

To Bradford & Bingley Shareholders

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Bradford & Bingley Action Group – Update No. 1

Introduction

This is the first newsletter that we are issuing to everyone who has contacted us about the nationalisation of Bradford & Bingley. Several hundred shareholders have already been in touch, with many complaining about the actions of the Government and asking us to set up a “shareholder action group” with the objective of pursuing some redress (as we have done for example for Northern Rock shareholders which is similar in some ways).

Many shareholders feel particularly disgruntled because they subscribed to the rights issue only a few weeks ago, which was promoted to them as putting the company on a sound financial footing for many months.

This note is intended to explain what has happened and why – at least so far as we know. It also attempts to give a brief summary of possible claims that shareholders may have and how they might be pursued, but without trying to give you specific legal advice.

The key questions which shareholders need answers to are:

1. The exact reason for the nationalisation of the company and the necessity to confiscate the property of the ordinary shareholders (as the owners of the business).
2. Whether the rights issues should have been permitted to proceed and whether shareholders were wrongly induced to subscribe to it, when it seems that this fund raising was insufficient to stabilize the company so that only a few weeks later the Government found it necessary to intervene.
3. Whether the comments concerning the strength of the company, only a few days before nationalisation took place, from the directors and from the investors relations department were misleading.
4. The question of what compensation, if any, shareholders will get from the Government and on what basis that will be determined.

These four questions are covered in detail below. Note that all shareholders should note that you effectively no longer own shares in the company, and the temporary suspension of the company's shares is effectively permanent. Those shares are unlikely to be returned to you in the future and the company is in reality being wound-up.

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Why Was the Company Nationalised?

The announcement by the UK Treasury on the 29th September stated "*The FSA determined on Saturday morning that the firm no longer met its threshold conditions for operating as a deposit taker under the Financial Services and Markets Act 2000 and FSA rules*", but no more details were given. See the full announcement which can be obtained from: www.hm-treasury.gov.uk/newsroom_and_speeches/press/2008/bradford_bingley_transfer.cfm

The "Transfer Order" also states "*It appears to the Treasury to be desirable to make this Order for the following purpose: maintaining the stability of the UK financial system in circumstances where the Treasury consider that there would be a serious threat to its stability if the Order were not made.*"

So what exactly were the nature of these threats to the financial system and specifically the breaches of compliance with deposit taking regulations? Was the company insolvent or about to run out of cash? Shareholders will certainly not have expected either to apply bearing in mind the large amount of cash raised by the rights issue. Although the share price had collapsed in the few days (it closed at 20p on the Friday before nationalisation when it had been as high as £3 in the past year), which clearly indicated some lack of confidence that the company could continue, share price volatility does not by itself affect the operations of a company.

But the Financial Times reported that tens of millions of pounds had been withdrawn by depositors via their internet site on Friday and Saturday. Queuing problems were also reported in some branches on the Saturday. One of our shareholder contacts reports having spoken to Katherine Conway of Investor Relations, and she apparently said that the company approached the Government on Friday for funding but that it was refused.

Clearly the company had been seen as vulnerable to the credit crunch. Like Northern Rock and HBOS, Bradford & Bingley was dependent on the money markets (lending from other banks and institutions) to finance its mortgage bank to a much greater extent than other banks. If money markets closed for any significant time, then it would be unable to roll-over previous loans as they became due. With money markets totally frozen, B&B's credit rating had been reduced and this was hampering the prospect of fund raising even more. One can see the impact on the company because on the 25th September it announced it was making redundant branch based mortgage advisors and intermediary sales staff which suggests it was reducing new mortgage lending very substantially.

So it looks like the company was suffering a run of cash with possibly bigger problems looming despite the rights issue fund raising, and the Government refused to provide any temporary liquidity. It then moved rapidly. According to press reports, on the Saturday they initially tried to find a buyer for the whole business but nobody wanted to take on the B&B mortgage book which was seen as risky with lots of "buy-to-let" and "self-certificated" mortgages. With no offers on the table, on Sunday a decision was made to arrange a disposal of the deposit taking business to Santander (Abbey) with a view to an orderly wind-up of the mortgage loan book over the next few years.

In essence it seems the Government might have wanted to avoid accusations of "dithering" as happened with Northern Rock (an unreasonable complaint in reality), and the necessity to provide Bank of England funding to keep it afloat. Of course they have had to provide £18bn in loans to cover the transfer of deposits to Santander and taken the whole liability for the mortgage book on their hands, but they apparently saw this as preferential to having a repeat of the Northern Rock saga.

Cleverly they have managed to invoke the Financial Services Compensation Scheme to ensure that some of the costs fall onto other banks and building societies.

The Rights Issue

The rights issue in July raised £400 million. It was proposed because *"The Directors believe strengthening the Group's capital base is the correct course of action to take during a time of continued financial market dislocation"* and that *"the Group will be better able to develop the business to exploit the opportunities available in its markets in the medium term"* – to quote from the prospectus. There are of course lots of "health warnings" in this document, but those kind of comments hardly suggest that the company was rapidly running out of cash or was close to no longer being a "going concern" so they could be seen as misleading in themselves, even though presumably they had the support of the FSA in launching this rights issue.

Those shareholders who subscribed for the rights issue certainly seem to think they were sold a pup. Unfortunately many of these investors took the words of the directors at face value without possibly studying the position more closely.

One of the key issues here is the quality of the assets underpinning the balance sheet. It may well be that the company, its directors and the FSA had more confidence in those assets than other people, particularly the Government.

Were these and other Comments Misleading?

The rights issue was clearly intended to fund the company into 2009 - witness the comments from Investor Relations Manager Neil Vanham to another investor in July: *"With regard to your comments on 'speculation that the company may be wound up', this is simply sensationalist press comment. B&B continues to be well funded into 2009 and has a fully underwritten rights issue in place that has the full support of our major shareholders."* As it turned out, many shareholders chose not to take up their rights and the underwriters were left with most of the shares.

On the Thursday before nationalisation, Chief Executive Richard Pym even said the bank was "strongly capitalised". But being solvent does not help if you run out of cash due to a run of depositors for the exit. As Peter Montagnon of the Association of British Insurers said, the Bank of England should have been *"more proactive in providing emergency liquidity funding for solvent institutions"* – this was of course the same problem which brought down Northern Rock where the Bank of England hesitated and the eventual support was leaked in a melodramatic way causing the stampede of depositors. Mr Montagnon also said as reported in the Times newspaper, that *"This is a bank with one of the highest capital ratios, if not the highest. It is a matter of serious concern that it has moved to terminal care within a matter of days"*, which is a nice concise description of the sequence of events.

Will Shareholders Be Compensated by the Government?

The Government has stated that a "Compensation Order" will be put in place to compensate shareholders in due course. But they have provided no more details on the basis of the compensation. Shareholders should be aware that this is the same process as took place with Northern Rock but the Government placed totally artificial terms of reference on the valuation process to be used by an independent valuer. Those terms were clearly designed to ensure that the Government paid little or nothing, and that is why Northern Rock shareholders have launched a legal action (a "Judicial Review") to try and obtain a fairer process.

In the case of Northern Rock, one of the Government's key arguments for not paying compensation was because the company clearly could not continue without support from the Government and the Bank of England. They presumably won't be able to use that argument in this case as no support was provided to Bradford & Bingley so far as we know but perhaps they can think up other arguments to minimise the compensation they will pay. In essence, under Human Rights legislation and previous UK legal precedent, the Government should compensate someone for confiscation of their property. Nationalisation and the compensation paid should be fair and proportional.

One issue that might be looked at here was whether nationalisation of Bradford & Bingley was a proportional act. Was it necessary to take such extreme measures or were there less drastic measures available that would have preserved the financial stability of the UK economy while preserving the company and the rights of shareholders? It would not be difficult to argue that there were.

Why for instance did the Bank of England not provide funding using the "Lender of Last Resort" facilities which are usually available to solvent institutions? Or bearing in mind the Governor's known concern about the "moral hazard" of encouraging questionable lending and business practices, did he decide that this was one company that should be treated as an example to others and effectively destroyed (because make no mistake, this is what is happening). It's worth pointing out that the Bank of England has just lent another £40bn to banks on the excuse of needing to inject liquidity into the system so why could not some of this have been made available to Bradford & Bingley? Perhaps the Government did indeed determine that the quality of the assets at B&B made it not worth saving.

Other Questions

Note that the intention is clearly to wind up the mortgage book which may of course take many years. It has been suggested that shareholders may simply be offered the residual value that remains after that process is completed, but it seems somewhat impractical to ask them to wait the 25 years that might take.

The "shareholder's equity", i.e. the surplus of assets over liabilities at the date of nationalisation, according to the last set of accounts was about £1.5bn – that is equivalent to about 100p per share. That should be what remains after the "run off" of the company. Is this a realistic figure though or did the Government judge that the assets were not fairly valued in the accounts? We may not know until time has passed to see how many mortgages go into default. But the implied value assumes that the wind-up process is handled properly and there is no rush to dispose of assets at less than fair value. Can one trust the Government to act in the best interest of the shareholders, or will they be keen to get shot of the problem as soon as possible?

Obviously any "fire sale" type process tends not to be in the interest of the shareholders (or the "residual owners of the assets" as they might be called in this case). And one immediate issue is whether the sale of the branch network to Santander was done at a good price. By rushing through this process in a matter of days, if not hours, it seems unlikely that the Government maximised the price.

The Government, who now have total control of course, can charge Bradford & Bingley with all manner of costs over which former shareholders have no control, and may choose to write down the value of assets on a whim.

In addition there is the question of the arrangement with GMAC to take on substantial amounts of “sub-prime” loans. Although this arrangement was recently renegotiated to reduce Bradford & Bingley’s forward commitments, can the Government extricate itself from this deal without significant penalties?

Actions Going Forward and How You Can Help

Clearly there are several possible grounds for action by shareholders, and taking legal advice on some of these issues is certainly worth doing. If nothing else it would make sense for us to co-ordinate any representation concerning the Compensation Order and make representations concerning any subsequent independent valuation that might take place. The UK Shareholders Association has some experience of these matters but the task on Bradford & Bingley is a larger one even than Northern Rock (which had less than 150,000 individual shareholders whereas B&B has about 900,000 – simply communicating with that many people is a major task).

As a first step we suggest that anyone who would like to join the steering committee that has been formed to progress this matter should contact me as soon as possible. Do not volunteer for this unless you are willing to put in some effort and a reasonable amount of your time! If you are keen to help please contact me via email, with some brief details of your location, relevant skills, and including a telephone number.

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Note that all previous information issued by UKSA in respect of Bradford & Bingley is present on the following web site page: www.uksa.org.uk/BradfordBingley.htm