Alistair Darling

**BANKS ON THE BRINK**

Interview of BBC business editor Robert Peston with
Alistair Darling, Chancellor of the Exchequer

Q: Chancellor, you've had obviously a bit of time now to reflect upon how we got to where we are in respect of what looks like a pretty sharp recession. What are the big lessons?

DARLING: The big lesson is that never again must we allow bank, the banking system to come so perilously close to collapse. The longer term cause is that banks lost confidence in each other. They realised that a lot of them were being propped up by lending in the American housing market which simply was based on no substance at all and then of course the most proximate cause to the immediate problems we faced in the autumn was when Lehman Brothers went down in America. Suddenly people thought, yes banks can fail.

And after that it was inevitable I think that we would have to take action not just here but right across the world to build up the banks, to recapitalise them but it really has been quite an extraordinary year and there's a lot of lessons to be learned particularly in relation to the strength of the banking system.

Q: I mean that weekend when the future of Lehman Brothers hung in the balance, and the US treasury, US treasury secretary, your counterpart Hank Paulson, was deciding whether to rescue Lehman or not, how momentous a decision did that feel to you sitting here?

DARLING: Well it was pretty momentous. I mean I spoke to Hank Paulson a couple of times that weekend. You remember that just prior to that, the Americans had had to bail out the two big mortgage corporations which psychologically for any administration in America let alone a republican administration to nationalise two of these huge corporations. It's quite a big thing and you know we had assumed that they would probably do the same thing for Lehmans but they decided that they wouldn't and there was, you know a lot of effort went into trying to rescue Lehmans that weekend but it just didn't work out. The terms just weren't going to work for anyone and so Lehmans went down.

The problem was though immediately after that right across the world it brought the whole system up short. Suddenly people thought banks can go down, and that is why we had to take action, why eventually everybody else had to as well.

Q: Just on that weekend, do you remember how late in the weekend you learned that actually a rescue wasn't going to be possible and this, this big bank was going down?
Well discussions had been taking place towards the end of the week and over the weekend, and during the course of the Saturday you know it looked as if something might be put together either in America or involving you know banks more widely. It was obvious though by Sunday afternoon that it had all gone wrong and it just wasn’t going to happen, and you know valiant efforts were made. You know we would have been ready to have played our part but it just, you know the Americans, you know it was their call, it was their bank and they took the view that by you know Sunday afternoon our time it just wasn’t going to be possible and that’s what happened.

Q: Do you think, do you think it was a mistake in retrospect that they didn’t nationalise Lehman?

DARLING: Well look it’s for the Americans. You know I think trying to second-guess or you know even with the benefit of hindsight, you know you know the Americans were in possession of all the facts. They took a decision and you know I would no more lecture them than I would appreciate them lecturing me. All I can say is that Lehmans brought the world banking system up very sharply indeed.

Q: I mean we then did have this extraordinary phenomenon of money managers controlling hundreds of billions of dollars, talking their money out of almost any bank or institution they perceived as risky. Did the speed with which you know the banking system started to be drained of the sort of vital cash that keeps it going, did the speed of this crisis shock you, surprise you?

DARLING: No you’ve got to remember, I’ve been living with this since August 2007 and you know frankly you know during the course of that time I had, nothing took me by surprise. What you’d seen over that period was you’d see the banking system going through a difficult period, then things got slightly better, then they got worse, then slightly better. This had happened. What was obvious though after Lehmans went down was you know that things had changed for the worse because you know whilst there had been difficulties over the summer, there was a marked change in the back end of September and come the beginning of October. We’d been working for some time on a plan to recapitalise the banks but the problems became acute and particularly acute by the first, by I think it was the 7th or 8th of October when people really did lose confidence in the banking system at that stage and it was quite obvious to me that we would need to bring forward our plans, make an announcement which we did and then of course we had to work through the details before it was finally agreed in the middle of October.

Q: I mean if we just go back to that process of coming up with this plan to recapitalise the banks, put them on a sounder footing, essentially, essentially rescue the banking system, there were three elements that, you know putting taxpayers’ money into it in
the form of capital, there’s the extension of the special liquidity scheme or the augmentation, the enlargement of the special liquidity scheme which allows banks to swap their mortgages for the equivalent of cash, and then there’s the guarantees for borrowing by banks, 250 billion of them. Three elements, they sort of fit together. How did the different elements in a sense coalesce in, in you know your mind, in the mind of the government? Was it all put together you know, was it obvious from the start you needed those three pieces? Where did it come from as a plan?

DARLING: Well at the beginning of this year it was obvious that despite the fact that central banks had had a co-ordinated cut in interest rates, there were still problems in the banking system and that’s why during March we developed the special liquidity scheme. That was to give the banks money to help them lend to each other and that was introduced in April, and actually that helped a great deal. It gave us you know a breathing space. We got over that. Over the summer though it became obvious that these problems were more deep-seated and I remember when Bradford and Bingley eventually failed, you know that was something that was pretty inevitably, I reached the view that we couldn’t carry on just dealing with institution by institution and waiting for something to happen. We needed a far bigger plan than that so we’d been working with the bank, the FSA on the recapitalisation scheme and there’s really two aspects to it. One is to make sure the banks had enough capital, not only to be able to carry on but also to enable them to lend more but the main purpose was to make sure that we kept the banking system intact. The second element was although the special liquidity scheme had helped, we needed to do something more. That’s why we guaranteed the interbank lending, because what’s gone wrong is banks just simply lost the confidence to lend to each other so the three elements were important but the big thing that really did help was firstly because you know we were able to act decisively on a much larger scale than anyone thought we would, and because we were also able to get the rest of the world into it within a matter of days, that made a huge difference and when you consider that the world banking system was you know standing on the very brink, it was looking over the edge by the beginning of October, within a period of a week to ten days we’d managed to pull things back, to recapitalise those banks so they haven’t failed, they’re still there. Of course the challenge of increasing lending, and particularly lending outside the banking sector is one that remains and that’s something that we’ll be doing more about.

Q: Now my recollection of the day and night where you put together the shape of the rescue plan prior to the announcement the following morning, I think you were in, in Brussels I think in the morning weren’t you? I think there was, I think there was an Ecofin that morning and then I think you then came back and then there was a great sort of working through the night to get, to get a package together. Did you know when you were in in, Ecofin, in
BANKS ON THE BRINK

Alistair Darling

Brussels for this European meeting that you were likely to come back and have to put this thing together very fast?

DARLING: During the weekend before that, there had been a lot of speculation about whether or not the banks would be recapitalised and the markets were very very febrile on the Monday morning. I wasn't surprised when I was called early on on the Tuesday that one bank in particular really was in difficulties and I decided that you know whilst there was a bit more work to be done, we needed to get our plans out and so I decided we'd do a statement in the House of Commons on the Wednesday which I did. It was obvious it would always have to be a two-stage process because you had to announce the principles, then sit down with the banks and of course I then had to go to Washington to the IMF meetings when I took the opportunity of course to speak to my counterparts, to say look we're doing this, you know I hope you can do it too. And then the final deal was done on that Sunday night and announced the following Monday.

Q: I mean that bank that was in difficulties is the Royal Bank of Scotland having tremendous difficulty renewing its short term borrowings on wholesale markets. Was this irrational, was there any fundamental reason do you think why Royal Bank was having such difficulty?

DARLING: There's lots of things been happening over the last few weeks and months that are you know, on one level you can say they're irrational because as it turned out RBS needed an awful lot of capital. It's one of the biggest banks in the world and we now own 57% of it. And when people had seen you know giant banks in the US collapse, everything that, that's happened, you can say on one level is irrational. On another, another, the other level you can understand why people began to lose confidence. What we had to do though is to say well never mind that, let's you know really take some decisive action. Let's make sure that we can maintain the banking system, and that's what we did.

Q: I mean I found it profoundly shocking I must admit at the time. I mean here was you know the owner of NatWest, this enormous bank, you know that one just assumes couldn't possibly fail, having these difficulties raising short-term funds. You announced the structure of the rescue but then again on the Thursday and the Friday they've still got these difficulties. There's a fear also that it's going to infect other banks like HBOS beginning to have difficulties of these sorts. You then come to the Friday of that week. Was it obvious to you again Thursday and the Friday that what you were going to have to do was negotiate with all the banks through the weekend to put together the detail of the rescue package, or in a sense did you decide quite late on the Friday that if you're going to do Royal Bank, maybe you should do all of them?
DARLING: I was very clear even before the turbulence of that week that whatever we did, we had to do it for the entire banking system. We couldn’t get ourselves into a situation where you’re simply fixing one problem because the problem was then moved to somebody else and you know we just couldn’t allow that to carry on happening. We’d seen it in America where they, no sooner had they sorted one bank’s problems out than the problems transferred to the next. So on the Wednesday I announced a general overall pan, the scheme if you like. Things did get worse during that week because confidence was just draining out of the system and in some ways that made it easier for us to talk to the banks and say look, we’re all in this together. No one’s got any choice. Everybody’s going to have to recapitalise. The only choice we’ll give you is you either do it through us or you raise the money on the markets yourselves and you know that’s precisely what happened. But on the Monday when we’d done it, it did actually, there was a sense of calm and the fact it then became clear that it wasn’t just us. The Americans were going to do something, we had, Gordon Brown had been in Europe on the Sunday before and he’d got agreement you know surprisingly quickly right across Europe that central banks, governments would do the same sort of thing.

So what helped I think was just people saw that governments here, right across the world, were prepared to do something, to do it decisively and do it on a far far bigger scale than people thought imagine, imaginable a few months ago.

Q: I mean you’ve been in the Cabinet since ’97. Was it clear to you this was the most momentous decision or set of decisions you’d have to, you know you were likely to take as a minister?

DARLING: Well yes, you know we haven’t anything like this, never mind ten years ago. You know we haven’t seen this for generations and this is a remarkable chain of events where you’ve got a credit crunch, you’ve got problems in banks in every corner of the world now. This is truly a global problem and one of the problems you’ve got as a chancellor in one country or finance minister in another country is you can do a lot of things on your own. There are things you can do but you actually need everybody else to come along as well, particularly in relation to the banking system which is so interconnected that no one country could have done it on its own as I made clear when I spoke to the House of Commons. This was a momentous decision but it was the right decision because as the governor had said, the world’s banking system hadn’t faced a calamity like this since before the outbreak of the First World War.

Q: And did it, I mean did you feel a lot of stress and pressure over these days? I mean or was the adrenalin running to that extent that you didn’t really notice what was going on in terms of the pressures?
DARLING: No, no I don’t think so. I mean you know it’s one of these things where there was huge problems building up but the best way of dealing with huge problems is to just sit down and work your way through them. You know occasionally, you know things you can do without – you know personally I don’t like negotiating in the middle of the night but you know these are extraordinary times and it does call for the odd sacrifice.

Q: Did you get any sleep that weekend in fact?

DARLING: Yes I did. I had to go to Washington on the Friday and Saturday and so I came back on the Saturday night overnight and you know there’s a limit to the amount of sleep you can ever get in an aeroplane. Then I had meetings all day on the Sunday and then at ten o’clock on the Sunday night just when you know everything was agreed as far as I was concerned, inevitably when you deal with a bunch of bankers, they started trying to re-open it. So I said about one o’clock, OK re-open it if you want. I’m going to my bed. If you haven’t agreed it by five o’clock, then you’re on your own. So happily when I woke up at five o’clock, we’d got an agreement.

Q: Crikey, and was the agreement very different from the agreement that you’d had at, you know or where you thought it was going to be when you went to bed?

DARLING: Not fundamentally, not at all. If you, look you’re negotiating with people who are running multi-billion pound businesses and who, you know whose world had changed and of course they had one or two legitimate points that we were ready to talk about and you know I talked to, to them about it but you know what I wasn’t going to have is someone trying to unpick the deal, basically ask for the bits they wanted and not the bits that I wanted. It had to be an all-encompassing deal. The deal was done you know, and completed, on you know the early morning of that Monday and it had to be because we had to make a market announcement when the markets opened at eight o’clock on the Monday morning.

Q: This is slightly technical but was it, was it the uneasiness about the preference shares that was being unpicked?

DARLING: Oh no. It was, it was in relation to, you know, the nature of how the guarantee scheme would work. There was an argument about how much money would need to be available. These were not, these were things that were important and which you know I was, you know frankly they weren’t going to disturb the overall shape and size of the scheme but you know a lot of these guys, that’s what they do. You know they, they like arguing right up to the wire and that’s fine. You know throughout the night one by one they agreed so the deal was done.

Q: And it’s again a slightly narrow point but did you ever feel uneasy about the fact that one bank, Barclays, wanted to raise the capital in a different way?
DARLING: No. I was very clear that banks had to have a choice. They could either go to the markets and raise the money, and of course that’s actually from my point of view fine because you know we’re not, we’re not, we have no part in that. We’re happy they should do that and a lot of the banks did just that. But we were also clear that two banks in particular, RBS and HBOS, were not going to be able to raise money in the markets and the only place to come to was the government. And I was quite clear that this would only work if we were recapitalising all of the banks because everybody knew we were all in this, in this together and you know we were right. The Americans have done the same thing. So have most other countries in the world with slight variations here and there but they’ve all had to do the same thing because they were all basically facing the same problems.

Q: When you flew in from Washington, was there a risk that you wouldn’t have a deal by Monday morning? How nerve-wracking was it?

DARLING: Well there’s always a risk that you don’t have a deal until everybody’s signed on the dotted line and you know the nature of these things when there’s so much at stake, it wasn’t surprising that throughout the Sunday people were saying can we do this, can we do that? But you know as long as, what I was keen was to get the overall shape of a deal in line with what I’d told the House of Commons in the previous week. That’s what we got. You know people will argue right up to the wire and you know as I say I was very happy they should argue all night you know but I was very clear I wasn’t going to stay up all night, especially if I’ve got to stand up in the House of Commons the next afternoon and explain what we’re doing. So you know the deal was done, you know shortly before five o’clock on the Monday morning and that was it.

Q: And were there any sort of, for you sort of slightly surreal moments? I don’t think, I mean – we’ve heard from people who were in the room with Fred Goodwin in a particular meeting where he you know offered the immortal line you know, this isn’t a negotiation, it’s more of a drive-by shooting which you know we’ve had confirmed he did say. Were there any sort of surreal moments of that sort?

DARLING: No you know when I sat down with the chief executives of the banks you know no one could possibly be happy about the situation they’d got themselves into.

Q: So you did have them all together in a room on the Sunday?

DARLING: Oh yes, you know I met them, met them in my room on the late Sunday night and said look this is the deal, this is what we’re prepared to do, this is what we’d like you to do in return for that. And of course naturally they would say well look can we talk about
this, can we talk about that? That’s what you’d expect. What I was very clear about was there was no going past the Monday morning announcement. That would have been disastrous and I think they knew that too.

Q: As you say the priority of the plan was to stabilise the banking system, to stop big banks from collapsing. I mean you know at the time what was at stake was the functioning of the underpinning of the economy, the banking system. A lot of evidence that it’s succeeded in that sense but there was also some hope I think that - certainly this was clear from the statements you made – that this would kickstart lending. It hasn’t really kickstarted lending in a serious, significant way. Is that because in its design it was, it was, you know it was always a bit of a secondary thought, the extent to which it was going to do much for lending and that’s why you’ve got to perhaps re-address that?

DARLING: The primary reason for our intervention was to stabilise the banking system because it really was right across the world, the banks were at risk of collapsing and we couldn’t have that so that’s what it was for. Obviously if you give the banks more capital, if you guarantee their lending, that does help in relation to what they do with the wider economy. I said at the time that we would keep those terms and conditions under review and that, that’s what we’re doing because we want to ensure that the banks do lend to the wider economy. Banking is there for a purpose. You know it can’t be the end of story, banks saved. What is necessary is to ensure that we maintain lending to the businesses and to people, home owners and so on, and we have always said that we would keep that under review and that we would do whatever it takes to ensure that we can support the wider economies along with other things like interest rates and of course the government’s action of putting money into the economy in and the pre-budget report.

Q: Now just going back to, in a sense the origins of the crisis, why do you think so many banks for so long failed to properly calculate the risks they were running in their lending?

DARLING: I think the primary cause actually lies in the boardrooms of banks. You know I don’t think there’s enough people asking themselves you know how are we making money here? You know what are these securitised assets that everybody is buying and selling? You know I think that the, I’ve always said the primary responsibility for running a bank must lie in its boardroom. You should, people should be asking themselves all the time, do we understand the risks, are we charging the right price for what we’re doing? Now that manifestly didn’t happen say in Northern Rock and we’ve seen the consequences there but it’s obvious it wasn’t just Northern Rock. It was happening in banks all over the place.
The supervisors, the regulators also have questions to ask themselves as to, you know what more could they do and you know that's one of the things we need to, as we move into the new year, we've got to strengthen the supervisory regime there but at the end of the day, the decisions like this are actually taken by men and women sitting in boardrooms or banks and other institutions and you know I think one of the lessons they've all got to learn is you know are they sure they actually know what they're doing? Are they confident they understand the risks to which they're exposed? This is critically important for the banking sector because whilst if you know a factory making you know tins or something, if it goes down it's a tragedy for that factory, for that factory and its employees, the banking system matters to every one of us and you can see the entire world is paying a pretty heavy price for this.

Q: It was also a very big global imbalance that I think most of us would now say lies behind the kind of crisis we're going through, which is for years you had these massive surpluses being built up in economies like China, and those surpluses were in a sense recycled into lending into economies like the US and the UK. This was an imbalance that was –

We all saw, I mean you know it was no great secret that there was this great imbalance in the global economy between as I say the sort of you know, the great trading surpluses, saving surpluses in places like China, the accumulation of debt in economies like the US and the UK. Why do you think governments, the US government, the UK government, didn't take action much earlier to correct these imbalances in a way that would have made the kind of adjustments that we're going through now much less painful?

DARLING: Well I think it's a classic case of where one country, two countries can't fix this problem. They needed everyone, including the Chinese for example, and you know we'd raised this with the Chinese. I'd raised it you know, when I was Secretary for Trade and Industry I'd raised it with the Chinese. Gordon Brown had raised it, the Americans had raised it. You know one of the many many lessons that needs to be learnt here is that we live in a truly global economy and everyone is in it together so those countries with those surpluses had to understand that they couldn't just ignore the problems that were building up elsewhere, so these are widespread problems and they need all of us to act together. You know people do that now. Frankly a couple of years ago trying to engage some countries on these was very very difficult.

Q: There is a lot of fear about the outlook among millions of people, or anger about the mess that we're in. Do you think they would be right, taxpayers, voters, to direct some of that anger at you, at the government?

DARLING: Well I can understand people's anger. You know, you know the last few months and the next year it will be difficult for many
people. I'm confident we can get through it because I think there are good reasons to be confident. We'll have low interest rates, lower prices, fuel prices will be coming down as oil falls. We've got lower inflation. All those things will help. But I'm afraid we've just, we just have to deal with these problems. We have to work our way through and critically of course have got to make sure we've done a lot in order to ensure the integrity of the banking system but you know the banking system has got to ensure the integrity of a lot of businesses, to look after the interests of a lot of people. We'll play our part but they've got to do a lot as well.

Q: I mean with the benefit of hindsight is there a big thing that the government should have done differently?

DARLING: Well I think there are many lessons and you know I don't think there's any one thing that you can say if you'd done that then none of this would have happened, partly because if you look at the origins of this, you know the problems that started arising in the American sub-prime market, those were problems that you know, that were frankly ones that the Americans saw building up but you know the world supervisory system, a lot of the banks' boards, people just did not see just how far-reaching and how deep-seated these problems had become. Now you can point to a number of things you could do but you know I'm pretty sure for the future we've got to run a far far tighter ship as far as this is concerned. You know you cannot allow ourselves you know here, everywhere across the world to get into a situation where the failures in board rooms lead to such a huge problem for the rest of the world.

Q: And how bad is 2009 going to be?

DARLING: It's going to be difficult but you know I am confident that we'll get through it. If you – and looking ahead, you know the World Bank estimates that the world economy is going to double in the next twenty years. And you know I think people, yes we've got to look at the problems we need to deal with today, next week and so on, next month but let's look ahead too because there are very good reasons to be confident that as we get through this, there are tremendous opportunities for us, for other countries too and you know we'll get them.

Q: Do you think the way that business is conducted will change in a fundamental way? Do you think for example the sort of winner-takes-all mentality that has really pervaded boardrooms over the last twenty-odd years, the cutthroat competition, if you do well, you pay yourself a fortune – do you think that approach is going to persist?

DARLING: Well look, people are going to be more cautious and we've got to balance the right degree of caution which is essential in any banking system with people becoming so averse to doing anything
that you know they’re not lending when they should be, but you know it reminds me of the railways in some system. What went wrong with Britain’s railways is that too many people left who actually knew how the railways worked, and we’ve got to avoid the problem that you know in the next ten fifteen years the people who are around now actually forget what happened, and we’ve got to make sure that collective memory stays there so that we don’t repeat the mistakes of the past.

Q: Alistair Darling, thank you very much.