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‘His finest moment’

The financial crisis A year since America adopted the rescue plan first activated by Gordon Brown, his role in saving the world banking system is disputed by some but hailed by others, writes **George Parker**

One year ago, Gordon Brown was being hailed by many as the saviour of the world's banking system. On October 14 2008 Hank Paulson, the US Treasury secretary of the time, announced a rescue plan for America's stricken banks. Germany, Italy, France and Spain had just done the same. All the initiatives had something in common: they looked very similar to the move announced a week earlier by the British prime minister.

In the intervening 12 months Mr Brown has staggered from one domestic problem to another; opinion polls suggest he could be out of office by next summer. It is a far cry from the mood a year ago when he was hailed as “a superhero” or “Flash Gordon”.

Tom Fletcher, Mr Brown's private secretary, recalls Nicolas Sarkozy, French president, telling the prime minister at the height of the crisis: “You know, Gordon, I should not like you. You are Scottish, we have nothing in common and you are an economist. But somehow, Gordon, I love you.” He hastily added: “But not in a sexual way.”

Mr Brown's plan did not just put a £50bn ($79bn, €53bn) capital wall around all the UK's banks; it issued £250bn of credit guarantees to underpin bank lending and increased to £200bn a special liquidity scheme. “We had to solve all the problems in all the banks,” says Shriti Vadera, a key adviser through the storm.

Looking back, British officials say it now seems obvious that a single one-off rescue was needed. But it was not obvious at the time, not least because the US appeared set on a different course. “For a while we were out on a limb,” Mr Brown has said.

Baroness Vadera, a former investment banker whose direct manner scares many Whitehall officials, admits that although she was certain the British plan was logical and the best option, she was scared: “I was so, so frightened.”

A year on, the Financial Times has spoken to some of the main policymakers involved to assemble the story of a pivotal month when Mr Brown and his team arrived at the decision to bail out the banks and sold the plan to the rest of the world. This is how it unfolded and what the lessons were that were learnt along the way.

September 15 2008

The collapse of Lehman Brothers in the US brings the financial crisis to a head but Mr Brown and Alistair Darling, chancellor of the exchequer, had been trying to map out a route through the banking crisis since Northern Rock, one of the country's biggest mortgage lenders, collapsed a year earlier.

It is five months since Mr Brown convened Britain's bankers for breakfast in Downing Street. “There was a mood of desperation but they kept focusing on liquidity. Gordon kept asking them: ‘What about your losses? What about capital?’” says one official present.

Mr Brown has been fixating on the danger that weak banks and a lack of demand could pose to the global economy: the risk that the mistakes made in Japan in the 1990s “lost decade” could be magnified.

Lady Vadera spends two nights at Mr Brown's holiday retreat in the Suffolk seaside town of Southwold at the end of July, where the prime minister relaxes in typical style, talking about the banking crisis and fiscal stimulus packages. They conclude that while some banks have successfully raised capital through rights issues, market tolerance for such offerings had reached its limit. Could Chinese or Gulf sovereign wealth funds step in?

September 17 2008

Two days after the collapse of Lehman, Mr Brown puts aside competition concerns and waves through the rescue takeover by Lloyds of HBOS, a bank crippled by bad commercial property loans and whose rights issue failed two months earlier. Officials who looked through the ailing bank's tattered books say: “You could see at that point it was clearly about capital.”

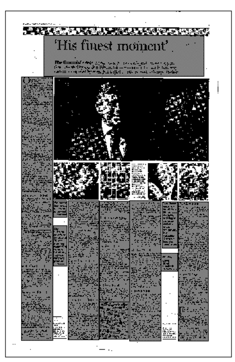
September 19 2008

British officials are “thrown” when Hank Paulson announces the $700bn “troubled asset relief programme”, centred on the purchase or insurance of the banks' toxic assets.

Although the plan is welcomed in London as ambitious, there are concerns that it only indirectly addresses losses and overleveraging. Will there be time for officials to value toxic assets, allowing the scheme to work? US officials later argue that Tarp always allowed for some of the fund to be used for recapitalisation, but that was not the original intention. A Senate committee is told by Mr Paulson that “the right way to do this is not going around injecting capital”.

September 24 2008

Having just headed off the first of two abortive coups against his leadership, Mr Brown flies out of a fraught Labour party conference to New York. Operating out of his suite at the Waldorf hotel, he takes soundings from economists and world leaders in town for the United Nations general assembly. It is here that Mr Brown hatches plans for a summit of the Group of 20 industrial and developing nations to be held in London the following April. Two days later he proposes to President George W. Bush that there should be an initial G20 meeting in Washington. The Americans see themselves as having driven the G20 process, often in the face of European resistance. British officials insist it is Mr Brown who helps to persuade Mr Bush – after enlisting support from Luiz Inácio Lula da Silva, Brazil's president, as well as prime ministers José Luis Rodríguez Zapatero of Spain



and Kevin Rudd of Australia – that such a global gathering would be useful in restoring confidence.

"Kevin Rudd pointed out that Gordon – as the next president of the G20 in 2009 – would be able to host a "save the world summit"," recalls one official at the meeting. "I think Gordon had already worked that out."

September 25 2008

While Wall Street investors are telling Mr Brown that a lack of capital was a problem with the banks, both he and Mr Darling are receiving different signals from the Bush administration. The suspicion grows in London that an ideological distrust of state intervention is holding the US back.

"Gordon said we've got to ask the US government, because if we go out on our own, how does it solve it?" recalls one official on the trip. "If we just had the UK banks doing this, potentially with the UK government providing the money, it somehow made it look like a UK-only problem, or it could be the market would discriminate against us in some way."

September 26 2008

Mr Brown makes an unscheduled trip to Washington for talks with Mr Bush at short notice. With his customary lack of small talk, the British leader goes straight to the point: the banks need more capital.

The US president explains that an exhausted Mr Paulson is doing all he could to get the Tarp plan as originally conceived through Congress. According to British officials, a state injection of capital into the American banks is not at the forefront of his mind. A dispirited Mr Brown sets off for home. He convenes his advisers at the front of the aircraft to discuss the intelligence they gathered from the US visit. His officials say it is at this moment he decides Britain will go it alone and recapitalise its banks.

"You can imagine how lonely tha felt," says one official on the flight "Hank Paulson, the former head o Goldman Sachs, had apparentl rejected that course of action and her we were, preparing to do it on ou own."

September 27 2008

Mr Darling and Treasury officials accelerate work on a comprehensive rescue strategy, including more liquidity, credit guarantees and – crucially – recapitalisation, although the plan is far from fully formed. Recapitalisation is considered a necessary precursor to any toxic asset insurance scheme, which the UK goes on tc announce in 2009. It has the addec advantage over the US scheme in that it is potentially cheaper.

October 2 2008

Lady Vadera invites Michael Klein, former Citigroup executive and a UK government adviser, to fly to London from New York at a few hours' notice for private talks. She then convenes a meeting at Standard Chartered's City of London headquarters – hosted by Peter Sands, chief executive – to do further work on the plan. Robin Budenberg and David Soanes of UBS are there, along with Tom Scholar, a trusted civil servant.

Mr Klein says the most "powerful decision taken in the room" was that the government will make access to liquidity contingent on capital raising. "That became the blueprint for other countries," he says.

October 4 2008

Mr Sarkozy hosts talks in Paris with three other leaders – Mr Brown, Angela Merkel, German chancellor, and Silvio Berlusconi, Italy's prime minister. The meeting is a disaster.

French officials describe Mr Brown as "very tense". Although he gives a "striking presentation" on how European banks are more highly leveraged than in the US and arguing that European Union action is vital, he provides few details of the dire situation facing British banks or what he plans to dc rescue them.

The French blame Mr Brown's reticence and the alleged intransigence of Mrs Merkel in backing an EU rescue package. The problems at Hypo Real Estate, a German mortgage lender, the following week confirm that no country's banking system is to be immune.

One senior aide to Merkel says it is a "fairy tale" to suggest the Hypo Real Estate debacle is what forces her hand, adding: "The lecturing tone coming out of the UK and US was mildly annoying. It suggested the continentals were too stupid to understand what was going on. We knew very well what was going on."

October 7 2008

Mr Brown, Mr Darling and senior British officials hammer out the final details of the plan. The mood among the banks, summoned at 7.30pm, is "professional", according to one observer. Another calls it "grumpy".

"The banks were resisting the numbers," says one official in the talks. "It was the early hours and Gordon had gone to bed." The final hours before Britain's decisive bank rescue see Lady Vadera stumbling through the dark corridors of Number 10 trying to find Mr Brown's bedroom.

When she trips over a tricycle belonging to the prime minister's son John, his wife Sarah wakes up. "Go back to bed, John," she says. "It's Shriti," comes the reply.

October 8 2008

The recapitalisation, liquidity and credit guarantee plan is revealed to the markets. French officials say they had one hour's notice. "We had no idea how it was going to play out," admits Lady Vadera. In the event the markets responded favourably. The opposition Conservatives back the plan although they call it "a desperate, last-ditch attempt to prevent catastrophe".

While trying to catch 20 minutes' sleep that afternoon on a sofa in her office, Sir Fred Goodwin, the boss of Royal Bank of Scotland, phones to say his bank needs £5bn-£10bn of capital. He spent the previous days insisting that liquidity was his only problem.

"You're going to be shocked," Sir Fred says as he discloses how much he thinks his stricken bank will need. "I am shocked because I think you're going to need more," Lady Vadera says. In the end the bank takes £20bn from the taxpayer.

October 12 2008

Mr Brown travels to Paris again to explain to Mr Sarkozy the detail of his plan. The president drags him into a meeting of eurozone leaders – normally a sanctum closed to the British – where Mr Brown explains what he has done. As French officials recount, Mr Brown plays two important roles in the week leading up to the summit: he teaches his counterparts about the scale of the problem and he works on Ms Merkel, getting her to sign up to an EU-wide framework.

"There was a real complicity between them," says one British official. "Sarkozy got it that Gordon got it." French officials say that while Mr Brown's experience is respected, he was forced into action because UK banks were in such a mess: "It wasn't a question of leadership or particular imagination – he just had to act." Nevertheless, within 24 hours the big European countries announce capital and state-backed funding guarantees similar to those in place in Britain.

Ms Merkel's team acknowledges Mr Brown's "very important role" in promoting bank capitalisation while others including Germany were placing more focus on issue of guarantees when overnight money markets were going up. "We think the decisions taken in Paris helped avert a disaster," says Ms Merkel's aide.

October 14 2008

Mr Paulson changes Tarp to include bank recapitalisation. US officials insist that such an option was always on the cards and that Mr Paulson decided to switch the focus of his scheme during his protracted battles with Congress as the economic situation deteriorated.

Nevertheless, the prevailing US view is that Mr Brown's contribution in setting out a comprehensive strategy for dealing with the problem proves useful at a time of flux in US policy – even if the prime minister tends to exaggerate his role.

For Mr Brown, Mr Paulson's decision came as a vindication of his gamble. But international finance is Mr Brown's natural habitat. Some of his cabinet ministers even wonder these days whether he is more interested in settling long-term questions of financial reform than the nitty-gritty of winning a general election in less than seven months' time.

For all the global approbation for his decisive action a year ago, domestically there has so far been little dividend. "It was perhaps Gordon's finest moment," says one cabinet minister. "I'm not sure how many votes there are in it, though."

Birth of a world order

The financial crisis helped spawn "a new world order" in the shape of the Group of 20 leading nations, according to Gordon Brown, who chaired the London summit in April. The UK prime minister argues the G20 is a nascent global economic government, since it includes fast-growing powers such as Brazil, China and India alongside big industrial nations from the G8. He has assigned Shriti Vadera, one of his closest aides, to help South Korea prepare for its G20 presidency next year. Some at Westminster speculate that he might like to run the organisation himself should it acquire a permanent secretariat.

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Shriti Vadera

'The lecturing tone from the UK and US was annoying, suggesting we were too stupid to grasp what was going on'
Merkel aide

'You know, Gordon, I should not like you . . . We have nothing in common and you are an economist. But somehow, Gordon, I love you'
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'You're going to be shocked'
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