

UK Shareholders Association Northern Rock Sub- Committee

June 2017

APPENDIX 2

EXTRACTS OF RELEVANT STATEMENTS AND MINUTES FROM THE BANK OF ENGLAND MEETINGS, TREASURY SELECT COMMITTEE AND THE FSA

1. From the B of E Minutes 12 September 2007:

“The FSA characterised Northern Rock as a fast growing mortgage bank. It exceeded its capital requirements, it had a loan to value ratio of 60% (or 59%) and was responsible for 7.5% of the residential market. There was no sub-prime exposure and it had a good quality loan book”.

(How can those official observations be squared with oft-repeated media comment on the poor standard of its lending policies?).”

From the B of E Minutes 13 September 2007:

2. *“A central bank has a reasonable margin of appreciation when it is giving, as the Bank is proposing to do, emergency liquidity assistance to a bank it believes to be solvent.”*

“A package of papers showing the relevant correspondence between Northern Rock and the Bank, the Bank and the Chancellor, the terms of the proposed facility, the impact on the Bank's balance sheet and the Tripartite statement that would be made, was circulated.”

Note: but never made public.

3. *“Members were told that the facility would be made at a penalty rate of 150 basis points over Bank rate. The important point to note was that this was above the one percentage point that is imposed on the Bank's standing facilities in normal money market operations. The risk “to the taxpayer” would be minimised by ensuring that the facility was made against collateral at an appropriate margin”.*

From B of E Minutes, 17th September 2007

“Court was told that the FSA were clear that Northern Rock's problems were liquidity related there was not a solvency issue. The FSA believed that with the assistance that was being proposed the institution would remain solvent. Without that assistance the FSA would be requiring that Northern Rock closes to new deposits.”

Note: NR was deemed by the FSA, the regulator responsible for banks, to be capable of continuing to operate without LOLR assistance, but would not be able to accept new deposits. That is in fact the manner in which NRAM continued to operate later. Note the date of the meeting, it took place before the emergency liquidity support loan had actually been granted.

Note: How can the above statements be reconciled with those terms included in the Compensation Scheme Order that implied that NR was “effectively” insolvent?

4. *“Security had been taken for the first facility, this was against dedicated collateral at a margin, and the second facility was set against a charge against all remaining assets of the company”.*

NOTE: At that time mortgages and other assets were noted at over £100 Bn.

5. *“It was recognized that the Northern Rock board should not have to organize their business to repay £40bn on 10th February (2008) whatever the circumstances, but equally the Bank and HMT would need to retain the right to require repayment depending on the circumstances. The way this issue would be expressed was still under discussion.”*

NOTE: The £40Bn mentioned in the B of E Minutes was the Maximum amount that the B of E thought that it might be necessary to provide. In fact the final figure of loans was £28.9Bn. Guarantees are not included because a

separate (insurance style) fee was paid for them, at a commercial rate, and they were never called upon.

6. *"It was confirmed that there was no maximum size to the facility other than that governed by the extent to which collateral is offered, netted by the margins described in the papers that were available to Court. The margins that are proposed on the different classes of collateral were based on a 99% confidence interval for assessing the risk of loss to the Bank, which is the approach adopted on all Bank of England money market operations and the same as that used by the ECB."*

"Court recognised that the terms meant that if Northern Rock defaulted on the loan facility, the Bank would be exposed to the performance of the underlying mortgages, but the margins meant that house prices would have to fall considerably for the Bank to realise a loss".

(NOTE: That did not happen).

Extracts from Minutes of a B of E Meeting held on 10th October 2007:

7. ***"In the absence of a special resolution regime for banks the consequences meant the authorities were in something of a game with other players, including the shareholders."***

8. *"The authorities needed to create leverage over the shareholders in order to achieve a resolution in the absence of the special regime. Nationalisation was an option to deal with shareholders and some pressure had been applied ahead of Northern Rock's emergency general meeting on 15 January 2008 with the announcement that Ron Sandler would act as Chair of a nationalised entity. The principal lever was through the financing."*

9. *"It was pointed out that while it was true that nationalisation did not itself solve the company's problems, it did open up another option. It would enable a fresh bidding process **without the shareholders** and with the Goldman Sachs financing option on the table."*

(NOTE: The option was a plan to issue bonds").

10. *"In discussion, it was noted that nationalisation only dealt with the legal position of Northern Rock's shareholders, nothing more. The Bank and the FSA were concerned that the Government's view was that the board of the nationalised entity would determine the company's strategy after nationalisation".*

Note: The Chairman and composition of the Board of NR at that time were appointees of H M Treasury, therefore its Members could be expected to follow Government decreed strategies.

From B of E Minutes:

11. *"Members of Court were told that both the Bank and the FSA were in total agreement that if Northern Rock was allowed to fail it would create serious economic damage"*

"Directors were reminded that the Bank supported the decision to nationalise Northern Rock, but on the basis that the balance sheet would be contracted sharply under a strategy of not extending new mortgages and not accepting new deposits."

From Treasury Select Committee 5th Report January 2008

12. *"FSA defines liquidity risk as the risk that a firm, although balance-sheet solvent, cannot maintain or generate sufficient cash resources to meet its payment obligations in full as they fall due, or can only do so at materially disadvantageous terms."*

NOTE: "Materially disadvantageous terms" essentially describes, *inter alia*, LOLR loans from a Central Bank at penal interest rates.

From the B of E Minutes:

13. *"Since the Treasury would be bearing the risk, they would also receive the benefit of the premium over Base Rate. HMT would also charge a guarantee fee and the Bank would charge a facility fee of 10 basis points on the unused facility up to a notional ceiling of £40bn".*

"The Chancellor of the Exchequer told us that "liquidity relationship appeared not to have been important to regulators. I am quite clear that regulators need to start looking far more at liquidity and not just solvency. They tend to be more concerned about solvency."

From Treasury Select Committee Conclusions in January 2008

14. *"The current regulatory regime for the liquidity of United Kingdom banks is flawed. That regime did not prevent the problems that arose in relation to Northern Rock in 2007".*

"If the Financial Services Authority was "very unhappy" with the stress testing conducted by Northern Rock, it appears to have failed to convey the strength of its concerns to the Board of Northern Rock, and to secure remedial action. It was the responsibility of the Financial Services Authority to ensure that the work of the Board of Northern Rock was sufficient to the task. The Financial Services Authority failed in its duty to do this".

NOTE: It was stated in a Court case brought by a shareholder that the FSA had no duty towards shareholders. That may well be true, nevertheless the FSA failed in its statutory duty to adequately regulate NR (the Bank) and that failure contributed to the financial losses suffered by the shareholders.

15. Hansard -- 19 Feb 2008 : - Column 166 Banking Bill Debate Excerpts

The following are some relevant parts of the contributions to the debate that dealt with the subject of Nationalisation.

William Cash (Stone) (Con) *"The question before us is very simple.---- The Bill does not have the urgency that the Government seem to claim for it by the means of its introduction, but they are railroading a series of parliamentary conventions. In introducing retrospective legislation, the Government are in fact trying to avoid the prospect of introducing a hybrid Bill by transferring the provisions over to a hybrid instrument—if that is what it turns out to be—while dealing with the matter in a way that will bypass the courts if they can possibly get away with it".*

NOTE: This is an interesting comment at this stage since the subsequent failure of appeals to courts failed because the Compensation Order set artificial conditions which ensured that the Courts had no ability to set them aside.

"It is absolutely and abundantly clear that House procedures and conventions on taxation are being overridden by the way that the Government are proceeding.---- By denying this House and thereby the people affected in the country through the methods that they are employing, all the Government are doing are bringing themselves into total contempt."

Yvette Cooper: *"Let me respond briefly to the points that have been raised, which I have listened to very carefully. ---I hope that hon. Members will recognise that the Bill is being introduced in very unusual circumstances. It will allow us to deal swiftly, by Order, with the position of Northern Rock, and it is right that we are able to do so.---- Northern Rock shares were suspended yesterday morning, and it is a bank that has faced a series of problems with implications for the financial stability of the banking system.--- It is important to resolve those issues as swiftly as possible, so I hope that hon. Members will recognise these unusual circumstances and understand that the House needs to respond to them.--- We need to respond swiftly, now that shares have been withdrawn, in order to be able to put the bank on a proper longer-term footing as rapidly as possible."*

"I hope that hon. Members will take this issue seriously and bear in mind that there is a sunset clause on the main powers in the Bill and that we will have an opportunity to debate at great length in the usual way the proper reforms that will be made to the banking system. We shall do so in the proper way through the revised Bill that will replace these powers. I support the motion."

NOTE: Although M/s Cooper stressed the need for swift action, the Banking Bill and related Compensation Order were only put forward five months after NR first received financial assistance. The debate on the banking system did not take place for another twelve months and did not include a reference to the Northern Rock situation.

16. Hansard - 19 Feby 2008 Excerpts from Col 229 of Banking Bill Debate

“transferring ownership of Northern Rock’s shares does not mean taking on legal responsibility for the full liabilities. The Government are simply becoming the shareholder. Granite remains a separate legal entity. It is not owned by Northern Rock, it is not being taken into public ownership, and it has not been guaranteed by the Government. The exposure for the taxpayer remains unchanged.

*“Northern Rock’s business plan will need to be agreed with the Government. The overarching plan will need to be published and agreed in terms of the strategic aims that we have set for the management. **They include removing all forms of public support for the bank, including Government guarantees, as soon as possible.**”*

NOTE: A Conservative member’s objection to the Government proposals was that they were not satisfied that the nationalised Northern Rock would operate as a company managed “*at arms length*” by its Chairman and Board of Directors. The statement above demonstrates that ultimate control would remain in Government hands.

Yvette Cooper: (commenting on opposition parties’ contributions) --*“I must make progress if I am to deal with all the points that have been made. The logical conclusion of their argument is that there should be no Government guarantees, and the logical consequence of having no Government guarantees, given the current state of the market, in which banks are not lending to each other in normal circumstances, the global credit crunch, and the history of difficulties at Northern Rock, would be for the bank to go under. That is why we do not support that course of action, and that is why Opposition Members are in fact calling for the bank to go under. Taxpayer exposure was mentioned by a number of Members, including the Hon. Member for Twickenham (Dr Vince Cable).”*

“I should make it clear that our action has not been at a cost to the taxpayer. The Bank of England has lent money to Northern Rock that is secured against its assets, and we expect that money to be repaid in full and with interest. We have provided further guarantees that have not been called: the taxpayer has not paid any money.”

NOTE: How can those statements be reconciled with the oft-repeated Government and media assertions that “*there was a great risk to taxpayers*” and the later NRAM “*maximise value for taxpayers*”.

“The director general of the CBI has said that “the Conservatives have been banging on about Northern Rock and what a disaster it is, but they haven’t told us what they would have done.”

17. B of E Minutes, 11 May 2008

“In relation to Northern Rock, it was stressed that communications (between the Tripartite partners) had been very difficult and had not worked. Communications could not overcome the absence of a framework or planning to deal with a depositor run. There had been no agreed strategy and inadequate preparation for stopping a run.”

18. The FSA stated in relation to the financial crisis :

“Northern Rock was only the first to fail among many other financial institutions that relied on access to a continuous stream of short-term liquidity to roll over expiring short-term debts.”

19. The B of E Minutes disclosed, “It was noted that the Northern Rock business model was not unique - it was following a path of a number of other, larger institutions where the strategy had worked successfully.”

NOTE: Northern Rock dealt only in mortgage and associated loans, whereas most banks in the UK, both geographically and by nature, had a much wider range of business that provided the possibility of having greater financial strength. However, the simplicity of the NR business portfolio made it much easier for an alert Regulator to spot overall weaknesses. A criticism of the FSA was that it did not do so. (*The FCA & PRA Report published in November 2015 on the collapse of HBOS emphasised the fact that NR was a relatively simply structured bank, when compared with a bank such as HBOS*).

NOTE also: Later in 2008 it transpired that the strategy had not worked successfully for other banks.

20. National Audit Office Report May 2012

“Given the scale and urgency of the banking crisis, the Treasury lacked sufficient in-house capacity to make the best use of external advice and challenge Northern Rock management effectively.”

21. [The Public Accounts Committee in 2012/13 stated:](#)

“The Treasury did not have sufficient capacity or the skills to understand and respond to the crisis when it began”.

22. [The Public Accounts Committee in 2012/13.](#)

*The Treasury was part of “a monumental collective failure to understand how the pre-crisis boom could lead to a banking crisis. It recognises that it took too long to realise that the crisis was systemic and too long, five months, to determine that a private sector buyer for **the whole bank** could not be found, even with Treasury underwriting. The delay in deciding what to do with the bank made a loss on the intervention difficult to avoid.”*

23. In November 2015 the FCA & PRA Report into the collapse (through insolvency) of HBOS recorded that prior to mid-2008 the executive management of the FSA had little involvement in the direct regulation of banks, including NR.

24. [From The Treasury Select Committee - 2012/13 Report on RBS.](#)

“the FSA’s philosophy and approach to supervision prior to the financial crisis was set within a context which included: a sustained political emphasis on the need for the FSA to be a light-touch regulator in order to retain the international competitiveness of the UK’s financial system.”

For example, at the launch of the Better Regulation Action Plan on 24 May 2005, the Chancellor (Gordon Brown) said in a Treasury press release that: *“---the new model we propose is quite different. In a risk based approach there is no inspection without justification, no form filling without justification, and no information requirements without justification. Not just a light touch but a limited touch”.*

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