UK Shareholders Association
BM UKSA
London
WC1N 3XX

Phone: 0870-70-60-600
Email: uksa@uksa.org.uk
Web: www.uksa.org.uk

Rt Hon Alistair Darling MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
LONDON
SW1A 2HQ

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Dear Mr Darling,

It would seem from recent press reports, including reports of meetings between John Kingman and various possible bidders for Northern Rock, that the fate of the company may be in your hands. Could I ask you to consider the following points in that regard:

1. Whether the directors of the company were as prudent as they might have been in the expansion of their operations, and reliance on money market funding is debatable. And it could be argued that they should have anticipated the risk of markets closing to them. But the circumstances that arose were very exceptional and unusual. In addition, the failure of the Bank of England to increase the liquidity in these markets contributed to the problem, when other central banks in other countries did take such steps so as to avoid similar crises. It is in the nature of banks, particularly those concentrating on mortgage markets, to borrow short and lend long, so they rely on reasonable liquidity in financial markets and ultimately on the confidence of investors and depositors. If that confidence is destroyed by outside factors, then the company will face short term difficulties, whatever it does.

2. It is unfortunate though that there seem to be suggestions that the company should be deliberately destroyed so as to discourage such alleged reckless financial strategy in future. But who will be damaged by this? Not the directors who will walk away, but the shareholders, the employees and other people in the North-East of England who rely directly or indirectly on its operations.

3. As the representative of private shareholders, who it now seems are the majority holders of shares in the company, recent events simply suggest to us that many private shareholders were lead into investing in this company in recent weeks by a false market in the shares. While institutional investors mainly sold out, and hedge funds “shorted” the stock aggressively, private investors were buying the shares. Why was this? Because although other people than the company knew it was in severe difficulties (certainly the Bank of England knew several weeks before the rescue was announced) and rumours abounded in the City, the company made no announcement so private investors continued to buy. We feel that such investors have a real grievance.

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4. But why destroy a company and the associated jobs when it appears to be profitable and could soon recover if it was given a reasonable breathing space to enable it to stabilise its financial position? Most of the customers of Northern Rock are pleased with the service the company gives, both to its depositors and mortgagees.

It simply makes no sense to let this company fall into the hands of private equity buyers for peanuts, with the ordinary shareholders being wiped out, when all the company needs is temporary financial support and funding at a commercial interest rate.

The company does not need "bailing out" in the normal sense in that committed funding from the Bank of England is only going to be on a loan basis, and at a commercial interest rate – in fact our sole concern is that the interest rate is higher than might be thought reasonable and will prejudice the recovery of the company.

5. It is very clear to us though that if the company is forced to look for a buyer of the business, or major parts of it, with any specific time scale in mind for such disposals, then this will prejudice the price that is obtainable and will almost certainly lead to the shareholders losing everything. This is exactly what happened recently with another company with which we were involved, Torex Retail, where a "fire sale" resulted in the buyers driving down the price to a ridiculously low level. Although the nature of that company's problems were somewhat different (it arose from alleged fraudulent accounting and there were doubts as a result that the company was profitable at all), the same process will no doubt be followed – this rewards the hedge fund operators who have made millions from the problems of Northern Rock, and enriches the private equity buyers of distressed assets, but does nothing to ensure probity and stability in the financial markets.

6. Of course the directors of Northern Rock may find such an "exit" an attractive proposition because it will enable them to avoid accounting to shareholders in due course and facing re-election. But we think they should face up to their responsibilities to shareholders and answer questions as to why they allowed a false market in the company's shares to develop as a result of a failure to make announcements in the critical period – which in our view was a breach of the Listing Rules.

In conclusion, I would ask you to consider the above and ensure that the Treasury does not force the company to accept offers for the business at any price, regardless of their merits. I suggest that you should encourage the company to develop alternative plans to re-establish itself as a sound business as the best way forward.

We also request a meeting with yourself or with the relevant people at the Treasury so that we can explain our concerns with the current process in more depth.

Yours sincerely

Roger Lawson
Communications Director
Email: roger.lawson@btclick.com
Direct telephone: 020-8467-2686

Supporting information on the position of Northern Rock

On 14 September, the FSA stated that: "The FSA judges that Northern Rock is solvent, exceeds its regulatory capital requirement and has a good quality loan book." According to press reports, the FSA did careful due diligence at Northern Rock's head office before reaching this conclusion. (Indeed, it would be very surprising for the FSA to make such a strong statement without having done careful due diligence.)

Provided the FSA's opinion of Northern Rock's solvency is correct, then there need be no cost to the UK taxpayer arising from the Bank of England's loan to Northern Rock. Indeed the penal rate of interest being charged provides a net benefit to the Bank of England of £80m a year. (Assuming a 1% margin on £8bn of loans.)

Closing Northern Rock to new business would remove one of the most competitive players from the UK mortgage market, and would therefore be likely to lead to higher mortgage rates. This would hurt UK homeowners and those who wish to become homeowners, but of course it would benefit other banks.

Closing Northern Rock would increase unemployment in the North-East and end the good works being done by the Northern Rock Foundation.

Forcing Northern Rock into either administration or a break-up that leaves little or nothing or shareholders, would send a signal to the rest of the UK banking industry that, even if a bank is solvent and exceeds its regulatory capital, that if it ever needs to use the Bank of England's Lender of Last Resort ("LLR") facility, the cost of that facility is that shareholders in the bank will be wiped out.

The nature of banking is to borrow short and to lend long, deliberately incurring a potentially serious liability mismatch. This process is necessary for the smooth working of the economy, but banks have long recognised that this mismatch between liabilities and assets exposes them to bank runs. For this reason, most central banks have some kind of LLR facility in place to protect their economies from the potentially very harmful effects of a loss of confidence in an otherwise solvent bank.

If banks come to perceive that the use of the LLR facility comes with the cost that their shareholders will be wiped out, even if the bank is "solvent, exceeds its regulatory capital requirement and has a good quality loan book" then (1) banks will want to hold more cash and be more cautious in their lending and (2) bank shareholders will expect higher returns from bank shares to compensate for the greater risk of their shares being wiped out. This policy change will impose long term costs on UK depositors and borrowers, long after the present problems have been forgotten.

About the UK Shareholders Association (UKSA)

UKSA is the leading independent organisation which represents the interests of private shareholders in the United Kingdom. We campaign to protect the rights of shareholders in public companies, and to promote improved standards of corporate governance. Our educational activities, regular regional meetings, company "analyst" meetings and the resources of our web site, help to inform the public on investment management. UKSA is a "not for profit" organisation which is financially supported primarily by its individual members.