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To: "jeevacation@gmail.com" <jeevacation@gmail.com>
Subject: Fw: BUSINESS LENDING
Date: Sun, 02 Aug 2009 19:00:11 +0000

Sent from my BlackBerry® wireless device

From: "Jeremy Heywood"
Date: Sun, 2 Aug 2009 20:00:07 +0100
To: Shriti Vadera (Personal)<svadera848@no10.x.gsi.gov.uk>; John Pond (E-mail)<114042@no10.x.gsi.gov.uk>
Subject: RE: BUSINESS LENDING

This is really helpful

Wd be good if you could take Charlie Bean and Paul Tucker through your analysis in detail – it is compelling in my view

How much more has been raised through the corporate bond market – or indeed rights issues - than you assumed at the time of the original gap analysis? The sooner we can get people to understand this point the better – as you imply

I still think HMT/BoE under-play the potential importance of non-bank players providing finance directly. Bank's QE focus on buying gilts is fine – but they have not done enough credit easing in the Fed sense

AND we need the same analytical focus on the mortgage market as you have provided on the corporate market. Lack of securitisation market will be a real drag on that for years to come unless we find a way of getting the market to reopen

-----Original Message-----

From: Shriti Vadera (Personal)
Sent: 02 August 2009 12:35
To: John Pond (E-mail)
Cc: Jeremy Heywood; Peter Mandelson (E-mail)
Subject: BUSINESS LENDING

I THOUGHT I SHOULD UPDATE YOU ON BUSINESS LENDING WITH MY THOUGHTS ON WHERE WE WERE IN LAST FEW MONTHS.

WHAT IS ACTUALLY HAPPENING?

- WRT TO THE DEBATE ON IS IT DEMAND OR SUPPLY THERE IS NOT A REAL PROBLEM ON AVAILABILITY OF LENDING TO SME'S AND LARGE CORPORATES ANYMORE. HBOS CONTINUES TO BE A DRAG ON THE WHOLE MARKET WITH UPTO 20% SHARE AS THEY ESSENTIALLY STOPPED LENDING OCT-MARCH AND IT TAKES A WHILE TO GET TO FULL CAPACITY AGAIN BUT IT IS BEING WORKED ON. DEMAND HAS DROPPED VERY SERIOUSLY (ATLEAST 15% IF NOT MORE). THERE IS NO GETTING AWAY FROM THE FACT.

- THERE IS A POTENTIAL PROBLEM OF INSUFFICIENT SUPPLY FOR THE DEMAND FROM MID SIZE COMPANIES (TURNOVER £10M-£500M) WHO ARE NOT BIG ENOUGH TO GO TO BOND MARKETS AND NOT SMALL ENOUGH FOR BANKS TO TAKE RISK. IRISH AND ICELANDIC BANKS WERE MORE ACTIVE IN THIS AREA. WE HAVE INVESTIGATED THIS ANALYTICALLY FOR THE LAST 8-10 WEEKS AND (IGNORING HMT OBJECTIONS) HAVE NOW PROVIDED ALL OF THE BANKS WITH THE NAMES AND ADDRESSES OF ABOUT 1700 GOOD CREDIT RISK COMPANIES WHO EMPLOY ABOUT 800,000 PEOPLE AND COULD NEED ABOUT £5BN. MORE THAN HALF ARE GROWTH COMPANIES. THIS IS POTENTIAL NOT REAL DEMAND AND THE LIST WILL HAVE SOME ERRORS. I DO NOT KNOW YET IF THE NUMBERS WILL STACK UP SO PLEASE DO NOT USE THEM IN PUBLIC. THE COMPANIES MAY NOT BE CONFIDENT ENOUGH TO BORROW. ALL OF THE BANKS WERE PLEASED WITH THIS WORK AND HAVE AGREED TO CONFIRM THE FINDINGS AND CONTACT THE COMPANIES TO OFFER LOANS. WE WILL FOLLOW UP. IF THERE IS GOOD EVIDENCE THAT IT WORKED WE CAN PUBLICISE THIS IN OCTOBER

- THERE IS POTENTIALLY A PROBLEM WITH LONGER MATURITIES (5 YEARS PLUS BUT FOR SOME MAYBE 3 YEARS PLUS). WE ARE INVESTIGATING TO GET AN EVIDENCE BASED APPROACH. ONE REASON MAYBE BANKS THEMSELVES CANNOT GET LONG TERM FUNDS. AFTER 6 MONTHS OF ASKING MYNERS HAS AGREED TO LOOK INTO THAT PROBLEM

- THERE IS POTENTIALLY A PROBLEM - BUT WE HAVE NO EVIDENCE - ABOUT TOO MUCH RISK AVERSION AND MARGINS GOING UP TOO MUCH. CURRENTLY BECAUSE INTEREST RATES ARE DOWN PRICES DO NOT LOOK TO BE HIGHER OVERALL TO BORROWERS THAN THEY WERE 2 YEARS AGO. OVERALL COST OF FUNDS IS NOT NECESSARILY A REASON FOR DEMAND FALLING (CONTRARY TO STATEMENTS BY AD). MARGINS SHOULD IN ANY CASE GO UP BECAUSE THEY WERE TOO LOW AND RISK HAS GONE UP. WE ARE INVESTIGATING HOW MUCH BY AND IF IT IS JUSTIFIED. HBOS MARGINS ARE GOING UP DRAMATICALLY BECAUSE THEY WERE SEVERELY UNDERPRICING IN THE PAST BECAUSE OF THEIR POLICY OF FUNDING SHORT AND LENDING LONG. IT IS CREATING THE BAD OVERALL IMPRESSION IN THE MARKET BUT THERE IS NO REAL ANSWER TO THIS AS THEY HAVE TO CORRECT

- THE THREE PIECES OF WORK ON RISK AVERSION, PRICING AND MATURITIES IS BEING DONE JOINTLY WITH HMT. THE MID SIZE WORK WAS DONE BY ME AND BIS. HMT MAY SLOW US DOWN ON THE OTHERS BUT I WILL LET YOU KNOW IF I NEED HELP

- WE NEED TO MANAGE EXPECTATIONS ON LENDING AGREEMENTS WHICH WILL NOT BE MET. THIS IS NOT BECAUSE WE CAN'T MAKE THE

BANKS DO THE RIGHT THING - WE CAN - BUT BECAUSE THE LARGE COMPANY NUMBERS HAS PROVEN TO BE NOT NEEDED AS BOND MARKETS ARE VERY STRONG COMPARED TO OUR PROJECTIONS IN JANUARY AND FOREIGN BANKS HAVE NOT WITHDRAWN AS MUCH AS EXPECTED IN THIS SEGMENT. THIS IS GOOD NEWS NOT BAD NEWS (EXCEPT OF COURSE THE FALL IN DEMAND PROBLEM)

- THERE WILL BE SOME INTRACTABLE ISSUES. FOR EXAMPLE 1. MANY COMPANIES ARE OVERLEVERAGED (EG 5 OR 6 TIMES THEIR PROFIT) BECAUSE OF PAST LAX CONDITIONS. WHEN THEY COME TO REFINANCE THEY WILL NOT BE ABLE TO REFINANCE THE SAME AMOUNT (EG CONDITIONS NOW 2- 3 TIMES THEIR PROFIT) AND SO WILL HAVE TO FIND EQUITY SOMEHOW OR SERIOUSLY RESTRUCTURE AND IN SOME CASES GO UNDER. 2. PRIVATE EQUITY DEALS WHICH DEPENDED ON LEVERAGE TO MAKE MONEY HAS BEEN UNABLE TO ACCESS DEBT SO THESE DEALS HAVE DRIED UP UNLESS THEY ALREADY HAVE DEBT. 3. COMMERCIAL PROPERTY WHICH WAS A LARGE PART OF THE RECENT INCREASE IN THE RUN UP TO 2007 IS FOR OBVIOUS REASONS A PROBLEM ALTHOUGH THE BANKS APPEAR TO BE BEHAVING SENSIBLY AND NOT FORECLOSING AS ITS NOT IN THEIR INTERESTS. THESE POCKETS OF PROBLEMS REMAIN.

- OVERALL I REMAIN CONCERNED THAT THE ECONOMY WILL DELEVERAGE. IT HAS TO BY DEFINITION AS IT WAS OVERLEVERAGED. WE ALSO FACE A WALL OF BANKS HAVING TO REFINANCE THEIR OWN DEBT IN 2010 AND 2011 WITH THEIR SECURITISATIONS COMING DUE, GOVERNMENT GUARANTEED DEBT WHICH ENDS THEN, AND OTHER DEBT. TRILLIONS. THE SECURITISATION MARKET HAS NOT RESTARTED AND THERE IS NO OBVIOUS SOURCE OF ALTERNATIVES TO GOVERNMENT GUARANTEED DEBT AND SECURITISATION. IF THERE ONE IS NOT FOUND THE DELEVERAGING OF THE BANKS IS INEVITABLE AND UNSTOPPABLE. WE HAVE BEEN SPEAKING TO HMT ABOUT THIS FOR MONTHS - THEY HAVE JUST STARTED TO LOOK AT IT

OUR APPROACH NEEDS TO CHANGE

- MERVYN KING IS OFF THE PAGE. HE IS WINDING PEOPLE UP ABOUT BANKS NOT LENDING WITH NO EVIDENCE AND HAS BEEN DESTABILISING THE SYSTEM BY TALKING ABOUT BANKS NEEDING MORE CAPITAL.

-IN MEANTIME HMT ARE UNAWARE OF THE ISSUES AT A GRANULAR LEVEL - EXHORTING BANKS TO LEND MORE AT A HIGH LEVEL WILL NOT WORK UNLESS WE CAN DO IT ISSUE BY ISSUE WITH EVIDENCE. AD STILL TALKED ABOUT SME LENDING NOT BEING AVAILABLE AND HAS NO

REAL UNDERSTANDING WHAT IS HAPPENING AT THE LEVEL SET OUT IN THIS EMAIL.

- THEY ARE MISINTERPRETING YOUR INSTRUCTIONS TO DO MORE ABOUT LENDING BY ASKING PAUL AND ME TO SEE CEO'S AND ASK THEM TO LEND MORE. THIS WAS A POINTLESS EXERCISE WHICH WILL NOT WORK AND HAS EXPOSED A DEGREE OF IGNORANCE I WAS EMBARRASSED TO BE ASSOCIATED WITH.

- AND THEY ARE WHIPPING UP THE PRESS ON THIS WHICH ONLY MAKES US LOOK IMPOTENT AND DESTROYS BUSINESS CONFIDENCE WHEN IN FACT WE HAVE BEEN SUCCESSFUL IN PART IN INCREASING AVAILABILITY OF LENDING. BUSINESSES NEED TO FEEL CONFIDENT THEY WONT BE TURNED DOWN.

- AD INSTRUCTED PAUL TO THREATEN BANKS WITH OFT INVESTIGATION. THIS IS COUNTERPRODUCTIVE, NOT JUST BECAUSE IT DESTABILISES THE LLOYDS MERGER WHICH THE OFT ARE DYING TO UNPICK, BUT BECAUSE WE ARE ACTUALLY ASKING BANKS TO INCREASE THEIR MARKET SHARE BY LENDING MORE TO MAKE UP FOR SMALL AND FOREIGN BANKS. AND THEN WE THREATEN THEM WITH OFT WHICH WILL INVESTIGATE THEIR MARKET SHARE. IT WAS BEYOND SILLY.

I THINK WE NEED TO CHANGE OUR APPROACH TO

- CHANGE OUR PUBLIC POSITION TO BANKS ARE PREPARED TO LEND. IT'S WORKING. WE HAVE FOUND SMALL POCKETS OF UNMET DEMAND AND BANKS ARE DEALING WITH IT. WE ARE INVESTIGATED PROBLEMS ON MATURITY AND MFEES ETC. GOOD BUSINESSES SHOULD APPROACH BANKS WITH CONFIDENCE. IF THEY ARE TURNED DOWN, GO TO THESE FOLLOWING NUMBERS FOR HELP (HESTER HAS AGREED TO WRITE TO EVERY MP AND GET A HELPLINE NUMBER FOR BUSINESSES TO CALL) OR COME TO US. ((YOU SHOULD BE AWARE ALMOST WITHOUT EXCEPTION EVERY CASE INVESTIGATED BY BIS, THE COMPANY HAD EITHER ASKED HBOS IN OCT -MARCH OR WAS NOT CREDITWORTHY)). SENIOR POLITICIANS SHOULD BE AWARE OF THE INDIVIDUAL ISSUES AND NOT MAKE GENERAL STATEMENTS THAT MAKE IT LOOKS UNSUCCESSFUL AND US IMPOTENT.

- WE SHOULD STOP USING THE OFT INVESTIGATION THREAT. YOU WOULD NEED TO ASK AD TO DO THAT

- WE SHOULD TALK TO THE BANKS ABOUT THE INDIVIDUAL ISSUES - MID-SIZE, PROJECT FINANCE, OVERLEVERGAED COMPANIES, RISK AVERSION, MARGINS - AND ON A BILATERAL BASIS AS NO BANK WILL SAY ANYTHING SERIOUS IN FRONT OF ANOTHER. IT SHOULD BE DONE ON

EVIDENCE ON EACH ISSUE WHICH WE ARE WORKING ON AND NOT ANECDOTES. I HAVE AGREED WITH THE BANKS THAT IS WHAT I AM GOING TO DO. NO IDEA WHAT HMT WILL DO.

- SOMEONE NEEDS TO HAVE A SERIOUS CHAT WITH MERVYN KING

- HMT NEEDS TO GET SERIOUS ABOUT THE PROBLEMS OF FUNDING MARKETS FOR BANKS

- WE NEED TO CONSIDER THE PROVISION OF EQUITY NOT JUST DEBT IF WE WANT COMPANIES TO SURVIVE. I HAVE ASKED FOR SOME WORK

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