

## IV

(Acts adopted before 1 December 2009 under the EC Treaty, the EU Treaty and the Euratom Treaty)

**COMMISSION DECISION****of 28 October 2009****on the State aid C 14/08 (ex NN 1/08) implemented by the United Kingdom for Northern Rock**

(notified under document C(2009) 8102)

(Only the English text is authentic)

(Text with EEA relevance)

(2010/262/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to the provisions cited above <sup>(1)</sup>, <sup>(2)</sup> and having regard to their comments,

Whereas:

**1. PROCEDURE**

(1) By decision of 5 December 2007 <sup>(3)</sup> (hereinafter 'the decision of 5 December 2007') the Commission found the liquidity facility implemented by the Bank of England (hereinafter 'BoE') on 14 September 2007 in favour of Northern Rock (hereinafter 'NR') not to constitute State aid. The Commission furthermore decided that the guarantees on retail deposits granted by the UK authorities between 17 and 20 September and 9 October 2007 contained State aid which was compatible with the common market as rescue aid for six months, until 17 March 2008, in conformity with the Community guidelines on State aid for rescuing and restructuring firms in difficulty <sup>(4)</sup> (hereinafter 'the R&R Guidelines'). The Commission in its decision also insisted on the submission of a restructuring plan within six months or the repayment of the aid.

(2) By letter of 21 December 2007, the UK authorities informed the Commission of the extension of those guarantee arrangements. On 8 January, 24 January, 6 February, 13 February and 10 March 2008 meetings were held between representatives of the United Kingdom and the Commission.

(3) On 17 February 2008 the UK authorities announced that NR was to be nationalised. By letter of 17 March 2008, the United Kingdom sent the Commission a restructuring plan for NR and informed it of State aid measures which would accompany that plan and enable it to be implemented. By letter of 31 March 2008, the United Kingdom sent a more detailed and slightly amended restructuring plan.

(4) By letter dated 2 April 2008, the Commission informed the United Kingdom that it had decided to initiate the procedure laid down in Article 88(2) of the Treaty in respect of the aid measures (hereinafter 'the opening decision').

(5) The opening decision was published in the *Official Journal of the European Union* <sup>(5)</sup>. The Commission invited interested parties to submit their comments on the aid.

(6) By letter of 2 May 2008, the United Kingdom responded to the opening decision. The Commission also received comments from interested parties. By letter of 15 July 2008, received on 31 July 2008, it forwarded those comments to the United Kingdom, which was given the opportunity to react; its comments were received by letter of 29 August 2008.

<sup>(1)</sup> OJ C 135, 3.6.2008, p. 21.

<sup>(2)</sup> OJ C 149, 1.7.2009, p. 16.

<sup>(3)</sup> OJ C 43, 16.2.2008, p. 1.

<sup>(4)</sup> OJ C 244, 1.10.2004, p. 2.

<sup>(5)</sup> See footnote 1.

(7) By letter of 25 April 2008, the Commission sent questions regarding the restructuring plan submitted on 31 March 2008. The United Kingdom provided answers by letter of 6 June 2008. On 30 June 2008, a meeting was held between the Commission and the UK authorities. Following that meeting, the UK authorities provided additional information by letters of 8 July and 13 August 2008.

(8) On 5 August 2008, the UK government publicly announced that it intended to convert up to GBP 3 billion of loans to NR into equity. The UK authorities had previously informed the Commission of this announcement.

(9) On 11 November 2008, 15 January 2009 and 4 February 2009, the UK authorities informed the Commission that they were considering plans for restructuring NR which, due to the impact of the financial crisis, significantly differed from those notified in March 2008 and outlined those plans.

(10) On 20 February 2009, the UK authorities provided additional information on the intention to split NR in two. A more detailed plan was notified by letters of 31 March 2009 and 2 April 2009.

(11) By letter of 7 May 2009, the Commission informed the United Kingdom that it had decided to extend the procedure under Article 88(2) of the Treaty to cover the amended restructuring plan that was submitted to it in March (hereinafter 'the extension decision').

(12) The extension decision was published in the *Official Journal of the European Union* <sup>(6)</sup> and interested parties were requested to submit their comments on the aid.

(13) The UK responded to the extension decision by letter of 22 June 2009. The Commission furthermore received comments from third parties. By letter of 14 August 2009, those comments were forwarded to the United Kingdom, which was given the opportunity to react. The United Kingdom submitted its comments by letter of 17 August 2009.

(14) On 10 June, the United Kingdom provided an updated restructuring plan for NR, which was discussed with the Commission in meetings held on 26 June and 21 August 2009. The United Kingdom also provided more information on 22 June, 26 June, 15 July, 17 August, 18 August, 4 September, 17 September, 18 September, 21 September, 22 September and 30 September 2009.

## 2. DESCRIPTION OF THE AID

### 2.1. THE BENEFICIARY AND ITS DIFFICULTIES

(15) Before the difficulties started in the second half of 2007, NR was the 5th biggest UK mortgage bank with a balance-sheet total of GBP 113,5 billion on 30 June 2007 and GBP 109,3 billion at the end of 2007. In 2006, it had a total balance sheet of GBP 101 billion, while interest income represented almost GBP 5 billion. NR recorded a profit of GBP 443 million over 2006. The bank had a staff of 6 000 persons in 2006, had 77 branches throughout the United Kingdom and was present in Ireland, Denmark and Guernsey.

(16) Residential mortgage lending was and remains NR's core activity. It represents more than 90 % of all outstanding loans to customers. In the first half of 2007, the bank had a market share of UK gross mortgage lending of 9,7 % and of net mortgage lending of 18,9 % <sup>(7)</sup>. NR financed the majority of its long-term mortgage loans by issuing Residential Mortgage Backed Securities and covered bonds, while a continuously declining share of its funding was realised through retail deposits. On 30 June 2007, retail deposits amounted to only GBP 24 billion out of a balance sheet total of GBP 113 billion. In March 2001 NR established a 'master trust' securitisation structure known as 'Granite' of which it has since made extensive use. Further information on NR is recorded in section 2.1 of the opening decision of 2 April 2008.

(17) NR's dependence on wholesale funding caused difficulties in the second half of 2007 when the mortgage securitisation market collapsed, as described in more detail in section 2.2 of the opening decision. NR's funding problems led the UK authorities to provide loans and guarantees, which were approved by the Commission as rescue aid until 17 March 2008 by the decision of 5 December 2007. Section 2.3.1 of the opening decision describes the circumstances which led the State to provide additional guarantees on 18 December 2007, which were approved by the Commission as compatible rescue aid (section 4.5.2 of the opening decision).

<sup>(6)</sup> See footnote 2.

<sup>(7)</sup> Gross lending is total advances, and net lending is advances less redemptions and repayments.

(18) In early 2008, NR and the UK authorities attempted to find a private sector solution. As a result, business plans for NR were submitted to the government by Virgin and by NR's management, which have been set out in sections 2.3.2 and 2.3.3 of the opening decision. The attempt to find a private sector solution failed and NR was subsequently nationalised on 22 February 2008 on the basis of legislation introduced the previous days (section 2.3.4 of the opening decision) <sup>(8)</sup>.

(19) The deepening of the global financial crisis after the fall of Lehman Brothers and the ensuing economic crisis and housing market crisis led to an increase in defaults on NR's outstanding loans and forced NR to take considerable loan loss impairment charges in 2008 and over the first half of 2009 well above the average for other banks. This is due to the fact that NR had made many risky loans, in particular through high loan-to-value (hereinafter 'LTV') loans, of which a considerable part were the Together loans (mortgages with LTV [...] <sup>(\*)</sup> 125 % combined with an unsecured loan).

(20) The loan loss impairment charges NR had to make negatively affected NR's capital ratios to such an extent that in July 2008 it obtained a waiver from the UK Financial Services Authority (hereinafter 'FSA') which allowed it to include all available Tier-2 capital within the NR's capital resources without restriction in order to meet its minimum regulatory capital requirements. That waiver was granted after the UK Treasury (hereinafter 'HMT') provided a commitment to the FSA that NR would operate above minimum capital requirements.

(21) In its reports regarding the first quarter of 2009, NR reported that it expected to be substantially loss-making over 2009. As a result, its capital base was reduced to a level below the minimum regulatory requirements. On 1 July 2009, NR announced that the FSA had confirmed that, taking into account HMT's commitment to provide an adequate level of capital, it did not intend to restrict NR's activities.

(22) Table 1 contains information on the financial performance of NR between 2006 and the end of the first half of 2009.

<sup>(8)</sup> All the descriptive information included in the opening decision, although not repeated in this Decision, has been taken into account in the assessment which follows in this Decision.

<sup>(\*)</sup> Business secret. Where possible, figures have been replaced by ranges in [].

Table 1

**Northern Rock's financial results 2006-2008 <sup>(9)</sup> and first half of 2009 <sup>(10)</sup>**

(GBP billion)

	2006	2007	2008	1H2009
Total balance sheet	101,0	109,3	104,3	88,7
Retail deposits balances	22,6	10,5	19,6	18,4
Gross new lending	32,9	32,3	3,0	1,3
Net new lending	16,6	12,2	(25,4)	(5,0)
Interest income	4,9	6,9	5,7	1,1
Net profit (loss)	0,443	(0,199)	(1,3)	(0,269)

## 2.2. THE RESTRUCTURING PLANS

### THE INITIAL RESTRUCTURING PLAN

(23) After the nationalisation of NR in February 2008, the UK authorities submitted a restructuring plan (hereinafter 'initial restructuring plan'), the contents of which were described in more detail in section 2.3.5 of the opening decision and also in section 2.2 of the extension decision. In short, the initial restructuring plan provided for:

(i) the reduction of the balance sheet of NR from GBP 109,3 billion in 2007 to GBP 48-53 billion at the end of 2011 through an active mortgage redemption programme and limited new lending;

(ii) a rebalancing of the funding mix by increasing the retail deposits from 15-20 % in 2008 to 48-52 % in 2012;

(iii) closure of NR's Danish operations;

(iv) rapid repayment of the government loans and release of government guarantees by the end of 2011; and,

(v) behavioural commitments including a cap on new mortgage origination, a Competitive Framework <sup>(11)</sup> and withdrawal from unsecured personal lending and commercial lending for the restructuring period.

<sup>(9)</sup> Consolidated.

<sup>(10)</sup> Unaudited.

<sup>(11)</sup> The Competitive Framework was implemented by NR following the nationalisation by the UK authorities. It aims to ensure that NR will not be able to use its Government support in order to compete unfairly on the market. The Framework contains commitments from NR that limit its presence on the UK mortgage and savings market. See also the description of the Competitive Framework in point 81 of the opening decision (footnote 1).

- (24) The active mortgage redemption programme, the limitations on new lending, the closure of NR's Danish operations and the behavioural commitments were implemented by the United Kingdom immediately without awaiting Commission approval of the restructuring plan.

#### THE AMENDED RESTRUCTURING PLAN

- (25) The worsening of the financial markets and the real economy in the final quarter of 2008 severely affected NR, making it necessary for the UK authorities to revise the initial restructuring plan. The UK authorities therefore submitted a new restructuring plan (hereinafter 'amended restructuring plan') to the Commission, which was described in detail in section 2.3 of the extension decision. The amended restructuring plan basically consists of the split-up of NR into:

- (i) 'BankCo' to which the following assets of NR would be transferred: the retail deposit book (approximately GBP 19,5 billion), matched with approximately GBP [9-12] billion of cash assets<sup>(12)</sup> and approximately GBP [7-10] billion of NR's best performing unencumbered mortgage assets; wholesale deposits, currently totalling approximately GBP [0,5-3] billion, matched by cash assets; NR's mortgage origination and servicing platform; NR's branches, relevant staff and systems and the GIC accounts<sup>(13)</sup> matched by cash assets of an equal value (approximately GBP [3,5-6] billion). The opening balance sheet of BankCo would be GBP [22-26] billion;
- (ii) 'AssetCo' would be the existing company, NR, which would be left with the remaining pool of residential mortgages and NR's wholesale funding instruments (its interest in the Granite securitisation vehicle and its liabilities under the covered bond and EMTN programmes<sup>(14)</sup> and associated hedging) together with the associated liabilities and hybrid capital. AssetCo would also retain liability for the existing Government loan to NR, which would be increased by up to GBP 10 billion to a total of GBP 23 billion in order to enable the implementation of the restructuring. Furthermore, AssetCo would be provided with a working capital facility of up to GBP 5 billion to ensure that it has adequate liquidity [...]. The (opening) balance sheet of AssetCo would be GBP [82-85] billion.

<sup>(12)</sup> Hereunder 'cash assets', consisting of cash and Treasury investments will be referred to as 'cash assets' or 'cash'.

<sup>(13)</sup> These are bank accounts in the name of the Granite securitisation structure that are held with NR.

<sup>(14)</sup> Covered bond programme consisting of several tranches of issued debt.

- (26) The amended restructuring plan also envisaged capital injections in BankCo and AssetCo, a change in the lending strategy, abandonment of the active mortgage redemption programme and changes to the Competitive Framework, which would allow NR to increase its lending in 2009 and 2010 by GBP 14 billion in total.

#### THE FINAL RESTRUCTURING PLAN

- (27) Following the adoption of the extension decision, the amended restructuring plan was altered by the United Kingdom to address some of the doubts expressed by the Commission and third parties (hereinafter 'the final restructuring plan'). As a result, BankCo's opening cash balance will be reduced by GBP [1,7-4,2] billion compared with the update of the amended restructuring plan of 10 June 2009, by removal of GBP [1,5-3] billion in the GIC accounts and the transfer of GBP [0,2-0,8] billion of additional mortgages from AssetCo to BankCo. BankCo will have an opening balance sheet of GBP [21-24] billion in 2009 growing to GBP [31-34] billion in 2013 as opposed to GBP [22-26] billion and GBP [38-41] billion respectively under the amended restructuring plan. In addition, GBP [600-900] million of initially planned new lending of BankCo in 2009 will be substituted for lower quality back book<sup>(15)</sup>. As a result, the weighted average LTV of BankCo will equal [62-67 %], made up of the average LTV of existing mortgage book ([66-69 %]) and new lending in 2009 ([58-61 %]). Graph A illustrates the opening balance sheets of BankCo and AssetCo after the split-up, while Table 2 contains the most relevant financial indicators for BankCo.

- (28) BankCo, from the split-up onwards, will also pay adjusted fees for the continuing guarantees on retail and wholesale deposits (see section 2.3).

Table 2

#### BankCo main financial indicators following the split (base case)

(GBP billion)					
	2009	2010	2011	2012	2013
Total balance sheet	[21-24]	[23-25]	[27-30]	[28-31]	[31-34]
Net interest income	n/a	[0-0,7]	[0-0,7]	[0-0,7]	[0-0,7]

<sup>(15)</sup> Portfolio of mortgages originated in the past by NR.

(GBP billion)

	2009	2010	2011	2012	2013
Gross new lending	n/a	[6-9]	[6-8]	[6-8]	[6-8]
Mortgage book	[7-11]	[13-20]	[19-25]	[22-26]	[23-28]
Retail deposits	19,3	[18-21]	[19-22]	[22-25]	[24-27]
Wholesale deposits	[1-3]	[1-7]	[3-10]	[3-8]	[2-8]

Graph A

**Opening balance sheet of BankCo and AssetCo after split-up**

[...]

(29) The United Kingdom furthermore provided the following commitments:

- (i) a commitment to achieve full operational separation between BankCo and AssetCo as soon as possible and by the end of 2010 at the latest;
- (ii) a commitment that BankCo will cap new lending to GBP 4 billion in 2009, GBP 9 billion in 2010 and GBP 8 billion in 2011; in the event that BankCo remains in Temporary Public Ownership (hereinafter 'TPO') after 2011, the lending cap of GBP 8 billion in 2011 will remain in place until 31 December 2013 or exit from TPO, whichever is earlier;
- (iii) a commitment that BankCo will cap its retail deposit balances across the United Kingdom, Ireland and Guernsey at GBP 20 billion until 31 December 2011; in the event that BankCo remains in TPO in 2012 and 2013, the retail deposit cap will be GBP 23 billion for 2012 and GBP 26 billion for 2013;
- (iv) a commitment that BankCo will not rank within the top three Moneyfacts mortgage categories for 2, 3, or 5-year fixed or variable mortgages (excluding mortgages with an LTV ratio greater than 80 % and products for first time buyers) until 31 December 2011 or exit from TPO, whichever is earlier;
- (v) a commitment that the United Kingdom will exit majority ownership of BankCo [...]. In this context, TPO is deemed to be exited if the United Kingdom has sold at least 50 % + 1 of BankCo's shares to a non State-owned or controlled entity (or entities) and the United Kingdom has lost control over BankCo within the meaning of Council Regulation

(EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings <sup>(16)</sup>;

- (vi) a commitment that [...] BankCo will give public notice that the UK retail deposit guarantee will be released by [...] and that the wholesale guarantee arrangements related to BankCo will be lifted by the United Kingdom by 31 December 2010;
- (vii) a commitment that existing subordinated debt will remain in AssetCo and that until AssetCo [...] AssetCo will pay no principal or coupons on subordinated debt instruments where it is contractually able to do so;
- (viii) a commitment that BankCo, while in TPO, and AssetCo, [...], will not engage in acquisitions of shares in other firms or promote the Government guarantee arrangements or ownership;
- (ix) a commitment that AssetCo will not undertake any new economic activities apart from activities necessary to provide operational support to BankCo until the operational separation is completed, [...].

### 2.3. THE STATE MEASURES ASSESSED IN THIS DECISION

(30) NR has received several aid measures which are <sup>(17)</sup>:

- (i) the BoE liquidity facility which later was novated to HMT (hereinafter 'BoE/HMT liquidity facility');
- (ii) the government guarantee on those of NR's retail deposits not covered by the United Kingdom's Financial Stability Compensation Scheme (hereinafter 'FSCS');
- (iii) the government guarantee on NR's wholesale deposits.

For NR:

- (iv) the retroactive application of a lower fee on the BoE/HMT liquidity facility from 1 April 2008 onwards and the subsequent reimbursement to NR of GBP 156,4 million after the Commission's final decision <sup>(18)</sup>;

<sup>(16)</sup> OJ L 24, 29.1.2004, p. 1.

<sup>(17)</sup> The Commission will, for the sake of clarity, when assessing the measures refer back to the numbering used in the description of the measures in recitals 30 and 31.

<sup>(18)</sup> See point 94 of the opening decision.



- (v) the commitment given by HMT to the FSA that NR (that is to say, its successors) would operate above regulatory capital requirements <sup>(19)</sup>.

For BankCo:

- (vi) the continuation after the split-up of the guarantees on retail and wholesale deposits (that is to say the measures referred to in points (ii) and (iii) of recital 30) into 2010 for BankCo at revised conditions <sup>(20)</sup>;
- (vii) the GBP 1,4 billion recapitalisation of BankCo after the split-up, in the form of ordinary shares <sup>(21)</sup>;
- (viii) the contingent liquidity facility of GBP 1,5 billion.

For AssetCo:

- (ix) the continuation after the split-up of the wholesale guarantee (that is to say, measure (iii)) [...] <sup>(22)</sup>;
- (x) the continuation and increase in the BoE/HMT liquidity facility (that is to say, measure (i)) by up to GBP 10 billion to GBP 23 billion <sup>(23)</sup>;
- (xi) the up to GBP 1,6 billion recapitalisation of AssetCo in the form of a debt for equity conversion <sup>(24)</sup>;
- (xii) the GBP 2,5 billion working capital facility <sup>(25)</sup>.

- (31) As regards measures (i)-(ii), the Commission observes that these have already been assessed by the Commission in the context of the earlier decisions taken in this case and have been qualified as rescue aid <sup>(26)</sup>. Further to the rescue measures, the United Kingdom notified to the Commission additional measures that are intended to enable the restructuring of NR, measures (iv)-(xii).

<sup>(19)</sup> See point 91 of the opening decision and point 28 of the extension decision.

<sup>(20)</sup> See points 32 and 39 of the extension decision.

<sup>(21)</sup> See points 26 and 49 of the extension decision.

<sup>(22)</sup> See points 33 and 46 of the extension decision.

<sup>(23)</sup> See point 22(ii) of the extension decision.

<sup>(24)</sup> See point 26 of the extension decision.

<sup>(25)</sup> See footnote 23.

<sup>(26)</sup> See Commission Decision in Case NN 70/07, *Northern Rock* (OJ C 43, 16.2.2008, p. 1), Commission Decision in Case C 14/08 (ex NN 1/08), *Restructuring aid to Northern Rock* (OJ C 135, 3.6.2008, p. 21) (opening decision) and Commission Decision in Case C 14/08, *Restructuring aid to Northern Rock* (OJ C 149, 1.7.2009, p. 16).

- (32) The rescue aid measures (measures (i)-(iii)), will be continued after the split-up. However, the entities for which they are intended will be the successors of NR and the conditions attached to those measures will change.

- (33) As regards the measures undertaken by the United Kingdom in the context of the restructuring of NR (measures (iv) and (v)), the fee NR has paid for the BoE/HMT liquidity facility will be lowered retroactively. Consequently, NR will receive a retroactive reimbursement of GBP 156,4 million of the fees charged for the BoE/HMT liquidity facility. This reimbursement follows from the revision of the fees undertaken by the United Kingdom in April 2008. Furthermore HMT has provided assurance to the FSA that NR will operate above capital requirements, thus enabling it to continue to operate below regulatory capital requirements.

- (34) The restructuring measures directed at BankCo (measures (vi)-(viii)) include the continuation of the guarantees on retail and wholesale deposits [...]. The fees and tenor of these guarantees, however will be changed compared to the approved rescue aid. For the guarantee on those retail deposits which are not covered by the United Kingdom's FSCS BankCo will pay a flat fee of [15-70] basis points (hereinafter 'bps'). For the guarantee on wholesale deposits BankCo will pay a fee in line with the United Kingdom's credit guarantee scheme (hereinafter 'CGS') <sup>(27)</sup>. BankCo will furthermore receive a GBP 1,2 billion recapitalisation after the split-up in the form of ordinary shares and a contingent liquidity facility of GBP 2,5 billion. For the contingent liquidity facility it will pay a monthly commitment fee of [80-150] bps on the undrawn balance. In the event that BankCo makes use of the facility, it will pay a one-off utilisation fee of [120-240] bps on any amount drawn and an interest rate of 1 month LIBOR + [200-600] bps on the drawn balance.

- (35) AssetCo will continue to benefit from a guarantee on wholesale deposits until [...] (measure (ix)). No changes are envisaged in the fee AssetCo will pay for the guarantee. AssetCo will also obtain an increase in the BoE/HMT liquidity facility (measure (x)) of up to GBP 10 billion (total amount of facility will be GBP 23 billion) together with a change in the conditions of the facility (LIBOR + [10-60] bps instead of BoE base rate + 150 bps + 10 bps facility fee). AssetCo will also receive a GBP 2,5 billion working capital facility (measure (xii)) for which it will pay 1 month LIBOR + [10-60] bps and potentially a recapitalisation of up to GBP 1,6 billion in the form of a debt for equity conversion (measure (xii)).

- (36) As the restructuring aid granted to NR consists of the continuation of measures combined with additional measures, they will be assessed together in this Decision. Table 3 sets out both the continuing and the additional measures.

<sup>(27)</sup> The fee was approved by the Commission in its Decision in Case N 507/08, *Financial support measures for the banking industry in the UK* (OJ C 290, 13.11.2008, p. 4).

Table 3

**Overview of aid measures granted to NR, BankCo and AssetCo**

No	Type of measure	amount	remuneration
	Rescue		
i	Bank of England/HMT liquidity facilities	GBP 25 bn	BoE rate + 150 bps + facility fee of 10 bps
ii	Guarantee on retail deposits NR not covered by FSCS	max GBP 20 bn (*)	[15-70] bps on aggregate amount deposits
iii	Guarantee on wholesale deposits NR	approx. GBP 10 bn	monthly fee of GBP [0,5-3] mln
	Restructuring		
	Northern Rock		
iv	Application of lower fee BoE/HMT liquidity facility and retroactive reimbursement NR	GBP 156,4 mn	n/a
v	Assurance to FSA by HMT that NR will operate above capital requirements	n/a	n/a
	BankCo		
vi	Continuation guarantee on retail deposits	max GBP 20 bn (*)	[15-70] bps flat fee
	Continuation guarantee on wholesale deposits	GBP 1,6 bn	in line with CGS
vii	Recapitalisation of BankCo after split	GBP 1,4 bn	ordinary shares
viii	Contingent liquidity facility for BankCo	GBP 1,5 bn	monthly commitment fee of [80-150] bps + one-off utilisation fee of [120-240] bps on any amount drawn + interest rate of 1 month LIBOR + [200-600] bps on drawn balance
	AssetCo		
ix	Continuation guarantee on wholesale deposits	approx. GBP 8,3 bn	GBP [0,5-3] mln monthly fee
x	Continuation and increase Bank of England/HMT liquidity facility	total GBP 23 bn	1 month LIBOR + [10-60] bps
xi	Recapitalisation of AssetCo in stress case (debt-equity swap)	GBP 1,6 bn	ordinary shares
xii	Working capital facility for AssetCo	GBP 2,5 bn	1 month LIBOR + [10-60] bps

(\*) Amount stated reflects total amount of retail deposits and does not take into account FSCS.

### 3. GROUNDS FOR INITIATING THE PROCEDURE

- (37) The Commission first opened the formal investigation procedure on the initial restructuring plan in this case on 2 April 2008. Thereafter, the initial restructuring plan was materially altered by the UK authorities. As a consequence, it was necessary for the Commission to extend the procedure to cover the amended restructuring plan. Most of the doubts reflected in the opening decision were specific to the initial restructuring plan. With regard to the opening decision, only the doubts that remain relevant for the assessment of the amended restructuring plan will be discussed in section 3.1 of this Decision.

#### 3.1. THE OPENING DECISION

##### THE EXISTENCE OF AID

- (38) In paragraph 91 of the opening decision, the Commission indicates that HMT's letter to the FSA, by which HMT confirms its intention to ensure that NR will operate above the minimal capital requirement, could constitute State aid.
- (39) Paragraph 94 of the opening decision indicates that the planned retrospective reimbursement of the excess fees charged by the United Kingdom in the period between 17 March 2008 and the final decision seems to constitute additional restructuring aid.

##### AMOUNT OF AID

- (40) Paragraph 96 of the opening decision raises doubts whether the aid can be quantified by using benchmarks like NR's credit default swaps prices or interest rate on credit facilities offered to NR by private banks after 17 September 2007 since they already take into account the rescue of the bank by the State.

#### 3.2. THE EXTENSION DECISION

##### EXISTENCE OF AID

- (41) The Commission indicated in paragraphs 47 and 48 of the extension decision that the split-up could be compared to an asset relief measure within the scope of the Communication from the Commission on the treatment of impaired assets in the Community banking sector<sup>(28)</sup> (hereinafter 'IAC'). It therefore invited the UK authorities to provide information on this issue.

##### RESTORATION OF LONG-TERM VIABILITY

- (42) In paragraph 58 of the extension decision the Commission noted positively that BankCo seems to

become a viable bank as a result of the measures proposed by the United Kingdom and does not risk encountering the same liquidity problems as NR. However, it also observed that no business plan demonstrating how BankCo will become a viable entity in the medium- to long-term had been submitted and that therefore the viability of BankCo could not be demonstrated.

##### AID LIMITED TO THE MINIMUM/OWN CONTRIBUTION

- (43) The Commission observed in paragraphs 59 and 58 of the extension decision that the aid to be granted to BankCo was of such a type and quantity that it would release BankCo from all the risky loans made by NR in the past and from the obligation to pay back the government loan, while it would receive good quality assets and a considerable amount of cash. Furthermore, the Commission noted that the UK authorities accept to fully finance the losses of AssetCo, whose mortgage book is valued at book value instead of the real economic value. The Commission therefore expressed strong doubts as to whether the aid was limited to the minimum.

- (44) As regards NR's own contribution, the Commission expressed doubts in paragraph 60 of the extension decision whether it would be sufficient since some of the measures in the first restructuring plan that could be regarded as own contribution were abandoned in the amended restructuring plan, in particular the active redemption policy and the cap on new lending.

##### LIMITING NEGATIVE SPILL-OVER EFFECTS/MEASURES LIMITING THE DISTORTION OF COMPETITION

- (45) In paragraph 62 of the extension decision the Commission questioned whether the funding available to BankCo after the split-up of NR will allow it to crowd out competitors on the mortgage lending market, thus leading to negative spill-over effects.
- (46) Concerning measures limiting the distortion of competition, the Commission expressed strong doubts in paragraphs 63 to 66 of the extension decision on whether the measures proposed were sufficient. Firstly the Commission noted that after the split-up of NR, BankCo will emerge as a very strong and competitive bank unburdened by the risky loans made by NR in the past. The Commission therefore doubted whether the fact that BankCo will be a bank with a small balance sheet would offset the distortion of competition.

<sup>(28)</sup> OJ C 72, 26.3.2009, p. 1.



- (47) Furthermore, the Commission noted that, taking into account the large amount of aid NR received, it was uncertain that sufficient measures could be implemented to avoid undue distortion of competition without endangering the viability of NR. It finally observed that some of the measures limiting distortion of competition had been amended or abandoned.

#### 4. COMMENTS FROM INTERESTED PARTIES

- (48) The Commission received third party comments following publication of the opening decision and the extension decision.
- (49) With regard to the opening decision, the Commission received comments from Unite the Union, the Building Societies Association (hereinafter 'BSA'), SRM Global Master Fund LP, Alliance & Leicester Building Society, the British Banking Association, Jim Cousins (UK MP), Doug Henderson (UK MP) and the Newcastle authorities. Although those comments do not relate to the amended restructuring plan that was the subject of the extension decision, they may be relevant in the broader context of this case and will be shortly discussed in section 4.1 of this Decision insofar as they are of a general nature.
- (50) Third party comments concerning the extension decision were received from Leeds Building Society, the BSA and a British citizen.

##### 4.1. OPENING DECISION

- (51) The comments received by third parties regarding the opening decision focussed mainly on the distortions of competition caused by the guarantees on NR's retail and wholesale deposits. The increase in NR's retail deposit base in the first months of 2008 caused particular concern as third parties indicated that NR was offering high savings rates while backed by a government guarantee, thus leading to a competitive disadvantage for NR's competitors. The third parties noted that the Competitive Framework seemed to mitigate some of their concerns. Other comments concerned the importance of NR as a large employer in the North-East of England and the compensation shareholders of NR should receive due to the nationalisation undertaken by the United Kingdom.

##### 4.2. EXTENSION DECISION

- (52) Leeds Building Society in its submission expressed its concerns regarding the distortion of competition potentially caused by NR, stressing that the own

contribution by NR in its view is insufficient and that the Competitive Framework in place only prevents distortion of competition by NR to a limited extent. It also is of the view that the small balance sheet of BankCo after the split will not offset distortions of competition, as BankCo does not have to absorb losses caused by NR's risky lending of the past and will have access to the benefits of AssetCo's balance sheet.

- (53) The BSA submitted detailed comments. It considered that BankCo is extremely likely to be a viable bank in the medium- to long-term as it will have a strong position on the UK mortgage market after the split-up with limited non-performing loans and a lot of funding to write new loans. BSA highlighted the difference between building societies and banks (constraints on funding and lending activities for building societies not present for banks). BSA also indicated that the Competitive Framework is unlikely to be effective enough to prevent distortions of competition. It furthermore made suggestions regarding possible measures limiting the distortion of competition:
- (i) BankCo should pay remuneration for the protection it has gained from the establishment of AssetCo; alternatively, BankCo's initial loan book should have characteristics close to those of an average competitor;
  - (ii) the State guarantees on retail and wholesale deposits should be removed as soon as possible; alternatively, BankCo should pay a price commensurate to that other banks are paying when using the government's credit guarantee scheme;
  - (iii) if the measures suggested in points (i) and (ii) cannot be implemented, more direct controls on BankCo's activities might be necessary;
  - (iv) BankCo should make a substantial proportion of its new lending in segments of the mortgage market where private sector lenders are not currently lending (for example, at high LTV ratios, or specifically to first-time buyers);
  - (v) in areas of the mortgage market where BankCo is competing with private sector lenders its price competitiveness should be limited, possibly by staying out of the Moneyfacts best buy tables for mortgage lending, that is to say, out of the top five lenders;

- (vi) until the guarantee covering retail deposits is removed, BankCo should stay out of the top five savings accounts in Moneyfacts best buy tables.

- (54) Finally, the comments of the British citizen concerned the payment of coupons on subordinated debt instruments issued by NR and the effects a suspension of those payments would have upon individuals holding those instruments.

## 5. COMMENTS FROM THE UNITED KINGDOM

- (55) The third party comments concerning the opening decision that have been described in this Decision only relate to issues that may be relevant for the assessment of the amended restructuring plan. The comments from the United Kingdom set out in section 5.1 regarding the opening decision will therefore also be limited to those issues.

### 5.1. UNITED KINGDOM'S COMMENTS ON THE DOUBTS RAISED IN THE OPENING DECISION

#### EXISTENCE OF AID

- (56) As regards the doubts expressed in paragraph 91 of the opening decision, the UK authorities claim that [...]. It can therefore not be characterised as aid. Even if it were the case, it could not be described as unlimited.
- (57) As regards paragraph 94 of the opening decision, the UK authorities do not contest that the backdating to 1 April 2008 — following State aid approval — of the new loan interest and fee arrangements will constitute additional restructuring aid. They submit, however, that they are the minimum necessary to ensure that NR continues to fulfil its regulatory capital requirements.

#### AMOUNT OF AID

- (58) As regards the doubts expressed in paragraph 96 of the opening decision, the United Kingdom first claims that it would be artificial to consider the aid amount as the full value of the State facilities and of the amounts covered by the State guarantees. Indeed, NR continues to own high quality assets and the good quality collateral charged in favour of the State at the time the facility and guarantee arrangements were provided should be taken into account. The United Kingdom believes that the least artificial methodology is to quantify the measures using benchmarks such as financing proposals made, Credit Default Swap rates and spreads for subor-

dated debt. At the very most, the quantum of aid could be calculated using the Commission's official reference rate which entered into force on 1 July 2008.

### 5.2. UNITED KINGDOM'S COMMENTS ON THE DOUBTS RAISED IN THE EXTENSION DECISION

#### EXISTENCE OF AID

- (59) As regards the applicability of the IAC to the split-up, the UK authorities have indicated that they do not accept the Commission's analysis for the following reasons. Firstly, NR is entirely government-owned, consequently, unlike other cases where the State takes over the losses on impaired assets from a privately-owned bank either by buying them or guaranteeing them, the United Kingdom cannot buy the impaired assets as it already owns them. Secondly, the UK authorities are of the view that the IAC is designed primarily to deal with situations where considerable uncertainty exists as to banks' exposures to complex and opaque impaired assets. NR's mortgage products, mortgage-backed securities and Treasury assets do not, according to the United Kingdom, fall into this category. Finally, the UK authorities argue that the IAC focuses on the principle of burden-sharing, primarily with the bank taking some element of first loss. In the case of NR this is not possible as the State already owns all the assets before the split-up.

#### RESTORATION OF LONG-TERM VIABILITY

- (60) The UK authorities indicate in their comments that they have provided the Commission with information that demonstrates BankCo's viability in the business plan submitted to the Commission on 10 June 2009 <sup>(29)</sup>. In the business plan, BankCo's viability has been stress-tested against a serious recession scenario (unemployment rising to 3,6 million in 2011 and house prices falling to 50 % of their peak). The stress test demonstrates BankCo's viability even in a serious recession scenario.

#### AID LIMITED TO THE MINIMUM/OWN CONTRIBUTION

- (61) With regard to the Commission's doubts whether the aid granted to NR is limited to the minimum necessary, the United Kingdom disputes that the amended restructuring plan creates a super-competitive new bank. The United Kingdom points out that the capital structure and funding of BankCo has been carefully designed in order for it to be viable even in a stress case.

<sup>(29)</sup> The business plan was updated on 18 September 2009 to take into account the concerns expressed by the Commission and third parties with regard to the competition distortions caused by the aid.

- (62) According to the United Kingdom, it is not the case that the State will accept to fully finance and support the losses of AssetCo. The United Kingdom points out that no guarantee has been given by the State for the assets of AssetCo. The UK authorities however have indicated that, [...], further support may be required [...].
- (63) As regards NR's own contribution to the restructuring, the UK authorities point out that the caps on lending and the active redemption policy in the initial restructuring plan were intended as compensatory measures instead of own contribution. With regard to the cap on mortgage lending, the United Kingdom argues that the UK mortgage market is capacity constrained due to the financial and economic crisis and that the proposed increase in lending by BankCo is limited and does not adversely affects its competitors. As regards the active mortgage redemption programme, it was exacerbating the tightness in the supply of mortgages on the UK market (accounting for 40 % of the drop in new lending). The United Kingdom is of the opinion that NR has contributed to the restructuring by the sale of its Home Equity Release Mortgage (hereinafter 'HERM') portfolio for approximately GBP 2,2 billion, the restructuring losses it has borne and [...].
- (66) With regard to AssetCo, the methodology advanced by the Commission, according to the United Kingdom, is based on the assumption that the United Kingdom would cover the difference between the book value and the market value of the assets. This is incorrect as the guarantees of the United Kingdom cover the difference between the ultimate value of AssetCo's assets and the book value of its liabilities (that is to say, if the assets do not yield enough to cover all the liabilities, the United Kingdom will cover the difference).
- (67) According to the United Kingdom, the correct methodology for estimating the amount of aid granted to BankCo is the sum of the book value of any direct capital injections plus the value of any ongoing guarantees taking into account the fees paid for them plus the value of BankCo's benefit from the high quality mortgage book plus the incremental value to BankCo of taking over NR's retail deposit book.
- (68) The amount of aid to AssetCo, according to the United Kingdom, is the difference between the total value of the aid granted to NR, less the aid granted to BankCo through AssetCo.

LIMITING NEGATIVE SPILL-OVER EFFECTS/MEASURES  
LIMITING THE DISTORTION OF COMPETITION

- (64) The United Kingdom indicates in its submission that it believes that the increased lending foreseen for BankCo is unlikely to have an effect on the mortgage market or BankCo's competitors as capacity is constrained on the market. The increase in the lending capacity of BankCo would ease these concerns slightly, but will leave enough demand for others. The United Kingdom also considers it unlikely that BankCo will rapidly increase lending, after the split-up and exit from TPO, as it will still need to obtain the necessary funding to finance the new lending. Finally, the United Kingdom notes that BankCo will have no privileged access to the pool of customers remaining in AssetCo.
- (65) As regards the amount of aid, the United Kingdom does not accept the Commission's suggestion that this can be determined by deducting the market value of AssetCo's assets from their book value. Such a methodology, in the opinion of the United Kingdom, would overestimate the amount of any aid granted to BankCo. The United Kingdom considers that a difference should be made between aid granted to BankCo and to AssetCo and that aid to AssetCo does not necessarily benefit BankCo. The aid amount for BankCo should reflect BankCo's competitive impact on its competitors, something which is not reflected in the methodology proposed by the Commission.
- 5.3. UNITED KINGDOM'S COMMENTS ON THE INTERESTED PARTIES' OBSERVATIONS IN THE OPENING DECISION
- (69) With regard to the concerns of third parties concerning the increase in retail deposits, the United Kingdom has submitted the following comments.
- (70) According to the United Kingdom, the third party comments on pricing of savings products do not take into account NR's depleted retail deposit base following the bank run in September 2007. In order to stabilise the balance sheet of NR, it should be allowed to build-up its retail deposit base. The United Kingdom points out that a UK market share cap of 1,5 % on retail deposits is in place. This cap will prevent NR from pricing too aggressively and will simultaneously limit the impact NR will have on the savings market. The United Kingdom also submits that NR has not followed an aggressive pricing strategy in its retail deposit products, evidenced by the fact that NR has not ranked within the top 3 in the Moneyfacts savings tables since the Competitive Framework was introduced.
- (71) Furthermore, the United Kingdom argues that setting any further limits on pricing of its savings products would prevent NR from obtaining the funding necessary to support planned new lending. It would also threaten NR's ability to satisfy its obligations under TPO and would prevent NR from reacting to events that would negatively effect its funding position.

- (72) As regards the Competitive Framework, in place since 31 March 2008, the UK authorities have indicated that the behavioural constraints in the Framework sufficiently limit NR in the way it competes on the UK markets.

#### 5.4. UNITED KINGDOM'S COMMENTS ON THE INTERESTED PARTIES' OBSERVATIONS IN THE EXTENSION DECISION

- (73) To address the concerns of the Commission set out in the extension decision and the comments provided by third parties, the UK authorities have altered the amended restructuring plan. Those changes have been set out in more detail in section 2.2 of this Decision (recitals 27, 28 and 29).

### 6. ASSESSMENT

#### 6.1. EXISTENCE OF AID

- (74) The Commission must assess whether the measures introduced or modified by the amended restructuring plan constitute State aid. Article 87(1) of the Treaty provides that 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 or the production of certain goods is, insofar as it affects trade between Member States, incompatible with the common market.
- (75) With regard to the measures already approved by the Commission as rescue aid in its two previous decisions pertaining to this case (namely measures (i), (ii) and (iii) as mentioned in recital 30); the guarantees on retail and wholesale deposits and the BoE/HMT liquidity facility), the Commission has already concluded that those measures constitute State aid in favour of NR. The Commission also observes that BankCo is to have access to the schemes the United Kingdom has introduced for banks during the financial crisis and which have already been approved by the Commission to the extent that those schemes are still in force after the split-up <sup>(30)</sup>.
- (76) The measures that have to be assessed in this Decision in order to determine whether they constitute State aid have already been described in recital 30 of this Decision. The relevant measures are for NR measures (iv) and (v), for BankCo measures (vi), (vii) and (viii) and, for AssetCo, measures (ix)-(xii).

#### STATE RESOURCES

- (77) All those measures are financed through State resources as the measures consist of government loans, grants and guarantees financed by the State <sup>(31)</sup>.

#### SELECTIVITY

- (78) The Commission also has to assess whether the measures confer a selective advantage on the beneficiary or beneficiaries of the aid. The measures concerned are selective as they solely benefit NR, BankCo and AssetCo.

#### ADVANTAGE

- (79) The measures confer an advantage on the economic activity of NR as carried on by it until the split-up and its successors BankCo and AssetCo thereafter.
- (80) NR will profit from the retroactive application of the lower fees for the BoE/HMT liquidity facility and the subsequent reimbursement of GBP 156,4 million to NR after Commission approval (measure (iv)). This confers an advantage on NR as those fees are below the market price.
- (81) NR also draws significant advantages from the commitment of HMT to FSA that it will operate above capital requirements (measure (v)) since, as a result, the FSA: (1) did not require NR to be recapitalised after nationalisation, (2) allowed NR to include Tier-2 capital in its regulatory capital position in June 2008 and (3) has subsequently allowed it to operate below regulatory capital requirements from July 2009 onwards until the split-up.
- (82) As regards the measures in favour of BankCo, the Commission has already concluded that the retail deposit guarantee (measure (vi)) confers an advantage on its beneficiary, in this case BankCo, when approving it as rescue aid to NR. Although the guarantee will be lifted [...], the advantage for BankCo still remains for the time the guarantee continues to be effective. The change in the fee which will be paid by BankCo is not in line with market conditions. In this respect, the CDS spread of NR is significantly above 50 bps. It must therefore be concluded that the measure confers an advantage on BankCo.

<sup>(30)</sup> For instance the CGS, see footnote 15 above.

<sup>(31)</sup> As regards the commitment of HMT to FSA that NR will operate above capital requirements, it can be considered as equivalent to a commitment to capitalise the bank in future that will materialize as a capital injection of BankCo after the split-up.



- (83) As regards the continuation of the wholesale guarantees for BankCo after the split-up until 31 December 2010 (measure (vi)), the Commission has already concluded that it constituted an advantage when approving it as rescue aid to NR. As regards the changes in the fee, upon the split-up, BankCo will pay a remuneration which is in line with the remuneration paid by other banks in the context of the UK CGS. As the remuneration accepted by the Commission in the CGS is below market price (but in line with the European Central Bank recommendations) this confers an advantage on BankCo.
- (84) Furthermore, the capital injection of GBP 1,4 billion in the form of ordinary shares into BankCo (measure (vii)) confers an advantage on it, since, without that capital, BankCo could not start its activities.
- (85) The contingent liquidity facility of GBP 1,5 billion provided to BankCo (measure (viii)) confers an advantage as it will give BankCo another source of liquidity which is not available to other banks. The contingent liquidity facility is intended to provide BankCo with sufficient sources of funding until it is sold by the United Kingdom or other lines of funding are identified.
- (86) With regard to AssetCo, the Commission concluded in the opening and extension decisions that the wholesale guarantees (measure (ix)) constitute State aid. The extension of the wholesale guarantee [...] therefore entails a further advantage on AssetCo.
- (87) The Commission has already concluded in its previous decisions<sup>(32)</sup> that the BoE/HMT liquidity facility constituted State aid. That conclusion also applies in the new circumstances of an increase in the amount of State lending to AssetCo by up to GBP 10 billion and the increase of its tenor to beyond 2020 (measure (x)). As regards the remuneration paid for the facility, AssetCo will pay a lower remuneration for it (LIBOR + [10-60] bps, compared to BoE base rate + 150 bps + 10 bps facility fee previously), which is below the market price and therefore confers an advantage on AssetCo. Furthermore, BankCo will benefit from the increase of the BoE/HMT liquidity facility as a significant amount of the increase will be transferred from AssetCo to BankCo as cash.
- (88) The proposed capital injection into AssetCo of GBP 1,6 billion (measure (xi)) in the form of a debt for equity conversion confers an advantage on AssetCo.
- (89) Furthermore, the working capital facility of GBP 2,5 billion (measure (xii)) will benefit AssetCo as it will have adequate liquidity [...] to fulfil its obligations as they become due. AssetCo will pay 1 month LIBOR + [10-60] bps for the facility, which is well below the market rate since AssetCo is a bank with nearly no capital.
- (90) Finally, the market economy investor principle does not apply to these measures since they follow several rescue aid measures in favour of NR. In addition, if it were applicable, that test would not be fulfilled as no market economy investor would take all those measures in order to facilitate the split-up of BankCo and [...] AssetCo. No market economy operator placed in a similar situation as the State would have been able to maintain the economic activity (of NR) without realizing a significant capital increase (the FSA relaxed its normal capital requirements only because the State committed to provide capital). Taking into consideration the situation on the markets, it would not be possible for a market operator to obtain such financing. This is confirmed by the proposals offering to buy NR submitted by both Virgin and the management of NR in February 2008 and which were described in more detail in the opening decision. Both offers relied on the continuance of State aid measures, indicating that without State aid no private investor would have been ready to purchase NR.
- DISTORTION OF COMPETITION AND EFFECT ON TRADE BETWEEN MEMBER STATE
- (91) It is also concluded that measures (iv)-(xii) in recital 30 are able to distort competition and affect trade between Member States.
- (92) The measures allow [...] of certain assets of NR, placed in AssetCo, which is a condition necessary for the creation of BankCo and implementation of its business plan. BankCo, as NR's successor, will be able to continue NR's activities unburdened by possible impairments on the lower quality assets, since the latter remain in AssetCo's balance sheet. As a result, BankCo has an advantage over its competitors that are faced with impairments on lower quality assets, which they have to absorb, limiting the capital available for new lending. BankCo, in contrast, will not have its capital base diminished by these impairments and the decreasing value of its mortgage portfolio. This is an advantage considering the current high cost of borrowing on the financial markets. In addition, BankCo will have a lot of cash to fund new lending. It is therefore concluded that measures (iv)-(xii) in recital 30 lead to a distortion of competition.

<sup>(32)</sup> See footnote 14.



- (93) BankCo will also be a bank competing on, amongst others, the UK retail deposit market and the UK mortgage lending market. In those two markets, some competitors are subsidiaries of foreign banks. The measures are therefore able to affect trade between Member States.

#### IDENTIFICATION OF THE BENEFICIARY OF THE AID

- (94) The Commission notes that the United Kingdom intends to introduce new aid measures and to amend existing ones. Those measures will enable the split-up of NR into two legal entities, BankCo and AssetCo. Without the aid provided to AssetCo, it would not be possible to transfer the loan portfolio of NR to it. As a result of the aid to AssetCo, BankCo is able to continue the economic activity of NR, being freed from the burden of the majority of NR's loan portfolio that will remain in AssetCo. In addition it will receive a large amount of cash from AssetCo (which it in turn has received from the State). BankCo can therefore be considered as the beneficiary of all the State measures, including those in favour of AssetCo.

- (95) Under the amended restructuring plan, AssetCo will carry out only limited lending required by existing contractual obligations, thus limiting the situations where it is in competition with other banks to the minimum. Its banking license will be withdrawn after the split-up, after which it will continue to operate under a mortgage lender's license. This will enable it to operate under lower regulatory capital requirements (1 %) compared to banks. AssetCo will, according to the UK authorities, only realise its assets as they mature or by selling them on the market. AssetCo will use the proceeds of those sales to repay its debts as they become due and fund its ongoing operational costs as well as any retained historic liabilities.

- (96) In order to facilitate [...], AssetCo will undertake economic activities, such as the sale of its assets and debt management on its portfolio. Furthermore, [...] will for a period of time (until the end of 2010 at the latest) provide services to [...]. This is necessary, since after the split-up [...] will lack certain operational functions that remain with [...] such as mortgage servicing (post completion), debt management and IT infrastructure and support. Those services will be provided by [...] to [...] on a commercial basis (that is to say, [...] will pay a fee to [...]) and at arm's length. [...] It is therefore concluded that AssetCo will continue to carry out some limited economic activities after the split-up and thus is to be considered as a beneficiary of the aid measures.

- (97) With regard to NR, prior to the intended split-up, NR has been able to continue to operate aided by guarantees on its retail and wholesale deposits, a government liquidity facility and the commitment by the UK authorities to the FSA that they would ensure that NR would operate above regulatory capital requirements. This commitment from the United Kingdom has allowed NR to operate temporarily below regulatory requirements until the split-up. NR is therefore the beneficiary of those measures. As indicated above in recital 92, the economic activities of NR will be continued by BankCo.

#### CONCLUSION

- (98) On the basis of the foregoing, it is concluded that measures (iv)-(xii) in recital 30 constitute State aid.

#### 6.2. AMOUNT OF AID

- (99) As regards the amount of the aid, the UK authorities have made several submissions on how the aid amount should be calculated in their responses to the opening decision and the extension decision. With regard to the suggestion forwarded by the United Kingdom regarding the aid amount in the opening decision, the Commission observes that those submissions are partly based on the aid measures contained in the initial restructuring plan. The suggestions forwarded by the United Kingdom including the use of CDS spreads and spreads on subordinated debt, also fail to take into account that those spreads already take into account the State aid granted to NR and its subsequent nationalisation. Those spreads therefore do not reflect the intrinsic risk of NR, absent the significant State support.

- (100) With regard to the United Kingdom's suggestions concerning how to calculate the amount of aid in its response to the extension decision, the Commission notes that those suggestions do not seem to take into account the current situation on the financial markets.

- (101) In that context, none of the parties contest that NR and its successors have received and will receive a very considerable amount of aid, which reflects the need for a far-reaching restructuring and which warrants a very significant reduction of its market presence.

### 6.3. COMPATIBILITY OF THE AID

#### 6.3.1. LEGAL BASIS FOR THE COMPATIBILITY ASSESSMENT

(102) As indicated in the extension decision (section 4.2.1), the Commission did not apply Article 87(3)(b) of the Treaty in its decision of 5 December 2007 with regard to the rescue aid granted to NR<sup>(33)</sup> or in the opening decision. Indeed, the aid granted at that time did not seem to tackle a disturbance in an entire Member State, but instead specifically aimed to address individual problems specific to the situation of NR<sup>(34)</sup>. In such circumstances and in accordance with the case law<sup>(35)</sup>, the Commission concluded that Article 87(3)(b) of the Treaty was not applicable.

(103) However, since then, the Commission has acknowledged that the global financial crisis can create a serious disturbance in the economy of Member States and that measures supporting banks are apt to remedy this disturbance in its 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<sup>(36)</sup> (hereinafter 'Banking Communication'), its Communication on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition<sup>(37)</sup> (hereinafter 'Recapitalisation Communication'), the IAC and its Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules (hereinafter 'Restructuring Communication')<sup>(38)</sup>. For the United Kingdom this was confirmed in the Commission's various approvals of the measures undertaken by the United Kingdom to combat the financial crisis<sup>(39)</sup>. Therefore, as indicated in the

extension decision, the legal basis for the assessment of the aid measures should be Article 87(3)(b) of the Treaty.

#### 6.3.2. COMPATIBILITY ASSESSMENT

(104) The Commission has established that NR, BankCo and AssetCo will benefit from several State aid measures. Those measures are of different types. The split-up of NR is comparable to an impaired asset measure, while the capital injections are recapitalisations. Before assessing the final restructuring plan submitted by the United Kingdom which includes those measures, the Commission will first assess the split-up of NR in the context of the IAC and the recapitalisations in light of the Recapitalisation Communication with a view of verifying whether they are in line with those Communications.

#### The application of the IAC

(105) In the extension decision the Commission indicated that the split-up of NR could be seen as a kind of asset relief measure benefitting the economic activities of NR that remain on the market through BankCo. The United Kingdom submitted a number of observations in that respect in its comments on the extension decision. In particular it pointed out that NR has been 100 % nationalised, that the plan of the split-up was only conceived at a later stage and that prior to the split-up the assets are government-owned. Those facts however, do not prevent the application of the IAC, as the effect of the aid measures undertaken by the United Kingdom have resulted in the creation of a bank (BankCo) that is relieved from the impaired assets of its predecessor (NR).

(106) The specific conditions applying to asset relief measures are laid down in the IAC<sup>(40)</sup>. Pursuant to section 5.2 of the IAC, an asset relief measure requires ex-ante transparency and should provide for adequate burden-sharing followed by the correct valuation of the eligible assets

<sup>(33)</sup> Commission Decision in Case NN 70/07, *Northern Rock* (OJ C 43, 16.2.2008, p. 1).

<sup>(34)</sup> Points 100 and 101 of the opening decision.

<sup>(35)</sup> See Cf. in principle case *Joined Cases T-132/96 and T-143/96 Freistaat Sachsen and Volkswagen AG v Commission* [1999] ECR II-3663, paragraph 167. This approach has been applied in Commission Decision 98/490/EC in Case C 47/96, *Crédit Lyonnais* (OJ L 221, 8.8.1998, p. 28) (point 10.1), Commission Decision 2005/345/EC in Case C 28/02, *Bankgesellschaft Berlin* (OJ L 116, 4.5.2005, p. 1) (points 153 et seq) and Commission Decision 2008/263/EC in Case C 50/06, *BAWAG* (OJ L 83, 26.3.2008, p. 7) (point 166). See also Commission Decision in Case NN 70/07, *Northern Rock* (OJ C 43, 16.2.2008, p. 1) and Commission Decision in Case NN 25/08, *Rescue aid to WestLB* (OJ C 189, 26.7.2008, p. 3).

<sup>(36)</sup> *Banking Communication* (OJ C 270, 25.10.2008, p. 8).

<sup>(37)</sup> *Recapitalisation Communication* (OJ C 10, 15.1.2009, p. 2).

<sup>(38)</sup> *Restructuring Communication* (OJ C 195, 19.8.2009, p. 9).

<sup>(39)</sup> See amongst others Commission Decisions in Case N 507/08, *Financial support measures to banking sector in the UK* (OJ C 290, 13.11.2008, p. 1), Commission Decision in Case N 650/08, *Notification of modifications to the financial support measures to the banking industry in the UK* (OJ C 54, 7.3.2009, p. 3) and Commission Decision in Case N 193/09, *Extension of credit guarantee scheme (CGS)* (OJ C 145, 25.6.2009, p. 3).

<sup>(40)</sup> IAC provides criteria to assess an asset relief measure in both rescue and restructuring scenarios. In a rescue scenario, when a temporary measure which is limited in amount is needed for the bank to tackle the crisis, it is assumed that the bank can return to viability once the situation in the markets stabilizes and that this does not necessitate any structural adjustments or restructuring. Conversely, in the cases where the bank needs significant amounts of aid or cannot provide for adequate burden sharing, a 'far reaching restructuring' of the bank is necessary. In the latter case, section 6 of the IAC lays down more specific requirements with regard to the burden-sharing condition.

and the correct remuneration of the State for the asset relief measure to ensure shareholders' responsibility.

- (107) Ex-ante transparency implies a clear identification of the assets and exposure. This is necessary to identify the amount of aid in the asset relief measure and to ascertain whether the aid is needed to address a temporary problem or whether the bank in question is technically insolvent.
- (108) Concerning the valuation of the impaired assets, point 38 of the IAC provides that where the valuation of assets appears particularly complex, alternative approaches may be considered such as the creation of a 'good bank' or *public ownership* of a bank (including nationalisation). In the latter scenario no ex-ante valuation of assets is needed insofar as the valuation is carried out over time in the context of restructuring or liquidation.
- (109) NR was indeed nationalised giving the United Kingdom, as NR's owner, the opportunity to review and investigate all assets of NR.
- (110) According to the IAC, the objective of valuation is to calculate the amount of aid and thus the level of competition distortion for the purposes of determining how far-reaching the restructuring should be. In this case, the restructuring can be considered as 'very' far-reaching. An ex-ante valuation of assets would, in this case, not lead to the imposition of additional requirements by the Commission concerning the depth of the restructuring.
- (111) In view of those two elements, valuation prior to the split up is not necessary. As regards the valuation of the assets over time, the [...] will lead to a valuation of those assets by the market over time.
- (112) Point 41 of the IAC states with regard to the transfer value of the impaired assets that the transfer value for asset purchase or asset insurance measures should be based on their real economic value. Moreover, adequate remuneration for the State must be secured. Where Member States deem it necessary — notably to avoid technical insolvency — to use a transfer value of the assets that exceeds their real economic value, the aid element contained in the measure is correspondingly larger. It can only be accepted if it is accompanied by far-reaching restructuring and the introduction of conditions allowing the recovery of this additional aid

at a later stage, for example through claw-back mechanisms. The transfer of the assets from NR to AssetCo will occur at book value. The real economic value of the assets as a result of impairments is lower than the transfer value. Therefore the asset relief effect is considerable as BankCo is not burdened by those losses. In accordance with point 41 of the IAC, a far-reaching restructuring of the bank is consequently required.

- (113) In this context, it is undisputable that without the aid NR would have been technically insolvent. NR was nationalised when the United Kingdom's attempt to sell NR to third parties failed. This is furthermore evidenced by the waivers obtained by NR from the FSA, firstly to include all its Tier-2 capital to its regulatory capital position and subsequently to operate below regulatory capital requirements. From the submission of the UK authorities it appears that if the bank was not split-up, a capital injection of at least GBP 6 billion (for comparison, before the crisis, the bank's capital was less than GBP 2 billion) would be necessary for the bank to be viable. Without the State intervention, the split-up of NR and the subsequent continuation of its economic activities by BankCo would not have been possible. The fact that the majority of NR's assets remain in AssetCo allows BankCo to avoid the losses on those assets and the subsequent depletion of its capital.
- (114) The conditions of point 41 of the IAC are fulfilled as a far-reaching restructuring is achieved<sup>(41)</sup> since NR economic activities continued by BankCo will be reduced by over 75 %. Furthermore, the United Kingdom nationalised the bank in February 2008, and therefore owns 100 % of the shares. By relieving the good bank of the bad mortgages, the State increases the value of the good bank, which it plans to sell within [...]. As a result the benefit from the asset relief will at least partially be captured by the State in the form of a higher sale price of the good bank.
- (115) As regards the burden-sharing of the costs related to the impaired assets between the State, shareholders and creditors, both the former shareholders and the hybrid capital holders will contribute to the restructuring of the bank to the greatest extent possible as the former have been wiped-out (i.e. lost a substantial amount of their investment) as a result of NR's nationalisation. The hybrid capital holders will [...] AssetCo. As a consequence they will not receive coupons that are discretionary and [...]. Additional burden-sharing is therefore not required (see also recitals 150 and 151).

<sup>(41)</sup> For the assessment of the restructuring plan under the Restructuring Communication see recitals 123 et seq.

- (116) 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 objective of a mandatory remuneration is two-fold: to ensure burden-sharing and to minimise the distortion of competition. In this case, burden-sharing is achieved due to the nationalisation of NR (see also recitals 148 and 149). As to the second objective, the distortion of competition can be considered as minimised as a result of the considerable down-sizing of NR in the context of the in-depth restructuring (see also recitals 156 et seq). Furthermore, any benefit which BankCo may enjoy as a result of the asset relief measure will be at least partially recuperated through a higher sale price. In such exceptional conditions, it is acceptable that the proceeds of the sale of the bank is a form of remuneration for the State to the extent that it diminishes the total rescue costs.
- (117) The impaired assets remaining in AssetCo will be managed exclusively by AssetCo, which will be separate and organisationally independent from BankCo.
- (118) It is therefore concluded that, in view of the far-reaching restructuring foreseen, the asset relief in favour of BankCo is in conformity with the IAC.

#### **The application of the Recapitalisation Communication**

- (119) Recapitalisations are foreseen for both BankCo and AssetCo. According to the Recapitalisation Communication, adequate remuneration should be paid for the recapitalisations.
- (120) In the case of BankCo, it will receive a GBP 1,4 billion capital injection in the form of ordinary shares. As regards the remuneration to be paid for the ordinary shares, the United Kingdom will already be a 100 % shareholder in BankCo at the time of the split-up. A further capital injection in the form of ordinary shares will not change the shareholding of the United Kingdom in BankCo. As already observed with regard to the asset relief measure in recital 114, the United Kingdom has nationalised NR and therefore owns 100 % of the shares. Furthermore, the injected funds will be at least partially recovered through the remuneration of the shares and the sale of BankCo.
- (121) AssetCo will need a capital injection of GBP 1,6 billion only in a stress case scenario. It will not pay a fee for the

recapitalisation, if it occurs. As AssetCo [...], it will sell assets on the market. It will use the proceeds of those sales to pay back the State, which is one of its senior creditors by virtue of the BoE/HMT liquidity facility. The proceeds will not benefit the economic activity of AssetCo. Therefore, the remuneration of the State is inherent [...].

- (122) Consequently, it is concluded that the recapitalisations are in line with the Recapitalisation Communication.

#### **The application of the Restructuring Communication**

- (123) 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 87(3)(b) of the Treaty, 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;
- (ii) include sufficient own contribution by the beneficiary (burden-sharing);
- (iii) contain sufficient measures limiting the distortion of competition.

#### **(i) Restoration of long-term viability**

- (124) Points 9, 10 and 11 of the Restructuring Communication state that the Member State should provide a comprehensive and detailed restructuring plan which should provide complete information on the business model. The plan should also identify the causes of the difficulties faced by a financial institution and alternatives to the restructuring plan proposed.
- (125) The information submitted by the United Kingdom meets the requirements of the Restructuring Communication as it provides information on the difficulties faced by NR, the cause of the difficulties and information on the business model of BankCo.
- (126) In its extension decision the Commission indicated that it appeared that BankCo will be a viable bank after the split-up. However as it had not received a business plan effectively demonstrating the viability of BankCo, it could not reach a conclusion in that respect. The United Kingdom submitted a detailed business plan on 10 June 2009.



- (127) According to the business plan, BankCo will be a viable bank after the split in both base and stress case scenarios. It will start with a considerably smaller balance sheet of GBP [21-24] billion, compared to NR GBP (GBP 104,3 billion at the end of 2008), which will grow to GBP [31-34] billion in 2013. The balance sheet contains high quality assets (GBP [9-12] billion of cash and unencumbered mortgages worth GBP [7-11] billion). The mortgage portfolio transferred to BankCo will have an average LTV of [62-67] %. BankCo's liabilities consist mainly of NR's retail deposits (GBP 19,3 billion) and very limited wholesale deposits (GBP [1-3] billion).
- (128) BankCo's commercial strategy will be more conservative than NR's. It will solely focus on the UK retail market. BankCo will operate as a mortgage and savings bank. Its risk appetite will be conservative, in line with its commercial strategy. BankCo will target a single A/P1 rating.
- (129) As regards BankCo's presence on the UK savings- and mortgage market, BankCo will not increase its presence on the market. As a result of the restructuring, BankCo will be one third of NR's original size. Its new lending will be limited to GBP 9 billion in 2010 compared to GBP 32,2 billion in 2007, which represents a market share of approximately 1,5 %. BankCo's market share of gross lending will be around [3-6] % compared to 9,7 % before the State intervention.
- (130) The funding used for writing residential mortgage loans will predominantly be based on retail deposits, starting with approximately [92-95] % of total funding being deposits in 2009 decreasing to a minimum of around [68-71] % in 2013 (compared to less than 30 % before the crisis). BankCo's reliance on wholesale funding will be limited to approximately [22-35] % of its mortgage assets.
- (131) Also, BankCo's targeted weighted average LTV as regards new lending will be < [68-71] %, with no loans going above [94-97] % LTV. It will focus on residential, owner-occupied, lending (around [...] % of total lending) and will also undertake some buy-to-let lending (around [...] %). It will no longer market the Together products (mortgages with LTV [...] 125 % combined with an unsecured loan) and will not carry out commercial lending. BankCo's lending, not taking into account any behavioural commitments, will be constrained by its reliance on retail deposits to fund its lending. BankCo intends to lend GBP [6-9] billion in 2010 and GBP [6-8] billion annually in 2011, 2012 and 2013.
- (132) BankCo, according to the business plan submitted by the United Kingdom, is expected to return to profitability in [...] with net interest income in a base case increasing from GBP [...] million in 2009 to GBP [...] million in 2013, a profit (loss) after tax of approximately -GBP [...] million in 2009 increasing to GBP [...] million in 2013 and a return on equity (hereinafter 'ROE') after tax of -[...] % in 2009 increasing to around [9-12] % in 2013. In a stress case the net interest income would increase from GBP [...] million in 2009 to GBP [0,1-0,6] million in 2013, the profit (loss) after tax would go from -GBP [...] million in 2009 to GBP [...] million in 2013 and the ROE would go from -[...] % in 2009 to around [...] % in 2013. Furthermore, according to the United Kingdom, those figures are not above the average generated by building societies, BankCo's main competitors.
- (133) As regards its regulatory capital position, BankCo will be sufficiently capitalised through the GBP 1,4 billion recapitalisation after the split-up. This, together with the considerable amount of cash it receives, will result in a Tier-1 capital ratio of over [48-53] % at the time of the split-up, decreasing to around [16-21] % in 2013 as BankCo will have increased its lending by using the large amount of cash received and by raising new funding. BankCo is also sufficiently capitalised [...]. According to the business plan, BankCo can [...] of GBP [...] billion-GBP [...] billion in a severe scenario-while remaining viable.
- (134) Finally as regards liquidity, BankCo intends to maintain a liquidity ratio (cash over assets) of above [19-22] % in 2009-2013, which according to the United Kingdom is in line with the ratio maintained by building societies and above the average for more diversified UK banks (liquidity ratio between 5-10 %). The core liquidity held by BankCo will cover [17-20] % of retail deposits and around [3-6] months of wholesale maturities.
- (135) The plan also contains information on the exit of BankCo out of TPO, which will have as a consequence the possibility for the State to recover part or all the money injected in NR, BankCo and AssetCo.
- (136) On the basis of the foregoing, the Commission's remaining doubts on the viability of BankCo have been allayed. This conclusion is in line with the Commission's initial assessment and the comments received from third parties in the context of the extension decision.



(ii) **Own contribution/burden-sharing**

- (137) The Restructuring Communication indicates that an appropriate contribution by the beneficiary is necessary in order to limit the aid to a minimum and to address distortions of competition and moral hazard. To that end: (a) both the restructuring costs and the amount of aid should be limited and (b) a significant own contribution is necessary.
- (138) The principles on the own contribution of the beneficiary bank in the restructuring phase are laid down in section 3 of the Restructuring Communication. It requires (i) that the restructuring aid is limited to the minimum to cover costs necessary for restoring viability; (ii) that the beneficiary bank should use to the extent possible its own resources to finance restructuring, for example, through the sale of assets and (iii) that the costs associated with the restructuring are also adequately borne by those who invested in the bank by absorbing losses with available capital and by paying an adequate remuneration for State interventions. The objective of burden sharing is twofold: to limit distortions of competition and to address moral hazard <sup>(42)</sup>.

*Limitation of restructuring costs*

- (139) The Commission's doubts on whether the aid is limited to the minimum necessary to restore long-term viability of NR (BankCo) have been allayed (see also recital 141). Indeed, the final restructuring plan does not foresee any new lending above pre-crisis levels or any acquisitions of new businesses.
- (140) The cash transferred to BankCo by AssetCo at the split-up will mainly be used to achieve a lending target in 2010 of GBP [6-9] billion. The United Kingdom considers that achieving this level of lending is necessary to stabilise the UK mortgage market, which has been suffering from supply constraints (notably as a result of NR's negative net lending due to its active mortgage redemption programme), thereby amplifying the fall in UK house prices. BankCo's lending target for 2011 will also decrease to GBP [6-8] billion. Taking this into account, the restructuring costs are limited to the minimum necessary.

*Limitation of the amount of aid, significant own contribution***Own contribution**

- (141) In designing the restructuring plan, the United Kingdom has opted for a solution that requires less aid than foreseen in the initial restructuring plan. As mentioned in recital 23, the alternative to the split-up of NR would have been a continuation of NR, which would have required a capital injection of at least GBP 6 billion (compared to a maximum of GBP 3 billion in a stress case in the final restructuring plan). Through the split-up, less capital is needed for BankCo and AssetCo combined,

since AssetCo will operate solely as a mortgage lender and as a result will be subject to lower regulatory capital requirements compared to a regular bank. The split-up therefore limits the aid necessary to ensure NR's viability.

- (142) Furthermore, as a result of the split-up, the mortgage portfolio of BankCo will have a LTV ratio that will be higher than that of most of the building societies, which can be considered its closest rivals, and BankCo's ROE will remain significantly below that of UK banks and building societies until 2013.
- (143) Furthermore, in the prevailing market conditions the results of stress tests have to be taken into account to ascertain the viability of the bank <sup>(43)</sup>. In this context, the UK authorities have confirmed that the GBP 1,4 billion for BankCo is the FSA's minimum regulatory capital requirement. Furthermore, BankCo [...]. The United Kingdom has demonstrated that if more impaired assets were to be transferred to BankCo, this would need to be counterbalanced by an additional capital injection to be provided by the State in order not to jeopardize long-term viability of the bank whilst maintaining limited lending to the real economy.
- (144) The restructuring costs are borne by the bank itself to the greatest extent possible through the redemption and the disposal of assets. Firstly, NR limited the amount of aid needed by actively inciting existing customers to redeem their loans and refinance them with competitors in the period from April 2008 until early 2009. Through this, NR has lost high quality customers, that is to say, those which have been able to find a bank ready to lend to them. The proceeds resulting from the active mortgage redemption programme have been used to repay the State. As a result, the BoE/HMT liquidity facility decreased from GBP 27 billion (end of 2007) to GBP 14,5 billion (30 June 2009).
- (145) Secondly, NR has sold its HERM portfolio for approximately GBP 2,2 billion. This measure generated funds which have been used to pay back part of the BoE/HMT liquidity facility. The inflow of funds is certain as the measure has already been realised.
- (146) NR has also reduced the aid necessary by originating a very low amount of new mortgages in 2008 and 2009 (GBP 3 billion and GBP 1,3 billion until 30 June 2009 respectively compared to GBP 32,3 billion in 2007).

<sup>(42)</sup> See point 22 of the Restructuring Communication.

<sup>(43)</sup> See point 13 of the Restructuring Communication.

- (147) In the light of foregoing, it is concluded that the Commission's doubts regarding the aid being limited have been allayed and that the own contribution of NR is sufficient.

#### Burden-sharing

- (148) As regards burden-sharing, the Restructuring Communication requires that the restructuring costs are not only borne by the State but also by a bank's past investors and former shareholders.

- (149) With regard to NR, the bank was nationalised and its former shareholders will only be compensated on the basis of the value of the company without any State support<sup>(44)</sup>. As a consequence, this compensation is likely to be close to zero. This means that the former shareholders have been wiped-out and thus can be considered as having sufficiently supported the consequences of the failure of NR.

- (150) Furthermore, NR's subordinated debt holders will remain with AssetCo. This means that they will be compensated through the amounts that are recovered from AssetCo's assets. As subordinated debt holders, [...]. The State, on the other hand, will be a senior creditor by virtue of the loans (BoE/HMT liquidity facility and the working capital facility) it has provided to AssetCo. Therefore, [...]. In addition, NR has recently decided to defer coupon payments and payments on the principal on cumulative Tier-2 and related Tier-1 instruments where it has discretion to do so. The United Kingdom has furthermore provided a commitment that AssetCo will continue to defer those payments after the split-up. [...].

- (151) As a consequence, moral hazard is adequately addressed by own contribution of past capital holders in the bank.

- (152) It is therefore concluded that NR and its capital owners have contributed to the restructuring to the maximum extent.

#### (iii) Measures limiting the distortion of competition

- (153) The Commission, in its extension decision, expressed doubts as to whether the measures proposed by the United Kingdom to limit the distortion of competition

are sufficient to offset the distortion of competition caused by the continued presence of NR's economic activities on the market through BankCo. This concern was shared by third parties, which pointed out BankCo's strong position in the UK mortgage and savings market and suggested measures remedying the distortion of competition caused by BankCo.

- (154) As regards the measures limiting the distortion of competition, the Restructuring Communication indicates that the Commission has to take into account in its assessment the amount of aid, the degree of burden-sharing and 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.

- (155) The distortions of competition caused by NR are significant. NR's successor BankCo will be well-funded and relieved of the burden of the risky lending made by NR in the past. In order to keep NR in business since September 2007 and to facilitate the split-up, a large amount of aid has been and will be necessary. However, NR will be a much smaller bank and sufficient measures limiting the distortion of competition have been put in place by the United Kingdom.

- (156) Firstly, NR will no longer continue as the same economic entity as before the State intervention. It has been subject to nationalisation and a profound in-depth restructuring. As a result, a much smaller bank than NR, BankCo, will compete on the UK retail market. After the split-up BankCo's balance sheet will be around [17-22] % of NR's balance sheet in 2007. However, since at the time of the split-up, the bank will have a lot of cash and be nearly exclusively financed by retail deposits allowing it to grow rapidly in the first years, it is fairer to use the 'stabilized' situation at the end of the restructuring period in order to assess the magnitude of the downsizing. At that time, the balance sheet will be less than [30-35] % of the original size of NR in 2007. Concerning the size of the bank on the markets after restructuring the market share (based on gross new lending) on the residential mortgage market will be around [3-6] % (GBP [6-9] billion) until 2013 compared to 8 % in 2007 (GBP 32,2 billion). On the UK retail deposit market, BankCo's share will not exceed 1,5 % until after 2013 (GBP 23 billion) versus 1,9 % before the bank-run in September 2007. This illustrates that BankCo will be a relatively small bank, not a market leader. Further reducing BankCo's presence on the UK mortgage and savings market would endanger its viability.

<sup>(44)</sup> See point 90 of the opening decision.

- (157) In 2008 and 2009 NR has voluntarily reduced its lending to very low levels (GBP 3 billion in 2008 and GBP 1,3 billion over the first half of 2009 compared to GBP 32,2 billion in 2007, see Table 1) because of the caps on its lending provided for in the Competitive Framework and by encouraging customers to transfer their loans to competitors through its active mortgage lending programme. The latter caused the net lending over 2008 to decrease by GBP 25,4 billion. In conclusion, NR reduced its market presence on the mortgage market from the moment the Competitive Framework was announced at the end of the first quarter of 2008.
- (158) Secondly, the United Kingdom has, compared with the amended restructuring plan, taken measures to make BankCo's balance sheet smaller, with less cash and more risky assets, by reducing it by approximately GBP 4 billion. BankCo will have less cash and more and lower quality mortgages. With less cash, BankCo will be limited in its mortgage lending capacity. The changes made to the balance sheet by the United Kingdom contribute to addressing the concerns expressed by third parties (see section 4.2).
- (159) Thirdly, the United Kingdom has provided the Commission with several commitments aimed at limiting BankCo's market presence, which have been described in more detail in Section 5.4. Caps on BankCo's retail deposits and mortgage lending have been put in place. Those caps will remain in place until at least the end of 2011, irrespective of whether BankCo exits TPO, and possibly even longer if exit from TPO occurs after 2011. The caps limit BankCo's ability to expand aggressively on the market.
- (160) In that context, it is necessary for those caps to remain in place even if exit from TPO occurs before 2011, as BankCo continues to profit from the State aid granted to it and to AssetCo in order to facilitate the split-up of NR. The aid provided ensures that BankCo will have a good starting position after the split-up. It has been rid of the risky lending of the past and has received a considerable amount of cash. BankCo will continue to benefit from the aid after the split-up. Early exit from TPO would not totally compensate for the distortion of competition by BankCo, thus justifying that the caps remain in place at least until the end of 2011.
- (161) With regard to the concerns raised by third parties as to BankCo's ability to crowd-out competitors through aggressive pricing strategies, the United Kingdom has given a commitment that BankCo will stay out of the Moneyfacts top 3 tables as regards mainstream mortgages (excluding mortgages with an LTV ratio greater than 80 % or products for first time buyers). The Moneyfacts tables include data on the top 5 mortgages in several segments that are considered to be the best buys in the market at a given moment. For smaller banks, it is important to be visible in the Moneyfacts table as it is an effective way to come into contact with customers. The United Kingdom's commitment ensures that BankCo, although still visible, cannot offer the best price on the market. Thus, potential crowding-out of competitors is limited during the years when BankCo is most reliant on State aid.
- (162) Furthermore, the United Kingdom has given a commitment to sell BankCo [...]. The sale of BankCo will allow the State to recover (part of) the funds injected into NR. In addition, timely exit from TPO ensures that third parties have the possibility to acquire BankCo. In that respect, NR's competitors complained, above all, that while in TPO, it is easier for NR to attract retail deposits as consumers are aware that the bank is State-supported. Putting an end to TPO will remove this distortion of competition.
- (163) The United Kingdom has also given a commitment that the guarantees on retail and wholesale deposits for BankCo will be withdrawn by [...]. As a result, BankCo will no longer be in a more advantageous position compared to its competitors as regards retail and wholesale deposits. That commitment therefore addresses third party concerns regarding the continuation of the guarantees.
- (164) As regards behavioural constraints, BankCo will be limited in its activities by an acquisition ban and a ban to promote the State guarantees and TPO. Those measures will continue until the end of TPO.
- (165) The withdrawal by NR from Denmark can be regarded as a measure limiting the distortion of competition, because NR and as a consequence BankCo will no longer compete on this market.
- (166) Finally, any distortion of competition by AssetCo as a result of it continuing to carry out limited economic activities is limited, as confirmed by the commitment given by the United Kingdom in point (ix) of recital 29. [...], its economic activities will decrease and so will the potential distortion of competition.

## Monitoring

- (167) Point 46 of the Restructuring Communication indicates that, in order to verify that the restructuring plan is being implemented properly, detailed regular reports from the Member State are necessary. Accordingly, the United Kingdom should provide the Commission with such reports every six months, starting from the date of this Decision.

## 7. CONCLUSION

- (168) The continuation of measures (i)-(iii) after the split-up of NR as well as measures (iv)-(xii) set out in point 30 are considered to be restructuring aid that should be declared compatible with Article 87(3)(b) of the Treaty,

HAS ADOPTED THIS DECISION:

### Article 1

The following aid which the United Kingdom has implemented in favour of Northern Rock, BankCo and AssetCo, is compatible with the common market, subject to the conditions set out in Article 2:

- (i) the retroactive application of a lower fee on the Bank of England liquidity facility which later was novated to the UK Treasury ('the BoE/HMT liquidity facility') and the reimbursement of the excess fees to Northern Rock after the split-up of Northern Rock into BankCo and AssetCo;
- (ii) the assurance by the UK Treasury to the Financial Services Authority that Northern Rock will operate above regulatory capital requirements;
- (iii) the continuation of the State guarantee on the retail deposits of BankCo;
- (iv) the continuation of the State guarantee on wholesale deposits of BankCo;
- (v) the GBP 1,4 billion recapitalisation of BankCo;
- (vi) the contingent liquidity facility of GBP 1,5 billion for BankCo;
- (vii) the continuation of the State guarantee on wholesale deposits of AssetCo;
- (viii) the increase of the BoE/HMT liquidity facility by up to GBP 10 billion to a maximum of GBP 23 billion;

- (ix) the recapitalisation up to GBP 1,6 billion of AssetCo; and

- (x) the working capital facility of GBP 2,5 billion for AssetCo.

### Article 2

The conditions referred to in Article 1 shall be as follows:

- (i) there must be full operational separation between BankCo and AssetCo as soon as possible and by the end of 2010 at the latest;
- (ii) new lending by BankCo must be capped to GBP 4 billion in 2009, GBP 9 billion in 2010 and GBP 8 billion in 2011; in the event that BankCo remains in Temporary Public Ownership (hereinafter 'TPO') after 2011, a lending cap of GBP 8 billion must remain in place until 31 December 2013 or exit from TPO, whichever is earlier;
- (iii) BankCo retail deposit balances across the United Kingdom, Ireland and Guernsey must be capped at GBP 20 billion until 31 December 2011; in the event that BankCo remains in TPO in 2012 and 2013, the retail deposit cap must be GBP 23 billion for 2012 and GBP 26 billion for 2013 or exit from TPO;
- (iv) BankCo, must not rank within the top three Moneyfacts mortgage categories for 2- 3-, or 5-year fixed or variable mortgages (excluding mortgages with a loan-to-value ratio greater than 80 % and products for first time buyers) until 31 December 2011 or exit from TPO, whichever is earlier;
- (v) the UK government must exit majority ownership of BankCo [...], in this context, TPO is deemed to be exited if the UK has sold at least 50 % + 1 of BankCo's shares to a non State-owned or controlled entity (or entities) and the UK has lost control over BankCo within the meaning of Regulation (EC) No 139/2004;
- (vi) BankCo [...] must give public notice that the UK retail deposit guarantee will be released by [...] and that the wholesale guarantee arrangements related to BankCo will be lifted by the United Kingdom by 31 December 2010;
- (vii) existing subordinated debt must remain in AssetCo and no principal or coupons is to be paid on subordinated debt instruments where AssetCo is contractually able to do so, [...];

(viii) BankCo and AssetCo must not engage in acquisitions of shares in other firms or promote the Government guarantee arrangements or ownership;

(ix) AssetCo must not undertake any new economic activities apart from the activities necessary to provide operational support to BankCo until the operational separation between BankCo and AssetCo is completed [...].

*Article 3*

The United Kingdom shall inform the Commission, within two months of notification of this Decision, of the measures taken to comply with it. Furthermore, the United Kingdom shall, from

the adoption of this Decision, submit detailed six-monthly reports on the measures taken to comply with it.

*Article 4*

This Decision is addressed to the United Kingdom of Great Britain and Northern Ireland.

Done at Brussels, 28 October 2009.

*For the Commission*

Neelie KROES

*Member of the Commission*

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