POMOC PAŃSTWA — ZJEDNOCZONE KRÓLESTWO

Pomoc państwa C 14/08 (ex NN 1/08) — Pomoc na restrukturyzację dla Northern Rock

Zaproszenie do zgłaszania uwag zgodnie z art. 88 ust. 2 Traktatu WE

(Tekst mający znaczenie dla EOG)

(2008/C 135/06)

Pismem z dnia 2 kwietnia 2008 r. zamieszczonym w autentycznej wersji językowej na stronach następujących po niniejszym streszczeniu, Komisja powiadomiła Zjednoczone Królestwo o swojej decyzji w sprawie wszczęcia postępowania określonego w art. 88 ust. 2 Traktatu WE dotyczącego wyżej wspomnianego środka pomocy.

Zainteresowane strony mogą zgłaszać uwagi na temat środka pomocy, w odniesieniu do którego Komisja wszczyna postępowanie, w terminie jednego miesiąca od daty publikacji niniejszego streszczenia i następującego po nim pisma. Uwagi należy kierować do Kancelarii ds. Pomocy Państwa w Dyrekcji Generalnej ds. Konkurencji Komisji Europejskiej na następujący adres lub numer faksu:

European Commission
Directorate-General for Competition
State aid Greffe
B-1049 Brussels
Faks: (32-2) 296 12 42

Uwagi te zostaną przekazane Zjednoczonemu Królestwu. Zainteresowane strony zgłaszające uwagi mogą wystąpić z odpowiednio uzasadnionym pisemnym wnioskiem o objęcie ich tożsamości klauzulą poufności.

TEKST STRESZCZENIA

I. PROCEDURA

1. Decyzją z dnia 5 grudnia 2007 r. Komisja stwierdziła, że środki przyznane w dniach 17–20 września i 9 października 2007 r. przedsiębiorstwu Northern Rock (dalej zwanemu „NR") przez państwo zawierały pomoc, która do dnia 17 marca 2008 r. była zgodna ze wspólnym rynkiem jako pomoc na ratowanie zgodnie z wytycznymi wspólnotowymi dotyczącymi pomocy państwa w celu ratowania i restrukturyzacji zagrożonych przedsiębiorstw [1].

2. Pismem z dnia 17 marca 2008 r. Zjednoczone Królestwo zgłosiło środki pomocy na restrukturyzację na rzecz NR.

II. STAN FAKTYCZNY

3. Beneficjentem pomocy jest NR, który jest piątym co do wielkości bankiem hipotecznym w Zjednoczonym Królestwie, którego całkowity bilans na dzień 31 grudnia 2006 r. wynosił 101 mld GBP. Hipoteczne kredyty mieszkaniowe są głównym elementem działalności NR. W ciągu ostatnich ośmiu lat bank średnio potroił swój udział w brytyjskim rynku hipotecznym. Rozwój działalności w zakresie udzielania kredytów NR finansował za pośrednictwem kredytów międzybankowych, a w szczególności poprzez sekurytyzację swoich aktywów. Spowodowało to problemy w momencie, kiedy w wyniku zawirowań na światowych rynkach finansowych, rynki sekurytyzacji papierów hipotecznych praktycznie się zamknęły, co sprawiło, że uruchamianie środków na rynku kredytów międzybankowych stało się bardzo trudne, gdyż banki stały się niechętne do udzielania sobie nawzajem pożyczek.

4. W dniu 18 grudnia 2007 r. władze Zjednoczonego Królestwa rozszerzyły ustalenia gwarancyjne wprowadzone w życie w dniach 17 września 2007 r. i 9 października 2007 r. obejmując nimi niektóre istniejące lub przyszłe niepodporządkowane obligacje międzybankowe banku NR.

5. W lutym 2008 r. władze Zjednoczonego Królestwa upaństwowiły NR.

6. W dniu 17 marca 2008 r. władze Zjednoczonego Królestwa zgłosiły Komisji plan restrukturyzacji, którego głównymi elementami są:

— zmniejszenie do końca 2011 r. kwoty bilansu z około 107 mld GBP w 2007 r. do mniej więcej połowy,

— stabilizacja kwoty bilansu poprzez dążenie do zwiększenia podstawy depozytów prywatnych w odniesieniu do ogólnej kwoty finansowania przy jednoczesnym utrzymaniu bilansów poniżej poziomu sprzed kryzysu,

— zakończenie działalności i rozpoczęcie procedury likwidacyjnej w Danii w 2008 r. oraz zachowanie w Irlandii i Guernsey tylko operacji o niskim górnym pułapie,

— odtworzenie zaufania rynkowego do marki Northern Rock,

— zmiana kierownictwa,

— przygotowanie przedsiębiorstwa na powrót do sektora prywatnego.

7. Plan ma być oparty na pomocy na restrukturyzację, która ma głównie polegać na przedłużeniu okresu obowiązywania środków pomocy na ratowanie, obejmujące ustalenia gwarancyjne wprowadzone w życie w dniu 18 grudnia 2007 r. Zamierzeniem planu jest całkowita spłata instrumentów wsparcia płynności do 2010 r. oraz stopniowe

[1] Dz.U. C 244 z 1.10.2004, str. 2.

zniesienie ustaleń gwarancyjnych — według scenariusza podstawowego — do końca 2011 r. (według scenariusza negatywnego gwarancje mogą być utrzymane do 2013 r.). Rząd brytyjski jest przygotowany na zaangażowanie następujących środków wyrównawczych w celu ograniczenia zakłócenia konkurencji i wymiany handlowej wywołanego przez wspomniany środek pomocy:

— zamierzone zmniejszenie bilansu do około 48–53 mld GBP do końca 2011 r.,

— radykalne obniżenie liczby nowo wydawanych kredytów hipotecznych,

— zaangażowanie w energiczną strategię spłat, obejmującą czynne nakłanianie klientów biorących kredyty pod zastaw hipotek do przechodzenia do konkurencji,

— zamknięcie i likwidacja działalności NR w Danii w 2008 r. oraz zobowiązanie się do powstrzymania się od rozwoju na innych rynkach UE do 2011 r.,

— zobowiązanie się do przestrzegania postanowień „Karty o konkurencji", która zostałaby opublikowana i stanowiła dla przedsiębiorstw podstawę konkurencji na rynkach produktów oszczędnościowych i kredytów hipotecznych dla klientów prywatnych,

— zobowiązanie do nieudzielania w okresie restrukturyzacji niezabezpieczonych kredytów prywatnych i dla przedsiębiorstw,

— zobowiązanie do niezwiększania ogólnej liczby filii w Zjednoczonym Królestwie.

III. **OCENA**

8. Komisja doszła do wniosku, że ustalenia gwarancyjne z dnia 18 grudnia 2007 r. stanowią pomoc państwa zgodną ze wspólnym rynkiem.

9. W odniesieniu do upaństwowienia NR Komisja doszła do wniosku, że nie zawiera ono elementów pomocy państwa w rozumieniu art. 87 ust. 1 Traktatu WE, gdyż udziałowcy otrzymują rekompensatę jedynie w odniesieniu do wartości przedsiębiorstwa bez uwzględnienia pomocy państwa. Jednak zobowiązanie skarbu brytyjskiego wobec urzędu nadzoru finansowego do podjęcia odpowiednich kroków w celu zagwarantowania, że NR wypełni minimalne warunki kapitałowe mogłoby stanowić dodatkowy środek pomocy na restrukturyzację.

10. W odniesieniu do pomocy na restrukturyzację zgłoszoną w dniu 17 marca 2008 r. Komisja postanowiła wszcząć szczegółowe postępowanie.

— Po pierwsze, Komisja zauważa wprawdzie, że obniżenie kwoty bilansu przyczyni się do przywrócenia rentowności, nie była ona jednak w stanie szczegółowo ocenić, czy plan restrukturyzacyjny pozwoli przedsiębiorstwu także na odzyskanie długoterminowej rentowności. Należy sprawdzić, czy przewidziany stosunek 50:50 między depozytami prywatnymi a innymi formami finansowania jest wystarczający do ustabilizowania kwoty bilansu i uniknięcia ryzyka nadmiernego uzależnienia od jednego źródła. Komisja ma wątpliwości co do tego, czy okres trwania planu jest możliwie najkrótszy. Wreszcie Komisja nie była w stanie stwierdzić w szczegółach, czy został on oparty na realistycznych założeniach co do przyszłych warunków działania.

— Po drugie, Komisja ma wątpliwości, czy podjęto wystarczające środki wyrównawcze w celu uniknięcia niepotrzebnego zakłócenia konkurencji i handlu. Z analizy właściwych rynków i obecności NR na odpowiednich rynkach Komisja wysnuwa wniosek, że NR posiada i nadal będzie posiadać znaczną część udziałów w brytyjskim rynku hipotecznym. Głównym celem środków wyrównawczych powinno być zatem ograniczenie obecności NR na przedmiotowym rynku. Może się ponadto okazać, że konieczne są także środki mające na celu ograniczenie obecności NR na brytyjskich i zagranicznych rynkach depozytów prywatnych. Za element pozytywny Komisja uważa zdecydowany wpływ, jaki będzie miało ograniczenie rozmiarów banku na jego obecność na brytyjskim rynku hipotecznym. Jednak Komisja ma wątpliwości, czy rozmiar i okres trwania tego ograniczenia są wystarczające do uniknięcia niepotrzebnego zakłócenia konkurencji. Komisja zauważa także, że jeżeli bank NR wdrożyłby system tzw. „through-lending", tj. proponowałby klientom mającym umowy hipoteczne ze zbliżającym się terminem spłaty bezpośrednio produkty podmiotów trzecich, osłabiłoby to zdecydowanie znaczenie ograniczenia rozmiarów w przełożeniu na zmniejszenie udziałów w rynku. Wreszcie Komisja ma wątpliwości, czy gdyby NR został w nadchodzących latach sprzedany nowemu właścicielowi, ten nie byłby zobowiązany do kontynuacji wdrażania środków wyrównawczych.

— Po trzecie, Komisja uznając fakt, że obniżenie kwoty bilansu pozwoli na szybkie zmniejszenie pomocy wątpi, czy pomoc jest ograniczona pod względem rozmiaru i okresu trwania do niezbędnego minimum. Wydaje się zwłaszcza, że możliwe byłoby przeprowadzenie szybszego i głębszego ograniczenia rozmiarów banku umożliwiając tym samym szybszą spłatę kredytów udzielonych przez państwo. Komisja ma ponadto wątpliwości, że gwarancje państwowe rzeczywiście nie mogłyby zostać zniesione wcześniej niż zakładał to plan restrukturyzacji. Wreszcie Komisja ma wątpliwości co do wysokości kwoty, jaką państwo powinno zażądać za wspomniane kredyty i gwarancje w celu zagwarantowania, że pomoc, a tym samym zakłócenie konkurencji, jest ograniczona do minimum.

TEKST PISMA

„The Commission wishes to inform the United Kingdom that, having examined the information supplied by your authorities on the measure referred to above, it has decided to initiate the procedure laid down in Article 88(2) of the EC Treaty.

1. **PROCEDURE**

(1) By decision of 5 December 2007 (hereinafter "the decision of 5 December 2007") the Commission [2] found the measures implemented by the Bank of England (hereinafter "BoE") of 14 September 2007 in favour of Northern Rock (hereinafter "NR") not to constitute State aid and decided that the measures granted by the UK authorities on 17-20 September and 9 October 2007 contained State aid which until 17 March 2008 is compatible with the common market as rescue aid in conformity with the *Community guidelines on State aid for rescuing and restructuring firms in difficulty* (hereinafter "the R & R Guidelines") [3].

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[2] OJ C 43, 16.2.2008, p. 1.

[3] OJ C 244, 1.10.2004, p. 2.

(2) On 17 December 2007, the UK authorities provided informal background information regarding the extension of the guarantee arrangements to be announced on the next day. The UK authorities officially informed the Commission about this measure on 21 December 2007. On 8 January, 24 January, 6 February, 13 February, and 10 March 2008 meetings were held between representatives of the UK and the Commission services.

(3) On 17 February 2008, the UK authorities announced that NR was to be nationalised. On 17 March 2008 the UK sent to the Commission a restructuring plan for NR and notified State aid measures which would accompany that plan and enable it to be implemented.

2. DESCRIPTION

2.1. The beneficiary

(4) NR, which is based in Newcastle-upon-Tyne, was the 5th biggest UK mortgage bank. Its balance-sheet total was GBP 101 billion on 31 December 2006 and GBP 113,5 billion on 30 June 2007. In 2006, its interest income represented GBP 5 billion, with a profit of GBP 443 million. The bank has a staff of 6 000 persons. NR has 77 branches throughout the UK, and is present in Ireland, Denmark and Guernsey ([4]). NR does not belong to a larger group.

(5) Residential mortgage lending is NR's core activity. It represents more than 90 % of all outstanding loans to customers. NR's lending has significantly increased over the last 8 years until mid 2007. The bank roughly trebled its share of the UK mortgage market over that period. In the first half of 2007, the bank achieved gross lending of GBP 19,3 billion and net lending of GBP 10,7 billion, representing market shares of UK gross mortgage lending of 9,7 % and of net mortgage lending of 18,9 % ([5]).

(6) Whereas retail funds and deposits constituted the main source of financing for the bank in 1998, it has since then funded the growth of its mortgage lending mainly via wholesale funding, including issuing mortgage-backed securities, covered bonds and medium term and short term unsecured funding.

(7) The success of the business model was dependent on (a) the ability of Northern Rock to raise money in the wholesale markets in order to repay its short term borrowing from those markets and to fund its lending; and (b) its ability to pay a lower rate of interest on the money which it borrowed from the wholesale markets than the interest which it charged to its mortgage customers.

(8) The structure of its liabilities therefore changed so that, in recent years, unlike most UK banks, NR financed the majority of its long-term mortgage loans by issuing securitised notes ([6]). In March 2001 NR established a "master trust" securitisation structure known as "Granite" of which it has since made extensive use (it had previously carried out standalone securitisations not forming part of the master trust). The Granite structure involved the creation of a trust into which NR sells mortgages and under which both Granite and NR are beneficiaries.

(9) NR also funded itself through the issue of "covered bonds". Covered bonds are another form of mortgage-backed security. The bonds in question are issued by NR itself (unlike Granite where the bonds are issued by SPVs) but a pool of mortgage loans and related security is transferred to an SPV, which provides a guarantee of the bonds secured over the SPV's assets. Investors therefore have direct recourse against NR as well as recourse to a pool of mortgage loans and related security.

2.2. The difficulties and the approved rescue aid measures

(10) In the summer of 2007, the world's financial markets entered a period of turbulence, which began with markets' fears over exposure to American sub-prime mortgages. A consequence of this turbulence has been a significant shift in trading conditions in the sterling and global money markets and the virtual closure of the mortgage securitisation market. Banks and other institutions started to retain cash to meet their own potential and actual liquidity requirements and to reduce their exposure to other institutions until it becomes clear what the impact of the turbulence has been on the assets and liquidity of those other institutions. This has created severe liquidity difficulties that especially threatened institutions whose business model is reliant on raising finance in the wholesale markets to fund their business. This is the case of NR, which funded new loans principally through money raised on the wholesale markets.

(11) As a result, NR had difficulties in meeting its funding needs ([7]). Funding needs in this context mean the funds it has to raise on a day to day basis in order to meet its day to day liquidity requirements and in particular to refinance its maturing wholesale borrowings, including short term commercial paper, as and when they fall due for repayment.

([4]) In the case of the Guernsey operation, the UK authorities consider that the majority of these deposits are from UK customers. These are likely to represent a small segment of high net worth UK individuals who make large deposits in order to gain from interest being paid on a gross rather than net basis and hence gain from the roll up of interest.

([5]) Gross lending is total advances, and net lending is advances less redemptions and repayments.

([6]) The Bank of England Financial Stability Report of October 2007 indicated that the industry average for UK banks' wholesale funding as a percentage of total funding was 50 %, while for NR it amounted to 66 % in 2006 and over 70 % at the first half of 2007. This difference is highly significant because experience shows that retail deposits are less likely to be withdrawn than wholesale funding in the event of a tightening of credit conditions in the market.

([7]) A more detail description of the causes of NR's liquidity crisis can be found in the *Financial Stability Report* of the Bank of England dated October 2007, pages 10 to 12.

(12) Its ongoing difficulties in meeting its funding needs as at 13 and 14 September 2007 were so serious that there was a real likelihood that, in order to meet its funding requirements (new lending and repayment of wholesale liabilities as they fell due), it would have to draw down on its buffer stock of high quality finite sterling liquid assets [8] and/or sell assets, probably at distressed sale values. Against this backdrop NR's auditors recorded their concerns that the firm might not be able to draw up its accounts on a going concern basis. In this context, NR explored all possible financing options, including a possible takeover, without success.

(13) NR, therefore, requested the support of the Bank of England (the "BoE") as lender of last resort for a substantial liquidity facility pending a longer term resolution of its difficulties [9]. The liquidity support was provided on 14 September.

(14) The difficulties of NR were further aggravated by a bank-run, which started after the news on the BoE granting support to NR was made public. In order to stop it and avoid contagious effects, the Treasury announced guarantee arrangements for all existing accounts in NR on 17 September 2007. Further, HM Treasury clarified the assumed liability guarantee backed by State resources via a publication on HM Treasury's website on 20 September 2007.

(15) On 9 October 2007, the Treasury extended the guarantee to new retail deposits and, together with the BoE, modified the terms and conditions of the emergency liquidity assistance (hereinafter "facility of 9 October", consisting of so-called B and C facilities, according to the Decision of 5 December 2007).

(16) By decision of 5 December 2007, the Commission authorised the above measures until 17 March 2008. Whereas the Commission considered that the measures implemented by the BoE on 14 September 2007 did not constitute aid until their amendments on 9 October 2007, all the measures implemented from 17 September 2007 onwards were found to constitute aid, which is however compatible as rescue aid pursuant to the R & R Guidelines.

2.3. **The persistence of the difficulties and the measures subject to the present decision**

2.3.1. *The extended guarantees of 18 December 2007*

(17) […] (*) a ratings downgrade would have had a further serious adverse affect on the company's financial position […] [10]. A ratings downgrade could therefore have prevented any restructuring plan from being designed and implemented, and therefore condemn the firm to exit the market.

(18) In order to avoid the adverse effects of such a downgrade, on 18 December 2007 the UK authorities extended the State guarantee arrangements to the following unsubordinated wholesale obligations, whether existing or arising in the future:

— all uncollateralised and unsubordinated wholesale deposits which are outside the guarantee arrangements previously announced by HM Treasury,

— all payment obligations of NR under any uncollateralised swap transactions,

— in respect of all collateralised swaps and all wholesale borrowings which are collateralised (including, without limitation, covered bonds of NR), the payment obligations of NR to the extent that those obligations exceed the available proceeds of the realised collateral for the relevant swap or borrowing, and

— all obligations of NR to make payments on the repurchase of mortgages under the documentation for the "Granite" securitisation programme.

(19) These measures […] were the minimum […] to ensure that NR's ratings were not downgraded.

(20) NR pays to HM Treasury a monthly guarantee fee of GBP […] for so long as these new guarantee arrangements shall remain in force.

(21) As regards the duration of the guarantee arrangements implemented on 18 December 2007, the UK authorities publicly announced that this measure should "*remain in place during the current instability in the financial markets*" in accordance with the wording used in the previous notices with regard to the guarantee arrangements granted on 17-20 September and 9 October 2007.

2.3.2. *The search for a private sector solution*

(22) The UK Government aimed to ensure that the process for considering proposals from third parties for the merger or acquisition of NR rigorously tests the scope of the private sector to deliver a viable restructuring of the company with the minimum aid necessary.

(23) Throughout the months of August and September 2007 various attempts were made to seek a speedy and orderly transaction for the sale of the whole entity, especially in the period after the need for BoE intervention became public. These attempts by NR and its adviser, Merrill Lynch, failed to achieve the desired results.

[8] Liquid assets such as bonds and securities that can be sold quickly to provide cash.

[9] Financial regulation in UK is ensured by the "tripartite" system in which the Bank of England, the Financial Services Authority (FSA) and HM Treasury have different responsibilities as set out in the Memorandum of Understanding between HM Treasury, the Bank of England and the FSA of 22 March 2006.

(*) Business secret. Where possible, figures have been replaced by ranges in [ ].

[10] […].

(24) Following the failure of the initial sale process, NR having also retained Citigroup and Blackstone alongside Merrill Lynch on 3 and 31 October respectively proceeded to put in place a revised and restructured sale process.

(25) NR's advisors asked for indications of interest from potential buyers in October 2007. The revised auction was designed to target a wide range of potential acquirers and contemplated different transaction structures, including sale of the whole or parts of NR, in an effort to maximise prospects for a commercial solution to be affected. Three companies expressed their interests for the whole entity, and one for part of it.

(26) On 26 November, NR declared the Virgin Consortium (hereinafter "Virgin") as the preferred bidder and decided to attempt to reach an agreement on a potential sale. On 6 December, JC Flowers withdrew from the sale process. […], discussions with Olivant Advisers were resumed and NR effectively initiated a two-party auction process. The original Virgin proposal submitted in November 2007 would have reduced the asset book to […] and the aborted Olivant bid — to […].

(27) In the discussions that followed, […].

(28) Indeed, as the bid process progressed it became increasingly clear that […]. Therefore the Tripartite Authorities asked Goldman Sachs, their financial advisor, to explore the possibility of devising a flexible financing solution that could be used by bidders in an effort to facilitate a private-sector solution.

(29) On 21 January 2008, HM Treasury publicly announced a new financing structure that would be made available to NR and other interested parties, in order to facilitate a private sector solution for the entire company. It was indicated that the financing structure — which consisted in the sale of an assets pool belonging to NR to a vehicle which would issue bonds covered by a State guarantee — would only be available for proposals that meet the Tripartite Authorities' publicly stated objectives ([11]).

(30) On 4 February 2004, the Tripartite Authorities received two proposals compliant with the above-mentioned announcement: from Virgin and NR. Olivant Advisors had announced that they were not pursuing their bid. The two business plans presented by the bidders, even though neither was definitive, given that the bank's nationalisation intervened before they could be agreed upon, did not diverge substantially and both required similar aid measures. They are described here below as potential benchmarks against which the plan notified on 17 March 2008 could be assessed.

2.3.3. *The restructuring plans submitted by NR and Virgin*

(31) The key elements of the restructuring plans were (a) a reduction and restructuring of the balance sheet; (b) a growth of the retail deposit base as a proportion of total funding; (c) a new commercial policy; (d) a rebranding of the firm; and (e) the grant of restructuring aid. These elements will be described in the next paragraphs.

2.3.3.1. Reduction and restructuring of the balance sheet

(32) […].

(33) […].

2.3.3.2. Growth of the retail deposit base

(34) […].

(35) […].

2.3.3.3. A new commercial policy

(36) […].

(37) […].

(38) […].

2.3.3.4. A rebranding of the company

(39) […].

2.3.3.5. Restructuring aid

(40) […].

(41) […].

(42) […].

2.3.3.6. Expected financial results

(43) […] ([12]) ([13]).

(44) […].

2.3.4. *The nationalisation of the bank*

(45) On 17 February 2008 the UK government announced that neither of the two private sector offers met the test of protecting the taxpayer's interest and that, accordingly, it would take the company in temporary public ownership. Legislation enabling this was introduced and passed in the UK Parliament over the following days, and NR became publicly owned on 22 February 2008.

(46) According to the UK authorities, the nationalisation did not result in any additional aid measures in favour of NR. The authorities did however provide an assurance to the FSA that its present intention was, subject to any constraints imposed by EC State aid rules and by Government Accounting rules, to take appropriate steps to ensure that NR will operate above the minimum capital requirements.

(47) The UK authorities also informed the Commission that existing shareholders will be compensated by a procedure for independent valuation of the shares on the assumption that all State support had been withdrawn and that no financial assistance would be provided by the State in future (apart from ordinary market assistance offered by the BoE subject to its usual terms). On this basis the purchase price paid would not contain State aid to the former shareholders of NR or to NR itself.

([11]) They mainly concern protection of taxpayers' interests, financial stability, protection of consumers.

([12]) […].

([13]) […].

2.3.5. *The notified restructuring plan*

2.3.5.1. Reduction in balance sheet

(48) The plan envisages that the NR balance sheet would contract in the first five years of the plan from about GBP 107 billion in 2007 to about GBP 48-53 billion at the end of 2011. Mortgage assets would contract from around GBP 98 billion in 2007 to GBP [30-50] billion by 2011.

(49) This would be achieved through:

(i) an active retail mortgage redemption programme with the aim of encouraging at least 60 % of customers with maturing products to remortgage with another lender; and

(ii) exiting all new commercial lending and new standalone unsecured lending.

(50) The company plans to achieve this through a pro-active redemption policy under which customers with products approaching maturity would be […] contacted and encouraged to seek a new deal elsewhere. Customers who remain with NR once their current arrangements expire would mature in line with their mortgage contract terms onto the standard variable rate (hereinafter "SVR") […]. NR is also exploring the implementation of a "through-lending" facility for prime residential customers i.e. making an arrangement with a mortgage provider in order to be able to offer third party branded products directly to customers with maturing mortgage deals. The financial benefit of these proposals (which are not yet included in the plan) would be marginal: the business rationale for this proposal is that it would increase the probability and speed of redemptions, allow NR to maintain full control of the sales and advice process and by assisting its customer to achieve a good outcome would better maintain Northern Rock's brand promise and reputation.

(51) A 60 % redemption rate (compared to […]) is considered to be a more realistic target in view of deteriorating mortgage conditions, and represents a substantial change compared to the pre-crisis rate of around [< 40] %. The mortgage market landscape has changed significantly in recent months: the 100 % loan-to-value (hereinafter "LTV") mortgage market has effectively closed and the decreased lending appetite of mortgage lenders is particularly affecting less credit-worthy borrowers and those seeking high income multiples.

(52) NR would also continue to conduct limited levels of new lending over this period (on the base case about 18-23 billion in total for the four years from 2008 to 2011 compared with about GBP 30-35 billion in 2007). This new lending would be offered predominantly to high credit quality new customers.

(53) The company intends that most of the new lending would be originated through intermediaries so as to maintain this important distribution channel. This channel historically represented approximately [85-90] % of the company's lending volumes and the retention of a minimum presence in the market is essential, given NR's small number of branches and low percentage of origination through them in the past; and given the significance of intermediaries in the UK mortgage market as a whole, in order to retain a basis for a long term return to viability. If NR were to withdraw completely from the intermediary channel it would take a considerable amount of time and investment to rebuild this franchise. The company therefore proposes to originate the minimum volumes (approximately GBP [3-5] billion a year or 14-16 % of historic volumes through this channel) necessary through this channel in order to maintain panel membership with key intermediaries and write a minimal yet meaningful mortgage capacity with each key group.

(54) The aim would be to restrict new lending to high credit quality borrowers. On the basis of the assumed total market volumes it is estimated that NR's market share of gross new mortgage lending would fall back from about 8 % in 2007 to [1,5-2,5] % for four years before rising to just over [< 4 %] in […].

(55) According to the UK authorities, given the quality of the Northern Rock mortgage book, it is expected that there will be alternative offers available in the market for customers switching away from Northern Rock. Much of the maturing mortgage portfolio comprises customers with good credit scores and LTV of below […] %, who should not experience any difficulty in finding more competitive products with other providers. Higher risk residential customers would be directed to a specialist panel of brokers who specialise in providing sub-prime or other non-mainstream mortgage products. For the proportion of customers who may experience difficulty in transferring their mortgage under current market conditions […].

(56) High quality new lending would be achieved by imposing high customer credit quality standards for any new business that is taken on and offering lower loan to value *ratios*. It is anticipated that lending margins would be in the middle of the industry range between 2008 and […], gradually being managed down thereafter […] to achieve target increases in mortgage lending under the plan.

(57) The unsecured and commercial lending portfolios would be discontinued and existing book would be run down over the period of the plan. On the basis of historical trends NR expects the unsecured lending portfolio to reduce from GBP 4,023 million to about GBP [< 1 billion] and the commercial portfolio (including commercial buy-to-let) to reduce […] from GBP 1,317 million to about GBP [< 600] million by the end of 2013. Earlier sale or other options to liquidate these portfolios would be considered if appropriate.

2.3.5.2. Stabilisation of the retail deposit base as a proportion of total funding

(58) Under the plan the proportion of retail funding to total funding would increase from 15-20 % in 2008 to about […] % in 2011 and about 48-52 % in 2012, re-balancing the balance sheet. This would be reflected in:

(i) a decrease in total funding from GBP 103 billion in 2007 to about GBP [40-50] billion in 2011, and;

(ii) an increase in retail deposits from GBP 10,5 billion at the end of 2007 to about GBP […] billion in 2011, which remains below the pre-crisis level of GBP 24 billion.

(59) The strategic objectives would be to recapture some recently lost customers of NR; to encourage a better balance of high value and lower balance depositors; and to encourage a higher percentage of accounts with balances of less than GBP 35 000. The projected growth in the deposit base represents only a moderate increase in share of the total market compared to current levels (about 1,2-1,5 % compared to 0,8 % currently) and below the pre-crisis share of 1,9 % for the duration of the period.

(60) Beyond the period of the stabilisation plan, a key strategic objective would be to achieve broadly a 50:50 *ratio* of retail deposits to non-retail funding.

2.3.5.3. Overseas activities

(61) NR proposes that its Danish operations would be closed and put into run-off in 2008 and no additional overseas businesses would be started prior to 2013.

(62) A small capability would be retained in Ireland and Guernsey to maintain some diversification of the funding base. NR's share in the Irish market is small, and has already significantly reduced. Even by 2013 this share is expected to be [35-50] % lower than pre-crisis levels (compared to UK shares which would remain [15-35] % lower).

2.3.5.4. Repayment of BoE facilities and release of guarantee arrangements

(63) The plan's priority is the rapid repayment of the BoE facilities. The plan envisages that these facilities would be fully repaid around […] 2010 in the base case, although there would be a BoE/Treasury liquidity facility that might remain in place until […] (the company intends to seek early replacement with a third party facility if conditions are appropriate). NR aims to achieve a long term credit rating of at least A- on a standalone basis during 2011 on the basis of significantly improved financial profile as a result of reduced borrowing, retail deposits as a greater proportion of the balance sheet, a return to profitability and discharge of the BoE facilities.

(64) The intention is that there would be a staggered release of the guarantee arrangements as the different aspects of the company's position stabilise. There is limited practical experience of the consequences of releasing State guarantees of bank deposits, and the practicability of implementing these proposals set out in the plan would need to be kept under review in the light of customer feedback and other market circumstances. However, the plan envisages, on the base case, the removal of all guarantees by the end of 2011 […]. As regards the retail funding guarantee arrangements (which currently cover all new and existing retail deposits) on the base case:

(i) the indicative earliest release date for the guarantee arrangements for new retail deposits would be […]. At this point it is anticipated that returning confidence would enable the company to raise new retail savings without them;

(ii) The indicative earliest release date for the guarantee arrangements for existing retail deposits would be […].

(65) For non-retail deposits, release of the guarantee arrangements would be determined by the company's ability to maintain […] capital requirements (also relevant to the retail guarantee arrangements) and a sufficient long term credit rating. The indicative date for removal of the guarantees on the base case would be during […], subject, in particular, to rating agency approval.

(66) On the base case, in addition, there would be an early release of certain specific aspects of the non-retail guarantee arrangements. The company expects that […], subject to ratings agency approval, it would be possible to release the guarantee arrangements in relation to: […].

(67) Under the recession case scenario, the guarantee arrangements would be withdrawn at the same time as on the base case subject to rating agency and regulatory capital (FSA) considerations, which could mean that the guarantee arrangements would be required until about 2013. The precise timing of the release of the guarantee arrangements would be driven by capital requirements and market conditions.

2.3.5.5. Retention of "Northern Rock" brand

(68) Although retail customer confidence has been eroded, the brand retains strong loyalty with certain customer groups (in particular in the north-east of England and with IFAs) and, in the light of evidence from recent customer focus groups, the company believes that the credibility of the brand can be restored. It therefore proposes to retain the "Northern Rock" branding, although a continuous detailed research programme would be undertaken to confirm the validity of this strategy.

2.3.5.6. Management

(69) There has been a significant change in the composition of the board with the appointment of a new executive Chairman, Ron Sandler, a new Chief Financial Officer, Ann Godbehere, and three new non-executive directors appointed by the Government: Tom Scholar from the Treasury, Philip Remnant from the Shareholder Executive and Stephen Hester, the former chief operating officer of Abbey National plc.

2.3.5.7. Preparing the company to return to the private sector

(70) Although no final decisions can be made on timing, the plan envisages the return of the company to private sector ownership […]. This could take the form of either a sale or flotation of the business.

2.3.5.8. Alternative scenarios

(71) The plan also involves three alternative scenarios:

(72) An "upside" scenario, under which a more benign market outlook and higher redemption rates enable the company to achieve accelerated repayment of the BoE/Treasury financing and earlier release of guarantee arrangements.

(73) A "downside — execution challenges" scenario, under which difficulties in implementing the commercial and financial strategy delays rebalancing of the portfolio and a delay in the repayment of BoE/Treasury financing until about the end of 2011. There should not be any impact on the planned timetable for release of the guarantee arrangements; and

(74) A "downside — recession case" scenario, which extends the "execution challenges" scenario to take account of the impact of a severe and prolonged downturn in the UK leading to significantly higher provisions being made over the period. Repayment of the BoE/Treasury financing would again be delayed until about the end of 2011. Under unfavorable circumstances, the guarantee arrangements may be delayed until 2013.

(75) The current financial forecasts for 2008-2013 would indicate that on the base and upside case NR would move into modest profit before tax in […] and on the recession case in […].

2.3.5.9. Financing proposals

(76) Subject to a potential increase in the margin for the BoE facilities and a revised facility fee (which are under consideration) the current economic terms of the BoE facilities (and the Repo Facility until it is repaid) would continue to apply until the Commission has reached a decision on the company's restructuring plan. The current economic terms are as follows:

(i) interest on the BoE facilities at BoE rate plus […] bps margin (as part of the PIK facility);

(ii) interest on the Repo Facility at BoE rate plus […] bps margin (which is not part of the PIK facility);

(iii) facility fee of […] bps which is calculated on the maximum aggregate principal amount of advances outstanding under the BoE facilities minus the average principal amount of advances outstanding during the life of the BoE facilities;

(iv) fees for the guarantee arrangements on new retail deposits of […] bps; and

(v) fee for the additional balance sheet guarantee arrangements of GBP […] per month. This fee relates to the guarantee arrangements announced on 18 December 2007;

(vi) the economic terms for the period of implementation of the restructuring plan, until the BoE facilities are repaid, would be set by reference to the anticipated profitability and viability of NR. They are likely to be finalised during the course of the State aid investigation, in particular to the extent that forecasts and other financial information are amended. The economic terms would be included in a schedule to the amended facility agreement.

(77) On this basis, the plan assumes that the cost to the company of the guarantee arrangements and funding costs would be about GBP [400-700] million between 2008 and 2011. The exact structure of the fee arrangements is, however, still being finalised (e.g. the division between fees in relation to the guarantee arrangements and fees relating to the BoE facilities) but it is intended that these fees will be set at the maximum level consistent with maintaining the ongoing viability of the business, and that these will be direct payments out of the business as the sums fall due. However, to the extent that the fees paid by the company under the rescue aid arrangements exceed the fees that the company would pay under the revised arrangements, the plan envisages a retrospective reimbursement of the difference, conditional on State aid approval being obtained, with respect to payments between 17 March 2007 and implementation of revised financing arrangements following receipt of final State aid approval. This would reduce the quantum of losses in 2008 and thus ensure the Company's capital position remains above prudential regulatory requirements.

(78) It is recognised that NR would need to return gradually to the wholesale market prior to the repayment of the BoE facilities and the lifting of the guarantee arrangements. The Government would encourage NR to finance itself via operating cash flow and the wholesale markets to the maximum extent possible, rather than relying on the UK State support.

(79) A liquidity framework document would be developed to set out the circumstances in which NR would be able to access the wholesale markets for short-term liquidity purposes. Proposals for new wholesale funding would be considered by the Government against this framework, which would include a test of acceptable value for money. In addition, counterparty limits and other limits on amount and duration would be set out in this liquidity framework document.

2.3.6. *Avoidance of undue distortions of competition and mitigating measures*

(80) The Government is prepared to commit to the following specific compensatory measures reflecting the company's current base case plan:

(i) a targeted reduction in the balance sheet by […] % to about GBP 48-53 billion by 2011;

(ii) a reduction of new residential mortgage origination from (on the base case) about GBP 30-35 billion in 2007 to about GBP 18-23 billion in total for the four years from 2008 to 2011, and in any event within the limits of the market share cap on gross new lending. This would clearly benefit its rivals who would be able to take up the additional demand;

(iii) a commitment to an aggressive redemption policy including the active encouragement of redeeming customers to move to competitors;

(iv) closure and run-off of NR's operations in Denmark in 2008 and a commitment not to expand in other EU markets before 2011;

(v) a commitment to a "Competitive Charter", described further below, which would set out the basis on which the business would compete in the retail savings and mortgage lending markets. Again, this would facilitate rivals in attracting the re-mortgage business of NR's existing customers;

(vi) a commitment to withdraw from unsecured personal lending and commercial lending for the restructuring period. A withdrawal would directly benefit rivals;

(vii) a commitment not to increase the overall number of branches in the UK.

(81) According to the UK authorities, competition in the marketplace for deposits and lending is based on a complex set of factors e.g. product availability and flexibility, speed and quality of service, brand reputation, channel offering and pricing features (rates, fees, charges, structure). This complexity of product design and day-to-day competitive activity in the market prevents effective management of price controls based in real time. However, NR would commit to a published "Competitive Charter" which would ensure that NR would not be able to use its Government support in order to compete unfairly in the market. The Competitive Charter would be designed to ensure that NR has no sustained presence as market leader, whilst allowing the company sufficient flexibility to take account of seasonal changes and tactical variations which mean that the levels of deposits and lending, and the competitive positioning of NR, would fluctuate (for example, the business can see a significant outflow of deposits as a result of a large number of fixed term deposits maturing, or may see a significant inflow as a result of rate cuts by competitors which make NR products more competitive). The Competitive Charter would include commitments that:

(i) NR would not promote its Government backing in any market;

(ii) NR would not allow its share of retail deposit balances to exceed 1,5 % in the UK and [0,8-1] % in Ireland (well below its historic levels);

(iii) NR would limit its share of gross new mortgage origination to below 2,5 % in any calendar year;

(iv) NR would ensure that it would not hold […] ranking […] in […] product categories, […] in […];

(v) NR would strive to differentiate itself on the basis of its service levels and product innovation, rather than simply on price;

(vi) NR would at all times treat its customers fairly.

(82) The UK estimates that NR's savings attrition since August 2007 will in any event curtail its ability to sustain aggressive price-based competition.

(83) The Government currently envisages that these compensatory measures, unless otherwise specified above, would remain in place until such time as the BoE/Treasury financial assistance has been fully repaid (and the liquidity facility transferred to a third party provider) and the balance sheet guarantee arrangements have been released in full. In the event of an earlier sale of assets or a part of the business, the Government envisages that these assets would be sold without the benefit of any guarantee arrangements or Government financial assistance (other than, for example, to manage execution risk), and therefore also would not need to be subject to compensatory measures, even if these continue to apply to the retained business.

3. **POSITION OF THE UK**

(84) The UK Government believes that in current market conditions the plan presented in this notification is most likely to meet the conditions specified in the R & R Guidelines.

(85) Overall, the effect of the plan will be to establish NR as a much smaller rival in the market. There will be a significant reduction in new mortgage origination and in NR's market share. Although there will be some growth in retail deposit taking over the period of the plan, this increase will not significantly exceed the anticipated growth in the total UK onshore retail savings market. NR's share of the deposit-taking market will remain significantly below pre-crisis levels for most or all of the restructuring period and will represent only a moderate increase in share of the total market compared to current levels. The potential for a distortive effect on any of the markets where NR will continue to be active therefore appears to be limited.

4. **ASSESSMENT**

4.1. **Existence of aid**

4.1.1. *The guarantees of 18 December 2007*

(86) The Commission must first assess whether the measure implemented on 18 December 2007 constitutes State aid. Article 87(1) EC lays down 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.

(87) The Commission observes that this measure fulfils all conditions laid down in Article 87(1) EC. It involves State resources since the State would have to indemnify the creditors of NR if the guarantees were invoked. It is selective since it is granted only to NR. It gives an advantage since in the absence of State guarantees NR's rating would have been downgraded, what would have created several problems for NR, as previously described. As regards the existence of an advantage, it must also be recalled that the Commission has already established in its decision of 5 December 2007 that NR is a firm in difficulty. The absence of access to the financial market at commercially-viable rates was precisely the reason for the State intervention. The behaviour of the State is therefore not similar to the one of a market economy guarantor in similar circumstances. As a consequence, this selective measure provides a clear advantage to NR since it allows NR to remain in the market.

(88) By preventing NR from exiting the market and allowing it to remain active, the State intervention distorts competition. This affects intra community trade since some competitors of NR on the UK mortgage loans and retail deposits markets are subsidiaries of foreign banks. In addition, NR is active in the Irish and Danish retail deposits markets. Due to all the above considerations, the measure implemented on 18 December 2007 constitutes State aid.

(89) It should be noted that the UK authorities do not contest this conclusion.

4.1.2. *The nationalisation of NR*

(90) As noted at paragraph 47 above, the UK authorities consider that the terms on which NR was nationalised did not provide further aid either to the bank or to its former shareholders. The Commission has noted that the terms of the legislation provide for the discounting of Government or BoE assistance when the price paid to shareholders is determined by an independent valuer. In these circumstances, i.e. if the shareholders are only compensated on the basis of the value of the company without any State support, the purchase of the shares from the existing shareholders does not in itself seem to contain aid to the bank or to its former shareholders.

(91) However, the Commission notes that in conjunction with the nationalisation of NR, HM Treasury addressed a letter to the FSA in which it confirms its intention to take appropriate steps to ensure that NR will operate above the minimum capital requirements, subject to State aid rules. Based on this commitment, the FSA did not force the new owner to proceed to an immediate capital injection, different from what would have been imposed on private sector bidders. It is arguable that this formal promise to inject capital if needed qualifies as State aid ([14]). Indeed, as with any other State guarantee, it seems to involve State resources, since the State would have to inject the amount needed if the capital of the bank became insufficient. Also, it constitutes an advantage to NR since the bank can continue to operate. If the State had not made this commitment, the FSA would have limited NR's operations. The Commission therefore doubts that this specific measure does not constitute State aid and therefore intends to review it. The Commission notes, however, that according to the NR's preliminary financial forecasts for the period of 2008-2013, no capital injection is envisaged even under the downside case scenarios.

(92) In the context of the investigation procedure, the Commission invites the UK and interested parties to submit comments as to whether the commitment of HM Treasury to the FSA involves State aid elements.

4.1.3. *The notified restructuring aid measures*

(93) The Commission observes that, except the one mentioned in the next paragraph, all the notified restructuring measures are basically the continuation of the rescue aid measures granted by the UK. The Commission has already established in its decision of 5 December 2007 and — as regards the measures implemented on 18 December 2007 — in the present decision that they constitute State aid.

(94) In addition to the continuation of the rescue aid measures, the UK indicates that, to the extent that the fees paid by the company under the rescue aid arrangements exceed the fees that the company would pay under the revised arrangements, the plan envisages a retrospective reimbursement of the difference, conditional on State aid approval being obtained, with respect to payments between 17 March 2008 and implementation of revised financing arrangements following receipt of final State aid approval. Such a retrospective reimbursement seems to constitute additional restructuring aid to NR.

4.2. **Amount of aid**

(95) The Commission notes that the bulk of the aid measures takes the form of loans and guarantees. The Commission notes that the quantification of the aid is particularly problematic in the present case. Indeed, the calculation of the aid element in loans and guarantees is normally derived from the comparison of the market rate with the rate effectively paid by the firm. In the present case, the State intervened precisely because the firm no longer had access to the market, and certainly not in the amounts granted by the State.

(96) The Commission observes that the calculation of the aid amount does not alter the nature and effect of the restructuring aid measures, which is to rescue NR and allow its restructuring and thus keep it — in a reduced form — on the market. The calculation of the aid amount is however relevant to the assessment of the compliance with certain conditions laid down in the R & R Guidelines for finding restructuring aid compatible (it is recalled that for *rescue* aid measures, the R & R Guidelines

([14]) Case C-13a/2003, *France Telecom*.

do not request the quantification the aid amount in the loans and guarantees). Therefore, the Commission intends to analyse possible quantification methodologies. First, the aid element in each loan and guarantee could be estimated by use of the Commission's reference rate methodology. Second, if NR could not have received the liquidity and the guarantees at all on the markets, then the aid element might be as high as the full amounts guaranteed or granted. Third, the aid element could be estimated by using market indicators like NR's credit default swaps prices or interest rate on credit facilities offered to NR by private banks since 17 September 2007. At this stage, the Commission doubts that the latter indicators are a valid reference point since they already take into account the rescue of the bank by the State. Such a State involvement dramatically improves the chances of viability. The Commission invites the UK authorities and interested parties to comments on this point in the context of the formal investigation procedure.

4.3. **Legality of the measures**

(97) Article 88(3) EC indicates that a Member State shall not put an aid measure into effect before the Commission has taken a decision authorising this measure. The Commission observes that on 18 December 2007 the UK implemented the new guarantee arrangements and therefore did not comply with this provision. Consequently, these arrangements constitute non notified aid. As regards the HM Treasury's letter to the FSA in February 2008, if it were to involve aid, it would also constitute non notified aid. As regards the measures notified on 17 March 2008, they have not yet been put into effect as of today and therefore the standstill obligation is currently complied with.

4.4. **Legal basis for the assessment**

(98) Article 87(1) EC Treaty lays down a general prohibition of State aid. Article 87(2) lays down some automatic exemptions to this general principle, but none of these apply to the present case. Article 87(3) indicates some categories of aid which may be considered compatible with the common market.

(99) Given that, as already established in the 5 December Decision, NR had financial difficulties, the aid could essentially be assessed under Article 87(3)(c) EC, and in particular under the Community Guidelines on aid for rescue and restructuring of firms in difficulty ([15]) (hereinafter "Guidelines"), in which the Commission has laid down the terms under which it may find aid in favour of a firm in difficulty compatible as rescue or as restructuring aid. Aid to such banks is amongst the potentially most harmful forms of aid, carrying in particular the risks of "moral hazard" under which economic operators are encouraged to take excessive risks because they will not endure the consequences of their actions. Rescue and restructuring measures in favour of such banks must necessarily aim at restoring its long-term viability, including a possible reorganisation, whilst any associated potentially serious distortions of competition must be limited to the minimum. It follows that, while measures in favour of individual banks in difficulties may in parallel also pursue wider public interest objectives such as to prevent harmful spill-overs on other banks or the financial system as a whole, they need in all circumstances and in any event to comply with the conditions set out in the Guidelines.

(100) The aid could finally in principle be considered under Article 87(3)(b) EC, which allows aid to remedy a serious disturbance in the economy of a Member State. However, the Commission would first like to point out that the Court of First Instance has stressed that Article 87(3)(b) EC needs to be applied restrictively so that aid cannot be benefiting only one company or one sector but must tackle a disturbance in the entire economy of a Member State ([16]). The Commission has consequently decided that a serious economic disruption is not remedied by an aid that "*resolve[s] the problems of a single recipient […], as opposed to the acute problems facing all operators in the industry*" ([17]). Also in all cases of banks in difficulty, the Commission has refrained from invoking this provision, as it already did in its Decision of 5 December ([18]).

(101) The Commission observes that the problems of NR are due to specific (risky) activities of significant size compared to the overall size of the bank. Therefore, the present case seems rather to be based on individual problems, and thus requires tailor made remedies, which can be addressed under the rules for companies in difficulties. As regards the claim that the default of this single firm would have affected other banks and created a systemic crisis, the Commission does not contest that the bankruptcy of NR would have had negative spill-over effects for other banks. However, the information provided by the UK authorities has not convinced the Commission that these negative consequences could have reached a size constituting "*a serious disturbance in the economy*" of the UK within the meaning of Article 87(3)(b). It can in particular be noted that the risk of systemic crisis was contained by the measures approved on 5 December and that the measures notified for the restructuring of NR are not therefore primarily seeking to address this issue.

([15]) Communication from the — Commission Community guidelines on State aid for rescuing and restructuring of firms in difficulty (OJ C 244, 1.10.2004, p. 2).

([16]) Cf. in principle Case Joined Cases T-132/96 and T-143/96, *Freistaat Sachsen and Volkswagen AG Commission* [1999] ECR II-3663, paragraph 167.

([17]) See Commission Decision in Case C-47/1996, *Crédit Lyonnais*, OJ 1998 L 221, p. 28, point 10.1.

([18]) See also Commission Decision in Case C-47/1996, *Crédit Lyonnais*, OJ 1998 L 221, p. 28, point 10.1, Commission Decision in Case C-28/2002 *Bankgesellschaft Berlin*, OJ 2005 L 116, p. 1, points 153 *et seq*. and Commission Decision in Case C-50/2006, *BAWAG*, not yet published, point 166, Case C-9/2008, *Sachsen LB*, not yet published, and Case C-10/2008, *IKB*, not yet published.

4.5. **Compatibility under the R & R Guidelines**

4.5.1. *Eligibility of the firm*

(102) The decision of 5 December 2007 already established that NR is a firm in difficulty. Its situation has not improved since then. In particular, if all the rescue aid measures were withdrawn, the firm would immediately exit the market.

4.5.2. *Compatibility as rescue aid of the measures implemented on 18 December*

(103) According to point 25 of the R & R Guidelines, rescue aid can only be granted during a six months period after the first implementation of a rescue aid measure. According to Commission decision of 5 December 2007, the first aid measures were implemented on 17 September 2007 and therefore the six month period ends on 17 March 2008.

(104) The Commission has assessed whether the non notified aid implemented on 18 December 2007 constitutes compatible rescue aid, taking into account that NR was already in receipt of rescue aid since 17 September 2007 and that these further measures represented therefore an increase in the total rescue aid being granted to the beneficiary.

(105) First, the aid must comply with the conditions of point 25(a) of the R & R Guidelines, according to which it must consist of liquidity support in the form of loan guarantees or loans. The Commission considers that the measures implemented on 18 December 2007 consist of liquidity support equivalent to a loan guarantee. In particular, as described above, the State guarantees insure third parties that have a claim against NR that they will receive the amounts due under these claims. It is equivalent to insuring a lender that he will be reimbursed the amounts due under a loan contract.

(106) The Commission observes that these guarantees do not diminish the cost of funding for NR below that of healthy banks, since after implementing this measure, NR's costs of funding rose: NR continues to pay the normal interest rates to the various categories of lenders (e.g. bond holders of Granite) and depositors and to bear respective administrative costs, but in addition NR is charged a monthly guarantee fee of GBP […] to the State. It therefore complies with the condition of the R & R Guidelines that the interest rate is "*at least comparable to those observed for loans of healthy firms*". In line with the Commission practice ([19]), even though the remuneration might be under the reference rate adopted by the Commission, since the cost of financing of NR is at least comparable to the one of a healthy firm, the Commission considers that this condition is fulfilled. Point 25(a) of the R & R Guidelines further indicates that "*any guarantee must come to an end within a period of not more than six months after the disbursement of the first instalment of the firm*". The Commission observes that no formal date has been set for the end of the guarantees. However, since the UK authorities undertook to communicate within six months from 17 September 2007 a restructuring or liquidation plan for NR — an undertaking which has since then been fulfilled — the Commission considers that these measures fulfilled the time limit of the R & R Guidelines.

(107) Second, the aid is in line with point 25(b) of the R & R Guidelines warranted on the grounds of serious social difficulties and has no unduly adverse spill-over effects on other Member States. On the one hand, since the alternative scenario would have led to the rapid liquidation of Granite, and as a consequence of NR, which may have led to job losses, the aid was justified on the grounds to avoid serious social difficulties. On the other hand, since these guarantees are the minimum necessary to keep the bank viable, the Commission considers that the condition concerning the absence of unduly adverse spill-over effects is fulfilled.

(108) Third, in line with point 25(c) of the R & R Guidelines the UK authorities undertook to communicate within six months from 17 September 2007 a restructuring or liquidation plan for NR, an undertaking which has now been fulfilled.

(109) Fourth, the amount must be the minimum necessary to keep the firm in business during the six months period as stipulated in point 25(d) of the R & R Guidelines. […], these measures were necessary to keep the existing rating and avoid a downgrade which, as previously explained, would have probably led to the bankruptcy of the firm, despite the presence of the measures already in place. The Commission therefore considers that this condition is fulfilled.

(110) Finally, the UK authorities confirm that NR has not benefited from any rescue or restructuring aid in the last ten years, with the exception of the rescue measures implemented from 17 September 2007 and of which the measures implemented on 18 December 2007 are the continuation and extension, since they aim at keeping the firm alive during the same six months period. Therefore the notified aid complies with the "*one time, last time principle*" as set out in points 72 *et seq*. and point 25(e) of the R & R Guidelines.

(111) From the foregoing analysis, it can be concluded that the aid measures implemented as of 18 December 2007 constitute compatible rescue aid ([20]), in addition to the measures authorised on 5 December, until 17 March 2008.

([19]) See Commission Decision of 26 September 2006 in Case NN 16/06, concerning rescue aid to CIT.

([20]) Since, as part of the restructuring plan notified on 17 March 2008, the UK notified its intention to prolong the guarantees implemented on 18 December 2007 beyond 17 March 2008 and beyond the date of a final Commission decision on the extended aid measures, the Commission will also analyse the compatibility of these measures as restructuring aid in the following parts of the decision.

4.5.3. *The compatibility of aid potentially included in HM Treasury's letter to the FSA in February 2008*

(112) To the extent that State aid is involved in the commitment given by the UK authorities to the FSA, it would constitute aid to NR. Consequently, the Commission would assess it in conjunction with the restructuring aid measures notified on 17 March 2008. The preliminary assessment of the latter measures is described in the next Section. The Commission notes that the letter addressed to the FSA does not contain any limit to the amount of capital which could be made available to NR, and could therefore be assimilated to an unlimited guarantee in the sense of paragraph 3.4 of the Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees ([21]).

4.5.4. *Compatibility of the measures notified for the financing of NR during the interim period*

(113) The Commission has noted that, to the extent that the measures authorised on 5 December remain in place unchanged or are adjusted to the disadvantage of NR, they remain authorised until a Commission decision on the restructuring plan by virtue of paragraph 26 of the R & R Guidelines ([22]).

(114) The same analysis applies also to the measures implemented on 18 December, since these are authorised as rescue aid by the current decision.

4.5.5. *Compatibility of measures notified for the financing of NR after the interim period*

(115) In this Section, the Commission will assess whether the measures notified on 17 March 2008 for the financing of NR after the interim period, i.e. the period of the examination by the Commission, comply with the conditions laid down in points 32 to 51 of the R & R Guidelines and therefore constitute compatible restructuring aid.

4.5.5.1. Restoration of long term viability

(116) According to point 36 of the R & R Guidelines, "*[t]he restructuring plan must describe the circumstances that led to the company's difficulties, thereby providing a basis for assessing whether the proposed measures are appropriate.* […] *It must enable the firm to progress towards a new structure that offers it prospects for long-term viability and enable it to stand on its own feet*". In their different submissions, the UK authorities have analysed the sources of NR's current difficulties. Over the last eight years, NR increased rapidly mortgage lending and funded this growth thanks to securitisation and other secured borrowing. The weakness in NR's business model that the current crisis has revealed is that, were the market appetite for securitisation notes or covered bonds suddenly to falter, NR would need to have access to alternative sources of funding to fund the mortgages planned to be securitised. If at that moment, it also faced difficulties in raising funds in the wholesale money market, the bank would find itself in a liquidity crisis. As explained earlier, this is exactly what started to happen in the summer of 2007, following the beginning of the US subprime crisis. The envisaged restructuring plan seems to address these weaknesses in the business model. In particular, as a result of the downsizing of the firm, retail deposits, which are a more stable source of funds, will account for a significantly higher share of the liabilities of the bank compared to June 2007. However, the Commission has at this stage not enough information to confirm whether a 50:50 *ratio* of retail deposits to non-retail funding is sufficient to stabilise the balance sheet and avoid the risk of being overly dependent on any one source. It invites the UK authorities to explain why this *ratio* is sufficient. Third parties are also invited to comment on that point.

(117) Point 35 of the R & R Guidelines indicates that "*[t]he restructuring plan, the duration of which must be as short as possible, must restore the long-term viability of the firm within a reasonable timescale and on the basis of realistic assumptions as to future operating conditions.* […] *The improvement in viability must derive mainly from internal measures contained in the restructuring plan*". The Commission considers positively the fact that the plan is mainly based on internal measures which will lead to the downsizing of the balance sheet. If the restructuring plan had aimed to keep the current size of the balance sheet, NR would have needed much more funds, which could only be achieved through a slower reduction of the State guarantees and/or by assuming a rapid and full reopening of the securitised notes market and the wholesale money market. This alternative scenario illustrates that the restructuring measures notified by the UK contribute to limiting the duration of the restructuring period and of the aid, and that the plan seems not to be depending on overly optimistic assumptions as to future operating conditions. However, the Commission doubts that the duration of the plan is "*as short as possible*". […] In addition, the Commission has some concerns that, by encouraging existing customers to refinance their mortgages with other banks, the restructuring plan may lead to adverse selection. Indeed, the high credit quality borrowers can more easily get a proposal from another bank than low credit quality borrowers. A high proportion of the latter customers risks therefore to remain within NR's mortgage loans portfolio, which could endanger the return to long term viability. The Commission therefore invites the UK to explain why the restructuring plan can be implemented without overly increasing the risk of the mortgage loans portfolio. Finally, whereas point 35 of the R & R Guidelines requests that "*The plan must be submitted in all relevant detail to the Commission*", the Commission has not received a viability analysis, as well as the opinion of the FSA on the plan. In addition, the Commission was not yet provided with the final financial figures of NR for 2007. The Commission has not been provided with the assumptions underlying the base case, the recession case, the upside case and the downside scenarios either (notably, regarding loss provisions, the interest margin). At this stage, the Commission has therefore not been able to assess in details the restructuring plan and to verify whether it was made "*on the basis of realistic assumptions as to future operating conditions*".

([21]) OJ C 71, 11.3.2000, p. 14.

([22]) "*Where the Member State has submitted a restructuring plan within six months of the date of authorization or, in the case of non-notified aid, of implementation of the measure, the deadline for reimbursing the loan or for putting an end to the guarantee is extended until the Commission reaches its decision on the plan, unless the Commission decides that such an extension is not justified*".

4.5.5.2. Avoidance of undue distortions of competition

(118) According to point 38 of the R & R Guidelines, "*[i]n order to ensure that the adverse effects on trading conditions are minimized as much as possible, so that the positive effects pursued outweigh the adverse ones, compensatory measures must be taken*". Point 40 further indicates that "*The measures must be in proportion to the distortive effect of the aid and, in particular, to the size and the relative importance of the firm on its market or markets. They should take in place in particular in the market(s) where the firm will have a significant market position after restructuring*".

(119) In order to apply these principles, it is necessary to identify the relevant markets on which NR was and would remain a significant player. In this respect, it is necessary to analyse the funding side and the lending side of NR's balance sheet.

(120) As regards the funding, NR was raising funds from three main markets: secured wholesale funding ([23]), unsecured wholesale market and retail deposits.

(i) As regards secured wholesale funding, the UK considers the relevant market to be non-government-guaranteed secured wholesale funding in a global market. In this regard, the Commission observes, that NR issued RMBS denominated in US dollars, Sterling, Euros and Canadian dollars. These issues were marketed in the US, Europe and Scandinavia. It more recently started to issue covered bonds. Since issuers of different continents try to raise funds from investors of different continents, it seems that, as regards secured wholesale funding, the relevant geographical market is at least European and possibly worldwide ([24]). In view of this geographical scope, it seems that, even if a narrower relevant product market is considered, the market share of NR was very limited and will remain so.

(ii) As regards the wholesale money market, the UK considers the relevant market to be unsecured wholesale funding in a global market. NR issued different types of bonds and notes, including commercial paper. These securities differ from the secured securities because they are not backed by any specific bank assets and cover a wide range of maturities. Regarding the geographical scope of that market, the same consideration seems to apply as for secured wholesale funding. Indeed, over the last five years, NR has issued unsecured notes in US dollars, Euros, Sterling, Japanese Yen and Australian dollars. These notes have been sold to US, European and Asian investors. In view of this at least European and possibly worldwide geographical scope, it seems that, even if a narrower relevant product market is considered, the market share of NR was very limited and will remain so.

(iii) As regards the retail deposits market, the UK authorities consider the relevant markets to be the respective national markets ([25]) and the Commission agrees with such definition of the relevant markets. It seems that nearly all the retail customers do not consider making deposits in other Member States. NR's share of UK retail deposits varied between 1,6 % and 1,9 % during recent years. In Ireland and Denmark, NR's market share reached respectively 3 % and less than 1 % in 2006. The market share is therefore limited in all these markets, but it is not negligible.

(121) From the foregoing preliminary analysis of the funding activities of NR, it seems that the presence of NR on these three markets is limited. Nevertheless, the markets like the retail deposits markets appear to be transparent and competitive in the sense that deposits can be switched between deposit-takers without incurring significant switching costs. More favourable terms offered by a deposit-taker, even if with a modest market share, could therefore have significant market effects, forcing the competitors to adjust their prices. The Commission invites the UK authorities and the parties to comment on this aspect, and whether the "Competitive Charter" described at paragraph 81 above, and the arrangements for its enforcement, are sufficient to address any concerns about distortion of competition in the future or whether other measures should be implemented.

(122) As regards the lending side of the balance sheet, the Commission observes that NR's lending is concentrated on one product, mortgage loans. Indeed, at the end of June 2007, 85 % of NR's assets were loans to customers, of which 91 % were mortgages. That market seems to be national since almost no customer contracts a mortgage with a bank located in another country. The Commission observes that in the recent years NR became one of the largest players on the UK mortgage market. In 2006, it accounted for 13,4 % of UK net lending, 8,3 % of UK gross lending and 7,1 % of the UK closing balances. In the first half of 2007, these market shares increased respectively to 18,9 %, 9,7 %, and 7,6 %. The growth of the market share was achieved by proposing very low interest rates. It seems that this aggressive pricing policy, which was made possible by the low cost of raising funds on the secured wholesale market and on the unsecured wholesale market, has forced competitors to revise downwards their own prices. The Commission observes that, without downsizing, NR would keep a significant position on this market after restructuring.

([23]) Such as securitisation through the issuance of Residential Mortgage-Backed Securities (RMBS), Commercial Mortgage-Backed Securities (CMBS) and Covered Bonds. The Covered bonds differ from RMBS in that the payments are guaranteed by the bank. Thus the credit risk remains on the balance sheet.

([24]) In particular, it seems that the relevant market is not the UK. Indeed, it seems that NR has not prevented other UK banks to raise funds by attracting funds at their expenses. It seems rather that NR has incited other banks to raise funds on that market by copying NR's model.

([25]) In the case of the Guernsey operation, it is believed that the majority of these deposits are from UK customers. Therefore, the UK authorities consider that for this operation the relevant geographic market is also believed to be the UK.

(123) From the prior analysis of the markets in which NR is active, the Commission at this stage concludes that the market were NR held and will continue to hold a significant market share is the UK mortgage market. Compensatory measures, which aim at avoiding undue distortions of competition, should therefore in priority aim at reducing the presence of NR on this market. Measures aimed at limiting NR's presence on the UK, Irish and Danish retail deposits markets could also prove necessary.

(124) The Commission notes that the measures proposed by the UK authorities should provoke a reduction of NR's presence on the UK mortgage market. First, during the restructuring period NR would strongly reduce the granting of new mortgage loans. This means that NR would only account for a small percentage of gross lending in the UK market during these years. The UK authorities explain that if NR were to stop completely any new lending, this would trigger the rapid amortisation of Granite and different early redemption provisions under different notes issued by NR, which would consequently exit the market. Second, during these three years NR would actively incite its existing customer to refinance their mortgages with competitors. This increase of the prepayment rate entails that NR would account for an even more limited share of the net lending during these years. Third, the combination of the two prior actions will cause a reduction of the mortgage portfolio to [30-55 %] the size recorded in June 2007, which means that NR will account for a much more limited share of the closing balances.

(125) It could be questioned whether the measures described in the previous paragraph are disqualified as compensatory measures on the basis of point 40 of the R & R Guidelines, which indicates that "*[w]rite-offs and closure of loss-making activities which would at any rate be necessary to restore viability will not be considered reduction of capacity or market presence for the purpose of the assessment of compensatory measures*". After a preliminary analysis, the Commission considers that it is probably not the case since the mortgage lending activities have not been loss-making, and therefore do not constitute "loss-making activities". The Commission notes that the problem of the viability of the bank appears, on the basis of information provided, to be rather a liquidity issue (i.e. lack of sufficient funding) than a solvency issue (i.e. insufficient capital following losses). In addition, the downsizing results from a dramatic reduction of its lending activity and from an active redemption policy of the existing mortgages during the restructuring period. It could also be argued that if the State would have been ready to provide guarantees during longer period, the firm would probably not have had to implement such drastic measures ([26]). Therefore, the downsizing seems to qualify, at least to a certain extent, as compensatory measure. Interested parties are invited to give comments on this preliminary assessment.

(126) Nevertheless, the Commission doubts at this stage that the size and the duration (i.e. until 2011) of the downsizing proposed by the UK are sufficient to avoid undue distortions of competition. Indeed, the size of the aid measures (in terms of the total potential exposure of the UK Government) is particularly large. In addition, as previously indicated, NR's growth has been particularly rapid over the last years, hurting competitors who lost market shares and had their margins squeezed. This rapid growth has been achieved by adopting a strategy which, at least with the benefit of hindsight, was highly risky. All these elements seem to warrant a particularly significant and durable reduction of the market presence and the adoption of measures to limit the distortion created by the State support during the restructuring phase. The UK authorities and interested parties are invited to comment on whether and why the proposed compensatory measures are sufficient to avoid undue distortions of competition.

(127) The Commission also observes that NR is considering to implement "through-lending" i.e. making arrangements with other mortgage providers in order to be able to offer third party branded products directly to customers with maturing mortgage deals. The business rationale is that this method would increase the probability and speed of redemptions, allow NR to maintain full control of the sales and advice process and by assisting its customer to achieve a good outcome will better maintain NR's brand promise and reputation. At this stage, the Commission considers that if NR would implement "through-lending", this would limit the reduction of NR's market presence and limit the extent in which the downsizing could be considered as a valid compensatory measure. Indeed, as just described, NR would remain the contact point for the customer and would maintain full control of the sales and advice process. In addition, at the end of the restructuring period, NR could probably rather easily replace third party branded products by its own products and grow rapidly. The UK authorities and interested parties are invited to comment these considerations.

(128) The UK authorities indicate that if NR were sold to a new owner in the course of the restructuring period, the bank would be sold free of any obligations, and in particular the compensatory measures indicated previously or any other appropriate measures. The Commission doubts that this can be accepted. Indeed, in order to avoid undue distortion of competition following from the rescue of the bank by the State, the market presence of the rescued economic entity has to remain limited during a sufficiently long period, whoever the owner of this economic entity is ([27]).

4.5.5.3. Aid limited to the minimum: real contribution, free of aid

(129) According to point 43 of the R & R Guidelines, "*[t]he amount and intensity of the aid must be limited to the strict minimum of the restructuring costs necessary to enable restructuring to be undertaken in the light of the existing financial resources of the company* [and] *its shareholders*".

([26]) […].

([27]) This also implies that the State could not grant to the new owner a guarantee that if any aid would be recovered from NR, it would receive an equivalent compensation. Indeed, without threat of recovery, the new owner would have no incentive to manage the bank in compliance with the compensatory measures.

(130) At this stage, the Commission doubts that the aid is limited to the minimum necessary for the following reasons.

(131) First, while it seems clear that the downsizing of the balance sheet contributes to reduce the aid amount necessary in the next years by allowing a reimbursement of the State facilities and a decrease of the amounts covered by the State guarantees, the Commission observes that […]. The Commission therefore doubts that, while preserving the firm as a viable independent entity, a deeper and more rapid downsizing could not be implemented:

(i) the Commission doubts whether the 60 % redemption rate which is targeted is the maximum possible, or whether a higher rate would be achievable (e.g. […] %, as envisaged in the private sector proposals);

(ii) it also doubts whether NR really need to conduct new lending of approximately GBP [3-5] billion a year over the period 2008 to 2011 "*in order for the company to retain a footprint in the mortgage market, to manage average credit quality effectively, to avoid any cessation of business triggers in existing financing and structured finance programmes (including Granite) and to originate sufficient new lending to provide for the continuation of the Granite and covered bond programmes*". In particular, the Commission does not have at its disposal sufficient information which would allow it to agree with the foregoing claim of the UK authorities. It requests the UK to provide full documentation and explanation of the Granite structure and other structured finance programmes, including a description and status of all the legal entities involved. The Commission cannot exclude at this point that these structures result in undertakings other than NR being beneficiaries, for the purposes of Article 87(1) EC, of the State aid measures under consideration in the investigation. The Commission will be examining this issue further during the investigation.

(132) Second, the Commission doubts whether the State guarantees can not be abolished earlier than foreseen in the current plan. In particular, the UK authorities have not precisely justified the choice of the proposed dates.

(133) Thirdly, the Commission does not have at its disposal information on the price which would be charged by the State for the guarantees (i.e. the guarantee premiums) and for the facilities (i.e. the interest rate and the facility fee) and only a mere indication of the total amount of fees that NR would be charged. In this regard the Commission doubts whether this amount could not be higher while not endangering the viability of NR. In particular, the UK authorities have not explained in detail how these premiums and rates will be set so as to ensure that NR's funding costs do not fall significantly below the revenues from the existing loans portfolio and thereby to prevent NR from generating profits from these existing assets which are financed or insured by the State. In conclusion, the Commission has doubts as to the level of funding costs and the premium for the different guarantees appropriate to ensure that the aid and thereby the distortion of competition is limited to the minimum.

(134) On these three points, the Commission invites the UK to submit the relevant missing information and to justify its claims and proposals, and it invites third parties to comment.

(135) As regards the own contribution that the beneficiary has to make to the costs of the plan, first of all, it should be underlined that point 43 of the R & R Guidelines indicates that "*[s]uch contribution is a sign that the markets believe in the feasibility of the return to viability*". The own contributions planned in the restructuring plando not include injections of funds in the form of loans or capital from private investors. They mainly consist in the sale/redemption of existing assets. It is therefore doubtful whether any of these own contribution can be considered as a sign that the markets believe in the feasibility of the return to viability. On the other hand, the Commission observes that one of the private bidders had in February 2008 gathered sufficient promises from investors to make a capital increase of several hundreds millions of pounds, in the framework of a restructuring plan which was similar to the plan notified by the UK on 17 March 2008. It is therefore not excluded that this could be considered as a sign that the markets believe in the feasibility of the return to viability. In the framework of the formal investigation, the Commission will therefore analyse whether this condition is fulfilled.

(136) For large companies, point 44 of the R & R Guidelines requires that the own contribution amounts to at least 50 % of the restructuring costs. This raises the issue of the calculation of the restructuring costs. Indeed, as already explained, NR does not face a solvency problem following loss of value of assets. NR faces a liquidity shortage, and therefore needs sufficient liquidity to be rescued and return to viability. It could be considered that the amount of funds which is lacking to finance the existing assets (and which was provided by the State as rescue aid — including the State guarantees which prevented that additional sources of funds vanished) constitutes the restructuring costs. The Commission has doubts about whether NR could be held, under the notified plan, to have attracted an own contribution of half this amount. The Commission invites comments on how this condition can be applied to the case in question.

DECISION

The Commission has accordingly decided that the measures implemented on 18 December 2007 are compatible with the EC Treaty and that if the shareholders are only compensated on the basis of an independent valuation of the company without any State support, the purchase of the shares from the existing shareholders does not constitute State aid.

In the light of the foregoing considerations, the Commission has also decided to initiate the procedure laid down in Article 88(2) of the EC Treaty with respect to the HM Treasury's commitment to the FSA in February 2008 and with respect to the measures notified on 17 March 2008. The Commission requires the UK, within one month of receipt of this letter, to provide in addition to all documents already received, information and data needed for the assessment of these measures.

In particular, the Commission would wish to receive comments on the points on which it raised doubts.

The UK is requested to forward a copy of this letter to the potential recipient of the aid immediately.

The Commission wishes to remind the UK that Article 88(3) of the EC Treaty has suspensory effect, and would draw your attention to Article 14 of Council Regulation (EC) No 659/1999, which provides that all unlawful aid may be recovered from the recipient.

The Commission warns the UK that it will inform interested parties by publishing this letter and a meaningful summary of it in the *Official Journal of the European Union*. It will also inform interested parties in the EFTA countries which are signatories to the EEA Agreement, by publishing a notice in the EEA Supplement to the *Official Journal of the European Union*, and will inform the EFTA Surveillance Authority by sending a copy of this letter. All such interested parties will be invited to submit their comments within one month of the date of such publication."