EUROPEAN COMMISSION

Brussels, 25.1.2010
C(2009)340 final

Subject: State aid – NN 19/2009 – United Kingdom
Restructuring aid to Dunfermline Building Society

Sir,

1 PROCEDURE

(1) On 30 March 2009, the UK authorities implemented restructuring aid (hereinafter referred to as "the measure") in favour of Dunfermline Building Society (hereinafter "Dunfermline") and notified it to the Commission on the same day.

(2) The Commission requested further information on 1 April, 30 June, 13 October and 26 November 2009 to which the UK replied on 14 May, 23, 24 and 30 June, 6 July, 4 November and 11 and 14 December 2009.

2 DESCRIPTION OF THE MEASURE

2.1 The Beneficiary

(3) Dunfermline Building Society is a financial services institution based in the UK. Established in 1869, it is the largest Scottish building society and the fourteenth largest building society in the UK, with 231,136 members as of December 2007 and a network of 34 branches and 37 agencies. As of 31 December 2008, Dunfermline had a balance sheet total of £3.3 billion and posted a loss after tax over 2008 of £25.8 million.

(4) Dunfermline's main retail products and services include savings (e.g. instant access saving accounts, children's bond, ISAs[1]), investments (e.g. equity-linked bonds and pensions),

[1] Individual savings accounts with tax benefits as all the interest and other gains earned within the account are tax-free.

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mortgages and general insurance products (e.g. home and contents insurance). Dunfermline also offers financial advice, personal loans, credit cards, foreign currency as well as equity release mortgages for its older members.

(5) The UK authorities have submitted that at a national level, Dunfermline has a market share of -[0.0 –2.0]% in mortgages, [0.0-2.0]% in savings products and less than [0.0-2]% in insurance, long term investments and pensions. In Scotland, Dunfermline's market share does not exceed [0.0-5.0]% in either mortgages or saving products.

(6) Dunfermline, as a building society, provides many of the same services as a retail bank but has a different structure. It is essentially "mutual" in nature which means that its depositors are its "members" and its profits are channelled back into the business for their benefit. Traditionally, building societies are local in nature and play a role in matching local borrowers with local savers. Most customers have both saving accounts and mortgages with their building society. As a result a building society's retail deposit book and its originated mortgage business are intrinsically interconnected.

2.2 The events triggering the measure

(7) During a series of reviews of its commercial lending book over 2008, Dunfermline identified […][*] high risk exposures (corresponding to […] loans) amounting to £[…] million. A further […] exposures […] were classified as watchlist during that exercise. The exposures were connected to loans for housing development, commercial investment and buy-to-let. Due to the increased likelihood of defaults on these commercial loans, Dunfermline was forced to make substantial provisions to cover potential impairments, resulting in a loss over 2008. This in turn raised concerns about its ability to satisfy the Financial Services Authority (hereinafter "FSA") regulatory requirements. On 28 March 2009 the FSA concluded that Dunfermline had breached, or was about to do so, these conditions. Failure of Dunfermline to meet the conditions would mean it would no longer be allowed to carry out regulated financial activities.

(8) As Dunfermline was due to publish its annual accounts on 2 April 2009, there was concern that the published results, including any disclosure on its ability to meet regulatory capital requirements, would undermine public confidence in Dunfermline. This would only increase the likelihood that the building society would fail as Dunfermline would in that case no longer be able to obtain wholesale funding in already difficult market circumstances. According to the UK Authorities, a failure of Dunfermline would furthermore have adverse consequences for local authorities and other building societies because of their exposure to Dunfermline through £[300-600] million of time deposits and would consequently threaten financial stability in the UK. For these reasons, the UK authorities decided to intervene.

[*] […] denotes confidential information

2.3 The Measures

(9) The UK authorities, through their powers under the Special Resolution Regime, arranged for the break-up of Dunfermline. It was decided that the good parts of Dunfermline's business were to be sold immediately to third parties, while the remaining part was to be put into special administration and liquidated. With respect to the good parts of Dunfermline, a Transfer Package was created that was sold in a tender procedure (see Table 1 for an overview of the measure).

The Transfer Package

(10) The Transfer Package that was created for the sale of the good part of Dunfermline's business contained the following assets and liabilities (see also Table 1):

Assets (at book value)

(i) Dunfermline's originated mortgage portfolio of £1.021 billion;

(ii) Dunfermline's Treasury assets amounting to £[300-500] million;

(iii) Dunfermline's social housing portfolio of £[465-485] million;

(iv) Others assets of £[40-60] million;

(v) The Head Office and related staff and infrastructure (including retail branch network) of Dunfermline.

Liabilities

(vi) Dunfermline's entire retail liabilities amounting to £[2.2-2.4] billion;

(vii) Dunfermline's wholesale funding, excluding subordinated debt, of £[500-700] million;

(viii) Other liabilities of approximately £[50-80] million.

(11) Given that the liabilities of the transfer package exceed the assets, to facilitate the sale of the Transfer Package it was necessary that the assets in the Transfer Package would be supplemented by cash (as described in recital 16 below) from the Treasury (hereinafter "HMT") in order to match the assets to the liabilities.

(12) Most of this gap between the assets and liabilities in the Transfer Package relates to the retail deposit liabilities of Dunfermline. In the normal resolution procedure of a failed financial institution, the Financial Stability Compensation Scheme (hereinafter "FSCS") would be required to make a contribution to compensate eligible depositors for their losses. The cost for the FSCS would have been what the FSCS would have had to pay out to eligible depositors[2] had Dunfermline gone into insolvency immediately before the transfer of the Transfer Package, less the amount, estimated by an independent valuer, that the FSCS would have recovered in the insolvency of Dunfermline. However, this process would have taken some time and could in the view of the UK authorities have led to

[2] Approximately 87% of Dunfermline's retail deposit book is covered by the FSCS.

depositors being unable to access their deposits in the interim, which in turn could have repercussions on the financial stability in the UK. In order to avoid this situation and to facilitate the quick sale of the Transfer Package, the UK authorities chose to first make the payment to match the assets and liabilities in the Transfer Package and then recover from the FSCS the amount that it would have to pay once the necessary calculations have been made. According to the UK, these calculations have not yet been completed.

The tender procedure

(13) The Transfer Package was sold through a tender procedure in the form of a reverse auction. On the basis of a pre-process analysis, five bidders ([…], [...], Nationwide Building Society, [...] and […]) were identified and included in the tender selection process. These bidders were selected on the basis of their likely interest in obtaining the assets, their ability to execute in a short timeframe and to finance and integrate the transaction and their likelihood to inspire depositor confidence. All parties were given the same information, had equal access to a data room and were given the opportunity to consult Dunfermline's management and the UK authorities.

(14) Potential purchasers were asked to submit offers on three packages: (i) the Transfer Package as a whole as described in recital (10); (ii) the Transfer Package excluding social housing loans and deposits and (iii) social housing loans and deposits as a separate business entity.

(15) Three bids were received from Nationwide, […] and […]. No acceptable bids were received for the social housing portfolio which, as a consequence, was transferred to a Bridge Bank (owned and controlled by the Bank of England) for a transitional period until it could be sold.

(16) The bid of Nationwide for the Transfer Package excluding the social housing portfolio was adjudged to be the most economically advantageous and to best satisfy the objective of maintaining financial stability and protecting consumers and taxpayers. The amount of cash from HMT necessary to match the assets and liabilities in the Transfer Package was determined at £1.486 billion. The negative price agreed for the Transfer Package was £68.5 million, being the discount to the net value of the assets transferred to Nationwide, meaning that the HMT paid £1.555 billion in total in order to facilitate the sale of the Transfer package to Nationwide. The Transfer Package was transferred to Nationwide on 30 March 2009.

The social housing loans portfolio

(17) As no appropriate bids were received for the social housing portfolio, the portfolio was transferred on 30 March 2009 to a Bridge Bank, until the UK authorities could procure a sale of the portfolio.

(18) During the period that the £[465-485] million social housing portfolio was held by Bridge Bank, it was supported by a liquidity facility from the Bank of England of £[170-220] million to make sure that the social housing portfolio would be able to fulfill its legal obligations as regards its undrawn commitments. The liquidity facility was guaranteed and

indemnified by HMT. It was repayable within three months and Bridge Bank was required to pay a rate of LIBOR + [70-120] basis points (hereinafter "bps"). As Dunfermline's social housing portfolio and associated deposits are substantially more valuable than their related liabilities, this surplus value has been used to capitalise Bridge Bank.

(19) For the sale of the social housing portfolio, the same process as for the sale of the Transfer Package has been followed by the UK authorities. A wide range of potential bidders were identified, on the basis of existing involvement in social housing lending and commercial presence in Scotland. In total eleven potential bidders were identified, of which seven indicated sufficient interest to be included in a two-round process; two bidders ([…] and Nationwide) submitted bids for the social housing portfolio. On the basis of the same criteria used to assess bids in relation to the Transfer Package, the UK selected Nationwide as the preferred bidder and announced this on 17 June 2009.

(20) The consideration received from Nationwide for the social housing portfolio was £367 million and was paid into the Bridge's Bank's company account. These proceeds will be paid into the remaining part of Dunfermline that was put into liquidation (hereinafter "the Rump Dunfermline").

(21) The sale process was concluded on 30 June 2009. As the purpose of the Bridge Bank was fulfilled, the £[170-220] million liquidity facility provided to Bridge Bank ended on the same date.

The Rump Dunfermline

(22) The remainder of Dunfermline's business comprising its substantial commercial lending business (including the non-retail buy-to-let business amounting to £[500-700]million), the purchased mortgage portfolio and the remainder of the Treasury assets (£[150-300]million) together with the liability of Dunfermline to HMT of £1.555 billion and the subordinated debt of £50 million has been placed in a special form of administration (i.e. bankruptcy) for building societies. The Rump Dunfermline is being wound-down by its administrators with a view to maximising the value of the remaining assets and avoiding (or at least minimising) any requirement for a contribution from the State.

(23) The Rump Dunfermline no longer undertakes any new economic activities on any market. Its principal activity is the collect-out or sale of the existing loan and investment portfolio for the benefit of the Dunfermline creditors. This is consistent with its status as an institution in administration under applicable UK law.

(24) The Rump Dunfermline's main creditors are HMT and the FSCS. The decision of the UK authorities (in this case HMT) to contribute to the Transfer Package to match assets and liabilities in order to facilitate a quick sale means that HMT has temporarily replaced the FSCS in compensating the depositors. However, the FSCS ultimately remains liable to HMT for the same amounts it would have had to pay in case of the failure of Dunfermline. HMT therefore replaces the depositors as creditor of the Rump Dunfermline. Instead of having a liability to its former retail depositors, the Rump Dunfermline now owes HMT the funds that it contributed to the Transfer Package. The UK authorities have the same ranking as the former ordinary depositors would have had in the wind-up of the Rump Dunfermline, which is as an unsecured creditor.

(25) Save as mentioned below, the Rump Dunfermline is not writing (or permitted to write) any new business; it is not offering (or permitted to offer) new lending, refinancing (or permitted to refinance) existing lending, or selling (or permitted to sell) insurance of any kind. In line with this, it has only maintained the regulatory authorisations necessary to permit the administrators to wind-down its business[3]. As a result the Rump Dunfermline no longer has a banking licence enabling it to take deposits. It does however still have licences authorising it to run-off mortgage contracts, to enter into mortgage contracts where necessary to facilitate the wind-down and to manage the portfolio. Furthermore, the Rump Dunfermline is not porting existing lending to new properties or rolling existing lending onto new fixed rate terms.

(26) The administrators have discretion to allow draw-downs[4] where refusal would be in breach of pre-administration contractual commitments or in circumstances where refusal would cause unreasonable financial hardship (though no material draw-downs have to date been made for hardship reasons). The Rump Dunfermline has a potential total exposure of £[…] million under pre-administration contractual commitments although it is expected by the UK that no more than £[…] million will be drawn. Further advances in respect of financial hardship will be limited to £5 million in total.

(27) The administrators may also permit roll-over of matured loans on revised (tightened) terms, where enforcement at the point of maturity is not seen as the best outcome for creditors (i.e. principally HMT and the FSCS), consistent with the obligations of the administrators under applicable legislation. Given the limitations noted above, these very limited activities have no meaningful impact on any relevant market.

(28) A revolving working capital facility of approximately £10 million has been put in place by the Bank of England, guaranteed and indemnified by HMT, for the Rump Dunfermline. The facility is in place to make sure that the Rump Dunfermline fulfils its legal obligations and has sufficient working capital to meet its needs in the course of its wind-down. It has been made available on an uncommitted, on demand and short-term basis (three months). The Rump Dunfermline will pay LIBOR + [70-120] bps for the facility.

(29) To facilitate the sale of Dunfermline's business to Nationwide, the continued operation of Bridge Bank until the sale of the social housing portfolio and the wind-down of the Rump Dunfermline, several service level agreements were agreed between the three entities Nationwide, Bridge Bank and Rump Dunfermline. These services are limited to operational support, accounting and finance, customer accounting servicing, continuity of banking payment services and associated IT services. The fees to be paid for these services are on market terms. These transitional services will cease in the beginning of 2010.

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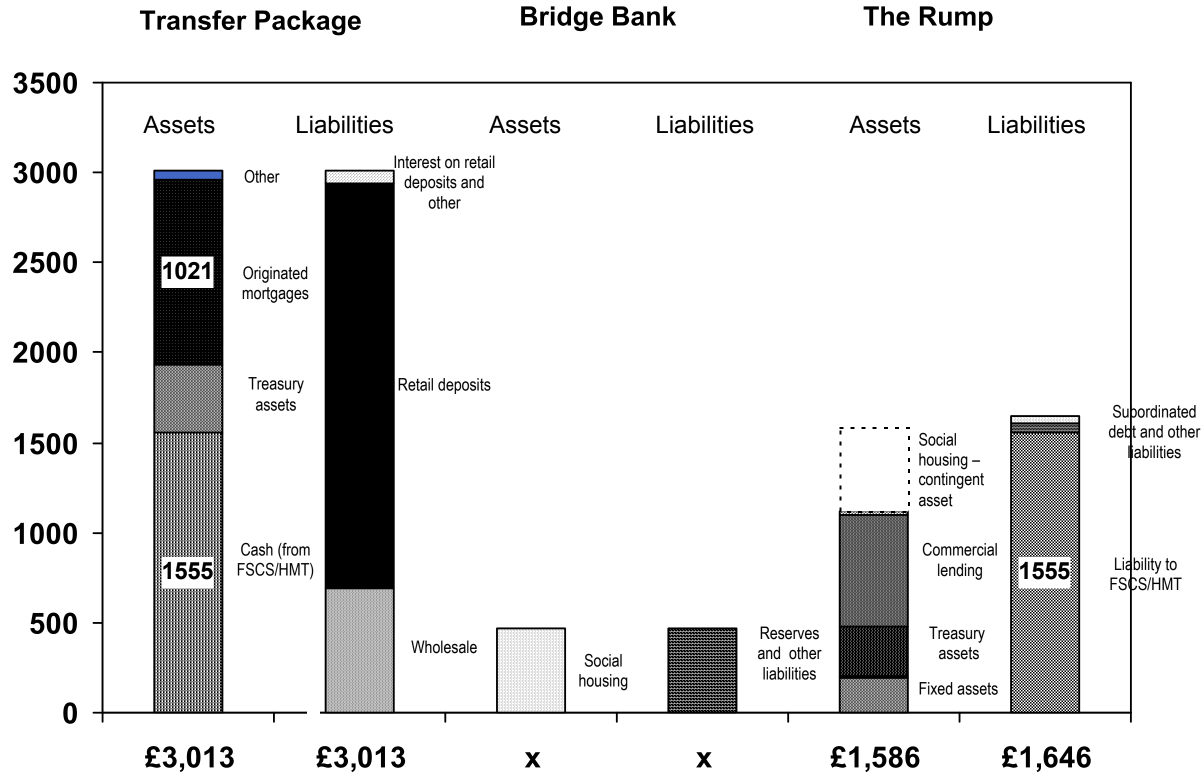
[3] The permissions currently held by the Rump Dunfermline are listed on the FSA website at http://www.fsa.gov.uk/register/firmPermissions.do?sid=77964.

[4] A draw-down is a legal commitment to provide funds that was entered into by Dunfermline prior to the State intervention and that is now part of the Rump Dunfermline in administration.

Table 1: Overview of split-up of Dunfermline



3 POSTION OF THE UK

(30) The UK authorities seek authorisation for the rescue and restructuring of Dunfermline, specifically for the working capital facility required for the wind-down of the Rump Dunfermline, the liquidity facility provided to the Bridge Bank and the cash contributed by FSCS/HMT to the Transfer Package.

(31) The UK authorities accept that these measures contain State aid elements. According to the UK both Dunfermline and the transferred business can be considered as beneficiaries of State aid. According to the UK, Dunfermline has to be considered as a distressed financial institution.

(32) The UK authorities consider that no State aid was given to the depositors, the buyer of the Transfer Package and the social housing portfolio and the subordinated debt holders.

(33) The UK submits that the measures are compatible with the internal market on the basis of Article 107(3)(b) TFEU[5] as they remedy a serious disturbance in the UK economy.

[5] With effect from 1 December 2009, Articles 87 and 88 of the EC Treaty have become Articles 107 and 108, respectively, of the Treaty on the Functioning of the European Union. The two sets of provisions are, in substance, identical. For the purposes of this Decision, references to Articles 107 and 108 of the TFEU should be understood as references to Articles 87 and 88, respectively, of the EC Treaty where appropriate.

According to the UK, the failure of Dunfermline would have had a twofold effect: (i) an immediate hit on the liquidity of the other building societies exposed to Dunfermline through the time deposits which would lead to liquidity problems for those societies and (ii) the undermining of confidence in other building societies which would limit their ability to obtain funding on the wholesale markets. These effects could have created significant difficulties for building societies to the extent that it may have precipitated the demise of other societies. As a result market sentiment would risk deteriorating rapidly, initially with regard to the building society sector but potentially then fanning out more widely across the financial system, with a domino effect on the financial market.

(34) The UK authorities note that, given the tension on the UK financial markets and the need to protect Dunfermline's members, urgent action was necessary and the only means of implementing this aim was through the permanent transfer of the Transfer Package to Nationwide and the social housing portfolio first to Bridge Bank and subsequently to Nationwide. Therefore the UK considers that due to concerns for financial stability at the time, it was necessary to effect the sale of the transfer package immediately.

(35) The UK authorities further explain that any aid must be warranted on grounds of "serious social difficulties". Dunfermline has around 361,000 retail deposit accounts and a substantial social housing portfolio. In the absence of the notified measures, Dunfermline as a whole would have become insolvent and its retail depositors would not have access to their accounts and mortgage arrangements for a considerable period of time. Serious social difficulties would also have occurred in relation to the social housing business.

(36) The UK authorities also consider that the aid granted through the measures is limited to the minimum necessary for the purposes of restructuring Dunfermline and procuring a sale into the private sector in a timely manner whilst preserving financial stability. This is also the case for the £[170-220] million liquidity facility for Bridge Bank to keep the social housing portfolio in business, which has meanwhile been repaid, and the working capital facility (of approximately £10 million) to allow the Rump Dunfermline meet its contractual obligations until it has been wound-down.

(37) Finally, the UK submits that the total wind-down of the Rump Dunfermline and the sale of the Transfer Package and the social housing portfolio, not only minimises any aid required, but also represent a major compensatory measure and own contribution amounting to the cessation and complete liquidation of businesses which had until very recently been central to Dunfermline and which generated very significant revenues. The UK government submits that this break-up of Dunfermline is a substantial and deep restructuring of the former which is proportionate to any distortive effect of the aid.

(38) The UK government has provided the following commitments:

(i) to submit yearly reports on the liquidation of the Rump Dunfermline, starting from the date of the present decision;

(ii) With regard to the Rump Dunfermline, the commitment that it will not carry out any new economic activities in the course of its liquidation, apart from the activities necessary to facilitate its liquidation.

4 ASSESSMENT

4.1 Existence of State Aid

(39) The Commission first has to assess whether the measures constitute State aid within the meaning of Article 107(1) TFEU. According to this provision, State aid is any aid granted by a Member State or through State resources in any form whatsoever which distorts, or threatens to distort, competition by favouring certain undertakings, in so far as it affects trade between Member States.

(40) In the present case, it is clear that State resources are involved, in particular regarding the working capital facility of £10 million for the Rump Dunfermline, the liquidity facility of £[170-220] million to keep the social housing portfolio in business until its sale to Nationwide and the HMT cash contribution of £1.555 billion in order to match the liabilities comprised in the Transfer Package.

(41) Given that Dunfermline is an undertaking active in the financial sector, which is open to intense international competition, the Commission considers that any advantage from State resources to Dunfermline would have the potential to affect intra-Community trade and to distort competition.

(42) Finally, it has to be examined whether the measures lead to a selective advantage for it to constitute State aid.

(43) The Commission identifies five parties that could potentially benefit from the aid contained in the Transfer Package (including the working capital facility to the Bridge bank and the liquidity facility to Rump Dunfermline): i) Dunfermline's retail depositors; ii) Dunfermline's holders of subordinated debt; iii) the purchaser of part(s) of Dunfermline, in this case Nationwide; and iv) the business transferred to Nationwide and (v) the Rump Dunfermline.

(i) Retail depositors

(44) Consistent with its previous Decisions on Bradford & Bingley and Kaupthing Luxemburg[6], the Commission is of the view that there is no State aid to retail depositors of Dunfermline because they are individuals and not undertakings. Even if there are enterprises among the depositors, the aid should be considered de minimis and therefore outside State aid control.

(ii) Subordinated debt-holders

(45) Dunfermline has in issue £50 million of 6% subordinated notes due for repayment in 2015. These notes have been transferred to the Rump Dunfermline. The UK has submitted that the subordinated debt holders rank behind all other creditors and will therefore only

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[6] Commission Decision in Case NN41/2008, Rescue aid to Bradford & Bingley, OJ C 290, 13.11.2008, p. 2 and Commission Decision in Case N344/2009, Restructuring of Kaupthing Luxemburg, OJ C 247, 15.10.2009, p. 3.

be eligible to receive payments out of the liquidation of the Rump Dunfermline in case there are remaining funds after the payment of all the more senior creditors.

(46) The Commission observes that the subordinated creditors only receive payments after all other, more senior, creditors have been paid. The Commission therefore concludes that the subordinated creditors will not have a special position in the Rump Dunfermline's liquidation and that consequently no advantage has been conferred on them. Therefore, no aid has provided to the holders of subordinated debt.

(iii) Purchaser (Nationwide)

(47) As regards the acquisition of the Transfer Package and the social housing portfolio by Nationwide, an advantage for it could only exist if the price paid by Nationwide was too low. On the basis of the information provided by the UK authorities, the Commission considers that the sale process of both the Transfer Package and the social housing portfolio is similar to an open and non-discriminatory tender which resulted in the best bid winning the tender. Several firms were approached and included in the tender procedure and the parties had equal access to information. The Commission has, therefore, no reason to believe that the price paid did not reflect the market price.[7] Consequently, Nationwide did not receive aid.

(iv) The Dunfermline business transferred to Nationwide

(48) With regard to the Dunfermline entity that was transferred to Nationwide as part of the restructuring process, the Commission has to investigate whether it continues to undertake economic activities. If the Commission concludes that this is so, the Commission has to establish whether it can be considered as a potential beneficiary of State aid.

(49) In the present case, the Commission notes that the Transfer Package comprises a substantial part of Dunfermline's business activities (at least 50% of the former Dunfermline's assets), including: branches, staff and IT together with originated mortgages, retail deposits and wholesale deposits. After the transfer of the business to Nationwide, the Dunfermline branches and network have continued to operate as normal. The transferred entity has thus been allowed to continue to provide the same products to its customers as it did before the transfer (i.e. mortgages, personal savings, insurance, etc). Nationwide has communicated its intention to operate Dunfermline as a separate brand, within Nationwide's established portfolio of regional brand franchises[8].

(50) The Dunfermline entity transferred to Nationwide undertakes economic activities, as it provides a variety of financial services to its customers on the financial markets. Taking

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[7] Please see paragraph 21 of the Commission Communication on the return to viability and the assessment of the restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009, p.9.

[8] See http://www.dunfermline.com/faqs.aspx.

the above into consideration, the Commission finds that the Dunfermline entity transferred to Nationwide continues to undertake an economic activity.

(51) The Commission observes that the State intervention allowed most of Dunfermline's economic activity to continue. Indeed, the economic activity corresponding to the Transfer Package would not have been transferred at the same conditions, in the sense that the Dunfermline brand and its associated customers and goodwill remained relatively intact, to Nationwide without the HMT/FSCS cash contribution.. Therefore, the HMT/FSCS contribution constitutes an advantage in favour of the economic activities transferred.

(v) The Rump Dunfermline

(52) The Rump Dunfermline has been put into administration. It will only carry out the activities necessary to collect-out or sell the existing loan and investment portfolio for the benefit of the Dunfermline creditors.

(53) In order to facilitate the wind-down, the Rump Dunfermline will undertake economic activities, such as the sale of its assets and debt management on its portfolio. Furthermore, the Rump Dunfermline will for a period of time provide transitional services to the Dunfermline businesses transferred to Nationwide. As those services are also provided by other operators on the market, the Rump Dunfermline will potentially compete with them. It is therefore concluded that the Rump Dunfermline will be able to continue to carry out some limited economic activities and therefore can be considered as an undertaking.

(54) The transfer of the Transfer Package combined with the aid measures has enabled the orderly restructuring of Dunfermline. The Commission notes that the sale of the Transfer Package to Nationwide would not have been possible without the contribution from HMT to match the assets to the liabilities. This contribution added to the overall value of the assets contained in the Transfer Package. Without the State intervention, the fair value of Dunfermline's customer goodwill (directly related to the retail deposit book) would have been significantly eroded. The cash contribution by HMT therefore effectively increased the price that the bidders were prepared to pay for the Transfer Package (or in this case reduced the negative price that they required).

(55) The Rump Dunfermline also receives a liquidity facility of £10 million to enable it to fund its working capital needs during the winddown process. The Commission therefore concludes that an advantage has been conferred to the Rump Dunfermline.

(56) Furthermore, the Commission notes that the transfer of the social housing portfolio by the UK authorities to Bridge Bank, combined with the £[170-220] million liquidity facility, prevented the loss of value to that portfolio that would have occurred if Dunfermline had been liquidated. The intervention of the UK also aided the subsequent sale of that portfolio to Nationwide, of which the Rump Dunfermline will acquire the proceeds. This would not have been possible without State intervention.

(57) The Commission finally considers that the market investor principle is not applicable in this case as no investor would have contributed £1.555 billion to an insolvent bank. The Commission also considers that no investor would have provided a £10 million working capital facility to a bank that was to be liquidated or a liquidity facility of £[170-220] in order to facilitate the sale of a social housing portfolio.

Conclusion

(58) Due to the above considerations, the Commission considers that the Transfer Package, containing the cash payment by HMT, together with the working capital facility to the Rump Dunfermline and the liquidity facility to Bridge Bank, fulfils all conditions laid down in Article 107(1) TFEU and, therefore, contains an aid to the Dunfermline business purchased by Nationwide and to the Rump Dunfermline.

4.2 Compatibility of the aid with the internal market

(59) As a preliminary remark, the Commission notes that the measures taken in this case combine a direct restructuring of part of Dunfermline's business (through the transfer of the Transfer Package and the social housing portfolio) and a liquidation of the remaining part, rather than a rescue measure which is later followed by a restructuring.

(60) Around 50% of the former Dunfermline's assets and almost all its liabilities have been transferred to Nationwide and, therefore, the majority of Dunfermline's business activities will continue as before, albeit under a new owner. The impaired assets, which to a considerable degree caused Dunfermline's difficulties, are left behind in the Rump Dunfermline. The Rump Dunfermline will be wound-down by the UK authorities.

(61) As regards compatibility of these measures with the internal market, the Commission first has to assess whether the aid remedies a serious disturbance in the economy of the UK. Subsequently, the Commission needs to assess if the measures at issue are in line with the conditions set out in the Commission's Communications on the application of Article 107(3)(b) TFEU.

Legal basis for the compatibility assessment

(62) Article 107(3)(b) TFEU provides for the possibility that State aid can be regarded as compatible with the internal market where it is intended to "remedy a serious disturbance in the economy of a Member State".

(63) Given the present circumstances in the financial markets, the Commission considers that the measures may be examined under that provision.

(64) The Commission notes that Dunfermline is the largest Scottish building society with a substantial amount of members (i.e. customers). Due to Dunfermline's considerable exposure to high risk commercial loans in the housing sector, the downturn on the housing market forced it to take substantial impairments. This in turn affected its capital ratios to such a degree that the FSA concluded it was likely to fail regulatory requirements.

(65) Building societies form an important part of the UK financial sector, particularly with regard to smaller savers and borrowers, in part due to their mutual status. The failure of Dunfermline would have had negative consequences for all other building societies holding time deposits with Dunfermline. These building societies would have suffered an immediate hit in their liquidity as they would have had difficulty to immediately absorb the losses caused by Dunfermline's failure. As a result other building societies could have

become troubled and in need of aid. Moreover, the failure of a significant building society would certainly have undermined confidence of depositors in the UK financial system.

(66) For these reasons the Commission accepts that Dunfermline's failure could have affected the financial stability in the UK and that the working capital facility to the Rump Dunfermline, the FSCS/HMT cash contribution to the Transfer Package and the liquidity facility for Bridge Bank were necessary to preserve the confidence of creditors in the financial system and to avoid a serious disturbance in the UK economy.

Compatibility assessment

(67) The Commission has established that the Dunfermline business transferred to Nationwide as well as the Rump Dunfermline will benefit from several State aid measures.

(68) The Commission notes that the break-up of Dunfermline, in order to facilitate the sale of part of it to Nationwide, is a kind of asset relief measure benefitting the economic activities of Dunfermline that remain on the market through the Dunfermline business transferred to Nationwide. The effect of the aid measures undertaken by the UK was the creation of an entity (sold to Nationwide) that is relieved from the impaired assets of its predecessor. By virtue of its intervention to enable the sale, the State temporarily replaces the depositors in the insolvency process and as such becomes a majority creditor of the Rump Dunfermline, as described in recital (12), while the Dunfermline business transferred to Nationwide benefits from the corresponding cash. Therefore, the Dunfermline business transferred to Nationwide, being the continuation of economic activity of the former Dunfermline, does not bear the consequence of potential losses on the assets left behind in the Rump Dunfermline.

(69) The Rump Dunfermline will contain the assets that were not included in the Transfer Package. Its administrators will realise these assets with a view to discharging Dunfermline's obligations. It should be noted however, that the State, as the Rump Dunfermline's largest creditor, will not necessarily bear all the losses from these assets. As described in recital (12), the FSCS is required to pay the State any shortfall between the amount that it would have recovered in the insolvency process from the assets of the Dunfermline absent the State intervention and the amount required to compensate eligible depositors.

(70) Notwithstanding the above, the split of Dunfermline was the result of a public intervention and accompanied by measures which qualify as State aid. The Commission observes that although in this transaction the State is formally not guaranteeing losses on the assets (whether as an owner or as a guarantor), it produced end-effects equivalent to a transaction guaranteeing losses whereby, at least in the short-term, the State assumes de facto a major part of the risk of losses from the impaired assets in the Rump Dunfermline. Therefore the Commission needs to first scrutinise it under its Impaired Assets Communication[9] (hereinafter "IAC").

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9 Commission Communication on the treatment of impaired assets in the Community banking sector, OJ C 72, 26.3.2009, p.1.

(71) The Commission furthermore observes that the split-up of Dunfermline by the UK authorities has as a consequence the restructuring of Dunfermline. It is therefore necessary for the Commission to assess whether the restructuring of Dunfermline is in line with the Commission's Restructuring Communication[10] and to take into account those conclusions in its analysis of the measures under the IAC.

The application of the Impaired Assets Communication

(72) The specific conditions applying to asset relief measures are laid down in the IAC. Pursuant to section 5.2 of the IAC, an asset relief measure should ensure ex-ante transparency and should provide for adequate burden-sharing followed by the correct valuation of the eligible assets and the correct remuneration of the State so that the asset relief measure ensures shareholders' responsibility.

(73) Ex-ante transparency implies a clear identification of the impaired assets. This indeed was already done in the present case, since Rump Dunfermline's assets are delimitated as those assets of Dunfermline that were not sold in the auction process of the Transfer Package.

(74) As regards burden-sharing of the costs related to the impaired assets between the State, shareholders and creditors, the Commission notes that both the former members and the subordinated debt holders will contribute to the restructuring of the bank to the greatest extent possible as they remain with the Rump Dunfermline. Depending on their degree of subordination, they will bear the potential losses from assets held by Rump Dunfermline in accordance with ordinary bankruptcy laws.

(75) The impaired assets remaining in the Rump Dunfermline will be managed exclusively by the Rump Dunfermline and its administrators. The Rump Dunfermline will be separate and organisationally independent from the transferred entity. The Commission therefore finds that the requirements of section 5.6 of the IAC are met.

(76) Concerning the valuation of the impaired assets, section 5.5 of the IAC outlines the approach that should be followed by any impaired asset measure. In particular it stresses the necessity that the transfer value of assets in an impaired asset measure should be based on their real economic value (hereinafter "REV"). The Commission notes that in the present case no ex-ante valuation of the assets has been conducted. The REV of the assets included in the Transfer Package was therefore not established; instead these assets were sold as part of an auction process. With regard to the assets in the Rump Dunfermline, the Commission observes that the contribution of the State to the sale of the Dunfermline business transferred to Nationwide is unrelated to the REV of these assets, as this contribution was based on the amount of cash needed to compensate depositors and ensure the sale of that part of Dunfermline's business. Consequently, the exposure of the UK to the Rump Dunfermline was not determined objectively ex-ante. Furthermore, the State is unable to adjust the transfer price paid in the event that the transfer value proves higher than the REV.

[10] Commission Communication on the return to viability and the assessment of the restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009, p.9.

(77) For the reasons stated in recital (76), the Commission considers that the measure does not meet the valuation requirement of the IAC.

(78) With regard to the remuneration paid for the asset relief, the IAC requires that banks must pay some form of remuneration for the capital relief achieved by impaired assets measures. The Commission notes that in this case there is no remuneration paid for the implied asset relief by the Dunfermline business transferred to Nationwide. In addition, the State will not recuperate any benefit which the Dunfermline business transferred to Nationwide may enjoy as a result of the asset relief measure through a higher sale price of the assets, since the business has already been sold without any possibility of revising the price obtained. Therefore, the measure does not meet the remuneration criterion of the IAC.

(79) In line with points 49 and 50 of the IAC, non-compliance with the requirement of the beneficiary to adequately contribute to the costs of the impaired asset programme can only be exceptionally accepted if such a contribution is materially not possible and is subject to stricter requirements on the measures necessary to guarantee the return to viability and remedy competition distortions.

(80) In order to establish whether it was "materially not possible" for the beneficiary to adequately contribute to the cost of the asset relief measure, the Commission has to take into account the valuation of the assets concerned and the remuneration paid for the asset relief.

(81) The Commission considers that in this case it was materially not possible to meet the valuation criterion of the IAC. When assessing whether an ex-ante valuation was materially possible, the Commission has to consider the specific circumstances of the case before it. The Commission observes that Dunfermline was sold through a relatively rapid auction (while still taking into account the principles of openness, transparency and unconditionality). This immediate sale targeted the objective of restoring financial stability and was feasible in particular thanks to the limited size of the bank and the fact that its business was sufficiently compact to be sold to and integrated rapidly by Nationwide. A rapid sale was a means of maximising proceeds from the sale (i.e. limiting the amount the UK had to contribute to the sale) and an acceptable way to preserve the value of the business. In these circumstances, an ex-ante valuation would have excessively delayed the sale that was otherwise desirable.

(82) With respect to the remuneration, the Commission notes that its determination was not carried out in accordance with the IAC. In this respect, in line with recital (81), the Commission recalls that, given the circumstances of the sale, it was not possible for the State to impose an appropriate remuneration.

(83) As a result, the Commission concludes that the criterion of an adequate contribution by the beneficiary to the costs of the asset relief measure is not met as the valuation and remuneration criteria are not complied with. In line with point 50 of the IAC, this has as a consequence that the conditions relating to the return to viability and measures limiting the distortion of competition are subject to stricter requirements.

(84) As regards the measures necessary to guarantee the return to viability and remedy competition distortions, which will be further discussed below in recitals (89) to (106) and (123) to (130), Dunfermline was indeed subject to a far-reaching restructuring which

addresses the issues of viability and limitations of competitive distortions. To summarise, the bank was split up, with a good part containing 50% of the assets of Dunfermline sold to a new owner. Considering the size of the bank and its very limited market shares, together with the fact that the Dunfermline business transferred to Nationwide was sold in a process that closely resembled an open, transparent and unconditional tender by the UK, that level of restructuring can be considered as sufficient in this context.

(85) As regards the attainment of the objective of appropriate burden-sharing, in this case, as indicated in recital (74), burden-sharing has been achieved as both the former members and the subordinated debt holders remain with the Rump Dunfermline, with a ranking corresponding to ordinary bankruptcy laws, and have no stake in the transferred Dunfermline business. As to the second objective, the distortion of competition can be considered as minimised as a result of the considerable down-sizing of Dunfermline in the context of its in-depth restructuring. In addition, the distortion of competition is also minimised by the fact that the transferred Dunfermline business was sold through an auction process. This process contributed to minimising the amount of State resources and aid contained the measure. Therefore, the Commission considers that the objectives pursued by the requirement for appropriate remuneration, namely burden-sharing and minimising competition distortion, have been attained by other means.

(86) It is therefore concluded that, despite non-compliance with the criteria of valuation and remuneration, in view of the far-reaching restructuring described below, taking into account that the competition distortion has been limited by the scaling-down and sale of part of Dunfermline in a process that closely resembled an open, transparent and unconditional tender, and considering that a rapid sale without an ex-ante valuation was desirable, the asset relief in favour of the Dunfermline business transferred to Nationwide is in conformity with the IAC, in particular its point 50.

<u>The degree of required restructuring</u>

(87) The Commission observes that on 28 March 2009 the UK authorities concluded that Dunfermline failed or was about to fail to meet the threshold conditions for authorisation under the Financial Services and Markets Act. The UK authorities then transferred the activities contained in the Transfer Package to a third party purchaser and decided to liquidate the remaining Rump Dunfermline. In view of the above the Commission considers that the restructuring should in effect be a liquidation indicating how Dunfermline will be broken up in an orderly fashion, in line with point 9 of the Restructuring Communication.

<u>The application of the Restructuring Communication</u>

(88) The Restructuring Communication sets out the State aid rules applicable to the restructuring of financial institutions in the current crisis. According to the Restructuring Communication, in order to be compatible with Article 107(3)(b) TFEU, the restructuring of a financial institution in the context of the current financial crisis has to:

(i) Lead to a restoration of the viability of the bank or demonstrate how it can be wound up in an orderly fashion;

(ii) Include sufficient own contribution by the beneficiary (burden-sharing);

(iii)Contain sufficient measures limiting the distortion of competition.

(i) Restoration of viability/wind-up in an orderly fashion

(89) The Restructuring Communication provides in points 9 and 10 that the Member State should provide a comprehensive and detailed restructuring plan which should include a comparison with alternative options. Where a financial institution cannot be restored to viability, the restructuring plan should indicate how it can be wound up in an orderly fashion. The plan should furthermore also identify the causes of the difficulties faced by a financial institution.

(90) As mentioned in recital (59), the UK authorities have chosen to embark on a direct restructuring of Dunfermline. In the notification as well as in the further information the UK has provided to the Commission, the details of the restructuring of Dunfermline have been set out. The UK authorities furthermore made clear that they considered various options before they decided to pursue a restructuring of the business. An analysis of the troubles faced by Dunfermline was also provided (see recitals 7-9 above). The Commission therefore considers the conditions of points 9 and 10 of the Restructuring Communication to be met.

(91) In the present case the Commission observes that the UK authorities have chosen an orderly wind-up of Dunfermline through the sale of parts of it to a third party and the liquidation of the Rump Dunfermline. The Commission therefore has to assess whether; a) the break-up of Dunfermline has occurred in an orderly fashion, b) the business of Dunfermline transferred to Nationwide will be viable and c) the Rump Dunfermline is liquidated in an orderly fashion.

a) Break-up of Dunfermline in orderly fashion

(92) The Commission notes that under the Special Resolution Regime, which is part of the legislative changes contained in the Banking Act 2009 adopted by the UK to combat the financial crisis, a legal framework is in place that gives the UK authorities the power to break-up a financial institution in an orderly fashion. The UK authorities have used these powers in the case of Dunfermline. Based on the information available to the Commission, it has no reason to doubt that Dunfermline has been broken-up in an orderly manner.

b) Viability of the entity transferred to Nationwide

(93) As regards restoration of viability, a major part of Dunfermline's business has been sold to Nationwide while the other part will be liquidated. Since the Commission has established that the business transferred to Nationwide continues to carry out an economic activity and has benefited from aid, it has to verify whether the restructuring will ensure long-term viability of the business.

(94) The Restructuring Communication in point 17 confirms that a sale of part of the financial institution to a third party can help to restore its long-term viability. In this context, the

Commission notes that chapter 5 of the Banking Communication[11] is also relevant. Given the sale process described in recital (13), the Commission is satisfied that the the requirements in the Restructuring Communication and the Banking Communication are met.

(95) The Commission notes that Dunfermline's high quality assets together with liabilities and cash from HMT were sold to a competitor, which is viable and capable of absorbing Dunfermline's business. Nationwide has a balance sheet total of £202 billion and recorded a pre-tax profit of £212 million over the last financial year (April 2008 - April 2009)[12]. In the period April 2009-September 2009, Nationwide recorded a pre-tax profit of £143 million. Nationwide's business model is conservative, with over 70% of its funding based on retail deposits. Its dependence on wholesale funding therefore is limited. The average loan-to-value (LTV) of mortgages in Nationwide Group is 63% (as on 30 September 2009). Approximately 73% of Nationwide's mortgages has a LTV lower than 70% (September 2009). The Group's core tier-1 ratio was 12% and its tier-1 ratio was 15% (September 2009).

(96) The Commission notes that the impact of the acquisition of Dunfermline on Nationwide's balance sheet was less than 1%, based on a Nationwide balance sheet of £179 billion at April 2008 and the Dunfermline business transferred to Nationwide of £1.7 billion, thus giving a balance sheet increase of 0.95%.

(97) The Commission furthermore observes that Nationwide, in September 2008, announced mergers with Derbyshire and Cheshire Building Societies, which were reported as having assets of £7.1 billion and £5 billion respectively (i.e. both significantly larger than the acquired parts of Dunfermline).

(98) As regards the integration of Dunfermline's business, Nationwide intends to operate Dunfermline as a regional brand and will in the medium-term integrate Dunfermline's business in order to realise cost synergies and efficiencies as a result of consolidation of spending within the group and consolidation of some product ranges.

(99) For these reasons, the Commission therefore has no reason to doubt the viability of Nationwide or its ability to integrate the Dunfermline business it acquired.

(100) In addition, the Commission also considers the Dunfermline business transferred to Nationwide to be a viable business. The Commission observes that the assets in the Transfer Package include mortgages (with an average LTV of 68%), cash from HMT/FSCS, branches, staff, the Dunfermline brand, IT and know-how. The liabilities include all retail deposits (approximately 70%) and wholesale deposits (approximately 30%). As such it is an entity with good quality assets and a good funding position (loan-to-deposit ratio of approximately 45%). It also has the benefit of its existing customer relationships and its branch network. The Commission notes in this context that the Dunfermline business transferred to Nationwide has continued business as usual.

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11 Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, OJ C 270, 25.10.2008, p. 8.

12 Source: Nationwide's annual accounts March 2008 – March 2009 and half-yearly financial report for the period ended 30 September 2009, available on: http://www.nationwide.co.uk/investorrelations/default.htm

(101) Furthermore, the Commission observes that the Dunfermline business transferred to Nationwide has been cleansed of its impaired commercial loans. The separation of Dunfermline has thus ensured that the Dunfermline business transferred to Nationwide is no longer burdened by potential losses on this particular loan portfolio. This aids its return to viability.

(102) The Commission is therefore satisfied that both the buyer of the Transfer Package and the Dunfermline business transferred to it are viable.

c) Orderly liquidation of the Rump Dunfermline

(103) Concerning the wind-down of the Rump Dunfermline, the Commission observes that, apart from the limited activities described in recitals (27) and (28), it no longer undertakes any new activities on the market and only provides those services to the Dunfermline entity transferred to Nationwide that are necessary to service the transferred loans. The Commission notes that the UK authorities have given the commitment that the Rump Dunfermline will not carry out any new business.

(104) With respect to working capital facility granted by the UK, the Commission notes that this is to be used to fund the pre-existing commitments of the Rump Dunfermline. The facility will facilitate the orderly wind-down of the Rump Dunfermline as it will ensure that the Rump Dunfermline will meet its legal obligations and prevent impairments which could negatively effect the orderly liquidation of the Rump Dunfermline.

(105) The Restructuring Communication in point 21 provides that governments should allow for the exit process to take place within an appropriate time frame that preserves financial stability. On the other hand, the Banking Communication in point 47 is clear that the liquidation phase should be limited to the period strictly necessary in view of the objective pursued.

(106) The Commission observes that the Rump Dunfermline has been placed into administration and has to be liquidated within the ordinary legal framework for such operations. The Commission notes that the insolvency procedure is likely to take a considerable period of time. The Commission furthermore observes that the UK authorities have provided a commitment to provide a yearly report on the liquidation of the Rump Dunfermline.

(107) The Commission understands that the Rump Dunfermline retains some limited regulatory permissions only for technical reasons not related to deposit taking activity, but which constitute part of the strategy to minimise costs foreseen in the liquidation plan. Therefore the Commission considers the retention of these permissions necessary for an orderly wind-down.

(108) On the basis of the forgoing, the Commission is satisfied that Dunfermline has been broken-up in an orderly fashion and that the restructuring of Dunfermline ensures the long-term viability of that part of its business that was transferred to Nationwide. The Commission furthermore concludes that the winding-down of the Rump Dunfermline satisfies the conditions of the Restructuring Communication.

(ii) Own contribution/burden-sharing

(109) The Restructuring Communication indicates that an appropriate contribution by the beneficiary is necessary in order to limit the aid to minimum and to address distortions of competition and moral hazard. To that end, firstly, the restructuring costs should be limited while, secondly, the aid amount should be limited and a significant own contribution is necessary.

(110) As regards the limitation of the restructuring costs, the Restructuring Communication indicates in point 23 that the restructuring aid should be limited to cover the costs which are necessary for the restoration of viability.

Limiting of restructuring costs

(111) The Commission has identified the following costs associated with the restructuring of Dunfermline: the £1.555 billion HMT/FSCS cash contribution to match the assets of the Transfer Package to the liabilities; the £[170-220] million liquidity facility provided to Bridge Bank to service the social housing portfolio until it was sold; and the £10 million working capital facility that is provided to the Rump Dunfermline.

(112) As regards the HMT/FSCS cash contribution, the Commission notes that the amount of the contribution was determined during the tender process conducted for the Transfer Package in which interested parties were asked to bid for assets and liabilities. In this process the best bid basically consisted of the biggest Transfer Package with the lowest HMT/FSCS cash contribution. Therefore the tender process has helped to limit the contribution of the UK to the sale process. The Commission also notes that HMT will, as the largest creditor of the Rump Dunfermline recover a considerable part of the cash it has provided to facilitate the sale of the Transfer Package[13]. Part of the shortfall, i.e. the difference between what HMT has put in to facilitate the sale and what it will receive out of the bankruptcy of the Rump Dunfermline, will be recovered from the FSCS (see recital 12 above). The exact amount HMT will recover has yet to be determined. However the fact that HMT will recover a substantial amount of its contribution, in fact, limits the costs for the UK.

(113) The UK has previously conducted similar interventions to refund the creditors of failing banks, as in the case of Bradford & Bingley[14] (hereinafter "B&B"), so as to maintain financial stability. However, in the B&B case, the UK did not include any financial assets of the bank as part of the transfer package, it simply provided cash to match the retail deposits and decided to realise the value of the remaining assets over the wind-down process. While this approach was effective in compensating depositors, raising the money represents a considerable strain on public finances.

(114) In the present case however, the UK includes some of the good assets of Dunfermline in the transfer package as well as some wholesale liabilities. This reduces the amount of cash

[13] In this context it is relevant to note that the FSCS, in case of a failure of a financial institution, covers all deposits up to £50,000 and that 87% of the retail deposit book of Dunfermline (approximately £2.3 billion) is covered by the FSCS.

[14] Commission Decision in Case NN41/2008, Rescue aid to Bradford & Bingley, OJ C 290, 13.11.2008, p. 2.

that the State had to provide as part of the Transfer Package to approximately £700 million, as the retail deposits alone amount to £[2.2-2.4] billion while the total cash contribution of HMT in this case was £1.555 billion. The approach taken by the UK thus reduces the amount of State resources committed up-front. Therefore the Commission considers that the UK has taken appropriate steps to reduce the amount of aid in the measure[15].

(115) Concerning the liquidity facility provided to Bridge Bank, the Commission considers that it was in place for a limited period of time (from 30 March 2009 to 30 June 2009). The liquidity facility was necessary to ensure that the social housing portfolio fulfilled its legal obligations as regards its undrawn commitments. No other commercial activities of the social housing portfolio were financed with the facility. The UK authorities received a remuneration of LIBOR + [70-120] bps for the facility. The facility was terminated and repaid on the day the social housing portfolio was transferred to Nationwide, thus limiting the aid.

(116) With regard to the working capital facility, the Commission notes that this facility will provide the liquidity necessary to sure that the Rump Dunfermline fulfils its legal obligations until it is wound-down by its administrators. This will help to maximise the value of the remaining assets as it will prevent impairments. The facility will not enable the Rump Dunfermline to engage in new business activities. The Rump Dunfermline will have to pay a fee for the working capital facility of LIBOR + [70-120] bps.

(117) The Commission considers that the pricing of the State measures granted for a bank under liquidation should be in principle market-oriented. However, if the presence of a liquidated bank is almost entirely removed from the market, a lower remuneration for a given measure does not produce significant market distortions. Therefore, in certain circumstances it can accept lower or even no remuneration[16].

(118) The Commission observes that the remuneration that the Rump Dunfermline pays for the aid it receives and the remuneration paid by Bridge Bank for its liquidity facility cannot be considered as market-orientated. However, the Commission notes, in line with point 25 of the Restructuring Communication, that inadequate burden-sharing can be compensated for by a far-reaching restructuring of the bank concerned. In this case, the Commission observes that a far-reaching restructuring takes place through the separation of Dunfermline and the liquidation of the remaining part. Furthermore, the Commission

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15 In the present case the UK could have followed the same approach as in B&B, excluding the financial assets from the transfer package, instead contributing more cash and recovering that cash from the proceeds generated from the wind-down of the building society. However, the Commission considers the Dunfermline approach as a better option. Firstly it reduces the cash that the State has to raise immediately, avoiding further straining public finances. Secondly it makes the wind-down of the Rump Dunfermline less complicated. The State no longer has to manage a mortgage portfolio nor be concerned with the treatment of the wholesale creditors, as these have been transferred. In addition, the Rump Dunfermline does not need to retain so many regulatory permissions, as its regulatory requirements are much simpler.

16 See Commission Decision in Case C14/2008 (ex NN 1/2008), *Restructuring of Northern Rock*, not yet published.

notes that the State in any case will retain priority on the proceeds from the wind-down of the Rump Dunfermline, which means that the State is in the position to maximise the recovery of any State aid granted.

Limited amount of aid/Own contribution

(119) The Restructuring Communication sets out in point 24 that companies should use their own resources to finance restructuring, for instance through the sale of assets. In addition the costs of the restructuring should also be borne by investors, loss absorption and by paying an adequate remuneration.

(120) The subordinated debt holders will in any case not benefit from the measures taken by the UK authorities to prevent Dunfermline's failure. They are part of the Rump Dunfermline which is in the process of being liquidated. They rank last or second last and will only be paid out after all the other creditors have been compensated. In this regard, the Commission also notes that the depositors, which in building societies such as Dunfermline are also the owners, have lost all ownership rights in the Rump Dunfermline.

(121) Furthermore, the Commission notes that the UK authorities intervened after they had been informed by the FSA that Dunfermline no longer satisfied regulatory capital requirements due to the losses on the commercial loans it had to absorb. As part of the intervention, a substantial part (50%) of Dunfermline's business was sold to a competitor through an auction process. This amounts to a far-reaching restructuring of Dunfermline, as set out in point 25 of the Restructuring Communication.

(122) Therefore, on the basis of recitals (111 to 118), the Commission concludes that the restructuring costs are limited to the minimum necessary. It also considers, based on recitals (119) to (121), that there has been a sufficient own contribution by Dunfermline and its subordinated debt holders in the context of the restructuring, thus limiting the aid to minimum neccessary.

(iii) Measures limiting the distortion of competition

(123) As regards the measures limiting the distortion of competition, the Restructuring Communication indicates in point 30 that the Commission has to take into account in its assessment the amount of aid and the conditions and circumstances under which that aid was granted (including, in this context, the degree of burden sharing) and the effects of the position the financial institution will have on the market after the restructuring. On the basis of that analysis, suitable compensatory measures should be put into place.

(124) In this context, the Commission observes that the break-up of the former Dunfermline and the subsequent wind-down of 50% of its business can be seen as a significant compensatory measure.

(125) The Commission also finds that the exit of a failed entity which engaged in excessive risk-taking is a clear indication that moral hazard is addressed, in that commercial failure results in a break-up and liquidation. As a result, the distortion of competition resulting from the State aid is greatly reduced.

(126) The Commission furthermore notes that the restructuring of Dunfermline, i.e. the sale of a large part of its business to a competitor, has been undertaken in an adequately open, transparent and non-discriminatory tender procedure. This has given competitors the opportunity to acquire part of Dunfermline. The procedure, which closely simulates the situation on the market without aid, has the effect of limiting the distortions of competition as it aims to ensure the establishment of a market price for the assets and liabilities taken over by the purchaser.

(127) However, the Commission observes that the Rump Dunfermline will continue carrying out some limited activities with existing clients, as described in recitals (26) to (27). Such activities will only be allowed during the liquidation phase insofar as they are strictly necessary to accelerate the liquidation process and minimise impairments while treating creditors fairly. In addition, the UK has committed that the aggregated value of all further advances based on hardship underwritten by the Rump Dunfermline will be limited to a maximum of £5 million. The Commission considers that these are sufficiently limited.

(128) As regards the parts of the Dunfermline business transferred to Nationwide that also benefitted from the aid, the Commission notes that this entity owes its existence to State aid. It is therefore necessary to assess whether appropriate measures to limit the distortion of competition are necessary in light of the characteristics of the market on which the beneficiary will operate.

(129) In this respect, the Commission considers that the distortions of competition due to the continued market presence are limited. Firstly, Dunfermline has a very limited market presence. Dunfermline before the split-up had a minimal market share on the UK markets as regards mortgages ([0-2]% by value of balances outstanding in 2008), savings ([0-2]% by balances in 2008) and insurance, long term investments and pensions (less than 2%% market share). For Scotland, the part of the UK market where Dunfermline is most active, its market shares are less than [0-5]%% in either mortgages and savings products. After the transfer of the business, the combined market share of Nationwide (including Dunfermline) in Scotland is between 5-15% in both savings and mortgage markets[17]. Secondly, given Dunfermline's small size (fewer than 40 branches), it does not seem likely that a viable entity can be divested from it.

(130) Taking into account the limited market presence of the Dunfermline business transferred to Nationwide, the fact that the sale was conducted through a market process and the profound restructuring of Dunfermline (including the liquidation of the Rump Dunfermline), the Commission considers that the restructuring of it as described above sufficiently compensates the distortions of competition caused by the aid.

[17] See Report of the Office of Fair Trading, ME/4108/09 of 22 May 2009 on the acquisition by Nationwide Building Society of parts of Dunfermline Building Society, available on http://www.oft.gov.uk/shared_oft/mergers_ea02/2009/Nationwide-Dunfermline.pdf.

5 CONCLUSION

(131) In view of the above, the Commission concludes that the FSCS/HTM contribution, the working capital facility, and liquidity facility for Bridge Bank, constitute State aid that, can be considered as compatible with Article 107(3)(b) TFEU in light of the IAC and the Restructuring Communication.

DECISION

The Commission concludes that the working capital facility, the liquidity facility and the FSCS/HTM contribution connected to the restructuring of Dunfermline constitute State aid pursuant to Article 107(1) TFEU.

As the UK has put the aid into effect in breach of Article 108(3) TFEU, the aid measures constitute non-notified State aid. However, as these measures are nevertheless compatible with the internal market pursuant to Article 107(3)(b) TFEU, the Commission raises no objection against them.

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Yours faithfully,
For the Commission

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