



EUROPEAN COMMISSION

Brussels, 01.X.2008
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**Subject: State aid NN 41/2008 – United Kingdom
Rescue aid to Bradford & Bingley**

Sir,

1 PROCEDURE

(1) The UK authorities notified the measures to the Commission on 30 September 2008.

2 DESCRIPTION OF THE MEASURES

The Beneficiary

- (2) Bradford and Bingley (hereinafter "B&B") is a UK-based financial institution, which provides specialist mortgages and savings products. Its three main products are buy-to-let providing loans to landlords and property investors; self-cert loans for individuals having more complex income streams; lifetime products enabling customers to gradually release the equity they have built up in their main residence.
- (3) B&B had a balance-sheet total of £ 52 billion as per 31.12.2007. At 31 December 2007, its profits after tax represented £ 93 million and the value of the bank's equity was £ 1.21 billion. B&B has 197 branches and 141 agencies spread geographically across the UK and organised into four operational regions.
- (4) B&B's mortgage products are sold through brokers and intermediaries under the Mortgage Express brand, and additionally a range of B&B branded products are available through its branches as well as through telephony and online distribution channels whose management is outsourced. B&B does not participate in unsecured consumer lending. Other financial services provided or arranged by the company include general insurance, wealth protection (financial planning) and personal loan products. B&B's market share of net new mortgage lending at the end of the 2007 was 7.7%.

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Bradford & Bingley's financial difficulties and the events triggering the measures

- (5) Events in September 2008 in the context of the ongoing financial turmoil had a serious impact on B&B's liquidity position. On 16 September 2008 Moody's downgraded the company's long-term, unsecured, unsubordinated credit rating from Baa1 to Baa3 and its short term unsecured unsubordinated credit rating from P-2 to P-3. On 23 September 2008, Standard & Poor downgraded the company's short term credit rating for A2 to A3 and put its covered bonds on watch. On the same day Fitch downgraded the company's long term rating to BBB- and its short term rating to F3 and put both ratings on watch evolving.
- (6) On the morning of 26 September 2008 the 5-year credit default swap spread for B&B reached with 1,339 basis points, a spread that was significantly higher than for other UK financial institutions, which made it difficult for the company to refinance itself. The company's share price had also sunk to below 20 pence on the same day. [...]*
- (7) On 27 September 2008, the Financial Services Authority (hereinafter "FSA") wrote to B&B to inform it that it had concluded that it was failing to satisfy the threshold conditions for authorisation under the Financial Services and Markets Act and that its permission to accept deposits would be varied at 7 a.m. on 29 September 2008 so that it could not from that time accept new deposits (effectively closing the bank down). [...].

The Measures

Transfer Order

- (8) During this period, HM Treasury, together with the other members of the Tripartite Authorities (HM Treasury, the FSA and the Bank of England), were closely considering how to best sell all or part of the company. [...]. As the situation developed, HM Treasury considered a number of possible alternative contingency plans with its financial advisers. It decided to pursue a wind-down scenario in which, the retail deposit book was to be sold while an orderly wind-down of the remainder of the business was to be carried out so as to maximise recoveries and minimise the burden to the taxpayer.
- (9) In order to transfer the retail deposit accounts together with the minimum assets and liabilities necessary to attract private investors, the HM Treasury carried out a competitive auction process involving the following assets and liabilities ("the transfer package" hereinafter):
 - a) The entire retail deposits of B&B along with cash in an amount agreed with the transferee.
 - b) The entire issued share capital of B&B International Limited, its Isle of Man subsidiary.
 - c) The branches, agencies and employees for a sum to be agreed (but not including any of the mortgage origination and servicing business).

* Business secret

- d) An option to acquire the Head Office and (related staff and infrastructure).
 - e) A provisional Transitional Services Agreement limited to payment services, customer account servicing, IT and central services.
- (10) [> 6] firms were contacted to ascertain whether they would be interested in bidding for such a package. Given the need to conclude a transaction quickly and maintain consumer confidence, they were selected on the basis that they had a strong reputation and existing branch network and the ability to complete such a transaction in a short time.
- (11) Two bids were received on the morning of 28 September 2008. The bid of Abbey National plc ("Abbey" hereinafter) was adjudged to be the most economically advantageous and to best satisfy the objective of maintaining financial stability and protecting the consumer and taxpayers. The price offered for the transfer package was £ 612 million. B&B received the benefit of this sale in that its liability to the Treasury was reduced by this amount.
- (12) On 29 September 2008 at 8 a.m., the "Bradford & Bingley plc Transfer of Securities and Property act" (hereinafter "Transfer Order") entered into force under the Banking (Special Provisions) Act 2008. The Transfer Order transferred all the shares in B&B to HM Treasury and immediately thereafter transferred the transfer package to the winning bidder.
- (13) The Transfer Order states that the transfer package will be part-funded by a compensation payment from the Financial Services Compensation Scheme (the "FSCS"), which is the manager of the UK deposit guarantee scheme. The remainder of that payment will be funded by HM Treasury.
- (14) The FSCS is liable to pay to Abbey an amount equal to the amount that B&B's depositors, which were covered by the FSCS, would have been entitled to claim from the FSCS in respect of claims against B&B for protected deposits, whereas the HM Treasury are liable to pay to Abbey the aggregate amount of the remaining liabilities less the purchase price of the transfer package. All payments by the FSCS to Abbey shall constitute the payment of compensation to each qualifying claimant under the FSCS scheme in respect of claims against B&B for protected deposits. In exchange, the FSCS and HM Treasury acquire rights by subrogation as creditors towards B&B in respect of amounts equal to the one paid by each of them to Abbey.
- (15) In order to enable the FSCS to make that payment to Abbey, the Bank of England (the "Bank") will lend approximately £ 14 billion to the FSCS, which is the estimate of the aggregate amount that it would require in order to compensate B&B's FSCS-eligible retail depositors up to the current limit protected under the FSCS, namely £35,000 per depositor. This amount, together with a further top-up payment from HM Treasury (anticipated to be [£ 4-5] billion) representing the amount of top-up compensation that HM Treasury would have had to pay to retail depositors in excess of the £ 35,000 FSCS limit in order to keep those depositors whole, will be paid into an account in the name of the eventual transferee held at the Bank. HM Treasury will indemnify the Bank on demand in respect of all amounts due under the loan to the FSCS and will undertake to the FSCS that it will take steps to refinance that loan or, if it cannot refinance it, indemnify the FSCS in respect of any amounts which it is required to repay to the Bank under such loan.

- (16) The facility from the Bank to the FSCS is made available on an uncommitted, on demand and short term basis. Advances under the facility bears interest at a rate (which is reset monthly) equal to the greater of (i) LIBOR plus a margin of 30 bps, and (ii) the Official Bank Rate. The loan is unsecured, but as noted in the previous paragraph HM Treasury provides a guarantee and indemnity to the Bank in respect of the FSCS's liabilities, and agrees with the FSCS to [...] refinance the Bank facility on agreed terms prior to its final repayment date the costs and expenses it incurs in repaying the Bank [...].

Guarantee arrangements to certain B&B's creditors

- (17) The remainder of B&B will be wound down on a solvent basis with a view to maximising the value of the remaining assets and avoiding any requirement for a contribution from the State. The remaining assets and liabilities of B&B – principally comprising its mortgage book, personal loan book, headquarters and relevant staff, treasury assets and its wholesale liabilities – will be transferred to the Treasury of the company's shares. HM Treasury and the FSCS will recover payments in the wind-down of the remainder of B&B.
- (18) HM Treasury is also putting in place, with immediate effect, guarantee arrangements to safeguard certain wholesale borrowings, derivative transactions and wholesale deposits existing as at midnight on 28 September 2008.¹ Arrangements will be put in place to ensure that B&B will pay an appropriate fee for the provision of these arrangements in order to ensure it does not receive a commercial advantage.
- (19) The continuation of the guarantee arrangements beyond 6 months is explicitly subject to the Commission's approval of any restructuring phase.

Working Capital Facility

- (20) A revolving working capital facility will be put in place in order to fund, first, advances in respect of mortgage offers made prior to 28 September 2008 where B&B is under a binding commitment to fund the relevant customer, and second, the general working capital needs of B&B. This facility will also be made available on an uncommitted, on demand and short term basis. Interest will accrue at the same rate as under the FSCS facility.
- (21) The working capital facility is at an economic rate at the highest of LIBOR + [0.5% - 2%] or [6% - 8%]. The facility does no more than provide liquidity support. The overall amount will be restricted to the minimum necessary to keep B&B in business and fulfilling its legal obligations until a wind-down plan can be filed. The facility will not enable B&B to write any new mortgage offers, but to keep B&B afloat whilst it is solvently wound-up.

¹ The guarantee will not extend to securities issued pursuant to B&B's securitisation programme, subordinated or other hybrid capital instruments, liabilities owed by B&B to its subsidiary companies (save for those obligations owed to B&B International Limited), any retail and wholesale deposits with and wholesale borrowing by or other liabilities of the subsidiaries of B&B, liabilities of B&B which are not in respect of borrowing or financial indebtedness (for example trade creditors, salary payments to employees and tax liabilities) and liabilities owed by B&B to the FSCS.

3 POSITION OF THE UK

- (22) The UK authorities seek urgent authorisation in the first instance for rescue aid to B&B, namely the working capital facility and the guarantee arrangements for wholesale depositors. According to the UK authorities B&B is a firm in difficulty within the meaning of paragraphs 9 -11 of the Community guidelines on State aid for rescuing and restructuring firms in difficulty² (hereinafter “the Guidelines”). It has not been the recipient of any aid in the last 10 years and so satisfies the ‘one time last time’ principle.
- (23) The UK authorities further explain that any aid must be warranted on grounds of “serious social difficulties”. B&B has over 3 million retail deposit accounts. In the absence of the notified measures the strong likelihood is that B&B as a whole would have become insolvent and its retail depositors would not have had access to their accounts for some considerable period of time [...]. If B&B became insolvent and the branches were obliged to close there would be a large number of redundancies. These factors would clearly demonstrate that the measures were warranted on the grounds of serious social difficulties.
- (24) Furthermore the amount will be restricted to the minimum necessary to keep B&B in business until a wind-down plan can be filed.
- (25) The UK authorities undertake to file a restructuring/liquidation plan at the earliest possible opportunity.
- (26) The UK authorities accept that the guarantee arrangements and the working capital facility contain State aid elements. However, the transfer package being not an aided undertaking for which the transferee paid the best price, the UK authorities considers that it does not contain State aid elements.
- (27) The UK authorities declares that the measures can be declared compatible with the common market to remedy a serious disturbance in the economy of the United Kingdom pursuant to Article 87(3)(b) of the EC Treaty. By contrast to the situation in Northern Rock, it is now apparent that the effects of the credit crunch are far from being restricted to individual banks in the UK. As the Commission is aware, HBOS has been in difficulties and is to be acquired by Lloyds TSB. B&B is the third significant mortgage lender to be in severe financial difficulties. In these circumstances, there is real systemic risk that has to be addressed, not individual difficulties.
- (28) If the Commission concludes that the measures constitute aid in favour of B&B and, notwithstanding the auction process, in favour of the purchaser as a result of the measures taken, the UK authorities submit that any aid is the minimum necessary for the purposes of restructuring B&B for sale into the private sector in a timely manner whilst preserving financial stability. The total, orderly wind-down of B&B not only minimises any aid required, but also represents a major compensatory measure and own contribution amounting to the cessation and complete liquidation of the mortgage

² Communication from the Commission Community guidelines on State aid for rescuing and restructuring of firms in difficulty, OJ 2004 C 244, page 2.

lending business of B&B. Similarly, the sale of the transfer package to Abbey constitutes a significant contribution from B&B's assets.

4 ASSESSMENT

Existence of State Aid

- (29) The Commission first assesses whether the measures constitute state aid within the meaning of Article 87 (1) EC. 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.
- (30) The Commission considers, in line with the position of the UK, that the guarantee arrangements to certain wholesale creditors and the working capital facility constitute state aid to B&B pursuant to Article 87 (1) EC Treaty.
- (31) An assessment is only necessary as regards the State intervention, which results from the Transfer Order, which the UK authorities do not consider to be aid. Given that B&B is active in the financial sector, which is open to intense international competition any advantage from state resources to B&B would have the potential to affect intra-Community trade and to distort competition.
- (32) It is also clear that State resources are involved, in particular regarding the compensation payment which corresponds to the uninsured portion of the deposits, amounting to [£ 4-5] billion being guaranteed by HM Treasury and is therefore considered as state resources. This also applies to the compensation payment that the FSCS is providing under the Transfer Order, given that the behaviour and the financing of the FSCS deviates from its normal framework as manager of the UK deposit guarantee scheme. Under the terms of the transfer order, the liability of the FSCS to pay compensation to eligible claimants has been modified and accelerated. Instead of determining its exposure at the end of an insolvency process, it is transferring cash assets equal to the insured portion of the deposits to the transferee. This derogation from its normal operations results from a parliament act (i.e. the Transfer Order) and not an autonomous FSCS decision. Finally, the Commission notes that the intervention of the FSCS is fully backed by the HM Treasury. Therefore, for all the above reasons, the Commission considers that the compensation payment from the FSCS contains state resources.
- (33) Finally, it has to be examined whether the Transfer order leads to an advantage for it to constitute State aid. There are three possible beneficiaries from the Transfer: i) B&B retail depositors; ii) B&B and iii) the acquirer of part of B&B.
- (34) Firstly, the Commission considers that the principal beneficiaries of this measure are B&B's retail depositors. Without the early concerted intervention of the FSCS and HM Treasury, which together allowed a private bidder to take over the retail deposit business of B&B, the deposit holders would have, at the very least, suffered serious difficulties in accessing their deposits, and may also have lost some of their deposits. The deposit holders have therefore received an advantage. But due to the fact that retail depositors are individuals they are not considered as undertakings, and as a result they fall outside the scope of State aid rules. Moreover, even if there should be some small

and medium sized enterprises among the depositors the aid should be considered de minimis. Thus, any advantage to the depositors falls outside the scope of state aid control and the Commission considers that the Transfer did not lead to a State aid for retail depositors.

- (35) Secondly, the Transfer Order enabled the sale of the retail deposit book to take place. If HM Treasury had not intervened, B&B would most likely not have been able to sell an intangible asset, such as the customer goodwill, the value of which would have been affected by the liquidation process. The sale of the deposit book and the branches realised £ 612 million, of which a significant proportion is attributable to the value of liquidity, branches and customer relationships embedded therein. The proceeds of the sale were used to reduce B&B's liability to HM Treasury and therefore placed B&B in a better financial situation than it would otherwise have been in.
- (36) Finally, the intervention of the state allowed the economic activity that was contained in B&B's retail deposit business to continue. The economic entity corresponding to the transfer package would not have existed without the State intervention.
- (37) Due to the above considerations, the Commission considers that the compensation payments provided by the HM Treasury and the FSCS under the Transfer Order fulfil all conditions laid down in Article 87 (1) EC and therefore contain an aid to B&B, with a potential aid to the retail deposit activity that was transferred.
- (38) In addition, it has to be examined whether the Transfer may have led to State aid to the acquirer of the transfer package. An advantage to the buyer may only exist where the price paid for the target is too low. In view of the procedure of the sales process indicated above, which was equivalent given the circumstances of the transaction to an open and non-discriminatory tender and which resulted in the highest bidder winning the tender, the Commission has no reason to believe that the price paid was below market price. Indeed, the Commission considers that the transfer package was reduced to the minimum necessary to attract private investors to take it over.

Compatibility of the aid with the common market

- (39) As a preliminary remark, the Commission notes that the measures taken in this case have the peculiarity that they integrate in one go a rescue of B&B, a restructuring of part of it (the transfer package) and a liquidation of the remaining part and considers that they had an undeniable character of urgency, given the situation of B&B on 26 September and as the three measures took place in the scope of one weekend.

Company in difficulty

- (40) First, B&B is a company in difficulty. The Guidelines state in point 9 that a firm is in difficulty where it is unable, whether through its own resources or with the funds it is able to obtain from its owner/shareholders or creditors, to stem losses which, without outside intervention by the public authorities, will almost certainly condemn it to going out of business in the short or medium term.
- (41) According to the information submitted in the notification, on 27 September, the FSA wrote to B&B to inform it that it had concluded that it was failing to satisfy the threshold conditions for authorisation under the Financial Services and Markets Act

and that its permission to accept deposits would be varied at 7 a.m. on 29 September so that it could not from that time accept new deposits (effectively closing the bank down). This clearly qualifies the bank as a bank in difficulty in the sense of the Guidelines.³

- (42) Furthermore it is not contested by the UK authorities that B&B is a company in difficulty.

Form of aid

- (43) Point 25 (a) requires also that the form of the aid must be loans or guarantees. Loans must be made at an interest rate at least comparable to those observed for loans to healthy firms, and in particular the reference rates adopted by the Commission.
- (44) There is no doubt that the provision of working capital and the guarantee for the wholesale deposits meet these criteria because they are limited in time.
- (45) Further, the Commission observes that this condition is fulfilled for the working capital facility which is at an economic rate at the highest of LIBOR + [0.5% - 2%] or [6% - 8%], slightly higher than the Commission's reference rate for companies with a strong credit rating (A or higher) and low collateralisation or companies with a good rating (BBB) and normal collateralisation. As regards the State guarantees, the Commission observes that these guarantees do not reduce the cost of funding for B&B below that of healthy banks. It therefore complies with the condition of the Guidelines that the interest rate is "at least comparable to those observed for loans of healthy firms". In line with the Commission practice, even though the remuneration might be under the reference rate adopted by the Commission, since the cost of financing of B&B is at least comparable to the one of a healthy firm once the measures have been granted, the Commission considers that this condition is fulfilled.
- (46) Regarding the aids attached to the Transfer Order, the Commission notes that it contains two aid elements: first of all an aid to B&B through the payment of the £612 million for the sale of the transfer package, and secondly an aid to the economic transferred entity, which corresponds to the ability for this entity to remain in the market not as collection of distinct assets and liabilities, but as a business. It has to be noted that the remaining part of B&B will be liquidated and therefore that any revenues generated from the sales of parts of B&B will be repaid to the State, which supersedes depositors. To that extent, it can be considered that at the moment of the sale of the transfer package, which takes place an instant after the rescue of B&B, the rescue aid has been in principle repaid. As regards the aid element to the transfer business, the Commission notes that according to paragraphs 6 and 16 of the Guidelines, structural measures which need to be implemented immediately can be undertaken within the framework of rescue aids. [...]. Given the current tension on the UK financial markets and the need to protect B&B's creditors, the State intervened urgently to avoid financial instability. The Commission has no grounds to dispute the UK position that the only means of implementing this aim was through the permanent transfer of the retail deposit books. In addition, without the State intervention, the fair

³ Cf. Commission Decision in Case C28/2002 *Bankgesellschaft Berlin*, OJ 2005 L 116, page 1, point 158.

value of B&B's customer goodwill (directly related to the retail deposit book) would have been significantly eroded. For all these reasons, the Commission considers that this measure is an urgent structural measure to halt a worsening of the financial situation of a company in the rescue phase, and therefore may be taken into account in the context of the present rescue plan.

Social and Community Dimension

- (47) In line with point 25 (b) of the guidelines, the measures are aimed at preventing serious social difficulties and have no unduly adverse spill-over effects on other Member States. The measure protects the jobs of some of the workers of B&B, who in the case of an ordinary liquidation may have lost their jobs. It also protects depositors, thus saving UK citizens from losing their savings. Most importantly, it maintains confidence in the UK financial system. Given the current turmoil in the banking sector, the scenario of depositors being unable to withdraw their money from a bank may have caused knock-on problems for other UK banks and could have led to run on otherwise stable banks. The measures will not unduly adverse spill-over effects, given that the main beneficiary of the aid, B&B, is being wound down.

Restructuring Plan

- (48) In line with point 25 (c), the UK authorities have undertaken to communicate within six months from 29 September 2008 a restructuring or liquidation plan for B&B. This restructuring plan has to include a compatibility analysis for all measures including the urgent structural measures.

Minimum Necessary

- (49) The measures must, according to point 25 (d), be restricted to the amount needed to keep the firm in business for the period of six months. In this respect the Commission notes that the working capital measure is restricted to the minimum necessary to keep B&B in business and in fulfilment of its legal obligations until a wind-down plan can be filed. With regard to the wholesale guarantee arrangements, this is also necessary to facilitate the winding down of B&B.
- (50) As regards to the aid element contained in the Transfer Order, the assets and liabilities sold were kept to the minimum necessary for this operation to take place. Moreover the transfer package was sold at the highest price possible which was used to reduce the liabilities vis a vis the state. Hence the Commission considers that the support for selling the deposits was kept to the minimum.

One time, last time condition

- (51) Finally, according to point 25 (e) of the Guidelines, the rescue aid may not follow up on any previous rescue or restructuring aid provided within the last ten years. The UK confirmed that B&B has not received any rescue or restructuring aid in the past ten years.

Compatibility under 87(3)(b)

- (52) Given that the Commission considers that the measure is compatible on the basis of Article 87(3)(c) EC, it did not consider it necessary at this stage to assess whether Article 87(3)(b) EC, which allows aid to remedy a serious disturbance in the economy of a Member State would apply.

Conclusion

- (53) In view of the above the Commission concludes that the working capital facility and guarantee arrangements constitute state aid but, under the specific conditions laid down above, can be considered as complying with the requirements for rescue aid set out in paragraph 25 of the Guidelines and therefore can be regarded as compatible with the common market. The aids attached to the Transfer Order, although structural in nature, can also be regarded as urgent rescue aids in the sense of the Guidelines.

5 DECISION

- (54) The Commission concludes that the working liquidity facility and the guarantee arrangements constitute State aids pursuant to Article 87 (1) EC Treaty. The aids related to the Transfer Order, although structural in nature, can also be regarded as urgent rescue aids.
- (55) As the UK has thus put aid into effect in breach of Article 88 (3) EC Treaty, the aid measures constitute non-notified State aid.
- (56) As these measures are however compatible with the Common Market as rescue aid pursuant to Article 87 (3) (c) EC Treaty, the Commission raises no objection against them.
- (57) The Commission expects your authorities to respect their commitment to communicate to the Commission, not later than 29 March 2009, a credible and substantiated restructuring plan or proof of the complete termination of the guarantee arrangement and repayment of the working capital facility.
- (58) The Commission underlines that the aid is authorised until 29 March 2009 or, where your authorities have submitted a credible and substantiated restructuring plan within that period, and the Commission does not decide otherwise pursuant to point 26 of the Guidelines, until the Commission reaches its decision on the plan.

If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of this letter to agree to the disclosure to third parties and to the publication of the

full text of the letter in the authentic language on the Internet site.

http://ec.europa.eu/community_law/state_aids/index.htm.

Your request should be sent by registered letter or fax to:

- European Commission
Directorate-General for Competition
State aid Greffe
Rue de la Loi/Wetstraat, 200
B-1049 Brussels
Fax No: (+32)-2-296.12.42

Yours faithfully,

For the Commission

Neelie KROES
Member of the Commission