of confidence spreading through the financial system as a whole. Accordingly, the Bank extended Emergency Liquidity Assistance (ELA) to two institutions, RBS and HBOS, in the Autumn of 2008.

In most cases, confidence can best be sustained if the Bank's support is disclosed only when the conditions that gave rise to potentially systemic disturbance have improved to a point where the disclosure itself should not be a cause of such disturbance. Having carefully weighed the public interest case for disclosure against the potential systemic consequences, the Bank decided to use its powers to limit the extent of disclosure in its financial statements in the 2009 Annual Report. However, as stated in the Bank's Annual Report 2009, it is the policy of the Bank that such assistance should be disclosed once the Bank considers that the need for secrecy has ceased. Now that RBS has signed up for the Asset Protection Scheme and Lloyds Banking Group has embarked on its alternative strategy for capital raising, the Bank judges that there is no longer a need for the assistance to remain secret and that it is now appropriate to disclose details relating to the ELA provided to RBS and HBOS last autumn.¹

2. The Bank's operations were underwritten by a Treasury indemnity which:

indemnified the Bank on a net basis against losses that it might suffer or incur in connection with the Bank's commitment to ensure that the banking system had sufficient access to liquidity, including this ELA. The indemnity was granted due to the size of the operations, and considered in the context of the existing demands on the Bank's balance sheet at that time. It was not related to any perception of any increased risk associated with lending to the banks.

The indemnity was provided initially for a period of two months. The Bank paid an indemnity fee of 170bps to the Treasury.²

3. On the same day, the Chairman of the Committee received a letter from the Chancellor of the Exchequer, dated 23 November. This letter also revealed the emergency liquidity assistance. In addition it set out the terms of the Treasury guarantee.

1 Ev 5

2 Ev 4

4. The assistance provided by the Treasury was a contingent liability. The House of Commons, of course, authorises government expenditure each year through the Supply cycle. When the Government gives an indemnity it is undertaking that it will if necessary provide funding, even though the House has not yet authorised it (and cannot, by definition, authorise it until the need for such funding is clear). Under long-standing arrangements contingent liabilities are required to be reported to the House of Commons by the department which has incurred them. This one had not been. The unusual nature of this procedure prompted us to inquire further and to make this Report to the House.

Normal Procedure

5. The current system whereby contingent liabilities are notified to Parliament was proposed by the Treasury in November 1977 following a report of the Committee of Public Accounts. The proposal was as follows:

The Treasury note the comments of the Committee. They propose, as regards the introduction of a standard procedure to notify Parliament of the details of each new case of a guarantee of any substance, that such guarantees, when no statutory procedure is already laid down, should be the subject of a Minute to be laid before Parliament. Wherever practicable the likely order of magnitude of such contingent liabilities will be given where the financial effect cannot be quantified with any certainty.³

Guarantees and contingent liabilities had been reported to Parliament before the standardised procedure was introduced, either by inclusion of a token sum in the estimates, or by ministerial statement or written answer. The Committee of Public Accounts had recommended:

We note that Parliament is informed of individual guarantees in a variety of ways, and that one might be merely through the inclusion of a token sum in the published Supply Estimates without specific attention being drawn to it. We therefore recommend that the Treasury should consider arranging for more specific notification to Parliament in each new case of any substance, preferably by one standard procedure; and that they should consider the possibility of informing Parliament of the likely order of magnitude of contingent liabilities on the Consolidated Fund in those major cases where the Government has given a general assurance whose financial effect cannot be quantified with any certainty.⁴

6. However, not all contingent liabilities can be openly reported or reported ahead of time. *Managing Public Money*, in effect the Treasury's manual for Accounting Officers, sets out what should happen in such cases:

3 Treasury Minute on the Reports from the Committee of Public Accounts Session 1976-77 and abstract of Appropriation Accounts, Cmnd 6977, p 28.

4 Committee of Public Accounts, Tenth Report of Session 1976-77, HC 536, para 67

If, exceptionally, the liability needs to remain confidential, the minister should inform the chairs of the relevant select committee and the PAC; then inform Parliament openly if the need for confidentiality lifts.⁵

Similarly, as *Erskine May* makes clear, the Chairmen should be informed if a contingent liability is incurred during a periodic adjournment of the House and *Managing Public Money* notes that “As a matter of record, when Parliament reconvenes, a Minute should be laid explaining what has happened, including any liabilities undertaken.”⁶ While it is important for Chairmen to be informed when the House is not sitting, we do not understand why the guidance does not simply require the Minute to be laid when they are so informed, since Command Papers can be laid during adjournments.⁷

7. The reason for reporting the liability is to provide Members with an opportunity to object. Indemnities should therefore be notified in advance. *Managing Public Money* states:

If an MP objects by letter, Parliamentary Question or Early Day Motion, the indemnity should not normally go live until the objection has been answered. In the case of an Early Day Motion, the Member(s) should be given an opportunity to make direct personal representations to the minister, eg proactively arranging a meeting with them. The Treasury should be kept in touch with representations made by MPs and of the outcome. When confidential reports to Chairmen are made then representations from those Chairmen should be treated in the same way.⁸

This provision has been included in Treasury guidance since 2000.⁹ **The Treasury clearly breached its own well established guidance to all parts of the public sector when it failed to inform the Chairman of this Committee and the Chairman of the PAC of the guarantee given to the Bank of England in respect of Emergency Liquidity Assistance.**

The Permanent Secretary’s explanation

8. The Committee called Sir Nick Macpherson, Permanent Secretary to the Treasury and Accounting Officer to explain why the indemnity had been concealed for so long. He first claimed, in a letter to the Chairman, that his action had been “consistent with the principles in *Managing Public Money*”. We asked his justification for this:

I think you will find, Mr Fallon, that in relation to the role of the Accounting Officer there is a line which says that the acid test is whether the Accounting Officer could justify the proposed activity if asked to defend it, and I believe I can.¹⁰

5 Chapter 5: Funding, Box 5.2: contingent liabilities: notifying Parliament

6 *Managing Public Money*, A5, 5.30

7 Erskine May, *Parliamentary Practice*, 23rd edition, page 265.

8 *Managing Public Money* A.5.5.26

9 *Government Accounting*, 2000

10 Q 2

I think you have to go back to the very exceptional circumstances of October of last year. Over a period of days there emerged a very considerable risk that the banking system would collapse altogether. The previous year in relation to Northern Rock emergency liquidity assistance had been offered but, you will recall, leaked prematurely, thus triggering the run on Northern Rock.¹¹

Sir Nicholas claimed both that the indemnity had to be kept secret to avoid triggering bank runs and that Parliament had been informed about the scale of potential Government support for the banks:

You will recall that the Chancellor came to Parliament, or certainly made a statement to Parliament, on 8 October, I think, which was before the guarantee supporting the ELA was given, which was on 14 October, so the Chancellor had already informed Parliament that the amount of guarantees we might give to the credit guarantee scheme could reach £250 billion. The ELA in effect was subsumed within that £250 billion, so that when, over the course of November in the case of RBS and, I think, December in the case of HBOS, those companies had managed to line up support from the credit guarantee scheme, they no longer needed the emergency liquidity assistance. In terms of the aggregate liabilities, we have always been totally clear to Parliament about the magnitude.¹²

9. It was clear that the decision to conceal the liability was taken by the Chancellor:

Sir Nicholas Macpherson: No, I did not advise concealment. We advised the Chancellor on this issue.

Q7 Mr Fallon: What was your advice?

Sir Nicholas Macpherson: The advice was consistent with notifying Parliament.

Q8 Mr Fallon: Did you advise the Chancellor to notify Parliament?

Sir Nicholas Macpherson: Yes, as we would with all contingent liabilities. The Chancellor, perfectly reasonably, took the view that he did not want to disclose the support at that time.

10. However, as Sir Nicholas himself pointed out, Accounting Officers have the power to demand explicit instruction if they consider a Minister is acting improperly. He did not consider this to be the case.

As Accounting Officer I could have demanded a direction on the issue but I thought, taking all the issues into account, that was a perfectly reasonable decision for the Chancellor to take and I did not think it right to demand a direction in this case.¹³

11 Q 3

12 Q 4

13 Q 8

.....I thought the Chancellor's decision was consistent with the principles of Managing Public Money because the circumstances were truly exceptional. I have mentioned already that the support was consistent with the broader guarantees which had already been notified to Parliament, so I did not feel that this was somehow an additional sum of money because it was subsumed within the money contained within the special liquidity scheme and the credit guarantee scheme.¹⁴

11. Later in Sir Nicholas's evidence, a picture emerged of decisions necessarily taken extremely quickly, in extreme circumstances:

you have to understand is that everything during this period happened at an extraordinary pace. This advice was put together in the course of about 45 minutes. We had that little time. The decision was taken within an hour, I think, of the advice being drafted.¹⁵

It was also clear that the Governor of the Bank of England considered that secrecy was paramount, and that:

The Governor was clear that for emergency liquidity assistance to be successful secrecy was of the utmost importance. What you need to remember is that they started the ELA initially without a Treasury guarantee. You should also bear in mind that at its peak we guaranteed £18 billion of the £60 billion. The Bank had £100 billion of quite good quality collateral being offered for the £60 billion, so initially at least there was a prospect that the Bank of England could provide the assistance without a Treasury guarantee, so it was only a few days after the ELA started that the guarantee was sought and given.¹⁶

However, Sir Nicholas was clear that the decision as to whether or not to inform the Chairmen was one for the Government, not the Bank.

12. One reason for Government reluctance to reveal the liability to the Chairmen was that the Treasury clearly envisaged that the two Chairmen would have to be advised by letter, as had been the case in the past, and that this would inevitably compromise the extreme secrecy needed:

the Chancellor of the Exchequer, and indeed the Treasury, have the highest respect both for the Chairman of this Committee and the Chairman of the PAC, but this was all about minimising risk and it is in the nature of letters that there is a risk that more than one person sees them and the decision was taken on that basis.¹⁷

13. Since the Committee hearing the Chancellor of the Exchequer has written to the Chairmen of this Committee and the Committee of Public Accounts and proposed that if such exceptional circumstances arise in future they should receive an oral briefing.

14 Q 9

15 Q 23

16 Q 28

17 Q 4

14. Sir Nicholas's evidence was exceptionally frank, and is to be commended. Given the events surrounding the failure of Northern Rock, the extreme urgency of the situation, and the Bank of England's view that "secrecy was of the utmost importance", we can understand why the Chancellor decided that absolute secrecy was paramount, and why Sir Nicholas considered that decision proper. Nonetheless, in our view, the decision was overly influenced by the assumption that disclosure of the liability would have to be in writing. We welcome the Chancellor's proposal that if such extreme circumstances arise in future the Chairmen should be briefed orally, and regret that this was not done when the indemnity for Emergency Liquidity Assistance was extended. In future, we expect Committee Chairmen to be briefed properly, whatever the circumstances.

Conclusions and recommendations

Reporting contingent liabilities to Parliament

1. The Treasury clearly breached its own well established guidance to all parts of the public sector when it failed to inform the Chairman of this Committee and the Chairman of the PAC of the guarantee given to the Bank of England in respect of Emergency Liquidity Assistance. (Paragraph 7)
2. Sir Nicholas's evidence was exceptionally frank, and is to be commended. Given the events surrounding the failure of Northern Rock, the extreme urgency of the situation, and the Bank of England's view that "secrecy was of the utmost importance", we can understand why the Chancellor decided that absolute secrecy was paramount, and why Sir Nicholas considered that decision proper. Nonetheless, in our view, the decision was overly influenced by the assumption that disclosure of the liability would have to be in writing. We welcome the Chancellor's proposal that if such extreme circumstances arise in future the Chairmen should be briefed orally, and regret that this was not done when the indemnity for Emergency Liquidity Assistance was extended. In future, we expect Committee Chairmen to be briefed properly, whatever the circumstances. (Paragraph 14)

Formal Minutes

Tuesday 9 February 2010

Morning sitting

Members present:

John McFall, in the Chair

Nick Ainger	Mr James Plaskitt
Jim Cousins	John Thurso
Mr Colin Breed	Mark Todd
Ms Sally Keeble	Mr Andrew Tyrie
Mr Andrew Love	Sir Peter Viggers

Reporting contingent liabilities to Parliament

Draft Report (*Reporting contingent liabilities to Parliament*) proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 14 read and agreed to.

Resolved, That the Report be the Fifth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Written evidence was ordered to be reported to the House for printing with the Report.

[Adjourned till this day at 6.00 p.m.]

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3	Letter from Sir Nicholas Macpherson to the Chairman of the Committee, dated 8 December 2009	Ev 5
4	Letter from the Chancellor of the Exchequer to the Chairman of the Committee, dated 8 December 2009	Ev 5
5	Letter from the Chancellor of the Exchequer to the Chairman of the Committee, dated 18 December 2009	Ev 5

Reports from the Treasury Committee during the current Parliament

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Third Report	Credit Searches	HC 197
Fourth Report	Pre-Budget Report 2009	HC 180

Session 2008–09

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Fifth Report	Banking Crisis: The impact of the failure of the Icelandic banks	HC 402
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Eighth Report	Budget 2009	HC 438
Ninth Report	Banking Crisis: reforming corporate governance and pay in the City	HC 519
Tenth Report	Appointment of Professor David Miles to the Monetary Policy Committee of the Bank of England	HC 765
Eleventh Report	Appointment of Dr Adam Posen to the Monetary Policy Committee	HC 764
Twelfth Report	Banking Crisis: International Dimensions	HC 615

Thirteenth Report	Evaluating the efficiency programme	HC 520
Fourteenth Report	Banking Crisis: Regulation and supervision	HC 767
Fifteenth Report	Mortgage arrears and access to mortgage finance	HC 766
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Fifteenth Report	Appointment of Charlie Bean as Deputy Governor of the Bank of England	HC 917
Sixteenth Report	Appointment of Spencer Dale to the Monetary Policy Committee of the Bank of England	HC 1009
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Ninth Report	Appointment of the Chair of the Statistics Board	HC 934
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Eighth Report	Bank of England Monetary Policy Committee: appointment hearing for Professor David Blanchflower	HC 1121
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Oral evidence

Taken before the Treasury Committee

on Tuesday 15 December 2009

Members present

John McFall, in the Chair

Nick Ainger
Mr Graham Brady
Jim Cousins
Mr Michael Fallon
Ms Sally Keeble

Mr Andrew Love
Mr James Plaskitt
John Thurso
Mr Mark Todd
Mr Andrew Tyrie

Witness: **Sir Nicholas Macpherson** KCB, Permanent Secretary, HM Treasury, gave evidence.

Q1 Chairman: Sir Nicholas, welcome to the Committee. Can you introduce yourself for the shorthand writer, please?

Sir Nicholas Macpherson: Yes. I am Nicholas Macpherson and I am Permanent Secretary to Her Majesty's Treasury.

Q2 Mr Fallon: Permanent Secretary, your letter to our Chairman in respect of the non-disclosure of the Treasury guarantee says it was consistent with the principles in the document *Managing Public Money*. Which principle is that?

Sir Nicholas Macpherson: I think you will find, Mr Fallon, that in relation to the role of the Accounting Officer there is a line which says that the acid test is whether the Accounting Officer could justify the proposed activity if asked to defend it, and I believe I can.

Q3 Mr Fallon: But I am looking at the document and paragraph 5.2 says, "If, exceptionally, the liability needs to remain confidential, the minister should inform the chairs of the relevant select committee and the PAC, then inform Parliament openly if the need for confidentiality lifts". Why was our Chairman, who is a Privy Councillor, not informed?

Sir Nicholas Macpherson: I think you have to go back to the very exceptional circumstances of October of last year. Over a period of days there emerged a very considerable risk that the banking system would collapse altogether. The previous year in relation to Northern Rock emergency liquidity assistance had been offered but, you will recall, leaked prematurely, thus triggering the run on Northern Rock.

Q4 Mr Fallon: You are suggesting that a Member of Parliament might have been responsible for that?

Sir Nicholas Macpherson: Absolutely not. As you know, the Chancellor of the Exchequer, and indeed the Treasury, have the highest respect both for the Chairman of this Committee and the Chairman of the PAC, but this was all about minimising risk and it is in the nature of letters that there is a risk that more than one person sees them and the decision was taken on that basis. This was a truly exceptional set of circumstances. The Treasury has been utterly

scrupulous in informing Parliament about contingent liabilities we have taken on. It is also worth expanding a bit on the nature of this emergency liquidity assistance. The ELA was effectively a bridge; it was a bridge to the respective banks getting support from the credit guarantee scheme and the special liquidity scheme. You will recall that the Chancellor came to Parliament, or certainly made a statement to Parliament, on 8 October, I think, which was before the guarantee supporting the ELA was given, which was on 14 October, so the Chancellor had already informed Parliament that the amount of guarantees we might give to the credit guarantee scheme could reach £250 billion. The ELA in effect was subsumed within that £250 billion, so that when, over the course of November in the case of RBS and, I think, December in the case of HBOS, those companies had managed to line up support from the credit guarantee scheme, they no longer needed the emergency liquidity assistance. In terms of the aggregate liabilities, we have always been totally clear to Parliament about the magnitude. It was the heading within which the guarantees took place which was at issue but this was exceptional—

Q5 Mr Fallon: No, no, Sir Nicholas, you are getting Jesuitical now. First you are saying this was so serious even the Chairman of this Committee could not be told about it. Now you are saying this was a minor sum contained within a larger sum but Parliament never knew about it. You cannot have it both ways.

Sir Nicholas Macpherson: Yes, I think I can have it both ways. There are two issues here. One is the potential liability to which the taxpayer was at risk. As I say, that was subsumed within the sums of money the Chancellor gave to Parliament on 8 October. The other issue was how that support was delivered. It is in the nature of emergency liquidity assistance that for it to be effective it must remain secret. The decision was taken at that time not to notify Parliament. Having said that, we were acutely aware of Parliament's interest in these matters. The Chancellor has already written to your Chairman saying that he wants to find a way forward on this, and indeed I have already had a conversation with

your Chairman on that basis and I would hope the Chancellor will write in the near future and we can resolve this matter for the future because, although it reflects exceptional circumstances, I think we all would want to agree a basis for dealing with one of these situations in future.

Q6 Mr Fallon: Okay, but paragraph 5.2 deals with exceptional circumstances. It says, “If, exceptionally, the liability needs to remain confidential, the minister should inform the chairs of the relevant select committee and the PAC”. You are the Principal Accounting Officer. Did you advise concealment?

Sir Nicholas Macpherson: No, I did not advise concealment. We advised the Chancellor on this issue.

Q7 Mr Fallon: What was your advice?

Sir Nicholas Macpherson: The advice was consistent with notifying Parliament.

Q8 Mr Fallon: Did you advise the Chancellor to notify Parliament?

Sir Nicholas Macpherson: Yes, as we would with all contingent liabilities. The Chancellor, perfectly reasonably, took the view that he did not want to disclose the support at that time. As Accounting Officer I could have demanded a direction on the issue but I thought, taking all the issues into account, that was a perfectly reasonable decision for the Chancellor to take and I did not think it right to demand a direction in this case.

Q9 Mr Fallon: So he overrode your advice. What is the other procedure there? Do you record your advice in writing for the Cabinet Secretary?

Sir Nicholas Macpherson: No. If I thought that the action was inconsistent with the principles of *Managing Public Money* I would then demand a direction, and the Chancellor would then direct me, and that correspondence would then be sent to the Chairman of the PAC and the Comptroller and Auditor General. In this instance I did not think that course of action was appropriate. I thought the Chancellor’s decision was consistent with the principles of *Managing Public Money* because the circumstances were truly exceptional. I have mentioned already that the support was consistent with the broader guarantees which had already been notified to Parliament, so I did not feel that this was somehow an additional sum of money because it was subsumed within the money contained within the special liquidity scheme and the credit guarantee scheme.

Q10 Mr Fallon: You have explained all that. Nonetheless your advice as Principal Accounting Officer was that this indemnity should have been disclosed to both Chairmen, for the record?

Sir Nicholas Macpherson: Well, I mean,—

Q11 Mr Fallon: Yes or no?

Sir Nicholas Macpherson: Yes.

Mr Fallon: Thank you.

Q12 John Thurso: Managing Public Money explicitly says departments should “inform Parliament openly if the need for confidentiality lifts”, and goes on to say, “If an originally confidential liability . . . can be reported transparently, the standard Minute . . . should be laid”. Why were you unable to report the liability once the money had been repaid, which was by January?

Sir Nicholas Macpherson: By January we were certainly not out of the woods on the banking crisis. You will recall that further announcements were made in late January and during February in relation to the asset protection scheme. It was really only through this autumn that it became clear that the banking system had really stabilised. A good measure of that was the announcement relating to RBS and Lloyds in November. You will recall that the announcement in relation to Lloyds revealed the extent of the support Lloyds was still receiving from the taxpayer. The market took that in its stride and in the light of that the Governor of the Bank of England, whose advice we had relied on heavily in terms of non-disclosure, decided that the time was right to disclose the support, and the moment the Governor announced that the Chancellor reported the guarantees to Parliament.

Q13 John Thurso: How often during the course of what was virtually a year did you discuss with the Governor or with the Chancellor whether or not it was time to reveal what had happened?

Sir Nicholas Macpherson: We did not discuss this regularly.

Q14 John Thurso: Was it reviewed at all? Was this something that was kept under review in any way?

Sir Nicholas Macpherson: I know that the Bank of England was keeping it under review and we were dependent on their advice in these matters.

Q15 John Thurso: So, having made the decision, basically, the Treasury became reactive rather than proactive?

Sir Nicholas Macpherson: Inevitably emergency liquidity assistance is a key tool of the Bank of England and we rely heavily on their advice.

Q16 John Thurso: Did you at any time consider during that period from when the money was repaid in January and the eventual announcement was made that it would be appropriate to inform the Chairman? In other words, did you ever reprise the advice that you had already given that the Chairman should be informed and suggest that, given the nature of the passage of time, it was appropriate that that should have been done?

Sir Nicholas Macpherson: No, we did not. We were conscious of the other guarantees which we had set out. Obviously, the money had been paid back, but, as I said earlier, in the light of recent events we are keen to find a way forward on this which protects Parliament’s legitimate interests in these matters.

15 December 2009 Sir Nicholas Macpherson KCB

This was exceptional. I would hope we can find a way forward to avoid such a situation occurring in the future.

Q17 John Thurso: In your response to Mr Fallon you stressed the fact that a letter could be seen by anybody and that if a letter had been written you were concerned as to where that might have gone, but in *Managing Public Money* it does not ask for a letter to be written; it says “inform”. Information can be passed verbally. The Chairman is a Privy Councillor. There are a number of members of the Privy Council from opposition parties and others who are informed on matters of grave national security and they have never leaked to my knowledge. Does it really stack up that the Chairman could not have been informed verbally and therefore only one possible potential leak, as it were?

Sir Nicholas Macpherson: I think you have identified a potential way of dealing with this situation. Historically guarantees of this nature have been notified in writing. I fully accept that the Chairman is a Privy Councillor and the fact that the Treasury did not write is absolutely no reflection on the Chairman, nor is it a reflection on the Chairman of the PAC. It was all about minimising risk.

Q18 John Thurso: It is not a reflection on the individual Chairmen; it is a reflection on the view of the executive of Parliament and that is what concerns us so much.

Sir Nicholas Macpherson: And I totally understand that and respect that. We are very keen to find a solution to this problem for the future and I think one potential way of dealing with this would be an oral briefing of the Chairman.

Q19 Mr Tyrie: I can well understand the reason that you came to your decision collectively as an institution but I very much hope you do understand what is at issue here is the need to maintain confidence in an appropriate level of public disclosure which appears to have been prejudiced in this case. You have said two very important things. You said you took a decision for disclosure but that the Chancellor overrode this decision.

Sir Nicholas Macpherson: I did not take a decision. The Treasury advice was to disclose. That was advice. The Chancellor in this case, for a very good reason, decided against that advice. That is the normal way, as you know, Mr Tyrie, that these decisions get taken.

Q20 Mr Tyrie: So the Treasury advice was that the management of the risk to which you refer did not require that level of secrecy?

Sir Nicholas Macpherson: The advice was to inform the Chairmen but this was a finely balanced decision. There was a huge requirement to minimise risk of disclosure in this instance, and in one sense this operation was hugely successful because a lot of other interventions have leaked over the last couple of years. This one remained completely secret.

Q21 Mr Tyrie: Yes, but what you have said is that the Treasury advice was wrong, in retrospect was mistaken, that it was a mistake to advise the Chancellor to disclose this to the chairmen of these committees.

Sir Nicholas Macpherson: I think this is an area where reasonable people can differ. Our job as officials is to advise, ministers decide, and that is wholly right. It is particularly right in this instance because it is the Chancellor who is accountable to Parliament and he is best placed to judge these matters.

Q22 Mr Tyrie: Either the advice you feel was right in retrospect to the Chancellor and the Chancellor made a mistake or the advice was wrong in retrospect and is still wrong that was given to the Chancellor. You said you were going to review how you get a reasonable level of disclosure to Parliament. Is not the real issue that you need to review the way the Treasury came to the wrong decision internally?

Sir Nicholas Macpherson: The Treasury is a learning organisation. We like to learn from everything we do and I think it is incumbent upon us, not least because of this Committee’s legitimate interest in this matter, that we review our procedures in this area.

Q23 Mr Tyrie: How was this advice formulated when this very important decision was taken? Who did you gather around you to obtain this advice and to subject it to review?

Sir Nicholas Macpherson: The first thing, Mr Tyrie, you have to understand is that everything during this period happened at an extraordinary pace. This advice was put together in the course of about 45 minutes. We had that little time. The decision was taken within an hour, I think, of the advice being drafted.

Q24 Mr Tyrie: I think that is a fair response. Could I possibly ask you one last question? When the Chancellor overrode the advice what reasons did he give for non-disclosure?

Sir Nicholas Macpherson: His reasons for not disclosing were about the absolute need for secrecy.

Q25 Jim Cousins: Can I say before I ask my question that I am extremely grateful to you, Sir Nicholas, for your frankness this morning and I would like to study the record of what has been said very carefully before drawing any real conclusions. There are just two points I want to put to you. One is that, of course, over this matter there had already been a leak, had there not, and that was the leak of the merger of Lloyds and HBOS? Would you regard that as having been a leak?

Sir Nicholas Macpherson: I am not certain there was a leak of the merger. I would have to go back and look at the newspapers at the time. There was a lot of speculation about what was going to happen to HBOS and I can remember in September an announcement was made.

Q26 Jim Cousins: You have been very frank with us this morning and I would like to give you a proper opportunity to consider that point, but the other point I want to put to you is that the Treasury release of the information about the recapitalisation of Lloyds and HBOS and RBS on 13 October says that the Government is making capital investments to RBS “and, upon successful merger, HBOS and Lloyds TSB”. I have never looked at this as closely before as perhaps I should have done. Are we to understand that the recapitalisation offer to HBOS and Lloyds TSB was conditional upon a merger?

Sir Nicholas Macpherson: The proposals set out at that time were based on a merger. Obviously, had Lloyds and HBOS subsequently chosen not to merge I am quite certain that we would then have been in a different situation where there is every likelihood that both institutions would have required some sort of government support, but we had to make a proposal at that time based on the most likely outcome and the outcome at that time which was the most likely was the merger because that had already been tabled.

Q27 Jim Cousins: I would just like to come back to that point because I appreciate that here we are talking about an event that is a fortnight before the prospectus is issued to the Lloyds’ shareholders and a fortnight after the indemnity has been given to HBOS, and this statement does look as though the recapitalisation was conditional upon a successful merger. That is how your press statement on 13 October reads.

Sir Nicholas Macpherson: The proposal was based on the merger. Had the merger broken down we would not have withdrawn the offer of capital but we

would then have had to reassess the situation on the basis of Lloyds’ and HBOS’s individual circumstances.

Q28 Chairman: Just a last point from me. You said that you relied on the advice of the Governor of the Bank of England. Was he consulted at that early stage when deciding whether to disclose or not?

Sir Nicholas Macpherson: The Governor was clear that for emergency liquidity assistance to be successful secrecy was of the utmost importance. What you need to remember is that they started the ELA initially without a Treasury guarantee. You should also bear in mind that at its peak we guaranteed £18 billion of the £60 billion. The Bank had £100 billion of quite good quality collateral being offered for the £60 billion, so initially at least there was a prospect that the Bank of England could provide the assistance without a Treasury guarantee, so it was only a few days after the ELA started that the guarantee was sought and given.

Q29 Chairman: Was the Governor consulted at that early stage regarding notification? Was he part of the loop?

Sir Nicholas Macpherson: The Governor was the initiator of the proposal to provide ELA. He also made clear it had to be secret. Then there was the issue of the guarantee, but by revealing the guarantee we would have effectively been revealing the ELA, so the Governor was very much part of the loop but we accept full responsibility for the issue of the Treasury guarantee.

Chairman: Okay, Sir Nicholas, thanks very much for coming along this morning. I know you have another engagement but we are very grateful.

Letter from the Chancellor of the Exchequer to the Chairman of the Committee, dated 23 November 2009

TREASURY INDEMNITY

The Governor is writing to you today to set out how, in exceptional circumstances, the Bank of England extended Emergency Liquidity Assistance (ELA) to RBS and HBOS in the autumn of 2008.

I am writing to inform you that the Treasury granted the Bank an indemnity in October 2008. This indemnified the Bank on a net basis against losses that it might suffer or incur in connection with the Bank’s commitment to ensure that the banking system had sufficient access to liquidity, including this ELA. The indemnity was granted due to the size of the operations, and considered in the context of the existing demands on the Bank’s balance sheet at that time. It was not related to any perception of any increased risk associated with lending to the banks.

The indemnity was provided initially for a period of two months. The Bank paid an indemnity fee of 170bps to the Treasury.

The Bank’s assessment at that time was that it was vital that their ELA operations remained confidential, and that any disclosure or leak of the operations would seriously jeopardise the financial stability of the system as a whole. I shared this assessment. I also judged that the risk to public resources was low given the quality of the collateral received by the Bank. Having carefully considered the case for disclosure of the indemnity, I decided that the risks associated with any disclosure at that point would not be in the public interest.

As the Governor has noted, the Bank no longer considers it necessary for the assistance to remain confidential. I also share that judgement. Market conditions have improved considerably, and the disclosure by Lloyds Banking Group in their recent prospectus of the current aggregate amount of support it has received from the Authorities was not destabilising to the markets. In the light of those developments, I now consider that the balance of the public interest is in disclosure.

**Letter from the Governor of the Bank of England to the Chairman of the Committee,
dated 24 November 2009**

In exceptional circumstances, as part of its central banking functions, the Bank acts as 'lender of last resort' to financial institutions in difficulty in order to prevent a loss of confidence spreading through the financial system as a whole. Accordingly, the Bank extended Emergency Liquidity Assistance (ELA) to two institutions, RBS and HBOS, in the Autumn of 2008.

In most cases, confidence can best be sustained if the Bank's support is disclosed only when the conditions that gave rise to potentially systemic disturbance have improved to a point where the disclosure itself should not be a cause of such disturbance. Having carefully weighed the public interest case for disclosure against the potential systemic consequences, the Bank decided to use its powers to limit the extent of disclosure in its financial statements in the 2009 Annual Report. However, as stated in the Bank's Annual Report 2009, it is the policy of the Bank that such assistance should be disclosed once the Bank considers that the need for secrecy has ceased. Now that RBS has signed up for the Asset Protection Scheme and Lloyds Banking Group has embarked on its alternative strategy for capital raising, the Bank judges that there is no longer a need for the assistance to remain secret and that it is now appropriate to disclose details relating to the ELA provided to RBS and HBOS last autumn.

From 1 October 2008 the Bank provided ELA to HBOS and from 7 October also provided ELA to RBS. The RBS facility was repaid by 16 December 2008, and the HBOS facility by 16 January 2009.

Use of the facilities peaked at £36.6 billion for RBS (on 17 October) and at £25.4 billion for HBOS (on 13 November). Total use of ELA across both banks peaked at £61.6 billion on 17 October. At this point the two banks provided the Bank with collateral (residential mortgages, personal and commercial loans and UK government issued debt) with a total value in excess of £100bn. The banks were charged fees for the use of the facilities. In addition, both institutions had access to the Bank's normal market operations and to other facilities including the Special Liquidity Scheme. From 13 October both institutions were also eligible to issue securities under the Credit Guarantee Scheme.

Letter from Sir Nicholas Macpherson to the Chairman of the Committee, dated 8 December 2009

You asked about my role as Accounting officer in relation to the decisions that were taken on the emergency liquidity assistance (ELA). The key question for me as Accounting officer was whether disclosure of the ELA, at the point at which the transaction was taking place, was in the wider public interest. I did not believe it was. My decision was consistent with the principles in *Managing Public Money*.

You will have received the Chancellor's letter today. As you know, he is reflecting on what steps we could take to deal with such an exceptional event in future.

Letter from the Chancellor of the Exchequer to the Chairman of the Committee, dated 8 December 2009

TREASURY INDEMNITY

Thank you for your letter of 26 November following a discussion in the House of Commons and Edward Leigh's letter of 25 November on the Treasury indemnity to the Bank of England.

You have seen my response to Edward Leigh. The circumstances last autumn were extraordinary. I am reflecting on what steps we could take to deal with such an exceptional event in future.

You asked specifically about the timing of the disclosure. The Bank's assessment was that conditions had reached a point such that it was no longer necessary for their assistance to remain secret. Market conditions had improved considerably, and the disclosure by Lloyds Banking Group in their recent prospectus of the current aggregate amount of support it has received from the Authorities was not destabilising to the markets. I supported that judgement.

I know that you have been speaking to Nick Macpherson and I hope that we can agree how to proceed.

I am copying this letter to Edward Leigh and the Speaker.

Letter from the Chancellor of the Exchequer to the Chairman of the Committee, dated 18 December 2009

I refer to your letter of 26 November. In my letter of 8 December I said that I would reflect on what steps we could take to deal with such an event in future. You have also, I understand, discussed this further with Nick Macpherson.

The extreme gravity of the events of last year have revealed the need to develop a special process for handling highly sensitive information, such as that relating to the provision of emergency liquidity assistance. Of course I recognise the need for accountability to Parliament. Yet, as I know you appreciate,

it was vital to take account of the potential for extremely serious consequences should such information become public prematurely, and the harm it could inflict on the UK economy and the broader public interest. Our overriding concern last year was to avoid further destabilising the markets.

It is difficult to foresee all possible future circumstances in which this special procedure might have to be invoked. But drawing on the lessons of the recent past, the case for notification would be heavily influenced by the underlying substance of the action. In particular, were the government to incur a contingent liability that would add substantially to the government's financial exposure, the clear presumption would be in favour of some form of early disclosure.

In such an event, where premature public disclosure of a contingent liability carried a strong danger of damage to the public interest, and given the particular challenges around maintaining document security, I would inform the Chair by providing an oral briefing, attended by the Governor, or ask the Permanent Secretary to the Treasury to do so.

I am also concerned that Parliament is assured that full disclosure to Parliament would be made at the earliest opportunity. To ensure that this happens, I intend to consult with the Governor every 3 months about whether it is possible to disclose more formally. If the decision were then taken to maintain confidentiality, I would hope to report on that decision, in confidence, to the chairs of the TSC and the PAC.

Before reaching a final decision, I would be happy to discuss this with you and Edward Leigh. Perhaps we could arrange a time to do that.

I am copying this letter to Edward Leigh, the Speaker and Amyas Morse.

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