

## **The economic case for the re-mutualisation of Northern Rock**

A report by Howard Reed, Landman Economics

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## About the author

Howard Reed founded Landman Economics in 2008 as a economic research consultancy which specialises in providing rigorous analysis of economic issues relevant to policymakers. Before founding Landman Economics Howard was Chief Economist at the Institute for Public Policy Research (ippr). Recent research by Landman Economics has encompassed a large range of topics including tax and welfare reform, public spending, public service reform, inequality and redistribution, macroeconomic policy and the public finances, public health, social care, the labour market, pensions policy, industrial policy, banking and financial issues, and environmental economics.

Recent clients for Landman Economics research have included the ippr, Demos, Compass, the Fabian Society, TUC, Unite, Unison, TBR Economics, ASH, Age UK, Gingerbread, the Irish Heart Foundation, the Womens Budget Group, the Welsh Assembly Government, the UK Department of Health, Brunel University and Bath University,

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## Introduction

Northern Rock has been in public ownership since February 2008, when the bank was nationalised after falling into severe financing difficulties when inter-bank lending markets froze in summer 2007, and following a package of emergency financial support and deposit guarantees from the UK government and the subsequent failure to find a willing private sector buyer for the bank<sup>1</sup>.

While the nationalisation of Northern Rock was a crucial emergency intervention which prevented the loss of around 6,500 jobs and the collapse of a major employer in England's northeast region, it has always been the UK government's intention to return Northern Rock to the private sector in some shape or form when economic conditions allow, rather than sustaining the business indefinitely as a nationalised bank.

Since the formation of the UK's current coalition government following the 2010 general election, recent events have led to increased speculation that Northern Rock is being readied for return to the private sector later in this parliament. In particular:

- On 28 March 2011 Northern Rock announced it was cutting 680 jobs in a bid to return to profitability<sup>2</sup>. The bank's executive chairman, Ron Sandler, said earlier the same month when Northern Rock reported a £232m loss that the organisation's cost base was too high. These job losses follow earlier losses of about 4,000 of the bank's staff of 6,500 at its point of greatest expansion in 2007.
- Also in March 2011, UK Financial Investments (UKFI), the state-owned holding company responsible for supervising the UK Government's holdings in Northern Rock and the partially-nationalised Royal Bank of Scotland and Lloyds Banking Group, appointed Deutsche Bank to undertake a feasibility study of "the strategic options for returning the company to private ownership."

These preparatory steps raise the crucial question: In what form should Northern Rock be returned to the private sector? There are two main options for "denationalisation":

1. **Privatisation**, either by flotation (selling shares to institutional and individual investors, as with the utilities privatisations of the 1980s), or by trade sale to a private sector bank.
2. **Mutualisation**: converting Northern Rock into a financial institution owned not by shareholders, but by its *members* – the people who hold bank accounts and/or mortgages with it. Northern Rock was originally a mutually owned financial

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<sup>1</sup> See Treasury Select Committee (2008) for a detailed account of Northern Rock's initial difficulties, and UK Financial Investments (2010) for details of the UK Government's acquisition of Northern Rock in February 2008.

<sup>2</sup> See *The Guardian*, 28 March 2011, "Northern Rock to cut 680 more jobs in run-up to privatisation." <http://www.guardian.co.uk/business/2011/mar/28/northern-rock-cuts-680-jobs>

institution prior to 1997, when it de-mutualised into a public limited company (plc) owned by shareholders. Thus, in the case of Northern Rock this option is more properly referred to as **re-mutualisation**<sup>3</sup>.

There is also the possibility of Northern Rock being sold off to a *mutually owned* financial institution rather than a private sector shareholder-owned plc (public limited company) such as Barclays or HSBC. Recent media reports have suggested that the Coventry Building Society might be interested in bidding for Northern Rock if it was sold off in a trade sale via an auction among various competing bidders<sup>4</sup>.

This report sets out the economic case for the re-mutualisation of Northern Rock into a self-contained mutual bank owned by its members, comparing the likely costs and benefits to the UK taxpayer and to the economy more generally of re-mutualisation with those of privatisation. The main aim is to compare the likely benefits and costs of re-mutualisation compared with a more traditional privatisation – either by flotation, or a trade sale to a private sector buyer.

Sections 1 to 6 of the report assess the likely impact of mutualisation of Northern Rock compared with conventional privatisation. In some cases (but not all) it is possible to provide indications of the size of the gains or losses from mutualisation compared with privatisation. Where this is not possible, qualitative evidence of the benefits to and/or risks from re-mutualisation are used instead. The possibility of Northern Rock being sold off to an existing mutually owned financial organisation rather than being bought by a banking plc is addressed specifically in Section 6. Section 7 of the report provides a summary of the relative merits of the two approaches, while Section 8 concludes. Throughout, I place the discussion in the context of the Coalition Government's approach to the banking sector and the likely recommendations of the Independent Commission on Banking under Sir John Vickers's chairmanship which is scheduled to report in mid-April 2011.

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<sup>3</sup> Although mutualisation has not previously been used in the UK as an option for transfer of businesses from the state to the private sector, the process by which mutualisation would be accomplished is quite straightforward. Michie (2009) gives full details.

<sup>4</sup> See Daily Mail, "Coventry in bid to buy broken Northern Rock", 31 March 2011. <http://www.dailymail.co.uk/money/article-1372093/Coventry-bid-buy-broken-Northern-Rock.html?ito=feeds-newsxml>

## 1 The impact of mutualisation on the stability of the banking system

It is impossible to consider the benefits of mutualisation versus privatisation of Northern Rock without some acknowledgement of the relationship between the structure of the UK banking system and the UK's vulnerability to systemic financial crises such as that experienced in 2007-08.

As Michie and Llewellyn (2009) point out, mutually owned building societies weathered the financial crisis reasonably well and more successfully than many plc-based banks – and in particular, more successfully than the banks that demutualised after financial deregulation in the 1990s. This is because most mutual financial organisations have tended to stick to the traditional model of the 'banking' firm with a reliance on retail deposits, limited use of wholesale market funding, and limited use of credit shifting derivatives.

Minimising the likelihood of a catastrophic failure of the banking system is a vitally important objective for any banking system to be effective, and will certainly be one of the key issues addressed when the Independent Banking Commission makes its interim report in mid-April. The expansion of the plc banking model in the UK over the 1980s, 1990s and most of the 2000s made our economy much more vulnerable to a catastrophic failure. Luckily, the converse is also true; an economy with a stronger mutual sector is less likely to suffer a "meltdown".

But just how large are the costs of catastrophic failure of the banking system? A recent report by Leaton and Reed (2010) on the role that a Green Investment Bank could play in providing financial support for the UK's transition to a low carbon economy provides some estimates of the costs of 'business as usual' for banking, i.e. moving back to a banking system along the lines of the pre-2007 system, dominated by large plcs pursuing high-risk investment strategies. Given that, despite strong rhetoric from world leaders in the wake of the 2008 crisis, the limited reforms to the banking system which have so far been put in place do not look anywhere near fundamental enough to prevent another systemic crisis by themselves, it makes sense to ask to what extent a greater mutual presence in the UK banking sector would make our economy less prone to future financial crises.

It is impossible to know for sure what the potential costs of returning to "business as usual" in the banking sector are. But as the respected *Financial Times* columnist John Kay has argued<sup>5</sup>, since the mid-1990s each successive financial crisis which the global economy has been confronted with – the Asian crisis of 1997-98, the "dot com" collapse of 2000-01 and now the near-meltdown of 2007-08 – has been worse than the previous one. Therefore, it seems reasonable to take the overall costs of the 2008 crisis as an estimate of the minimum

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<sup>5</sup> John Kay, "The cause of our crises has not gone away", *Financial Times*, 5 January 2010. <http://www.ft.com/cms/s/0/1959f72c-fa2f-11de-beed-00144feab49a.html#axzz1IHfWM5rY> (behind paywall)

costs of any future crisis in the absence of implementing policies to make the UK economy less likely to encounter such crises in the future.

But just how much did the 2008 crisis cost the UK? There were three main elements of the cost, which can be analysed using figures from the National Audit Office's 2009 report *Maintaining financial stability across the UK's banking system* (NAO, 2009).

First, there was the **cost of bailing out UK banks**. This comprises the nationalisation of Northern Rock itself in February 2008 following the provision of £50 billion of public support, but also a number of other bail-out measures:

- An initial purchase of £37 billion of shares in Lloyds Bank (which became 43 percent taxpayer owned as a result) and Royal Bank of Scotland (which became 70 percent taxpayer owned) in October 2008;
- Agreement to purchase up to an additional £39 billion of shares to provide additional capital for the part-nationalised banks, increasing the public stake in RBS to 84 percent (November 2009);
- Indemnification of the Bank of England against losses incurred in providing over £200 billion of liquidity support;
- A guarantee of up to £250 billion of wholesale borrowing by banks to strengthen liquidity in the banking system;
- Provision of up to £40 billion of loans and other funding to Bradford and Bingley and the Financial Services Compensation Scheme (which compensates investors in the event of banking failure);
- Agreement in principle to provide insurance covering nearly £600 billion of bank assets, reduced to just over £280 billion in November 2009.

The Treasury's total net cash outlay for purchases of shares in banks and lending to the banking sector, including Northern Rock, between 2007 and 2010 amounts to about £117 billion. The Treasury's additional potential exposure to banking losses (through insurance of bank assets and Bank of England lending) totals over £1 trillion. However, these losses would only be realised in the worst case scenario of total banking system failure, which looks to have been averted by the scale of the 2008 bailouts. Therefore, the overall expected losses to the taxpayer from these operations is much smaller. The Treasury estimated in 2009 that there may be an overall loss to the taxpayer of between £20 and £50 billion. Taking a midrange point of this estimate - £35 billion – implies a loss per household of around £1,500 (based on an estimate of 23.5 million UK households from the Office for National Statistics.) This would be a one-off loss rather than an ongoing loss every year. There is a high degree of uncertainty attached to this estimate as the loss to the taxpayer depends on the performance of banking shares on the London FTSE index.

Second, there was the **cost of lost productive capacity**. When the business cycle is relatively mild, recessions are assumed not to have an impact on the economy's long-run growth rate.

However, particularly severe recessions can have longer lasting impacts because they lead to reductions in the level of *potential* output – not just the level of actual output. This occurs for example because business failures on a large scale reduce the potential output level of the economy, *even after the economy emerges from recession*. Both HM Treasury and independent forecasters agree that the 2008-09 recession (which was the worst, in terms of lost output, since the 1930s) resulted in a permanent reduction in output. The Office for Budget Responsibility's estimates from the June 2010 Budget suggest that the financial crisis permanently reduced UK output by about 8¾ percent. How much is this in cash terms? The latest ONS data suggest that in the 2010-11 tax year, GDP was valued at about £1.5 trillion. 8¾ percent of this figure equates to about £130 billion. Given that there are about 23.5 million households in the UK, this equates to a loss of around £5,500 per year for every household in the UK at current prices. This is an ongoing annual loss rather than a one-off loss.

Finally, there is the **impact on the public finances**. The OBR also publishes forecasts of the structural deficit in the public finances (also known as the “cyclically adjusted deficit”.) This is defined as the amount by which the public finances would be in deficit if the economy were operating at full capacity. Because the economic crisis had a permanent impact on productive capacity, there was a knock-on impact on the public finances. This is particularly severe given that some of the activities that took a large hit (e.g. financial services) were large contributors to tax revenue.

In the 2007-08 tax year (when Northern Rock first got into difficulties, but before the main financial crisis came to a head in autumn 2008) HM Treasury calculated the structural deficit to be 2.5% of GDP. The recent forecasts from the OBR estimate that the structural deficit increased to 8.9% of GDP in the year 2009-10<sup>6</sup>. The correct measure of the impact that the financial crisis has had on the structural deficit can be arrived at by subtracting the 2007-08 deficit (pre-crisis) from the 2009-10 deficit (post-crisis). This gives a figure of  $(8.9 - 2.5) = 6.4$  percent of GDP.

This suggests that the financial crisis had an overall impact on the public finances equal to around £95 billion, or about £3,900 per year for every household. This implies that taxes will have to rise, or spending be cut, by an average of £3,900 per household to balance the books.

Overall, it seems unarguable that the 2008-09 financial crisis had a devastating impact on the UK's productive capacity. If the crisis could have been avoided and UK output growth maintained at the trend levels seen over the previous decade 1997 to 2007, the UK could have avoided a £130 billion per year output loss, and a related deterioration in the structural public finances position of over £90 billion per year.

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<sup>6</sup> See OBR (2011), Table 4.23, figure for ‘cyclically adjusted net borrowing’, 2009-10 outturn.

How much would the mutualisation of Northern Rock reduce the chances of a future banking crisis which is likely to be at least as costly as that of 2007-08? Northern Rock is not one of the largest banks in the UK (unlike Royal Bank of Scotland or Lloyds Banking Group, which both have substantial government holdings, although not fully nationalised) but nonetheless Northern Rock plc, which is the viable “good bank” part of the old Northern Rock (the part which the Government is looking to return to the private sector) had a total candidate for denationalisation, had total assets of £22.5 billion in January 2010 (of which £10.3 billion were mortgages)<sup>7</sup>. It also has an extensive branch network and the capacity to expand its mortgage lending after being returned to the private (or mutual) sector if funding allows.

The re-mutualisation of Northern Rock would help reduce the likelihood of systemic failure in the UK banking system in two ways. First, it would increase the size of the mutual sector in UK banking relative to the private plc sector. This would in itself help to increase stability and systemic resilience in UK banking (provided of course that Northern Rock’s management adopted an investment and customer strategy consistent with the lower-risk strategies which helped mutuals weather the financial crisis better than plcs in the wake of the 2008 crisis).

Second, re-mutualisation would broaden diversity in the banking sector. Recent research by the Centre for European Policy Studies (Ayadi *et al*, 2009) and the International Monetary Fund (Hesse and Cihak, 2007) has identified the clear advantages which flow from having a diverse range of banking structures and models – including a strong mutual sector - in national economies. A diverse set of institutions and business models increases competition and makes the financial services sector more robust to shocks because it stops there being a ‘monoculture’ of financial services companies, all investing in the same way, and all vulnerable to the same set of pressures in the economy. It was this ‘monoculture’ of high-risk plc-based banking which largely caused the crisis of 2007-08, both in the UK and other countries.

Encouraging diversity is very much in line with the current UK Government’s stated objectives for the banking sector. The Coalition Agreement of May 2010 states:

“We want the banking system to serve business, not the other way round. We will bring forward detailed proposals to foster diversity in financial services, promote mutuals and create a more competitive banking industry.” (HM Government, 2010, p9).

The Treasury White Paper *A New Approach to Financial Regulation: Judgement, Focus and Stability* in 2010 stressed:

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<sup>7</sup> Source: UKFI (2010). The “bad bank” part of the old Northern Rock holds and services the closed mortgage book of around £75 billion of assets, of which £54 billion were mortgages. The UK Government is not aiming to return this part of Northern Rock to the private sector but rather, is looking to run down the mortgage book gradually over time. Again, see UKFI (2010) for further details.

“The need to maintain diversity in the financial services sector (for example, by removing barriers to entry where possible, and ensuring that its rules do not disadvantage mutually owned financial institutions. (HM Treasury 2010, p32)

It is important to be realistic about the role that a re-mutualised Northern Rock could play in maintaining the stability of the banking system. There is still a chance that, even with a mutual Northern Rock, an otherwise unreformed banking system could implode spectacularly in the fashion of the 2008 crisis. Northern Rock is not a big enough player in the savings or mortgage markets to stop that happening by itself. However, having Northern Rock as a mutual certainly decreases the chances of another financial meltdown by a small, but non-negligible extent, compared with conventional privatisation of the bank. unreformed plc. The costs of the last financial crisis were so vast that even a small reduction in the probability of another crash could be worth billions of pounds to the UK economy and UK taxpayers.

## 2 Providing increased lending to businesses

The aftermath of the financial crisis has seen a huge reduction in net lending to businesses . Figures from the Bank of England (2011) show that net business lending in real terms averaged around £1.6 billion a year between 1998 and 2005, before increasing to £7.4 billion in 2007 at what turned out to be the height of an unsustainable lending boom. The aftermath of the 2008 crisis has seen a collapse in lending, with net lending falling to minus £3.9 billion in 2009 and minus £2.1 billion in 2010.

The one growth sector for business lending, particularly for the small business sector, has been among mutually owned banks and building societies. For example, between 2007 and 2010 the Co-operative Bank doubled the annual amounts it lent to small businesses<sup>8</sup>.

A mutualised Northern Rock would be able to take a longer view on returns to capital than an independent plc or a subsidiary of a larger bank fixated on short-term returns to capital. It is likely that this would be useful for small businesses and community run businesses (such as social enterprises) in particular.

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<sup>8</sup> See Daily Telegraph, “Co-operative Bank doubles lending”, 27 August 2010. <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/7966490/Co-operative-Bank-doubles-lending.html>

### 3 Improving the customer experience

There is evidence to show that mutual banks have greater public trust and also higher levels of customer service satisfaction than plc-based banks (Cook *et al*, 2003)<sup>9</sup>. Other things being equal, market forces should ensure that organisational forms which provide the most satisfying customer experience predominate, but in the 1990s and early 2000s other things were *not* equal. Financial deregulation which allowed mutual building societies to convert to plcs produced a wave of conversions (including Northern Rock), leading to very rapid but unsustainable growth and contributing to the 2007-08 crisis. Not one of the demutualised former building societies survived the crisis as an independent financial institution – all were partly or wholly nationalised, or bought out by other banks.

Based on existing evidence from mutual financial services companies, reintroducing Northern Rock as a large mutual player in the banking market would improve the customer experience of its account and mortgage holders relative to the alternative of privatisation.

### 4 The impact on local communities

Northern Rock still has a substantial employment base in the North East of England, a region whose Gross Value Added (output) per head is substantially below the UK average, and which also has a higher than average proportion of public sector employment – and so will be hit particularly hard by the spending cuts taking place between 2010 and 2014. Because mutual organisations are responsible to their members (bank account and mortgage holders) the focus of their business operations will tend to be on the communities in which those members live and work. By contrast, shareholders in a publicly quoted bank may not even live in the same country or continent as the account holders, let alone in the same region or local area. Mutualisation would allow Northern Rock to have more of a regional focus and concentrate on providing finance to improve the local economy (although of course it would be likely to maintain a broader national presence as well.)

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<sup>9</sup> Note that the research was carried out before the crisis of 2008, and if anything it is likely that public trust in mutual banks and building societies relative to shareholder-owned banks has increased since then.

## 5 The payoff to UK taxpayers

Given the cost of the original bailout to Northern Rock, one of the key objectives of the UK Government in either mutualisation or privatisation has to be to secure an adequate return to the taxpayer. A conventional privatisation through flotation of UKFI's holdings in Northern Rock, or trade sale to a private sector bank or other financial institution, would realise an immediate financial return. However, this would be limited to the market value at the time of sale (either through shares or a trade sale).

Because Northern Rock is fully nationalised its shares are not currently traded on the stock exchange and so we have no information on how much the UK Government would earn from a flotation. However, shares in the part-nationalised Royal Bank of Scotland (RBS) and Lloyds Banking Group are traded on the London Stock Exchange and give us some idea of general share price movements in the banking sector for financial institutions which faced similar problems to Northern Rock in the crisis. Data from UKFI (2010) show that the average price of the UK taxpayers' shareholding in RBS, including share purchases in December 2008, April 2009 and December 2009, is around 50 pence per share. The current price (as of 1 April 2011) is around 42 pence per share, implying loss of several billion pounds for the taxpayer if RBS were to be privatised by flotation in the immediate future. The currently performance of Lloyds Banking Group is similar – the taxpayer would make a modest loss if the shares were sold now. In both cases, there are no clear signs of consistent and strong upward trends in the share price.

Given the similarities between the predicaments experienced by the three banks over recent years, there is good reason to think that market valuations of Northern Rock (relative to the size of the business in terms of number of people employed and its total savings and mortgage portfolio) would be similar to the two part-nationalised banks in the event of a privatisation. This suggests that the proceeds from a Northern Rock flotation or trade sale in the near future would not be sufficient to cover the £50 billion or so of support from public funds already provided in the run-up to and following nationalisation.

By contrast, a mutualisation of Northern Rock would provide little or no upfront income for the Treasury, as the mutual equity would essentially be gifted upfront to Northern Rock members. The payoff to the UK government from re-mutualisation would come more gradually, via a stream of income from a mechanism known as profit participating deferred shares (PPDSs – see Michie and Llewelyn, 2009 for details of how these work). Provided that Northern Rock achieves viability as a mutual business, the value of (discounted) stream of income from PPDSs would almost certainly be greater than any upfront return realised from privatisation.

Northern Rock has already been split into “good” and “bad” parts, with the most unviable ‘sub-prime’ mortgage debt being incorporated into UK Asset Resolution – the “bad bank”

which also incorporates unviable loans from Bradford and Bingley (the “good” part of which is now owned by Santander Bank). This means that what remains is the relatively “good” part of the business and should be profitable – whether in private or mutual ownership – in the future.

## **6 An alternative mutual option: sale to an existing mutual financial organisation**

As mentioned in Section 1, an alternative type of trade sale for Northern Rock would be for the bank to be sold to an existing *mutual* financial services provider rather than a private shareholder-owned plc bank. This would secure mutual status for Northern Rock via a different route from that considered above – with an existing mutual buying the Rock from the Government rather than the Government selling the Rock to its existing account holders. Consolidations of this type have occurred in the mutual financial services market in recent years (for example through the merger of the Co-operative Bank and the Britannia Building Society in 2009).

Sale to an existing mutual provider may be an easier way to re-mutualise the rock than creating a new mutual “from scratch”, but the idea of a sale to an existing mutual does raise a few potential problems. First, would an existing mutual be able to raise enough capital to purchase Northern Rock – particularly if bidding against plcs who are more easily able to raise external capital? Second, what would be the relationship between the existing members of the mutual society buying Northern Rock and Northern Rock’s existing customers? Would both sets of account holders be on an equal footing, and if not, what would the implications be for mutuality? Finally, this option would presumably result in there being a smaller number of big competitors in the mutual financial services sector than if Northern Rock were re-mutualised as a separate entity, which could be bad for competition in the sector.

## 7 Weighing up the options: re-mutualisation vs privatisation

Table 1 below gives a summary of the evidence from previous chapters on what the economic impact of a re-mutualised Northern Rock would be compared with a privatised Northern Rock. The particular issues regarding trade sale to a mutual as an alternative type of mutualisation, covered in Section 6 above, are included as additional points in the ‘re-mutualisation’ column.

**Table 1. Benefits and Costs of Re-Mutualisation vs Privatisation of Northern Rock**

<b>Economic impact on:</b>	<b>Re-mutualisation</b>	<b>Privatisation</b>
Likelihood of avoiding another systemic crisis in the UK banking system	Would make a systemic crisis less likely. The costs of the last systemic crisis in lost output were estimated at around £130 billion	Would do nothing to lessen the risk of another systemic crisis
Diversity in UK banking	Re-mutualisation via transfer of Northern Rock to existing account holders would increase diversity by strengthening the UK’s mutual banking sector (which is small by international standards).  Trade sale to another mutual would increase the size of the mutual sector relative to the plc banking sector but would not increase diversity <i>within</i> the mutual sector	Would do nothing to increase diversity
Providing increased lending to businesses	Based on evidence from existing mutuals, would increase lending to businesses (and small businesses in particular)	Would not increase lending to businesses compared to the <i>status quo</i>
Improving the experience of Northern Rock customers	Based on evidence from existing mutuals, would increase levels of customer satisfaction	Levels of customer satisfaction in a privatised Northern Rock would probably be equal to the average among current private sector plc banks – which tends to be lower than among mutuals
Impact on local communities	Mutual financial sector organisations tend to be more responsive to their members and hence more sensitive to local community needs	Plcs are legally obliged to put shareholders’ interests first. Some of these may be locally based, but many will not be

The payoff to UK taxpayers	<p>Re-mutualisation via transfer of Northern Rock to existing account holders would provide no upfront payoff, but instead a steady stream of revenue over time. The exact amount depends on the financial instrument used and the performance of a mutualised Northern Rock.</p> <p>Trade sale to an existing mutual would provide an upfront payoff (but, as with trade sale to a plc, proceeds would probably be low by historical standards)</p>	Proceeds from privatisation will be immediate – but probably low by historical standards due to depressed stock market values
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## 8 Conclusion

Overall, there is a strong economic case for the re-mutualisation of Northern Rock on the grounds of increasing stability and diversity in the UK banking system, as well as making Northern Rock more responsive to local community needs, more likely to lend to businesses – particularly small businesses, and more likely to pursue high levels of customer service. In addition, the taxpayer is just as likely – if not more likely – to receive good value for money from the mutualisation of Northern Rock as from a quick privatisation. Although the Treasury will receive payment over a much longer period of time if Northern Rock is denationalised as a new stand-alone mutual entity rather than being sold to a private or mutual sector bidder, it is likely that a disposal of Northern Rock via flotation or trade sale would represent poor value for money for the taxpayer, given the current market valuation of shares in comparable banks such as RBS and Lloyds Banking Group.

The principles of mutualisation have support from the front benches of all three major UK political parties front benches as well as the May 2010 Coalition Agreement and the recent Treasury White Paper on financial regulation. There is also substantial support among backbench MPs: 78 MPs, including representatives from the Conservative, Labour, Liberal Democrat and Green Parties, signed a recent Early Day Motion (EDM 1351) on the re-mutualisation of Northern Rock. This report shows that, in addition to the strong support for re-mutualisation across the political spectrum, it is also the best long-term solution for Northern Rock from an economic perspective.

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