



BANK OF ENGLAND

Report under Section 80(1) of the Banking Act 2009 on the Dunfermline Building Society (DBS) Bridge Bank

July 2010

1. This document comprises a report on the Dunfermline Building Society (DBS) Bridge Bank ("Bridge Bank") by the Bank of England ("the Bank") for the purposes of Section 80(1) of the Banking Act 2009 (the "Act"). The report covers the period from 30 March 2009, the date of the transfer to the Bridge Bank, to the subsequent liquidation of the Bridge Bank. The Bridge Bank was placed into liquidation on 12 November 2009 and its final general meeting was held on 15 March 2010. The Bridge Bank was formally dissolved on 19 June 2010.

Background

2. On 30 March 2009, following the Financial Services Authority's ("FSA") determination that the general conditions set out in section 7 of the Act had been satisfied in relation to Dunfermline Building Society ("Dunfermline"), the Bank of England exercised its transfer powers under the Special Resolution Regime ("SRR") of the Act to transfer parts of Dunfermline's business (including its retail and wholesale deposits, head office and originated residential mortgages) to Nationwide Building Society ("Nationwide"). This transfer was effected by the Dunfermline Building Society Property Transfer Instrument 2009 (the "Transfer Instrument"). On that date, as part of the resolution of Dunfermline and pursuant to the Transfer Instrument, the social housing loan book of Dunfermline and deposits held with Dunfermline by social housing lending customers (the "Business") were transferred to Bridge Bank, a 100% group undertaking of the Bank of England. The Bridge Bank was an off-the-shelf company, incorporated in Scotland with company number SC356970, which was acquired by the Bank for England for the purpose of facilitating the resolution of Dunfermline. It was authorised and regulated by the FSA. The Directors of Bridge Bank were Andrew Bailey and Warwick Jones, who are both Executive Directors and employees of the Bank of England.

Activities of the Bridge Bank

3. The transfer allowed the Bank of England to stabilise the Business, consistent with the objectives of the SRR, while a permanent solution was secured (in this case, a sale to a suitable purchaser). During this period, in accordance with the Code of Practice issued in accordance with Sections 5 and 6 of the Act (the "Code of Practice"),⁽¹⁾ the Bank of England sought to ensure that the Business was run on a conservative basis to protect the value of the Business and to provide continuity of banking services. This included complying with the obligations of the Business under existing loan agreements entered into with housing associations, including honouring undrawn commitments in accordance with the existing terms and conditions governing those commitments, negotiating and completing documentation for loans to housing associations that were part of the pipeline business transferred to the Bridge Bank and considering new loans to housing

associations. The Bridge Bank honoured its obligations under existing deposit liabilities transferred to it but, except in one case, did not accept or roll over any new deposits.

The sale of the Business

4. In accordance with bridge bank objectives set out in the Code of Practice, the Bank of England established a competitive auction process to select a preferred bidder and agree a price for the Business.

5. Bridge Bank appointed Ernst & Young LLP ("E&Y") to conduct a competitive auction process, for the sale of the Business. Four bidders carried out due diligence, and, subsequently, two bids were received for the Business. The Bank of England sought confirmation from the FSA that the bidders from whom offers were received were suitable for taking on the Business. The bids included consideration for five additional loans which, prior to the resolution, had sat with the Business but which, on account of their specific terms, did not transfer to Bridge Bank in accordance with the Transfer Instrument and remained in Dunfermline (together with the Business, the "Transferred Business").

6. On 17 June 2009, the Bank of England selected Nationwide as the preferred bidder for the Transferred Business. The selection of Nationwide as the preferred bidder followed consultation with the Bank's Financial Stability Committee, and further consultation with the FSA and HM Treasury, as required by the Act. The transfer of the Transferred Business to Nationwide was completed on 1 July 2009.

7. The aggregate consideration paid, following post-completion adjustment, for the Transferred Business was £377,247,362. Bridge Bank received £367,173,539 on completion and the balance on 2 September 2009.

8. Following receipt of the consideration referred to in paragraph 7 above, the Bridge Bank paid £18,973,622 to the Bank of England to repay the drawn amount (plus interest) under a liquidity facility from the Bank of England. The Bridge Bank also paid operating costs and professional fees of £3,122,000.00 in aggregate and a tax liability to HMRC of £308,932.12. The Bank of England charged no fee for the services that it provided, but recovered costs of £7,000.00. This left an aggregate sum of £356,651,596.69 to the account of Bridge Bank to be distributed by the liquidators to the Dunfermline Resolution Fund as referred to in paragraph 12 below.

(1) A copy of the Code of Practice is available on the Bank of England's website at www.bankofengland.co.uk/financialstability/role/risk_reduction/srr/index.htm.

9. As referred to in paragraph 8 above, the Bridge Bank paid operating costs and professional fees of £3,122,000.00 in aggregate. These included fees of £2,325,721 paid to E&Y between April and July 2009 for the provision of management and other services to the Bridge Bank both on the operational side and in relation to the sale process. This included E&Y overseeing the tasks required for the Bridge Bank to function as a separate company and the management of the operational risks from the split of the Business from Dunfermline. E&Y also co-ordinated the implementation by the Bridge Bank of the Transitional Services Agreement entered into with Nationwide, managed the cash flow of the Bridge Bank, provided a secondee to act as the Bridge Bank's Money Laundering Reporting Officer and oversaw compliance with Data Protection and regulatory reporting requirements. These services reflected the fact that the board of the Bridge Bank needed to ensure the effective running of the Business for which only four operational staff had been transferred from Dunfermline. During the sale phase, E&Y's role included advising the Bridge Bank on the sale process, producing the information memorandum and data room for the use of bidders and providing valuation advice for the sale. Also included in the professional fees paid by the Bridge Bank, were fees of £656,745 paid to Freshfields Bruckhaus Deringer LLP for legal advice provided to the Bridge Bank on the sale of the Transferred Business to Nationwide and fees of £43,585 paid to KPMG LLP for tax advice provided to the Bridge Bank in relation to the sale of the Transferred Business.

10. Following the sale of the Transferred Business, Bridge Bank did not carry on any further business. It surrendered its authorisation by the FSA on 17 July 2009.

11. On 12 November 2009, the Bank of England, as sole shareholder of Bridge Bank, resolved to appoint Margaret Mills and Patrick Joseph Brazzill of E&Y as joint liquidators of Bridge Bank, thereby placing Bridge Bank into a members' voluntary liquidation.

12. On 12 February 2010, the liquidators made a distribution in the sum of £356,651,596.69 to the Dunfermline Resolution Fund established pursuant to The Dunfermline Building Society Compensation Scheme, Resolution Fund and Third Party Compensation Order 2009 in accordance with Part 2 of Schedule 1 to that Order.

13. On 15 March 2010, the Final General Meeting of Bridge Bank was held, following which the return of the final general meeting was filed with the Registrar of Companies. The Bridge Bank was formally dissolved by the Registrar of Companies on 19 June 2010.

14. The Annex to this Report contains the unaudited management accounts for the Bridge Bank. The Bridge Bank did not appoint auditors as it was liquidated prior to having to file audited statutory accounts with the Registrar of Companies.

Annex Unaudited Management Accounts

DBS Bridge Bank Limited

Balance Sheet £'000

	31-Mar-09	30-Jun-09	31-Jul-09	31-Aug-09	30-Sep-09	31-Oct-09	30-Nov-09	31-Dec-09	31-Jan-10	28-Feb-10	30-Mar-10
Assets											
Held for sale - mortgage balances	363,320	375,511	-	-	-	-	-	-	-	-	-
Accrued interest on mortgage balances	1,429	1,314	-	-	-	-	-	-	-	-	-
Receivables from Nationwide		131	10,066	10,066	-	-	-	-	-	-	-
Cash at bank		366,764	348,345	348,165	358,105	357,331	357,264	357,213	356,960	356,651	-
Other assets		3	-	-	-	-	-	-	-	-	-
	364,749	743,723	358,411	358,231	358,105	357,331	357,264	357,213	356,960	356,651	-
Liabilities											
<i>Held for sale</i>											
- Capital Reserves Deposits	7,613	2,808	-	-	-	-	-	-	-	-	-
- Term Deposits	4,264	150	-	-	-	-	-	-	-	-	-
<i>Accrued interest</i>											
- Opening Balance Sheet Cap Reserves		50	-	-	-	-	-	-	-	-	-
- Opening Balance Sheet Term Deposits		1	-	-	-	-	-	-	-	-	-
- Capital Reserves Deposits and Term Deposits	78	14	-	-	-	-	-	-	-	-	-
- BOE Facility		77	-	-	-	-	-	-	-	-	-
Commitment fee payable on BOE facility		92	-	-	-	-	-	-	-	-	-
Bank of England short term facility		18,805	-	-	-	-	-	-	-	-	-
Taxation		309	309	309	309	309	309	309	309	-	-
<i>Other Creditors</i>											
Bank of England		7	7	7	7	7	7	-	-	-	-
Nationwide TSA recharges		198	198	25	4	-	-	-	-	-	-
Nationwide assets transfer		366,755	-	-	-	-	-	-	-	-	-
Ernst and Young LLP		1,015	1,015	1,015	1,015	253	253	253	-	-	-
Freshfields Bruckhaus Deringer		126	126	126	23	23	-	-	-	-	-
KPMG LLP		44	44	44	44	44	-	-	-	-	-
Other creditors		63	61	54	52	44	44	-	-	-	-
	11,955	390,514	1,760	1,580	1,454	680	613	562	309	-	-
Equity											
Ordinary share capital	-	-	-	-	-	-	-	-	-	-	-
Capital contribution for the administrators	352,794	352,794	356,236	356,236	356,236	356,236	356,236	356,236	356,236	356,236	-
Profit and loss account		415	415	415	415	415	415	415	415	415	-
	352,794	353,209	356,651	356,651	356,651	356,651	356,651	356,651	356,651	356,651	-
Total Equity and Liabilities	364,749	743,723	358,411	358,231	358,105	357,331	357,264	357,213	356,960	356,651	-

	P&L for period 30 March 09 to 1 July 09 ¹
Profit and Loss	
£'000	
Interest Income	
Interest income on mortgages	4,048
Other interest income	<u>1</u>
Total interest income	<u>4,049</u>
Interest Expense	
Interest payable on deposits from customers	(34)
Interest on BOE Facility	(78)
Commitment fee payable on BOE facility	<u>(91)</u>
Total interest expense	<u>(203)</u>
Other income and costs	
Other income	15
<i>Expenses</i>	
Ernst and Young LLP	(2,325)
Freshfields Bruckhaus Deringer	(656)
Nationwide TSA recharges	(198)
Bank of England	(7)
KPMG LLP Tax fees	(44)
Other expenses	(289)
Net fair value movement on held for sale mortgage balances	<u>382</u>
Total other income and expenses	<u>(3,122)</u>
Profit before tax	<u>724</u>
Taxation	(309)
Profit after tax	<u>415</u>

¹ No P&L charged since the date of sale