

# Andrew Caldwell

*Independent Valuer appointed by HM Treasury under  
The Northern Rock plc Compensation Scheme Order 2008*

7 December 2009

Dear Sir or Madam

## **Independent Valuation under the Northern Rock plc Compensation Scheme Order**

When I last wrote to you, I outlined seven stages to my valuation process, which may be summarised as follows:

1. finalise valuation procedure;
2. request and obtain information relevant to the valuation process;
3. review and analyse the information obtained;
4. prepare and issue the consultation document;
5. review and analyse responses to the consultation;
6. issue Assessment Notices to notify you of any compensation payable; and
7. reconsider and issue Revised Assessment Notices where I am required to do so.

This letter is to inform you that I have now made the consultation document, referred to above, available on my website, [www.northernrockvaluer.org.uk](http://www.northernrockvaluer.org.uk). This consultation document explains: the method that I propose to use to determine the amount of any compensation payable by HM Treasury ("the Treasury") and the information that I have received and considered. I also set out, based on this method and information, my provisional views on both the valuation and amount of any compensation payable.

The consultation document is inevitably a detailed document and I have therefore summarised the key points within this letter.

You are invited to submit written representations on the consultation document. Details of how to submit your representations are set out on page 4 of this letter.

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## Summary of valuation process so far

In this letter I use the expression "Affected Parties" to refer to the following categories of persons affected by the Northern Rock plc Transfer Order 2008 (the "Transfer Order"):

- those who held ordinary, foundation or preference shares in Northern Rock;
- those whose rights to receive shares in Northern Rock (whether by subscription, conversion or otherwise) were extinguished by Article 4 of the Transfer Order; and
- those whose "consequential rights" were extinguished by Article 12 of the Transfer Order.

No one has submitted evidence that their "consequential rights" were extinguished by Article 12 of the Transfer Order, so I have not considered this category of Affected Parties further at this stage.

I have reviewed and analysed a substantial amount of information. Over the last 14 months, I have received several thousand responses or enquiries. In addition to meeting personally with former shareholders and others who wished to make representations to me, I have also met with approximately 70 other people whom I thought could provide me with relevant information.

The time required to complete the consultation document has taken longer than I had anticipated at the outset, due to difficulties I encountered gathering information relevant to the valuation. Information that I have been given to understand from my terms of appointment would be readily available, was not made available to me for some considerable time after I was appointed. This significantly delayed progress, particularly in the six months or so following my appointment. The Northern Rock plc Compensation Scheme Order 2008 was amended in late March 2009, following representations I had made to the Treasury, to enable me to apply to the Court to compel people to provide me with information. From this point onwards, access to relevant information was more straightforward although some of the information I needed to finalise the consultation document was not made available until November 2009.

## Valuation Assumptions

My letter of 13 November 2008 detailed the Valuation Assumptions that I am required, by law, to apply and I set these out again, for clarity. I must assume that:

- all financial assistance provided by the Bank of England or the Treasury to Northern Rock has been withdrawn (whether by the making of a demand for repayment or otherwise);
- no financial assistance would in future be provided by the Bank of England or the Treasury to Northern Rock (apart from ordinary market assistance offered by the Bank of England subject to its usual terms); (together I refer to these two assumptions as the "withdrawal of financial assistance")
- Northern Rock is unable to continue as a going concern; and
- Northern Rock is in administration.

## Valuation Approach

I set out below a summary of the valuation method I propose to take to determine the amount of any compensation payable by the Treasury. This is intended to be a high level summary and I refer you to the consultation document which is available on my website for further detail.

I am required to assess the amount of any compensation payable by the Treasury based on the value of the shares or rights (as the case may be) immediately before the transfer of Northern Rock into temporary public ownership at the beginning of 22 February 2008. I refer to this point in time as the "Valuation Date". Immediately prior to the Valuation Date Northern Rock owed approximately £25.38 billion to the Bank of England and also had the benefit of several guarantees granted by the Treasury in connection with depositor accounts and other financial liabilities of Northern Rock.

I must assume that as at the Valuation Date these monies and guarantees had been withdrawn. The effect of this is that I have to assume immediate repayment of approximately £25.38 billion to the Bank of England, which requires realising sufficient of Northern Rock's assets to pay this money back. I have therefore considered the assets that would need to have been realised to repay the debt to the Bank of England immediately before the Valuation Date.

The consequence of the withdrawal of financial assistance, together with the further assumptions that Northern Rock is in administration and unable to continue as a going concern, is that I consider it unlikely that Northern Rock could have been sold by an administrator in its entirety. I have therefore considered the likely realisable value of Northern Rock's remaining assets in administration.

From the total value of these remaining assets, I have deducted Northern Rock's liabilities to parties other than the Bank of England. The remaining surplus, if any, would then form the basis for any compensation payable to Affected Parties.

### **Application of Valuation Approach**

Prior to the assumed realisation of assets to repay the Bank of England, Northern Rock had a stated balance sheet surplus of assets over liabilities of approximately £1.63 billion.

The total amount of assets on Northern Rock's balance sheet was approximately £106 billion. Approximately £50 billion of these assets were available to be realised to repay the Bank of England. Taking into account the circumstances attaching to an immediate realisation, the assets realised to repay the Bank of England would have to be discounted (i.e. they would be realised for less than their book value as stated in the balance sheet). I have selected for realisation those assets which would attract the lowest discount in a distressed situation: cash; UK gilts; and certain categories of residential mortgage loans.

In September 2007, when analysing the likely outcome of an administration with continuing Government support, the advice provided to Northern Rock's Board of Directors suggested that a discount of 10% would apply to its residential mortgage loans if sold at that time and if Northern Rock was in administration. It is my provisional view that, taking into account the Valuation Assumptions together with the fact that the prevailing economic circumstances were worse in February 2008 than September 2007, a larger discount than 10% would have been appropriate around the Valuation Date. My analysis suggests that it would have been necessary to give discounts of up to 30% in distressed situations such as that which I am asked to assume.

I am of the view therefore that Northern Rock's residential mortgage loans would have to be realised at an average discount of 15% to book value. I do not consider that any discount would need to be applied to the realisation of cash and UK gilts.

In order to repay the Bank of England liability of approximately £25.38 billion, I have assumed a realisation of £0.73 billion of cash, Northern Rock's £1.60 billion holding of UK gilts and £27.12 billion of residential mortgage loans (realised at approximately £23.05 billion, after applying a discount of 15% to book value, which is approximately £4.07 billion). The realisation of these assets would therefore lead to a deficit of approximately £2.44 billion (i.e. £1.63 billion less £4.07 billion).

Following the withdrawal of financial assistance, I must consider the assumed administration of Northern Rock. An administrator would have to decide how to raise value from the remainder of Northern Rock's portfolio of assets, that is whether to sell all assets immediately, or sell part and run off the rest. Although I have made optimistic assumptions about the administration, I believe that further losses of at least £3.24 billion would be produced.

The total deficit would therefore become approximately £5.68 billion. (i.e. £2.44 billion plus £3.24 billion).

## Provisional views

When assessing the value of the shares or rights to receive shares (as the case may be) as at the Valuation Date, it is necessary to consider the outcome of the assumed administration, in particular whether there is any surplus. My provisional view is that there would be no surplus. This means that there is no value in the shares or rights as at the Valuation Date and therefore that no compensation is payable to Affected Parties.

This is my provisional view but as I have previously mentioned, I am at the consultation stage, and you now have the opportunity, if you wish, to make written representations to me in connection with the consultation document which sets out full details of my reasoning. I have identified in Section 1 of the consultation document certain specific points on which you may wish to comment.

The Valuation Assumptions that I am required to adopt are fixed by law, and therefore they are not something on which I am seeking written representations.

You may submit your comments and representations to me as follows:

by post to: Andrew Caldwell  
Northern Rock Valuer  
c/o BDO LLP  
55 Baker Street  
London  
W1U 7EU

by e-mail to: [northern.rock@bdo.co.uk](mailto:northern.rock@bdo.co.uk)

The deadline for all responses is 29 January 2010.

I shall consider all written representations made in response to this consultation document which I receive by the deadline. All responses will be considered, not just those from Affected Parties. However, it is not practical for me to respond directly to every person or organisation making comments or representations to me.

If any further matters arise during the consultation period, which are relevant to the matters addressed in this document, they will be published on my website. I suggest that you check the website from time to time as it contains all available information regarding my work on the valuation.

Once I have finalised my independent valuation, having taken into account representations on my provisional view, I shall determine the amount of any compensation payable by the Treasury to Affected Parties and I shall issue Assessment Notices to Affected Parties which set out the amount of any compensation determined by me as being payable and the reasons for my decision.

If you have any queries in connection with this letter, please contact my helpline on 0800 3777 353.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Andrew Caldwell', written in a cursive style.

Andrew Caldwell