BANK OF ENGLAND

Mark Carney
Governor

The Rt Hon George Osborne
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

10 June 2015

Dear Chancellor,

Thank you for your letter of 10 June which outlines your goal of returning RBS to private ownership.

The Bank of England believes that the interests of the people of the United Kingdom are best served by a vibrant, resilient and privately owned banking sector. Such a system is best able to allocate capital efficiently and competitively to grow jobs, investment, and income.

In my judgement and in light of the Bank of England's responsibilities, it is in the public interest for the government to begin now to return RBS to private ownership.

Public ownership has largely served its purpose. It prevented enormous financial contagion at a time when the UK financial system was extremely fragile. It has stabilised RBS and helped catalyse the refocusing and necessary strategic change to build a viable business model that concentrates on serving UK households and businesses.

Continued public ownership without a foreseeable end point runs risks including limiting RBS' future strategic options, and continuing the perception that taxpayers bear responsibility for RBS losses. In these regards, there could be considerable net costs to taxpayers of further delaying the start of a sale.

In contrast, a phased return of RBS to private ownership would promote financial stability, a more competitive banking sector, and the interests of the wider economy. Given the progress RBS has made in recent years, there are considerable potential benefits to commencing this process in the near-term.

When the UK Government injected a cumulative £45.5bn into RBS in 2008 and 2009, it did so with the objective of averting the enormous adverse impact on financial stability that would have arisen from the disorderly failure of such a systemically important bank. That objective has been achieved.

RBS' strategic plan now articulates a clear vision for repositioning its business model towards its core UK retail and commercial lending franchises. Once this plan is executed RBS will be a smaller, simpler, and less risky bank, with better capacity to support the UK real economy.

While the new leadership team at RBS has demonstrated its willingness to take the tough decisions necessary to deliver a sustainable business, it is widely recognised that it will likely take several years for RBS to complete restructuring towards its target business model. RBS itself has commented on the financial headwinds facing the business including the drag on earnings from restructuring costs. It is also widely known that RBS could face headwinds arising from litigation and remediation of past misconduct, systems transformation, the implementation of structural reform, and work to separate the Williams & Glyn business.

But while risks inevitably remain, the threats posed by RBS to the UK financial system are now materially different to those faced in 2008/9. And these headwinds will likely persist regardless of the ownership structure of RBS. The need for public intervention is therefore now much diminished, and indeed may now pose an impediment to the next phase of RBS' recovery.

Beginning the process of reducing the Government's stake would be an endorsement of the bank's strategic plan and a vote of confidence in management to develop the business. It would also remove the perception of Government influence on RBS' strategy, demonstrate that the firm is now strong enough to stand alone without extraordinary public backing, and free management to pursue a wider range of strategic options.

The progressive return to private ownership should help deliver a stronger RBS that is better placed to increase its lending and compete for business. This is important because RBS accounts for around a tenth of UK mortgage lending and around a quarter of lending to UK SMEs.

Returning a major institution to private ownership would also support the reforms we are implementing to end Too Big to Fail. An RBS increasingly owned by private investors would reinforce the credibility of resolution by highlighting that it falls to private investors – not tax payers – to take risks, to benefit from profits, and to bear losses if they occur.

While questions of ownership and valuation are of course for the Government, the Bank's view is that a decision to start the return to private ownership will, over time, bring benefits to the wider economy. As long as RBS is held by the state, questions will persist about the strength of the business, about the extent to which its strategy is the management's own, and about who will bear the costs of failure should they occur.

On that basis a clear and managed sell down would support RBS' prospects, financial stability in the United Kingdom, and the wider UK economy.

With best wishes