KPMG

Dunfermline Building Society
(in building society special administration)

Joint administrators' second progress report to creditors pursuant to Rules 26 to 29 of The Building Society Special Administration (Scotland) Rules 2009

29 March 2010

KPMG LLP

22 April 2010

This report contains 19 Pages

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Joint administrators' progress report to creditors pursuant to Rule 2.38 of the Insolvency (Scotland) Rules 1986
KPMG LLP

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Contents

Appendices

Notice: About this Report

This Report has been prepared by the Joint Building Society Special Administrators of Dunfermline Building Society ("DBS"), solely to comply with their statutory duty under the Rules (26 to 29) of The Building Society Special Administration (Scotland) Rules 2009, to provide the creditors with an update on the progress of the Administration, and for no other purpose. It is not suitable to be relied upon by any other person, or for any other purpose, or in any other context.

This Report has not been prepared in contemplation of it being used, and is not suitable to be used, to inform any investment decision in relation to the debt of or any financial interest in DBS.

Any estimates of outcomes for creditors included in this report are illustrative only and cannot be relied upon as guidance as to the actual outcomes for creditors. Any person choosing to rely on this report for any purpose or in any context other than under Rules 26 to 29 does so at their own risk.

To the fullest extent permitted by law, the Joint Building Society Special Administrators (the "Joint Administrators") do not assume any responsibility and will not accept any liability in respect of this report. Blair Nimmo is authorised to act as an insolvency practitioner by the Institute of Chartered Accountants of Scotland; Richard Heis and Mike Pink by the Institute of Chartered Accountants in England & Wales and Richard Fleming by the Insolvency Practitioners Association. The Joint Administrators act as agents for DBS and contract without personal liability. The appointments of the Joint Administrators are personal to them and, to the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability to any person in respect of this Report or the conduct of the Administration.

1 Glossary

BoE	Bank of England
Bridge Bank	DBS Bridge Bank Limited - an SPV set up by the Bank of England in order to assist in the facilitation of the transfer of certain assets and liabilities from DBS to NBS.
BSSAR	Building Society Special Administration (Scotland) Rules 2009.
DBS	Dunfermline Building Society.
HMT	Her Majesty's Treasury.
Joint Administrators	The joint building society special administrators, being Richard Heis, Mike Pink and Richard Fleming of KPMG LLP, 8 Salisbury Square, London EC4Y 8BB and Blair Nimmo of KPMG LLP, Saltire Court, Castle Terrace, Edinburgh EH1 2EG – appointed on 30 March 2009.
NBS	Nationwide Building Society.
Objective 1	Objective 1 is to ensure the supply to Nationwide Building Society and/or DBS Bridge Bank Limited of such services and facilities as are required to enable it, in the opinion of the Bank of England, to operate effectively.
Objective 2	Objective 2 is to:- a) rescue the residual bank as a going concern, or b) achieve a better result for the residual bank's creditors as a whole than would be likely if the residual bank were wound up without first being in bank administration.
PTI	Property Transfer Instrument made by the BoE transferring all or part of the business of DBS to NBS (via Bridge Bank).
The Rules	The Building Society Special Administration (Scotland) Rules 2009
Pension Trustees	The Trustees of the Dunfermline Building Society 1974 Pension and Life Assurance Scheme.

2 Introduction

We, Richard Heis, Blair Nimmo, Mike Pink and Richard Fleming of KPMG, were appointed Joint Administrators of DBS on 30 March 2009, by an order made by the Court of Session in Edinburgh under an application made by the BoE under the BSSAR (which was enacted following the Banking Act 2009 that had introduced the Special Resolution Regime). The functions of the Joint Administrators may be performed jointly or by any of them individually.

In accordance with the Rules we set out below our second six monthly progress report. However, the disclosure of certain sensitive information relating to certain assets and liabilities could seriously prejudice the commercial interests of DBS and its creditors and so this information has been either excluded from this report or abbreviated in order to preserve value for the benefit of creditors.

The cumulative receipts and payments account for the period 30 March 2009 (the date of appointment) to 29 March 2010 is attached at Appendix 2. This shows funds in hand totalling £470.3 million as at 29 March 2010.

3 Building Society Special Administration procedure

3.1 Objectives 1 and 2 of the BSSAR

As referred to in our previous progress report, under the BSSAR, building society special administrators have two special objectives, known as "Objective 1" and "Objective 2", which override the normal statutory objectives of administrators as set out in the Scottish insolvency regulations.

As at the date of issuing this second update report DBS remains in the Objective 1 phase. Once the Bank of England issues an Objective 1 Achievement Notice, we will issue our proposals and call a meeting of DBS' creditors as soon as practicable.

3.2 Transitional Services Agreement

As previously reported, the Administrators of DBS entered into a Transitional Services Agreement ("TSA") with NBS on 30 March 2009.

These arrangements with NBS were for a maximum 12 month period, and were only capable of extension by agreement. NBS have always made it clear that they are not in the third-party servicing business. In order to protect DBS' loan assets and establish a stable operating platform going forward, either for a collect-out of the portfolio or eventual sale, new servicing arrangements were needed. The related separation and migration activities are outlined below (Section 3.3). In the meantime we have negotiated a short extension of the TSA with NBS, together with run-off arrangements post separation.

The total cost of services received from NBS under the TSA to 29 March 2010 was £1.37 million.

3.3 Separation and migration of retained business

Since our appointment on 30 March 2009, a joint project team from the Joint Administrators', NBS and third party suppliers have been working on a project to separate, extract and transfer the business of DBS away from the NBS (ex Dunfermline) systems and resources. This has involved the transfer of data and some servicing activities to a specialist third party mortgage servicing business, with key account management and strategic control of the loans retained by the Joint Administrators, supported by a small team of experienced commercial banking staff – effectively a Special Servicing Team ("SST").

We are pleased to advise creditors that shortly after 29 March 2010 this migration project was successfully implemented, which we believe will greatly improve our ability to control and monitor the loan portfolios, substantially assisting our efforts to maximise realisations for creditors as a whole.

The newly formed SST comprises eight former employees of DBS (who were originally transferred to NBS by the PTI), supplemented by experienced work-out bankers that the Joint Administrators have recruited to DBS on temporary contracts. The team is managed by the Joint Administrators, and its objectives are to deal with complex servicing and arrears management for the commercial loans portfolio. Alongside the SST is a Third Party mortgage servicing company, Target Loan Services Limited ("TLS"), which will manage the servicing and arrears on the residential loans portfolio under the guidance of the Joint Administrators, together with the direct debit collection and processing system, and management information for both the residential and commercial loan portfolios.

This project was a long and complex undertaking which involved identifying and migrating over 200 different systems and data sources. In total there were over 2,000 open loans, 3,400 closed (but connected) loans and 75 collateral deposit accounts moved across to TLS which required the transfer of the transaction history for each account. On top of this, new bank accounts and Merchant Acquiring facilities have also been opened and all customers are being transferred onto new Direct Debit instructions, which will reduce their servicing costs going forward. .

4 Progress to date including realisation of assets

4.1 Treasury assets

As at 29 March 2010 we have realised principal and interest relating to these assets of approximately £59.68m. The estimated mark-to-market of the remaining assets at 29 March 2010 was £130.7 million (face value: £131.3 million). We continue to monitor regularly the remaining treasury assets and have recently met with our agents, Henderson, to discuss the portfolio. As a result of this meeting our strategy remains to hold these assets as the returns are as good, or better, than we could achieve by investing the money elsewhere and no significant risks of holding the assets were identified.

4.2 Commercial loan portfolio

As at 29 March 2010 capital realisations from the commercial loan book totalled £33.8 million, together with £20.3 million of interest and charges; an increase of £16.9 million and £9.5 million respectively on the previous six months.

We continue to hold a number of cash deposits with RBS on trust, from commercial borrowers as collateral against their loans. A number of receipts and payments have been made from these accounts in the period in respect of rental income and mortgage payments and the total held as at 29 March 2010 was £1.27 million.

As previously reported, the conditions in the credit markets over the last year have depressed both the quantity and prices of reported UK loan portfolio sales. Therefore, the strategy for dealing with these loans remains to collect revenue and restructure and work out the loans for the foreseeable future in order to maximise realisations (net of collection costs) for the benefit of the creditors. We will continue to assess the markets and any offers we may receive to purchase the portfolios with a view to achieving the best outcome for creditors as a whole.

4.3 Retail loan portfolio

As with the commercial loan portfolio, NBS had been administering these loans for DBS through the TSA, using former DBS systems and personnel. However, the recent migration process means that the portfolio is now being administered by TLS, the third party mortgage servicer. The Administrators continue to oversee these services and perform the key strategic management and controls.

In the full year to 29 March 2010 we had realised approximately £11.4 million of capital and £6.6 million of interest and charges from the retail portfolio; an increase of £5.9 million and £3.1 million respectively on the first six months.

4.4 Equity Release

As at 29 March 2010 we had received £3.07 million of annuity payments in respect of this portfolio. In the same period we have paid £0.36 million in servicing and set-up costs following the insolvency of the third party mortgage originator (IRS), and have advanced (pre- IRS' insolvency) a total of £0.65 million to IRS to fund increments to borrowers.

4.5 Investments in subsidiaries and other shareholdings

Dunfermline Development Services Limited, a dormant wholly owned subsidiary of DBS with no assets has now been struck off the Companies Register following an application made by the sole director.

Another DBS wholly owned subsidiary, Dunfermline Commercial Finance Limited ("DCF"), was placed into members' voluntary liquidation on 14 October 2009 and any surplus capital realised after the creditors of DCF have been paid in full will be remitted to DBS. At present we estimate the potential realisations from this liquidation to be in the region of £1.4 million, subject to the final quantum of valid creditors' claims and the costs of winding the company up.

Title to certain of the IT related assets and licences historically used by DBS (and post-PTI by NBS) lay within Dunfermline Services Limited ("DSL"), DBS' only other subsidiary. DSL recently sold its assets and licences to Nationwide. However, as the proceeds were less than DSL's net liabilities (which are in excess of £11 million) there is no prospect that DBS will see any realisation as its shareholder. It is expected that the directors of DSL will shortly pass a resolution to appoint a liquidator to wind up that company.

Under the first PTI, DBS retained its interest in Funds Transfer Sharing Limited ("FTSL") (a company limited by guarantee) which was effectively a special purpose vehicle set up with other small and medium sized building societies to facilitate entry into the ATM and card market (what has now effectively been superseded by LINK). It is anticipated that FTSL will be wound up and the residual funds returned to shareholders by way of distribution. At this time the timing and quantum of this distribution is unclear.

4.6 Dunfermline Building Society Resolution fund

As at 29 March 2010 £356.5 million had been received from the Dunfermline Resolution Fund. Since 29 March 2010 a further £0.1 million has also been received. No further amounts are now expected.

4.7 Assets remaining to be realised

We continue to manage the orderly wind-down of the commercial, residential and treasury portfolios. We will continue to monitor all of the portfolios with a view to opportunistic sales of assets where it can be achieved at a value which we believe will maximise the return to creditors of DBS.

The recent migration of the administrative and loan management functions away from NBS should provide a more stable platform of operations which will also enhance the prospects of any future sale of the residual portfolios when market conditions make that option commercially attractive.

The treasury assets are currently being held, as mentioned above, as the returns on these assets are better than would be received if the funds were invested elsewhere. Depending on market conditions these assets may either be held to maturity or sold.

5 DBS creditors

5.1 HMT

As a result of the first and second PTI's the total HMT subrogated claim in DBS is some £1.54 billion. In accordance with the requirements of the first PTI, we are in the process of assisting HMT in determining the apportionment of this claim between its unsecured creditor element (ranking pari passu with all other unsecured creditors) and its element ranking with the society's members (i.e. subordinated to the unsecured creditors of DBS).

5.2 Pension fund

Post-PTI, DBS retained the liability for its defined benefit pension scheme and in accordance with Section 75 of The Pensions Act 1995, the DBS Pension Scheme Trustee made an indicative unsecured claim of approximately £43m in the administration. This represented the shortfall of the scheme assets against the cost of insuring all liabilities measured at 30 March 2009. An initial review of this claim concluded that the range of potential liabilities due to the pension scheme would most likely be in the region of £37m -£43m.

The scheme trustees' objective was to secure the pension benefits for the scheme members, and wished to receive funds from the Administrators to enable an insurance contract to be acquired which would replace DBS' obligations. Although unusual, we decided that the best way of meeting the trustees' objectives and avoiding the problem of market risk to the scheme, potentially resulting in loss of members' benefits, was to fund the transaction, thereby removing the claim against DBS, taking advantage of a favourable period in the insurance buy-out market. This agreement was entered into to minimise the cost to creditors and members as a whole and maximise the return to the estate.

This agreement was formalised on 9 April 2010 and consideration of £38.8 million has been paid to a third party insurer, Aviva. This payment was made to Aviva via the Pensions Protection Fund which facilitated this agreement. Overall, this was a very satisfactory resolution to a complex claim and has enabled the settlement to be made at the lower end of the anticipated range as well as saving on additional claims which may have arisen.

5.3 Subordinated loan notes

DBS issued £50.0 million subordinated loan notes with a coupon value of 6% and redemption date of 31 March 2015. The PTI set out that this creditor remained with DBS. A claim has been submitted by the Trustee for the loan notes of approximately £53 million inclusive of accrued interest. The Trustee for the loan notes has also submitted an initial claim for fees and expenses of £0.1m, which will rank as an unsecured creditor claim.

5.4 General

Aside from the claims referred to above, we have also identified a further 30 potential unsecured creditors' claims totalling approximately £8.7 million, the largest of which is a potential claim from another financial institution for £8 million, plus additional interest accrued, in respect of its sub-participation in some of DBS' commercial loans.

We hope shortly to formally notify creditors of an intention to pay a dividend and will be writing to all known unsecured creditors to seek submission of a formal claim. The Scottish process for advertising and payment of dividends is relatively convoluted and protracted, for the purpose of ensuring creditors are fully protected. In this case, as unsecured creditors will certainly be paid in full we do not consider that a lengthy process is useful, and are in the process of applying to the Scottish court to assist us in truncating the process.

6 Other matters

6.1 Tax and VAT matters

Given the level of tax losses in the year ended 31 December 2008, we submitted a loss carry back claim seeking to relieve the profits (in full) of the year ended 31 December 2007. We can confirm that HMRC have issued a repayment for £2.9 million plus interest in respect of this loss carry back claim.

We met with HMRC again in March 2010 and are currently finalising the tax returns for the period up to our appointment on 30 March 2009 and reviewing projections for the first post-appointment corporation tax accounting period. Given the level of losses up to 30 March 2009, we are considering the merits of a terminal loss claim. Furthermore, we are seeking to agree the methodology of the accounting for post-appointment corporation tax accounting periods.

6.2 Change of principal place of business

As of 12 April 2010, the principal place of business for DBS became:

Dunfermline Building Society (in Building Society Special Administration)
Unit 8
Evans Business Centre
15 Pitreavie Court
Dunfermline
KY11 8UU

6.3 Change of name

It is the intention of the Joint Administrators to apply to the FSA within the next few months to change the name of DBS to "DB Realisations Building Society". This is intended to make a clearer distinction between the business and trading name transferred to NBS by the PTI and the residual business and assets held under the control of the Joint Administrators. We will write to you once this has happened.

7 Joint Administrators' fees

I enclose, at Appendix 3, an analysis of our time and costs properly incurred up to 29 January 2010 (the last date our time costs were submitted for approval to the BoE). In this period, a total of 25,873 hours were spent by me and my firm's staff in relation to the activities listed below at a total cost of £9,435,082. In accordance with the BSSAR, these costs and our hourly rates have been approved by the BoE and settled from the estate.

R Heis
Joint Building Society Special Administrator

22 April 2010

Appendix 1

Statutory and other information

Statutory and other information

Relevant court
The Building Society Special Administration Order was made in the Court of Session in Edinburgh on 30 March 2009.

Extensions to initial period of appointment

To date, we have not made any request to extend the period of the administration albeit we are likely to do so at the appropriate time.

Registered office and trading address

The former registered office of Dunfermline Building Society was situated at:

Caledonia House
Carnegie Avenue
Dunfermline
Fife KY11 8PJ

As part of the Administration process, the registered office for the Company has been changed to:-

191 West George Street
Glasgow
G2 2LJ

Joint Administrators and their functions

Richard Heis, Mike Pink and Richard Fleming of 8 Salisbury Square, London EC4Y 8BB and Blair Nimmo of Saltire Court, Castle Terrace, Edinburgh EH1 2EG were appointed as Joint Administrators of DBS on 30 March 2009. All of the Joint Administrators act jointly and severally in the pursuance of Objective 1 and Objective 2 of the Building Society Special Administration of DBS.

Appendix 2

Transfer of business, assets and liabilities

As we reported in our first progress report, the two PTIs issued by the BoE have resulted in all property, rights and liabilities (including the DBS brand name and all property, rights and liabilities that fall within any of the descriptions specified in section 35(1) of the Banking Act) of DBS being transferred to NBS other than excluded property, rights and liabilities as set out below:

a) the Bridge Bank business;
b) certain treasury assets;
c) all property, rights and liabilities in respect of the £50,000,000 6 per cent. Subordinated Notes due 2015 issued by DBS;
d) all property, rights and liabilities in respect of acquired mortgage loans;
e) all property, rights and liabilities in respect of commercial loans;
f) the shares held by Dunfermline in Dunfermline Solutions Limited, Dunfermline Commercial Finance Limited and Dunfermline Development Services Limited and any rights (including membership rights) and liabilities of DBS in respect of Funds Transfer Sharing Limited;
g) certain rights and liabilities of DBS in respect of shares held by shareholding members;
h) all rights and liabilities in respect of tax;
i) all rights, obligations and liabilities under or in respect of the DBS pension scheme;

The above listing is not exhaustive but sets out materially the essence of the PTI.

Certain other assets and liabilities were also transferred to Bridge Bank as part of the second PTI as follows:

a) All property, rights and liabilities in respect of the housing association loans together with the related housing association.

b) All property, rights and liabilities in respect of any customer databases owned by DBS relating exclusively to the property, rights and liabilities referred to above.

Appendix 3

Administrators' cumulative receipts and payments accounts to 29 March 2010

Administration cumulative receipts and payments account to 29 March 2010

	30/03/2009 to 29/09/2009	30/09/2009 to 29/03/2010	30/03/2009 to 29/03/2010
Receipts	**£'000**	**£'000**	**£'000**
Treasury assets (interest)	1,202	1,498	2,700
Treasury assets (capital)	37,085	19,899	56,984
Commercial portfolio realisations (interest)	10,800	9,483	20,283
Commercial portfolio realisations (capital)	16,969	16,865	33,834
Retail portfolio realisations (interest)	3,487	3,130	6,617
Retail portfolio realisations (capital)	5,519	5,915	11,434
Equity release funds received	641	2,429	3,070
Bank interest	18	241	259
Tax refund	510	3,037	3,547
Commercial Deposits (held on behalf of depositors)	374	894	1,268
Timing differences re NBS	(71)	71	0
Bridge Bank resolution fund	0	356,552	356,552
Total receipts	**76,534**	**420,014**	**496,548**
Payments			
Drawdown payments (Commercial)	(3,701)	(765)	(4,466)
Drawdown payments & servicing costs (equity release)	(742)	(266)	(1,008)
Swap closure costs	(4,506)	0	(4,506)
Servicing costs	(660)	(708)	(1,368)
Agents fees to be charged to customers	(137)	(589)	(726)
Administrators' fees	(4,478)	(4,957)	(9,435)
Administrators' disbursements	(122)	(160)	(282)
Legal costs	(699)	(1,006)	(1,705)
Agents fees and other administrative costs	(153)	(444)	(597)
Irrecoverable VAT	(828)	(1,003)	(1,831)
Force majeure payments to unsecured creditors	(282)	0	(282)
Total payments	**(16,308)**	**(9,898)**	**(26,206)**
Net funds in hand	**60,226**	**410,116**	**470,342**
Less: Monies due to depositors	(374)	(894)	(1,268)
	59,852	**409,222**	**469,074**

Appendix 4

Joint Administrators' time costs to 29 January 2010.

Statement of Insolvency Practice 9: summary of Administrators' time costs for the period to 29 January 2010

	Breakdown of hours charged by grade					
	Partner/ Director	**Manager**	**Administrator/Support**	**Total hours**	**Time cost**	**Average hourly rate**
Accounting & Administration	401.5	1,163.0	1,241.6	2,806.1	£997,193.00	£355.37
Bank & Statutory Reporting	322.8	413.5	625.9	1,362.1	£521,863.00	£383.13
Business separation and migration	160.7	4,130.4	2,825.9	7,116.9	£2,737,276.20	£384.62
Commercial portfolio	51.0	2,509.4	3,667.3	6,227.6	£2,055,822.50	£330.11
Creditors and claims	109.7	53.1	134.5	297.3	£115,637.00	£389.02
Equity Release portfolio	130.8	297.0	514.0	941.8	£347,018.0	£368.46
Investigations and CDDA	6.5	15.0	0.5	22.0	£9,170.00	£416.82
IT Security	0.6	263.4	0.0	264.0	£111,181.60	£421.21
Other asset realisation	522.6	183.0	21.7	727.3	£386,570.50	£531.51
Pension and other employee matters	213.1	75.2	186.1	474.4	£200,075.50	£421.74
Retail portfolio	43.6	701.5	2,272.4	3,017.5	£943,470.00	£312.67
Statutory and compliance	398.0	345.0	185.0	928.0	£417,435.50	£449.85
Trading	90.1	44.5	371.0	505.6	£167,654.00	£331.59
Treasury	128.0	231.0	141.8	500.8	£197,492.50	£394.35
VAT & Taxation	84.3	207.7	390.0	682.0	£227,223.00	£333.20
Total in period	**2,663.10**	**10,632.58**	**12,577.45**	**25,873.13**	**£9,435,082.30**	**£364.67**