

**EXPLANATORY MEMORANDUM TO
THE NORTHERN ROCK PLC TRANSFER ORDER**

2009 No. 3226

1. This explanatory memorandum has been prepared by the Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. **Purpose of the instrument**

2.1 Following Northern Rock plc being taken into temporary public ownership on 22 February 2008, this Order makes provision in respect of the restructuring of the company. Part of Northern Rock's business will be transferred by this Order to a new company, also wholly owned by the Treasury.

2.2 For clarity it should be noted that the new company is presently called Gosforth Subsidiary No.1 plc. But the intention is for Northern Rock plc to be renamed Northern Rock (Asset Management) plc and for Gosforth Subsidiary No.1 plc to be renamed Northern Rock plc (through an application to Companies House in the normal way). So as to avoid confusion, the generic names "ACo" and "BCo" are used in the Order to refer to Northern Rock plc and Gosforth Subsidiary No.1 plc respectively.

3. **Matters of special interest to the Joint Committee on Statutory Instruments**

3.1 Most provisions of the Order (including the provisions effecting the transfer) are brought into force on 1 January 2010, and do not therefore depart from the 21 day rule. Two sets of provisions are brought into force with immediate effect (and before the Order has been laid before Parliament).

3.2 First, article 8 and Schedule 2 provide for the Treasury and the Financial Services Authority to make certain notifications in accordance with Directive 2001/24/EC on the reorganisation and winding up of credit institutions (which provides for the mutual recognition of reorganisation measures, amongst other things, in respect of credit institutions within the European Union). The legislation which implements the Directive in the United Kingdom¹ does not apply to reorganisation measures effected under the Banking (Special Provisions) Act 2008. In light of this, the Order contains provisions which require the Treasury and Financial Services Authority to

¹ SI 2004/1045.

make the necessary notifications. The Directive requires these notifications to be made without delay following the decision to adopt a reorganisation measure, and it is for this reason that the relevant provisions of the Order are brought into force immediately on the making of the Order.

3.3 Second, articles 6 and 7 make provision to ensure, in very broad terms, that third parties do not acquire or incur new rights, interests, obligations or liabilities as a result of the making of the Order or things done in relation to it. For example, they prevent a third party from terminating a contract on the basis that the Order has been made. Were such provisions not brought into force immediately on the making of the Order they would not address the full range of circumstances that they need to address, and the effectiveness of these provisions could be impaired.

3.4 These provisions are considered appropriate, and compatible with the Convention rights, given in particular the following factors-

- (i) the value of assets transferred to BCo will be matched to the value of liabilities transferred meaning that the net value of the transfer of assets and liabilities will be zero so that ACo will be no worse off than it is currently,
- (ii) there is a strong public interest in ensuring that the restructuring of Northern Rock plc does not result in disruption to the continued operation of Northern Rock plc's business,
- (iii) other rights of third parties (including rights to terminate a contract on other grounds) will be unaffected, and
- (iv) both companies will, after the split, continue to be wholly owned by the Treasury.

3.5 Similar provisions have been included in all previous orders made under the Banking (Special Provisions) Act 2008 (and in all cases were brought into force on, or very shortly after, making).

3.6 Certain other provisions (such as the interpretation provisions of article 2) are also brought into force immediately on the making of the Order, in consequence of the commencement of the provisions outlined above.

3.7 This Order incorporates lists of property, rights and liabilities to be transferred which are contained in an agreement (the "Transfer Administration Agreement") entered into in connection with the transaction by ACo and BCo on 7 December 2009 and which will take effect when the Order comes fully into force on 1 January 2010. As highlighted in the Explanatory Note to the Order, this agreement and related documents are available for inspection on the Treasury's website (<http://www.hm-treasury.gov.uk>). Copies can also be obtained from Victoria Tickle, Resolution Team, HM Treasury, 1 Horse Guards Road, London, SW1 2HQ.

3.8 Article 22 of this Order provides by subdelegation for ACo and BCo to be able to modify the provisions of this Order. This is expressly authorised by

the Banking (Special Provisions) Act 2008.² The Treasury draw attention to the need for Treasury consent before the power may be exercised and the arrangements made for publicising instruments used to effect the modifications

4. Legislative Context

4.1 The Banking (Special Provisions) Act 2008 (“the 2008 Act”) provides, amongst other things, for the securities of authorised UK deposit takers to be transferred to a nominee of the Treasury (“temporary public ownership”), should one of two statutory purposes be satisfied. Northern Rock plc was taken into temporary public ownership on 22 February 2008, by the Northern Rock plc Transfer Order 2008 (S.I. 2008/432).

4.2 The 2008 Act provides (in section 8) a power to make onward transfers to any specified person of, amongst other things, the property, rights and liabilities of the deposit-taker. This power can be used to restructure the deposit-taker by transferring part of its business to another company, as this Order does. This onward transfer power has been used previously, for example to transfer the deposit book and certain other property of Bradford & Bingley plc to Abbey National (under the Bradford & Bingley plc Transfer of Securities and Property etc. Order 2008 (S.I. 2008/2546)).

4.3 This Order does not contain any provision of the kind described by section 8(6) of the 2008 Act (consideration). No consideration is being paid by BCo in respect of the property, rights and liabilities being transferred to it by the Order. The value of assets transferred to BCo will be matched to the value of the liabilities being transferred, so the net value of the transfer of assets and liabilities will be zero. In light of this, the Order does not contain any provision for determining the amount of consideration which is payable by BCo.³ In light of this, the Order is subject to the negative procedure.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom and has extra-territorial effect to the extent specified in paragraphs 1(3) and 17 of Schedule 1 to the Order.

² Section 8(5)(b) as read with section 6(3) and Schedule 2, paragraph 2(1)(j).

³ The agreements entered into by BCo and ACo in connection with the transfer provided for by the Order contain provision for payments to be made between ACo and BCo after the time at which the transfer takes effect. These payments are not “consideration” for the transfer. Rather they will be balancing payments to reflect the precise value of the property, rights and liabilities which are being transferred. This reflects the commercial reality that things will change in a way which cannot be anticipated between the time when the Order is made and the time at which the transfer takes effect. For example, mortgage customers may choose to redeem mortgages during that period. Such events may have a material effect on the value of the property, rights and liabilities being transferred making it appropriate to make provision for balancing payments. No provision is made in the Order as to how the amount of such payments is to be determined.

5.2 The 2008 Act provides that orders made under it may transfer property, rights or liabilities governed by foreign law⁴. These powers are used to transfer property, rights and liabilities of ACo in respect of its branch in Ireland.

6. European Convention on Human Rights

The Chancellor of the Exchequer has made the following statement regarding Human Rights:

In my view the provisions of the Northern Rock plc Transfer Order 2009 are compatible with the Convention rights.

7. Policy background

7.1 In the summer of 2007 Northern Rock found it impossible to finance its business because the nature of its business model left it exposed to turbulence in global financial market. In providing financial support to Northern Rock the Government had three objectives: financial stability; safeguarding depositors' money; and protecting interests of taxpayers.

7.2 Because of market conditions, it became clear that no institution was prepared to make an offer to take over Northern Rock without substantial Government financial support. An insolvency procedure might have led to a fire sale exacerbated by market turbulence. In February 2008 the Government therefore decided to take Northern Rock into a period of temporary public ownership. This was done on 22 February 2008 using an Order made under the 2008 Act to transfer the bank's shares into Treasury ownership (with the shares being held by the Treasury Solicitor as nominee for the Treasury). The Treasury considered that taking Northern Rock into temporary public ownership was the best way of meeting the Government's publicly stated objectives of protecting the taxpayer and consumer, and maintaining wider financial stability.

7.3 In February 2009 Northern Rock announced that it would undertake new lending of about £5 billion per annum in 2009, and £3-9 billion from 2010 onwards, subject to market demand. This new lending will be wholly on commercial terms, to help build a high quality mortgage book and a viable mortgage bank with a view to a later private sale.

7.4 To allow Northern Rock to undertake new lending as well as carrying on its current deposit and mortgage businesses whilst minimising the required capital injection into the company, Northern Rock is now being restructured so that the majority of its existing mortgage book as well as its existing wholesale funding structures will be managed separately from its other businesses. This Order gives effect to this restructuring by transferring part of Northern Rock's business to a new company, also wholly owned by the Treasury:

⁴ Section 8(5)(b) of the 2008 Act as read with section 6(3) and paragraph 1(e) of Schedule 2.

7.5 The business transferred to BCo will include Northern Rock's retail and wholesale deposit business (other than certain wholesale deposits held on behalf of Northern Rock's Granite securitisation and covered bond programme), a proportion of its unencumbered mortgages and its mortgage origination and servicing platform. BCo will be regulated as a deposit taker by the FSA.

7.6 The legal entity which is Northern Rock plc (ACco) will retain the remainder of Northern Rock's mortgage book, arrangements relating to the Granite securitisation and the covered bond programme, the Government loan, its other borrowings, derivatives and certain wholesale deposits held on behalf of its Granite securitisation and covered bond programme.

7.7 As noted above, the intention is that the companies will be renamed in conjunction with the transfer, such that Bco will be named "Northern Rock plc" and the existing company (ACo) will be named "Northern Rock (Asset Management) plc".

7.8 Both entities will continue to be wholly owned by the Treasury (via a nominee) and operate at arms' length from Government on commercial principles.

7.9 The restructuring will enable the new company to undertake new mortgage lending within the parameters permitted by the EC Commission's state aid approval announced on 28 October 2009 and to support the Government's desire (announced in February of this year) to see a well functioning mortgage market with responsible lending and access for consumers to a wide range of affordable mortgages.

7.10 After the restructuring, ACo will undertake no new economic activities to the extent they are inconsistent with the EC Commission's state aid approval announced on 28 October 2009. As for BCo, the Government believes that it is in the public interest to pursue our intention to return BCo to the private sector as and when the opportunity arises.

7.11 The Government and Northern Rock have agreed this approach as offering best value for the taxpayer, and with a view to creating a viable entity for sale at a later date.

8. Consultation outcome

8.1 The Government consulted with Northern Rock, the Financial Services Authority and the Bank of England. It was not considered appropriate to consult on the Order beyond the above institutions given the market sensitivity of the instrument.

9. Guidance

9.1 Guidance is not available in relation to the Order.

10. Impact

10.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.

10.2 The Order itself does not have any order on the public sector. However, to support the restructuring provided for by the Order, the Government will provide BCo with capital support. The Government will also increase the existing loan to ACo and will provide a working capital facility to enable ACo to be wound down in an orderly fashion. The Government intends to provide Parliament with details of the financial support provided to support the restructuring of Northern Rock in January 2010.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 The progress of the restructuring will be kept under review by the Treasury.

13. Contact

Victoria Tickle
Resolution Team
HM Treasury
1 Horse Guards Road
London
SW1 2HQ

Tel No: 0207 270 4733

Email: victoria.tickle@hmtreasury.gsi.gov.uk