

WEST BROMWICH BUILDING SOCIETY PIBS (“WB PIBS”)

BRIEFING PAPER – DISPUTE WITH PIBS HOLDERS

	QUESTIONS	ANSWERS
1	<p>What is the Society doing to its PIBS?</p>	<p>On June 12th WB announced an equity for debt exchange with its holders of £182.5 Million debt. At the same time, the holders of £75 Million of PIBS were told that their income would be drastically reduced and would be tied in future to the post tax returns of debt holders.</p> <p>The future income is to be the <i>lower</i> of the yield to debt holders (now called PPDS holders) and the face value of the coupon (6.15%). This effectively puts a cap on PIBS income, whereas there is no cap on PPDS income, although WB claim yield equivalence.</p> <p>Tying the PIBS yield to PPDS yield means that in years when the Society makes a loss, there will be no payment to PIBS holders. In other years, the amount payable is uncertain, because (1) yield will depend on WB profits, (2) the amount payable to PPDS depends on the Board’s discretion (some share of profits can be set aside to PPDS reserve rather than being paid out), and (3) the Society has not clarified how PIBS yield is to be computed by reference to PPDS yield in all circumstances.</p>
2	<p>Why are PIB Holders so upset about these actions? The Society was in serious financial difficulty, so it was reported.</p>	<p>We are upset – and shocked.</p> <p>The result for PIBS holders is to be a drastic reduction in, and complete uncertainty of income from these PIBS, but also the market value fell by two thirds to circa 20 pence. This compares with the issue price of £1.</p> <p>Not only did the price of WB PIBS fall, but the values of PIBS of all other Societies fell. Some, like Newcastle, fell very sharply. So it affected the value of our other PIBS holdings as well. Understandably, there is a fear that other Societies might follow the WB example.</p> <p>There were several factors in our reaction:</p> <ul style="list-style-type: none"> • Though the press had started to speculate about financial difficulties, FSA concerns, and a possible merger with another society, you need to remember that even as late as May, the Society was issuing robust statements that there were no problems financially. Also this was a society with much less exposure to wholesale funding than the likes of the Nationwide and Britannia. And even after suffering a loss of £39 Million the capital and reserves were still £340 Million at 31 March 2009, before the effect of the Capital Exchange. So it was a surprise, and difficult to comprehend, how the Society could have been close to administration, as it now claims. • Even if there were problems of the magnitude now claimed, we would have expected short term and, at worst, medium term adjustments to the interest paid on our PIBS. We were completely unprepared for the long term fundamental changes that were announced. • We could not believe that a mutual Society would make such permanent and fundamental changes without consulting its PIBS holders, who are part of its membership, and without obtaining their consent (a 75% majority) at a duly convened meeting. That was also our reading of the terms and conditions set out in the PIBS prospectus.

3	<p>But surely the Society must have legal grounds for its actions?</p>	<p>The terms and conditions of the PIBS, as with other Society PIBS, are set out in the original prospectus, issued in 2005.</p> <p>It is true that WB claims to have unfettered discretion on the amount of interest it pays to PIBS holders, but we question the validity of that claim.</p> <p>WB says that it has taken legal advice, even leading Counsel opinion, to support their view that the prospectus gives the Board this unfettered discretion.</p> <p>They have even reclassified PIBS as equity, instead of as a liability (like other Societies) in their balance sheet. This is on the tenuous grounds that because PIBS have no right to repayment and the future income is both uncertain and discretionary, they are really equity, not debt.</p> <p>But when PIBS holders bought this security, we were led to believe that we were buying fixed interest (debt) securities. This includes many professional investors, who are household names, for their corporate bond funds.</p> <p>This is the section of the prospectus which WB say gives them unfettered discretion. The section is in italics in the original document – to give emphasis: <i>“Whilst Condition 4(3)(b) entitles the Society, in its sole discretion, to cancel, in whole or in part, any scheduled interest payment as required by current policy of the Supervisory Authority, it is the Society’s intention not to cancel any part of a scheduled interest payment other than in the circumstances described in Condition 4(3)(a).”</i></p> <p>To explain, condition 4(3)a is all about complying with FSA capital adequacy rules. That would no doubt include the well publicised stress tests system.</p> <p>It is surely stretching ambiguity beyond the reasonable, to say that this statement gives the Board unfettered discretion. For a start, the discretion is qualified by reference to current policy of the FSA. That could, and almost certainly does, include other constraints, given the supervisory powers of the FSA over building societies.</p> <p>Then there is the statement about the Board’s intentions. This statement was clearly made with the intention of inducing investment. The WB says that this intention has been overridden by events.</p> <p>The events may be good reason for a temporary suspension of payments/possible short term reduction. But they are no reason for changing the level of interest payments permanently.</p>
4	<p>But surely the Society was in a position, for whatever reason, where they had to act very quickly? It’s just unfortunate for PIBS holders that this was the best deal they could come up with, in all the circumstances, at the time.</p>	<p>Yes, WB has said that it had no option.</p> <p>But we question that.</p> <p>We have been told that the whole transaction with the debt holders had to be negotiated and completed within a matter of days. For such a complex transaction and involving a completely new financial instrument, it is hardly surprising if some aspects are not entirely satisfactory – in particular the provisions related to PIBS.</p> <p>And that would not be surprising, when one considers that PIBS holders were not consulted or given an opportunity to take professional advice. That is in marked contrast to every other party involved – the Society, the debt holders (as a group) and the FSA – all three had legal advisers.</p> <p>We do not know what actually happened, or why there was such a deadline, given the Society’s robust prior announcements about its financial position, etc.</p>

		<p>The Society has mentioned the need to satisfy the auditors on going concern, but that would not seem a sufficient reason, given the timescales available.</p> <p>If the problems were of the magnitude now reported by the Society, PIBS holders of course recognise the need to share short term pain - perhaps an immediate suspension of the payments and/or a medium term reduction. But what they have come up with is unnecessary and unfair to PIBS holders, let alone being imposed in a manner totally inconsistent with the terms and conditions set out in the prospectus.</p> <p>Now any immediate problems have been overcome, we want the Society to reconsider the provisions being imposed on PIBS holders and reach an agreement that is fairer to PIBS holders, yet acceptable to all parties including PPDS holders.</p> <p>We think that this would also go some way to restoring market confidence in financial instruments issued by building societies.</p> <p>Bear in mind also that (1) PIBS holders are automatically members of the Society and (2) the requirement, as set out in their 2009 Corporate Governance report: <i>“There should be a dialogue with shareholders based on the mutual understanding of objectives. The Board as a whole has a responsibility for ensuring that a satisfactory dialogue with shareholders takes place.”</i></p> <p>Consider too this statement in the WB constitution:</p> <p><i>“Your Society remains committed to both the principles and practice of mutuality and will demonstrate this through the following core values:</i></p> <p><i>Treat everyone fairly both customers and colleagues.</i></p> <p><i>Build lasting relationships earning the trust and respect of customers, colleagues, business partners and communities.</i></p> <p><i>Take personal responsibility by being accountable and keeping our promises”</i></p>
5	<p>If what you say is true, why has the FSA approved the Society’s plans?</p>	<p>Good question!</p> <p>We don’t understand why the FSA has approved this aspect of the WB actions.</p> <p>Several of us have complained to the FSA about this.</p> <p>The recent feedback from the FSA is that they are still considering the complaints, and that a substantive response may take longer than four weeks. That may be too late to rectify the situation.</p> <p>We suspect that, in the haste to improve the Society’s capital ratios (these are now one of the strongest in the movement), the FSA overlooked the dramatic impact of the WB proposals on its PIBS holders.</p> <p>WB has told us that they were given a matter of days to conclude the equity-debt swap with the Debt holders and that there was no time to consult with PIBS holders. Apparently this haste came about because HM Treasury had approved, at the eleventh hour, a new financial instrument for building societies (PPDS). This was used for the equity-debt transaction with the WB debt holders.</p>

		<p>But it is still not clear to us why there had to be such unseemly haste, given the complexity of the situation and the powers of the FSA. After all, this was a Society with capital and reserves of £340 Million at 31 March 2009 (after a loss of £39 Million), hardly an institution about to go bankrupt</p> <p>In addition to their responsibilities for supervising Building societies, the FSA website states that it is also responsible for:</p> <ul style="list-style-type: none"> • Promoting efficient, orderly and fair markets; • Helping retail consumers achieve a fair deal <p>So we also question whether there has been a fundamental conflict of interest for the FSA in this case – between the two roles.</p>
6	<p>Can't the Financial Ombudsman help here?</p>	<p>We have also asked for his assistance here too - on the grounds that we have suffered a capital loss because the FSA approved the WB actions.</p> <p>The Ombudsman has explained that he has no powers of investigation of the FSA and that any recommendations he may make can be ignored by the FSA, if they so choose. This is clarified by the Memorandum of Understanding between his office and the FSA, published on his website.</p> <p>In this case also we cannot demonstrate a causal link between the actions of the FSA and the capital losses we have suffered, because we do not know and cannot ascertain details of the FSA actions here.</p> <p>The FSA is of course responsible directly to HM Treasury and from them to Government ministers. So, although this seems a hammer to crack a nut, we have also asked MPs to raise questions with ministers.</p>
7	<p>Have you raised these issues with the Society and what has been their reaction?</p>	<p>Yes, of course. Several of us have written to the CEO, the Chairman of the Board, and other officers. We have tried to explain our complaints in detail, to ask them to reconsider the PIBS aspects of their actions, and made suggestions, with a view to some sort of accommodation.</p> <p>The CEO did agree to meet with our action group representative and a director of UKSA on 1st July. However, the purpose appears to have been solely to justify the WB actions.</p> <p>The CEO is adamant that the PIBS changes were demanded by debt holders as a condition of their agreement to the equity –debt swop.</p> <p>As PIBS holders were not represented at the negotiations with debt holders, we do not know what occurred in the, no doubt, hectic negotiations. Nor were we able to defend our position, or to contribute to the settlement.</p> <p>Whilst the WB subsequently replied to various letters, they refuse now to entertain any further discussion because of the management time involved.</p> <p>The CEO has written that PIBS holders must now seek a legal remedy in the High Court if they remain dissatisfied.</p> <p>The Society is surrounded with expert professional advice and has deep pockets, whereas individual PIBS holders are in an entirely different situation – a most unequal contest.</p> <p>In any case, whilst our group does not rule out this option, apart from the huge potential expense, we do not think that the courts are the appropriate place to develop an accommodation to resolve differences with members of a mutual.</p> <p>We are still hopeful that the FSA will broker some accommodation, when they review the transactions, though this does not appear to be promising.</p>

<p>8</p>	<p>If the total value of the Society's PIBS is £75 Million, there must be a lot of PIBS holders. Why aren't more people making a fuss?</p>	<p>There are now about 50 of us complaining. Our combined holdings approach £1.5 Million at nominal value. The numbers have gradually increased, largely because of people contacting UKSA when they have read the press releases.</p> <p>From the start we wanted to contact all PIBS holders to discuss our views and to seek support.</p> <p>The Society refused to allow us to access the register of PIBS holders because of data protection legislation. When we asked them to facilitate contact by requesting permission of PIBS holders or sending a letter along with their own documentation, they refused.</p> <p>We think that a lot of individual PIBS holders don't know about the WB actions. Or if they do, they do not understand them, think that nothing can be done, and are not aware of their rights.</p> <p>There are difficulties for private investors getting notified of its plans by the Society in the first place.</p> <p>The PIBS register contains a significant number of nominee accounts, where there is a single nominee name that may cover a large number of holdings by separate clients. In such cases only one copy of any announcement is sent to the name on the register. As a result, many of our group have not received copies of the WB announcements from their brokers and in some cases the brokers have not received them either.</p> <p>More importantly, because of these nominee accounts, most private PIBS holders have no right to attend Society meetings, let alone speak, even if they are able to make arrangements with their brokers to receive notices and to register their votes by proxy.</p> <p>The rules about receiving notices of meetings, rights to attend, speak and vote are complex and difficult to understand. Under pressure from our group, the Society belatedly recognised this and recently posted, on their website, advice to PIBS holders who wished to attend and/or vote at the PIBS meeting on September 4th.</p> <p>However, the advice does not address the most fundamental problem - only the nominee named on the PIBS register is allowed to attend or speak at meetings.</p>
<p>9</p>	<p>You mentioned institutions holding these PIBS. Why haven't they objected?</p>	<p>Almost certainly the majority of WB PIBS are held by the institutions (corporate bond funds, pension funds, insurance companies, investment trusts, etc).</p> <p>However, as you may know, there is no requirement for institutions to publish their holdings or to report their voting records on their holdings. Indeed there is currently some debate on such matters, because of pressures from their own investors. So identifying who holds the WB PIBS is very difficult, given that the Society itself will not facilitate access to the PIBS register.</p> <p>That said, very recently, we have managed to identify, by trial and error, some very large holdings by 6 institutions, with a combined value of over 10% of the PIBS in issue.</p> <p>Those institutions we have managed to identify have in general refused to discuss the Society's actions with us or their voting intentions. We are not sure why this is the case. It seems counter productive.</p> <p>So we have also complained to their trade bodies that they appear to be unwilling to take a lead, despite the weight of their holdings and their professional expertise. This would appear to be borne out by the results of the votes on 4 September.</p>

		<p>Basically, we do not understand why institutional investors have been so unwilling to object to the Society's actions.</p> <p>It is possible that some fund managers found themselves in a difficult position, if their company had both debt and PIBS investments in WB? It seems also possible that there has been a reluctance to intervene because of the FSA's involvement and the fear of a total loss if the Society collapsed?</p> <p>The answer may be more mundane. Given the value of holdings relative to the total size of their funds, they may not consider the matter worth investing time and effort?</p> <p>We are still hopeful of persuading some funds to take a more active interest in the WB actions than appears to have been the case. Though it appears there is little appetite for assisting the private investor, even when we have common cause.</p> <p>In contrast to the attitude of institutions, one major broker is seemingly so disturbed by the WB actions that they wrote uncompromisingly to all their clients holding WB PIBS. Their letter unusually stated they would vote their entire client holdings against the WB resolutions at the PIBS meeting, unless they received an instruction to the contrary.</p>
10	<p>Have you complained to the Stock Exchange?</p>	<p>We were very reluctant to do that, because, though it seems unlikely, theoretically trade in the PIBS could be suspended. Nobody wants that to happen.</p> <p>But, in view of the Society's resolute refusal to discuss any of these issues with us, other than to repeat their position, we have now, very reluctantly, made a formal complaint to the Exchange.</p> <p>In fact it is not the Stock Exchange itself that deals with this sort of complaint. It is UK Listing Authority, which is now part of the FSA.</p> <p>No doubt it will take some time for the UKLA to respond substantively.</p>
11	<p>You mentioned that the Society called a meeting of PIBS holders. Weren't these issues discussed then?</p>	<p>Yes, on 11 August WB announced that there would be a meeting of PIBS holders on 4th September.</p> <p>But the fundamental problems we are complaining about weren't going to be discussed. Only the Society can call a formal meeting of PIBS holders and sets the agenda for the meeting. The rules for such meetings, set out in the prospectus, are complex and difficult to understand. For instance, the Society's legal advisers have confirmed that proxy representatives had no right to speak at the meeting, except on procedural issues.</p> <p>The resolutions weren't about the fundamental changes to the interest rate. The Board says it has unfettered discretion on that. So, they claimed, no approval from PIBS holders was needed for that.</p>
12	<p>What was the purpose of this PIBS holders' meeting then?</p>	<p>WB called the meeting, because they are required to do so by the PIBS prospectus.</p> <p>They wanted PIBS holders to approve three resolutions to change terms and conditions of the PIBS. These are consequential on their decisions about the PIBS interest rate.</p> <p>The resolutions were about removing certain safeguards contained in the prospectus. These safeguards were designed to reassure investors that the Society would not cancel or reduce the interest payments without having to go through various "hoops".</p>

		<p>In particular, the Society was required to convene a general meeting of members every time the Board passed a resolution to cancel or reduce the PIBS payment. Because payments are made half-yearly, that would have entailed calling two meetings a year, just to announce the reduced payments, to explain that to members, etc.</p> <p>There is no vote, per se, at such meetings. Hence the WB claimed that this requirement was pointless in future – so they wanted it removed.</p> <p>They claimed also that it would carry an annual cost of £250,000. We questioned this estimate. One of the notifications could be made at the AGM, provided that was suitably timetabled. The other notification could no doubt be dealt with primarily by a member mailing.</p> <p>Another change the Society wanted was to remove a 5 month delay in payments to PPDS holders, which would otherwise arise.</p> <p>Our group recommended to all PIBS holders that they should vote against these resolutions because we believed that approval would be tantamount to approval of the WB actions generally over its PIBS.</p> <p>For the resolutions to be approved, there had to be a quorum of one third of voting members either in person or by proxy. Also 75% of votes cast had to be in favour.</p> <p>The resolutions were in fact all carried, though notably the resolution on the accelerating payments to PPDS holders was carried by a substantially smaller margin than the other two resolutions. Could this reflect the fact that there are no doubt some institutions that do not have both debt and PIBS investments in WB?</p>
13	<p>If what you say is true, why is the Society so adamant about pushing this through?</p>	<p>Difficult to understand.</p> <p>From the Society’s viewpoint, it will be saving money. But it seems all wrong that the Society is, on the one hand, cutting interest rates that it committed to on its PIBS, but, on the other hand, it’s paying a top market rate of 5.45% to attract new business.</p> <p>Not paying the full coupon of £4.61 Million a year for many years isn’t going to make a material difference to the Society’s capital in the longer term, but is a real risk for PIBS holders. WB achieved an average profit before interest and tax of nearly £60 Million a year in 2007 and 2008. Whilst it may be many years before profits return, if ever, to those levels, with sound management one would expect WB to return to a level of profitability which comfortably covers all interest payments under the pre-capital exchange terms. But in such a scenario, the full PIBS coupon may now not be paid.</p> <p>We also note that the 2009 accounts report that the Society obtained the legal advice on the extent of their discretion before 31 March 2009 – well in advance of the deal with the debt holders. Could it be that WB had seriously considered this action anyway?</p>
14	<p>Your group of PIBS holders, what do they want to see happen, ideally?</p>	<p>The WB actions have been unnecessary and have a totally disproportionate effect on PIBS holders – a huge percentage fall in income, total uncertainty about future income levels, and a two thirds fall in value, etc.</p> <p>The actions have also unsettled the whole PIBS market – brokers, fund managers, investors alike. And what will be the response if other Societies seek to raise money outside their depositor base in future? If nothing else, it will push up the cost, because of the risks of another West Brom.</p>

	<p>The WB PIBS are to be neither equity nor unsecured debt. Although there is risk akin to equity, how can it be equity, when there is a cap on income and, therefore, no prospect of real capital gain either? It does not appear to be debt either. There is no fixed servicing payment and indeed no certainty of payments at all, irrespective of the robustness of WB's capital ratios.</p> <p>The terms contained in the prospectus appear now to be out of date and misleading. Income is to be payable by reference to the terms of PPDS, for which no document is publicly available to investors.</p> <p>In many ways, it would be preferable for the PIBS to be converted into PPDS, with a revised set of terms and conditions to be agreed with PIBS holders, and providing they retain their stock exchange listing.</p> <p>Alternatively, as many PIBS holders would no doubt prefer, the PIBS should be restored to the fixed interest instrument originally advertised, with an appropriate adjustment to interest payments in the short to medium term.</p> <p>We still hope that the Board can be persuaded to reconsider.</p>
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