LETTER TO FELLOW PIBS HOLDERS FROM PETER MORGAN

Dear Fellow PIBS holder,

WEST BROMWICH BUILDING SOCIETY 6.15% PIBS
ANNOUNCEMENTS OF CHANGES TO THE COUPON

I write further to the press release of 9 July 2009 from UKSA and in view of the impending PIBS Holders' meeting to be called by the Society.

It is not clear what will be contained in the notice of the meeting from the Society. But the Society states that it will be seek, inter alia, PIB holders' consent to a change in the terms and conditions of PIBS. This change concerns the current requirement for a Society general meeting every half-year that the coupon is reduced. Such meetings the Society wishes to avoid on the grounds of expense.

It would seem to me that if PIBS holders consent to this change, they will in effect consent to a more fundamental change in the terms and conditions of the PIBS – reduction of the coupon ***on a permanent basis*** in line with the Society's announcement. That in turn has led to a dramatic fall in the market value of the PIBS and falls in value of the PIBS of other Societies.

This letter contains more information on the Society's actions, provides more detail on my own concerns and the Society's responses, and goes on to suggest possible ways of addressing this unfair treatment of PIBS holders by the Society.

I should have liked to write to all fellow PIBS holders personally in good time before the meeting. But as you will understand from the press announcement, the Society has chosen not to facilitate any contact with you. Hence this rather unusual step of providing an open letter on the UKSA website in the hope that it will reach a number of you.

PIBS changes announced by the Society

The text of the Society's announcement on 12 June concerning its PIBS is as follows:

"The PIBS are not part of the Capital Exchange and will remain outstanding.

The PIBS bear interest at 6.15% per annum, payable on 5 April and 5 October each year. However, the Board of the Society has discretion to reduce or cancel the interest payments.

As a result of the Capital Exchange and a desire to achieve yield equivalence between the holders of PPDS and the Society's PIBS, the Society will implement the following policy in relation to the interest payments on the Society's existing PIBS:

• With respect to the interest payment date of 5 October 2009, to pay an interest payment which reflects the level of accrued interest (at an annualised rate of 6.15%) from 5 April 2009 to the date of the completion of the Capital Exchange plus, with respect to the period from completion to 5 October 2009, such amount as represents, when annualised, up to 1.5% of the outstanding principal amount of the PIBS;
• With respect to the interest payment date of 5 April 2010, to pay an interest payment which represents, when annualised, up to 1.5% of the outstanding principal amount of the PIBS; and
• With respect to subsequent interest payments, as a condition of the PPDS, the Society has undertaken to pay an amount which, when annualised, represents the lower of: 6.15% of the outstanding principal amount of the PIBS and the dividend yield attributable to the PPDS with respect to the prior financial year ending 31 March.

As part of the Capital Exchange, the Society has also undertaken not to purchase any of the existing PIBS at any time before 5 April 2021. The purchase of any of the existing PIBS at any time on or after 5 April 2021 remains a matter within the discretion of the Society."

Effect of changes on PIBS coupon

Although it is denied by the Society, these changes amount to a fundamental change in the terms and conditions of PIBS because they have a ***permanent*** effect on the coupon. The prospectus accompanying the issue of the PIBS envisages only one off reductions in, or cancellation of, a coupon payment. The coupon formulas imposed are in my view a totally different investment to the one I considered, when I reviewed prospectus before I bought my PIBS. In my view, fundamental changes like this require, inter alia, the consent of a three quarters majority of PIBS holders or a resolution at a specially convened meeting, as set out on page 22 of the prospectus.

You will note that in future the coupon is to be the ***lower*** of the stated coupon (6.15%) and the yield on PPD Shares to be issued to subordinated debt holders under the Capital Exchange. On the basis, for example, of an average of the post tax profits of the Society for 2007 and 2008, that yield would be a maximum of approximately 5.3% . In respect of 2009 results, the yield would be nil. Realistically, on the basis of, say, a future post tax profit of £10 Million, that yield would fall to a maximum of circa 3%. It may be even lower, because the PPDS dividend is at the discretion of the Society and share of profits may be partly or wholly allocated to the PPDS reserve account, instead of being paid out as dividends.

Comparing the position generally with that of PPDS holders, over time the restriction of the coupon to the *lower* of 6.15% and the PPDS yield acts as a cap on future PIBS income, whereas there is no such cap for PPDS holders. This will be particularly the case if inflation increases in future, as some experts predict. Indeed, if concessions were needed from PIBS holders as part of a rescue, one may ask why our PIBS are not being converted into listed PPDS (see later in this letter).

There is a further anomaly in this comparison of the effect on PPDS and PIBS holders. The Society's text refers to "a desire to achieve yield equivalence between the holders of PPDS and the Society's PIBS". If PIBS holders are, as seems likely, to receive the same (lower) yield as PPDS holders for the foreseeable future, there can be no yield equivalence. The tax treatment of dividend income to PPDS holders is entirely different to the tax treatment of interest income to PIBS holders. For companies holding PPDS, there is no tax to pay on the dividend income. PIBS holders receiving the same yield, as interest, will be taxed at their highest rate.

Background to and Society's justification for the changes

The Society has explained that the Capital Exchange was arranged in great haste because of perceived concerns about the Society's financial position and the lack of viable alternative merger arrangements. Additionally, the PPDS instrument used for this Exchange only became available, as an option, a matter of days before the transaction had to be agreed.

In that context and considering that PIB holders were not consulted or allowed to take professional advice, it is hardly surprising that the terms effectively imposed on PIBS holders are unsatisfactory.

The Society has countered that if the Capital Exchange transaction had failed, so would the Society. In that event the CEO has stated that, like PIBS in the Dunfermline Building Society, the investment would have been a total loss. At the very least the investment has been preserved, albeit with lower income at present, though with the prospect of income increases in future.

The recent Society results announcement states total shareholders equity to be £340 Million, after incurring a post tax loss of £40 Million, and before the effect of the Capital Exchange. £265 Million of this equity represents reserves. The size of these reserves is such that the Society would appear to be able to absorb further annual losses of a similar magnitude to last year, for several years without affecting its solvency. Indeed the Society had been at pains to announce publicly that this was not a Society in terminal financial difficulty. This is hardly another Dunfermline Building Society.

The total annual cost to the Society of paying in full the current PIBS coupon is £4.6 Million. This figure appears hardly significant to the survival of the Society with reserves of £265 Million, though the proposals have a dramatic effect on your holdings.

The restructuring of subordinated debt under the Capital Exchange, although clearly very welcome, is a quite separate matter. Technically, it should have no bearing on the terms and conditions of PIBS. Unlike this Capital Exchange, the proposed changes to the PIBS coupon have no benefit to the Society's capital ratios, for example to meet FSA requirements.

What can be done?

At a meeting the CEO, Robert Sharpe, stated that the new terms for PIBS are non-negotiable. They are linked to the Capital Exchange due to complete on 13 July.

I do not agree. All Agreements are variable by mutual consent. Dialogue with PPDS holders may produce a better outcome for PIBS holders without materially affecting the interests of PPDS holders.

For example, at worst the coupon could be cancelled or reduced in the short term, the PPDS returns could be calculated *prior* to PIBS interest, and a formula could be agreed that enabled the coupon to be paid only if there are sufficient profits for both PIBS and PPDS holders.

A legal challenge could be mounted in the High Court, as to whether the prospectus does indeed give the Society the right to impose these permanent changes without consent.

There is an immediate opportunity to challenge the Society here, at the PIBS meeting. If the Society is seeking PIBS holder consent to deleting or modifying the requirement for a general meeting every half-year the coupon is less than the normal amount, I suggest you speak and/or vote against that resolution, either in person or by proxy.

You could also write to the FSA complaints department, as I have done, to complain that the FSA has not adequately protected the interests of PIBS holders in approving the Society's actions.

Conversion of PIBS into PPDS

A more radical solution could be the right of PIBS holders to convert into PPDS, as an option.

However, terms for PPDS are currently quite complex, are quite different from any other investment (a one-off at present), and are not easily evaluated. Currently there appear to be no plans for them to be listed (perversely perhaps an attraction to the debt holders). For most PIBS investors, it is likely to be essential for PPDS to be listed in order to provide marketability.

The Society claims that there is an advantage to PIBS holders under the present deal, because the PPDS are loss absorbent, whereas technically PIBS are not. Furthermore, any share of losses written off against the capital of PPDS holders must be restored by an equal amount of share of profit before any dividends can be paid. Thus the restriction on PIBS yield is justified in the Society's view by the reduced risk.

However, that difference appears somewhat illusory. The market value of PIBS falls and rises with perceptions about future income, etc, and no doubt in future those perceptions will be influenced by what happens to PPDS.

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Please appreciate that this letter is not intended, nor purports, to provide investment advice. In the usual way, investment advice should be sought from suitably qualified professionals.

The letter represents only the personal views of the writer. The comments made are intended to inform and stimulate debate amongst fellow PIBS holders about the announcements by the Society. Whilst every effort has been made to check information and the reasonableness of comments in this letter, the writer cannot be held responsible for any actions taken by readers on the basis of the contents of this letter.

Notwithstanding the above, I hope that the letter helps fellow PIBS holders better understand some of the issues involved.

Yours sincerely

P J Morgan

See **www.uksa.org.uk/WestBromwichBS.htm** for more background information