

Update on the PSB holders' situation – July 2009

A brief history of B&B PIBS/PSB

PIBS were issued approximately 30 years ago by building societies to increase their capital. At the time interest rates were between 10% and 15% in the UK and the rates paid on PIBS reflected this, B&B paid 11 5/8% and 13%. As interest rates reduced in the UK the price of these bonds rose and the running yield paid by them reduced to around 6.5% in the late 1990's. It is important to clarify this point as Ian Pearson, (Parliamentary Under-Secretary (Economic and Business), Department for Business, Enterprise & Regulatory Reform), has suggested that bondholders should have been aware of the high level of risk as they were receiving a high level of interest. They were not receiving a high level of interest.

In building societies which became banks PIBS became permanent subordinated bonds (PSB). All PIBS and PSB have reliably paid the interest due on them since their launch and none have been suspended or become worthless. This reliability made them attractive and acceptable to retired savers and those seeking a reliable long term income.

Savers relied upon the reputation of British banks and building societies for safety when investing in these bonds and were not made aware of the structure and ranking of tier1, tier2 upper/lower debt versus covered bonds and shares (where they existed) in the extremely unlikely event of winding up of the business.

The Labour Government and in particular, Gordon Brown, bear some responsibility for the failure of the FSA to control the excessive lending and availability of easy credit through the banking system. The FSA is Brown's creature and Brown was responsible for giving the FSA responsibility for bank governance after he removed this responsibility from the Bank of England. He then insisted upon his now infamous "light touch control" which in the event meant no control over the ambitious lending practices of the bank and building society boards.

The Financial Services Authority must bear an element of the blame for the lack of public advice and information available to savers who bought these bonds, particularly as the FSA was one of the parties to the decision to break up B&B thereby threatening the loss of bondholders capital and later defining the B&B business plan which allowed the bank to cease interest payments on these bonds.

The third party bearing responsibility for the significant change to level of risk contained in these bonds is the board of directors of B&B. After B&B changed status to become a bank the board decided upon an aggressive growth strategy which involved massive lending to the developing "buy to let" market and lending to borrowers who "self certified" themselves as suitable for the loan amount, instead of applying the traditional loan assessment parameters to these applications. As B&B could not fund these loans through the normal branch deposit channels the board authorised large scale borrowing on the financial markets. To grow the bank ever faster the board also purchased securitised loans from an American company, GMAC, a subprime mortgage processor active in the UK mortgage market. These activities significantly changed the degree of risk contained in the PSB of B&B but the bank did not provide any notice to bondholders of the changed level of risk inherent in their new business activities. Significant bonuses were paid to the directors based upon the growth of the B&B business.

Description of the ranking of debt in B&B

- 1 Depositors - Now the Government (Treasury and FSCS loans)
- 2 Tier 2 lower - large institutions
- 3 Tier 2 upper - large institutions
- 4 Tier 1 - PSB (retail investors)
- 5 Shareholders- The Treasury

There are 1600 bondholders with a total of £105 million invested in the PSB Tier 1 capital and they rank last for payment in winding up but ahead of the shareholders.

The Government has cancelled the shareholders shares and seized the shareholder capital. Peter Clokey of PricewaterhouseCoopers has been appointed as valuer of B&B at the point of nationalisation and will report the value attributable to shareholders as compensation, after he completes his investigation according to the parameters set by the **Government alone**. The UKSA is reviewing these parameters and will seek access to all the data used by the valuer in his assessment in order to determine whether the valuation is fair.

The potential outcome in the future

Clearly the repayment of PSB holders' capital depends upon the amount of money recovered from the B&B mortgages and loans when they are repaid and this will vary with the passage of time and the recovery of the housing market. This process will be measured in years not months.

Although much of the foregoing may appear rather negative several positive factors also affect the standing of PSB holders.

- 1 B&B is in "profitable run off". The business was profitable at the time of nationalisation but was unable to continue funding its mortgage book due the freeze in the money markets which occurred in late 2008. One view would suggest a profitable run off of the business until all creditors are repaid, including PSB holders. This would take many years and the Government is unlikely to wait until the last mortgage is redeemed to rid itself of its investment in B&B. It is probable that the Government will seek to sell sections of the mortgage book to other institutions during the run off once the UK economic situation improves. The important point here is clearly the value achieved by the Government for the mortgage book and the UKSA will be monitoring this situation closely when it occurs.
- 2 The interest which would normally be paid to the depositors, who have now been replaced by the Government (Treasury and FSCS), is being paid by means of a levy upon the UK financial sector each year and is not being charged to B&B. This improves the financial position of B&B considerably and allows it to retain cash.
- 3 The terms of the PSB deeds, which are reflected in the debt ranking, provide for PSB holders to be repaid in full before B&B's shareholder (the Government - Treasury) receives payment arising from the run off. The last set of accounts showed approximately £1 billion of shareholder capital still contained within the bank and provided that this is not consumed in the run off, PSB holders would receive full repayment at par value of £1 per bond. NOTE: Many investors will have paid more than £1 per bond for their PSB and so will incur a loss upon repayment.

PSB interest payments

These have been stopped (all interest payments to both Tier 1 and Tier 2 debt have been stopped) upon the direction of the Board of B&B which is acting in accordance with the terms of the business plan defined by the Government. The interest unpaid will continue to accumulate and may be paid in the future.

Lawyers for the UKSA have written to the B&B Board putting a series of questions to the Chief Executive, Francis Pym, in order to obtain an explanation for the cessation of interest payments. Belatedly, a reply was received from P G Jordan, Group Solicitor, but this made no attempt to answer the series of specific questions which had been posed, it simply referred the UKSA to the business plan for B&B. The Chief executive and board have failed to explain the reasoning behind the cessation of interest payments or to state when and how interest payments might be resumed.

In this context, it must be remembered that 6 months ago the board agreed to pay a bonus of £2 million to staff and made charitable contributions. It is effectively, now saying that it cannot pay its creditors. This is not only bad management but may be mismanagement which is actionable.

The reality of this situation is that the Government wishes to prioritise the repayment of its loan over the normal conduct of the business and this may provide a more meaningful explanation for the cessation of interest payments. The UKSA will continue to press Francis Pym for a full and better explanation of his actions.

The continued failure of both the Government and the Board of B&B to provide answers to very reasonable and clearly stated questions put to them has generated suspicion of worst kind. Unequivocal, straight forward answers to simple questions would do much to inform the understanding of bondholders about what the Government is trying to achieve.

Important

Access the website address below and register yourself with the valuer. To do this you will need your bond certificate number.

<http://www.bandbvaluer.org.uk/>

You can submit questions to the valuer through this website. You may wish to submit a question seeking confirmation from the valuer that he will obey the ranking for settlement and that bondholders will be settled in order before shareholders?

The human aspect of the PSB holders' situation

Who pays for the mistakes?

Viewed objectively, the ambition of the B&B board, the ambition of those people who wished to speculate in property together with the connivance of the Labour Government in allowing B&B to provide excessive credit while ignoring the traditional conservative lending criteria (loans of up to 130% of value were allowed) has led to the situation that caused the nationalisation of B&B.

The people, whose life savings are invested in the PSB of B&B, are now being forced, by the Labour Government, to pay for the incompetence and excesses of others even though they had no part in creating the problem. **These people did nothing wrong.** They lent their savings to B&B in return for modest interest (6.5%) and should not lose either their capital or their interest.

Paying for the cost of rebuilding the banks

The Government is often heard to bleat in its defence that it must act to save taxpayers money but the PSB holders are also taxpayers.

For the next 20 years or more all UK taxpayers will pay for the indulgence in excess credit that led to bank and building society failures. Each person will pay according to their ability through the tax system. What would be quiet wrong and unacceptable, would be for the cost to be spread unfairly between all UK taxpayers so that some paid much more than others and more than they could reasonably be expected to pay.

If the B&B PSB holders lose their capital and/or interest then that is exactly what will happen. The PSB holders will pay their share of the cost of rebuilding the banks and building societies through the tax system but will also pay by losing their capital and/or interest as well, meaning they will pay a great deal more than other comparable UK taxpayers. This is simply wrong.

When you also account for the fact that many of these people are older, pensioners, widows and people who are long term sick, it is totally unacceptable that they should be treated in this manner by the Labour Government. A society which treats its vulnerable members in this manner can have no moral standing and cannot claim to call itself "civilised".

A simple, cost free solution

On behalf of the PSB holders, I have sent a report to Chancellor Darling, which describes a simple solution to this situation. This solution would return the PSB holders to their original situation but invested in a different and functioning bank. **The solution has no cost to the taxpayer.** This report was placed on the Chancellor's desk in front of him, by John Thurso MP on the 25th May 2009. To date, neither John Thurso nor myself, have received the courtesy of an acknowledgement from Chancellor Darling. We will continue to press the matter aided by several other MPs.

To date the B&B bondholders action group of the UKSA has been successful in having articles printed in the Sunday Telegraph, The Times and The Daily Mail describing this appalling situation. The media campaign will now step up its pressure on the Government with the appointment of a Professional PR company to plan and execute our future PR campaign under the UKSA banner.

N.Williamson, July 2009 UKSA, www.uksa.org.uk