Bradford and Bingley: British government nationalises second failing bank

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The chancellor of the exchequer, Alistair Darling, announced minutes before the London Stock Market opened on Monday that the government would take over the Bradford and Bingley (B&B).

The second such nationalisation after Northern Rock, the B&B is Britain's largest buy to let (BTL) mortgage lender and faced bankruptcy. The Labour government organised the bailout on behalf of powerful financial interests without any public discussion, after private talks over the weekend with banking chiefs and regulators.

Darling said that nationalisation was necessary after B&B's share price had fallen to 20p, down from a high of £5.20 only two years ago, raising the spectre of a run on the bank that might spread throughout the banking system.

"We had to stabilise the situation in order to protect the banking system as a whole, he said, insisting that Britain would do "whatever it takes."

Prime Minister Gordon Brown also made it clear that he would intervene to protect the City. He said, "The governor of the Bank of England, the chancellor and I will take whatever action necessary to ensure continued stability."

This is a pledge to use the money of hard-pressed working people, whose wages have for years been held down at the behest of big business and the City, to protect the wealth of the financial oligarchy--not just in this instance but in future bankruptcies.

The chancellor used his powers acquired under the emergency banking legislation to enable the nationalisation of Northern Rock, Britain's fifth largest mortgage lender, last February. The legislation permits him to circumvent normal bankruptcy law and transfer a bank to another bank or take it over, with as much or as little compensation as he thinks fit.

The government will take over B&B's £51 billion mortgages and loans. B&B's £20 billion savings arm and its 197 branches are to be sold to the Spanish bank, Santander, which also owns the Abbey and the Alliance & Leicester mortgage lenders, for £600 million, making it the fifth largest bank in the UK. To ensure that Abbey has the funds to pay back the depositors, it will receive £20 billion from the Financial Services Compensation Scheme (FSCS).

Since the FSCS, essentially a depositors' insurance fund provided by mortgage lenders should a lender collapse, has no funds of its own, the Treasury will loan the FSCS £4.5 billion and the Bank of England £14.6 billion, all of it taxpayers' money. In the meantime, members of the FSCS, the 700 financial companies that take deposits, must pay interest on the loan estimated at £450 million for the first seven months due in 2009, and nearly double that the following year. This they will no doubt pass on to their depositors in the form of higher charges or lower interest rates on savings accounts.

The FSCS and thus the government, as the chief creditor, hope to recoup the £20 billion loan from when--or if--B&B's mortgages are repaid or sold on. But it is far from certain that the £51 billion mortgages--85 percent of which are in the risky BTL and self-certification market--will realise £20 billion in the foreseeable future.

The government will seek to run down B&B's mortgage book as it has with Northern Rock, by encouraging those who can to take out new mortgages with other lenders. This will leave those homeowners with the worst credit ratings with the B&B, offering the prospect of the government issuing repossession orders and turning families out on the streets.

The move came as:

* The fourth largest US bank, Wachovia, had to be bought out in a rescue deal brokered by the US authorities.

* The six largest US bank and savings and loan company, Washington Mutual, was taken over by the US government and JP Morgan Chase.

* The Fortis bank had to be nationalised by the Dutch, Belgian and Luxembourg governments.

* Glitnir, Iceland's third largest bank, was taken over by the Icelandic government.

Since then Dexia has become the second Belgian bank in a week to be bailed out by governments in Belgium, France and Luxembourg to the tune of €6.4 billion.

The B&B bailout comes just one week after the government brokered a takeover of another failed bank and mortgage lender, HBOS, by Lloyds TSB by relaxing competition rules and providing other unspecified "support."

B&B, with a history going back 150 years, demutualised just eight years ago under legislation announced by the Labour government in 1997, in order to gain access to the wholesale markets for funds to expand and thus avoid reliance on deposits.

It expanded recklessly in the riskier markets of BTL and self-certification mortgages and bought the loan book from GMAC-RFC, General Motors' lending arm, further increasing its exposure to risky lending.

As the downturn in the housing market and the credit crunch took its toll, lenders struggled to keep up with repayments and the bank found it difficult to finance its activities. It was forced to launch a rights issue in May. But the situation was so grave that even after twice restructuring its rights issue, only 20 percent of its shareholders responded to its call for the £400 million necessary to bolster its capital reserves. This left the bulk of the shares with the six high street banks and two investment banks that had underwritten the issue.

This month, as fears rose about the financial crisis and mounting mortgage arrears, the ratings agencies cut B&B's credit rating to just a notch above junk bond status. It renegotiated its contracts with GMAC-RFC, whose mortgage arrears have turned out to be even greater than B&B's own arrears, slashed jobs, mounted an aggressive TV advertising campaign, and sold or wrote down its more exotic and toxic financial instruments to increase its capital ratios. But this was not enough. Its share price plummeted and its credit default swaps, a measure of risk, doubled in a week.

With its shares virtually worthless, tens of millions of pounds were being withdrawn by savers from B&B's branches and Internet site on Friday and Saturday.

This raises new doubts over the BTL market that collectively owes £132 billion or 11 percent of all mortgages. As soon as the nationalisation of B&B was announced, some BTL lenders increased their rates, while others have closed their doors to new customers.

B&B's collapse means that all the six building societies that demutualised to become banks since 1986 have been taken over or been declared bankrupt:

Woolwich was bought after just three years as a bank by Barclays in 2000. Halifax was bought by the Bank of Scotland in 2001 after four years as a bank. The Abbey demutualised in 1989 and was taken over by Santander in 2004. Northern Rock collapsed in 2007 after 10 years as a bank. Alliance and Leicester was bought by Santander in 2008 after 11 years as a bank when it found itself unable to obtain funding.

A 2005 study by a group of MPs of the demutualised societies found that consumers had benefited very little and in most cases were paying more for a mortgage from a bank than from a building society. The claims of the new owners added 35 percent to a bank's costs. The real winners were the top managers, who saw their paychecks increase almost threefold compared with the 65 percent rise in pay for their counterparts in the building societies. The cost of converting to banks cost more than £1 billion.

The reason for the collapse in the US sub-prime market that has now spread to other mortgage lenders is the inability of the poorest and most vulnerable members of society to keep up their repayments alongside rising food, energy and transport costs and on wages that have failed to keep up with inflation.

The restructuring of the mortgage lenders and banks will further concentrate financial resources and power in the hands of a few giants. This will in turn increase pressure on small and medium size banks, undermine their competitive position, and force them to close or sell out to their larger rivals.

It will lead to high charges for loans and more aggressive threats of repossessions, should homeowners fall behind with their payments. It will also result in the loss of thousands of jobs as branches close and services are "rationalised," adding to the thousands of jobs that have already been cut in the financial, property and construction sectors since the onset of the credit crisis in August 2007.

The government bailout of Northern Rock and B&B adds at least £127 billion onto the public sector's liabilities, a sum equal to 8.6 percent of GDP in 2007-08, and increases total net debt to GDP to about 48 percent--assuming the government does not fiddle the books yet again.

To get some sense of the scale of what is involved, the cost of these two bailouts alone--without including the billions pumped into the money markets by the Bank of England--is more than the £110 billion scheduled for healthcare, by far the largest spending area, for 2009-10. It is double the £60 billion worth of capital investment in hospitals, schools, transport, etc., by the private sector over the entire lifetime of the Labour government since 1997. Yet the turn to private finance for public infrastructure was in part at least justified in terms of accessing the finance that the government could not provide.

Far from the rescue of B&B calming the financial markets, there are widespread fears that it could have a domino effect throughout the banking sector. Lord Turner, the chairman of the Financial Services Authority, said, "We are not necessarily right at the end of this process. We believe our other high street banks are well capitalised, and in a reasonable condition, but we will have to keep this situation under review."

As he said this, shares of Britain's banks were in free-fall. Mark Deans, dealing manager at Moneycorp, said, "Confidence in UK banking has fallen to a new low with the nationalisation of B&B."

With interbank lending virtually at a standstill, despite an interbank lending rate of 6.26 percent, well above the Bank's official rate of 5 percent, the Bank of England was forced to inject £40 billion of credit into the money markets and provide £10 billion in overnight credit.