

To Northern Rock Shareholders

21 August 2009

**UK Shareholders Association**  
Chislehurst Business Centre  
1 Bromley Lane  
Chislehurst  
BR7 6LH  
Phone: 020-8468-1027  
Email: [uksa2@btconnect.com](mailto:uksa2@btconnect.com)  
Web: [www.uksa.org.uk](http://www.uksa.org.uk)

## **Northern Rock Shareholders Action Group – Update No. 61**

### **Appeal Decision**

The feedback we got from supporters to our last newsletter expressed overwhelming backing for us to support a further appeal on the judicial review decision. More information will follow on this at a later date.

### **Interim Results**

Northern Rock recently published some financial results for the half year ending June 2009. The “underlying loss” improved compared with the comparable period in 2008. Net interest income improved and operating costs were reduced, although loan impairments were high. Non performing loans rose slightly to 3.9% but you must bear in mind that the Government allowed Lloyds Bank to cherry pick the best of the loans, leaving Northern Rock with those that were likely to default.

Borrowings from the Government, which had been reduced to £8.9 billion, rose to £10.9 billion but this is primarily because of the decision to resume new lending and a cessation of the active redemption programme. Indeed new lending was behind plan due to constraints on its capital position and regulatory issues.

### **Capital Restructuring**

It is now clear that the proposed restructuring of Northern Rock involves splitting the bank into two – a “good bank” and a “bad bank” with the latter containing the poor quality loans. The latter company would then be put into “run off”, ie. wound down over a number of years. The former would be attractive enough to be sold off at a good price. By doing this split, the regulatory capital requirements are minimised.

The Building Societies Association promptly condemned the proposal in a submission to the European Commission (who will have to approve any such restructuring plan). They claimed it would give Northern Rock an unfair advantage in the marketplace.

### **Subordinated Debt**

The “bad bank” would also likely take on the subordinated debt of Northern Rock – this is held by both institutions and retail investors (the former PIBS in the latter case). As a prelude to this restructuring, and possibly to encourage the debt holders to support it, the company has announced it is suspending interest payments on this debt. The company has the right to suspend payments on this debt due to the prospectus terms but had not previously done so.

Now the retail investors are in the same position as the holders of similar debt in Bradford & Bingley (see [www.uksa.org.uk/B&B\\_Subordinated\\_Bonds.htm](http://www.uksa.org.uk/B&B_Subordinated_Bonds.htm)). Effectively the Government has defaulted and the bondholders (who often bought the PIBS to provide retirement income) have lost all their income and seen their capital almost wiped out - the debt is still publicly traded but the price has collapsed as a result.

The Government seems to be treating all subordinated debt holders as suitable candidates to suffer in their financial re-engineering of these companies. Look also at the failure of the FSA to protect the interests of West Bromwich Building Society PIBS holders which is covered on our web site at: [www.uksa.org.uk/WestBromwichBS.htm](http://www.uksa.org.uk/WestBromwichBS.htm). The Government seems keen to protect the interest of the depositors in banks and building societies, but if you bought your "bonds" from a stockbroker (which was the main channel for PIBS sales) then you are seen as a second class citizen apparently. There seems to be some peculiar class distinction here between small investors who buy their fixed rate bonds from their local Building Society branch and investors who might have some shares. Of course Northern Rock shareholders will know only too well how depositors, employees and other "stakeholders" in Northern Rock were protected but their interests have been simply ignored.

## **Book Review**

There have been a plethora of books on the banking crisis and the events at Northern Rock which were the first indication of major problems in this sector in the UK. Often these tomes were rushed out and contained a superficial analysis, or even "populist" approach to the subject. As a result the underlying research was frequently inadequate and the conclusions erroneous. Now we have a publication which is more thoughtful and more comprehensive in a book by Bill Brown ("The Decline and Fall of Banking" by Bill Penman-Brown).

Mr Brown had a lifetime career in international banking, working for several major firms, and subsequently became Financial Services Commissioner for Gibraltar responsible for regulating financial services and investment firms. So he has seen banking from both sides of the fence.

His book entitled "The Decline and Fall of Banking" stretches to 500 pages and is a comprehensive analysis of the banking scene from a UK perspective over the last couple of years. If you don't understand the causes of the crisis, then this is an invaluable work as it covers the sub-prime crisis that arose in the USA, the growth of securitisation and covered bonds, the rise and fall of monoline insurers, the impact of credit rating agencies and the other factors that combined to create the crisis.

An extensive analysis of the events at Northern Rock is provided and a more comprehensive and accurate history of that saga would be difficult to find. The role of the Government and the regulatory authorities in failing to prevent the crisis, and their subsequent attempts at resolution is critically examined. Likewise the quality and negative impact of the media coverage (which gets off lightly in some commentaries) is well explained.

Incidentally the book contains a number of references to the activities of the UK Shareholders Association (UKSA), such as this comment when discussing the low priority attached to the interests of shareholders by the company and the Government: "In fact, but for UKSA, Northern Rock shareholders might have been non-existent".

The latter part of the book covers how the liquidity crisis expanded to impact banks worldwide and almost caused the collapse of the world financial system. The author's commentary on events and his solutions to avoid repetitions in the future are well worth reading.

In summary, an invaluable work that any investor who wishes to understand the banking sector and what went wrong should peruse.

The book is available at the list price of £34.95 from any good book store or direct from the publisher (Troubadour – see [www.troubador.co.uk/shop.asp](http://www.troubador.co.uk/shop.asp) ) but you can buy it direct from the author at a specially discounted price of only £26.95 (including post and packing) arranged by UKSA. Please send orders to Bill Brown at 79 Whitehouse Road, Edinburgh EH4 6PB (contact details in case of queries: [bilbro@talktalk.net](mailto:bilbro@talktalk.net) , telephone 0131 336 3131). Cheques should be made payable to W.P. Brown and please send a cheque with your order.

Roger Lawson  
Chairman, Northern Rock Shareholders Action Group  
Email: [uksa@uksa.org.uk](mailto:uksa@uksa.org.uk)  
Web: [www.uksa.org.uk](http://www.uksa.org.uk)  
Direct telephone: 020-8467-2686

*Note that all previous "Update" notes on Northern Rock that we have issued are present on the following web site page: [www.uksa.org.uk/NorthernRock.htm](http://www.uksa.org.uk/NorthernRock.htm)*