14th March 2018

Dear Stephen,

NORTHERN ROCK: A COMPELLING CASE FOR COMPENSATION

Thank you for your response to my letter of 14th September 2017 which was addressed specifically to the Prime Minister. I have copied this reply to the PM for her information.

My colleagues and I have now had an opportunity to consider the contents of your letter and we wish to comment as follows:

The first two paragraphs restate HMT’s known interpretation, however, in paragraph three you state that “former shareholders of Northern Rock should receive compensation for their shares in line with the value that those shares would have had if the government had not stepped in”.

That paragraph does not relate the actual circumstances. The government “did not step in” until August 2008. The initial action to resolve the liquidity problems confronting Northern Rock in 2007 was undertaken by the Bank of England which provided Emergency Assistance loans in accordance with normal Central Bank practice for solvent banks (such as Northern Rock) that had suffered a liquidity problem. Nationalisation in February 2008 was carried out “only to deal with the shareholders”, as we learned when the Bank of England, on the initiative of its new Governor, Mark Carney, published copies of its Minutes of the Court in 2014.

Whilst it was the case that in September 2007 the Government provided a 100% guarantee to depositors, it charged fees for that guarantee, which was never called upon. It has also to be acknowledged that the guarantee was not primarily intended to protect NR depositors, it was necessary to prevent the withdrawal of deposits from extending throughout the UK banking system. Moreover, a guarantee has to be differentiated from an actual loan of money.

In paragraph four you describe how the independent valuer, Andrew Caldwell, was appointed to carry out a valuation that concluded that no compensation was payable. You also state that this was upheld following an appeal to the Upper Tribunal in 2011.

Whilst the facts related in that paragraph may be correct, they do not present a full picture. In particular, the valuer had no option but to reach his conclusion because of the “assumptions” contained in the Northern Rock PLC Compensation Order 2008 that he was obliged to observe. Only if those “assumptions” are taken into account would it have been possible for Northern Rock to be declared “effectively insolvent” and therefore subject to the Insolvency Act 1986, the only statutory law that was available for use in the absence of a Special Resolution Regime as has since been provided for in The Banking Act 2009. This was a serious deficiency noted by the Governor of the Bank of England in evidence to the Treasury Select Committee in 2007 and commented upon by him in a TV interview in 2017.
In 2007/8 it was widely acknowledged in Government circles, by The Bank of England and by the FSA that Northern Rock was not insolvent, as that expression applies to banks, because the Emergency Assistance loans (provided by the BoE acting as the UK Central Bank) - which are only available to SOLVENT banks - resolved its temporary LIQUIDITY problem. A need to observe "the assumptions" at a time when the only money lent to Northern Rock had been the LOLR loans from the Bank of England, that were fully secured, was contrary to the globally accepted concept of Central Bank Emergency Assistance to solvent banks. The Government made no loans to Northern Rock until August 2008 when it caused the remaining balance of the Bank of England loans to be "novated" to HMT.

In your sixth paragraph you state that the government will use any proceeds resulting from the sale of former Northern Rock assets, and any other financial assets acquired during the financial crisis, to recover the significant, but unspecified costs incurred by “the taxpayer”. NRAM (the renamed Northern Rock) was a private sector company governed by its own Board of Directors, a fact of which much was made from time to time in Parliament. It was not a government department and it was officially declared in Hansard that “it operated at arm’s length from HM Treasury”.

The legality of such a use of excess assets to offset the liabilities of other banks is questionable and it is our intention to seek legal clarification. The concept is not accepted as being valid, particularly when one takes into account the SRR provisions in The Banking Act 2009, Part One, particularly the statement that “the government does not intend to benefit from failing banks”.

NRAM (a Company that did not exist in its present form in 2008) should now be treated as a company within Part 1 of the Banking Act 2009, the only Act that now has relevance in all the circumstances.

Even if it may be debatable that the Banking Act 2009 should have an application to NR, it must have an application to the re-named NR, namely NRAM to which certain NR assets were allocated in 2010 at a time when the Banking (Special Provisions) Act 2008 had expired and had been replaced by the Bank Act 2009.

The 2009 Banking Act states that:

a). “The government does not intend to profit from failing banks”, i.e. banks that do not meet the FSA regulations for the right to conduct deposit taking business. (A “failing bank” is not necessarily an insolvent one).

b). The 2009 Banking Act provides that reverse transfers enable property to be moved back from public ownership to the original holders.

Quote: 6.10 those subsequent transfers may become necessary, for example, if “additional details come to light” about the nature of the transferred securities or business after the initial transfer. As with all other forms of transfer, the Treasury must consult with the Bank of England and the FSA before making the order.

“Additional details HAVE come to light” in the case of NRAM in that, whilst in 2007 NR was deemed to be “effectively insolvent”, it could not have been so since NRAM has continuously for ten years been an active and solvent company.

You are also responsible for the administration of the Equitable Life Policy Holders Compensation Scheme and you will be very aware that that Scheme was only put in place by a Conservative Government because it recognised that the Financial Regulatory system had failed to effectively carry out its responsibilities. The same can be said of the Triumvirate regulation of Northern Rock, yet you make no reference to its (in official Government reports) widely acknowledged shortcomings.
Whilst the extreme uncertainties in the financial markets, and public opinion, formulated by adverse media commentary in 2007, may have been justification for assuming a costly outcome of nationalisation, since 2015 it has been known that has not been the case. It was probably not the case from 2010 onwards, but 2015 was the first official acknowledgement that a profit would arise.

Banking Law has changed. What is left of NR, even after disposal of part of the company at a small loss, is solvent and will realize residual assets to produce a profit. It follows that compensation of shareholders should be considered in the light of the positive outcome and not on the negative NR situation as it was perceived in 2007/8.

It is our intention to pursue those matters through other official channels and for your information we enclose a Summary of our assessment of the Northern Rock situation. We also provide you with a Draft copy of our full Report that examines all the circumstances, compiled principally from official sources. We trust that you will give those papers the consideration that they deserve.

Yours faithfully,

Dennis Grainger
Chairman
Northern Rock Small Shareholders Action Group
UKSA
Email dennis.grainger@proteus.nildram.co.uk

Enclosed:
Summary &
Main Report