12-17-2009

State Aid N 677/2009 - United Kingdom Prolongation of the Financial Support Measures to the Banking Industry in the United Kingdom

European Commission
Subject: State Aid N 677/2009 - United Kingdom
Prolongation of the Financial Support Measures to the Banking Industry in the United Kingdom

Sir,

I. Procedure

(1) On 4 December 2009 the UK notified a prolongation of its support measures to the banking industry.

(2) The original measures, designed to ensure the stability of the financial system, were notified on 12 October 2008 and approved on 13 October 2008. On 18 December 2008, the UK notified amendments of the measures which were approved on 23 December 2008. On 27 March 2009, the UK notified a prolongation until 13 October 2009 which was approved on 15 April 2009. On 1 October 2009 the UK notified a second prolongation until 31 December 2009 which was approved on 13 October 2009.

II. Description

2.1 The original support measures

(3) In response to the exceptional turbulence in world financial markets, the UK brought forward a package of measures designed to restore stability to the financial system.

---

2 State Aid N 650/2008 "Modification to the Financial Support Measure to the Banking Industry in the UK", OJ C 54, 7.3.2009, p. 3.
4 State Aid N 537/2009 "Prolongation of the Financial Support Measures to the Banking Industry in the UK", not yet published.
and to remedy a serious disturbance to the economy of the UK. The purpose of these measures is to restore confidence and encourage healthy inter-bank lending, through the provision of liquidity, the recapitalisation of the financial sector and provision of a State guarantee to new debt issuance.

(4) The measures comprise the Bank Recapitalisation Scheme ("the Recapitalisation Scheme") and the Wholesale Funding Guarantee Scheme ("Credit Guarantee Scheme" or "CGS"). Details on the measures are provided in the Commission's earlier decisions. The Recapitalisation Scheme and CGS are referred to jointly in this decision as "the Schemes".

2.2 Reports on the operation of the Schemes

(5) The UK has undertaken to report every six months on the operation of the Schemes. Such reports have been submitted with the notification.

2.2.1 The Credit Guarantee Scheme

(6) The UK has provided a report on the operation of the CGS in the period from 13 October 2009 to 27 November 2009. This report demonstrates that Government-guaranteed debt of approximately £133.014 billion (approx. EUR 146.33 billion) was issued in the market as at 27 November 2009, which is up only slightly from £132.703 billion (approx. EUR 145.99 billion) at the time of the previous report (10 September 2009). In essence, a reduction of around [...] in guaranteed issuance by Lloyds Banking Group (LBG) has been offset by the expected issuance by smaller institutions and also an increase of CGS-guaranteed debt by Royal Bank of Scotland (RBS) of around [...]. RBS' overall use of the scheme has fallen from a peak of [...] earlier in the year (May 2009) to [...]. As short-dated paper issued in the first few days of the scheme is expiring, the overall maturities' structure continues to shift to longer dated notes, reflecting a positive development towards a desire for a longer-dated funding portfolio seen in the market more generally. Since 13 October 2009 no CGS-guaranteed debt has been issued by any of the large financial institutions that are not currently subject to lending commitments.

(7) The UK reports that, since the last prolongation of the CGS, there have been encouraging signs of renewed activity in the wholesale markets. However, this recovery, where it exists, remains fragile. While markets have recovered somewhat in qualitative terms, they have not yet recovered in the quantity necessary to service all of wholesale funding requirements. Moreover, markets remain susceptible to sudden shocks.

(8) The UK also submits that the ceiling on guaranteed issue of £250 billion (approx. EUR 275.03-billion) remains appropriate. £133.014 billion (approx. EUR 146.33 billion) of guaranteed debt is currently issued and, according to the UK, it is appropriate to retain a buffer against the likelihood of increased use of credit guarantees by smaller banks and building societies. The UK submits that the buffer also presents an appropriate and proportionate contingency against unanticipated

* Confidential information
events requiring major institutions that do not yet issue guaranteed debt to participate in the CGS.

2.2.2 The Recapitalisation Scheme

(9) The Recapitalisation Scheme provides a cash facility of up to £50 billion (approx. EUR 55.01 billion) to support eligible institutions in the form of preference shares, permanent interest-bearing shares or to assist in raising ordinary equity.

(10) No capitalisations (or repayment of capital) were undertaken between 13 October and 2 December 2009, when the notified measure was submitted. The participation of HM Treasury in rights issues of LBG and RBS has been separately notified to the Commission.

2.3 The notified measure

(11) The UK reports that the recovery in the wholesale markets remains fragile and patchy. The UK thus submits that the State guarantees and the recapitalisation facility which have as their objectives the maintenance of market confidence and the encouragement of healthy inter-bank lending will need to continue until 28 February 2010. The UK has submitted a letter from the Bank of England which endorses the need for the extension of the Schemes.

(12) The UK consequently wishes to extend the drawdown window of the Schemes from 1 January 2010 to 28 February 2010⁵.

III. Position of the UK

(13) The UK authorities have notified the extension of the drawdown window of the Schemes as State aid within the meaning of Article 107(3)(b) Treaty on the Functioning of the European Union (TFEU)⁶.

(14) The UK authorities consider that in view of the fragility of the emerging recovery in the financial markets it is necessary to prolong the schemes for a further two-month period from 1 January 2010 to 28 February 2010. The UK consequently considers that the notified extension of the Schemes remains compatible with the common market pursuant to Article 107(3)(b) TFEU as aid to remedy the continuing serious disturbance in the economy of the United Kingdom. The UK argues that the extension strikes the correct balance between maximising the impact of the Schemes on financial and wider economic stability while ensuring they do not crowd out market-based lending now or when better market conditions return.


---

⁵ The UK stress that this notification is without prejudice to a possible further extension, the necessity of which is currently under assessment.

⁶ With effect from 1 December 2009, Articles 87 and 88 of the EC Treaty have become Articles 107 and 108, respectively, of the Treaty on the Functioning of the European Union. The two sets of provisions are, in substance, identical. For the purposes of this Decision, references to Articles 107 and 108 of the TFEU should be understood as references to Articles 87 and 88, respectively, of the EC Treaty where appropriate.
The UK authorities have confirmed that during the two-month extension they will only guarantee the wholesale funding obligations of an eligible institution or provide capital under the recapitalisation scheme where they are reasonably satisfied that market conditions at the time of the request are such that the institution concerned is unable to effectively access funding or capital in the financial markets, either because the funding or capital requirements cannot be met at all, or can only be met on terms that would be unsustainable for the institution.

The UK authorities have confirmed that during the two-month extension there will be

(a) a limit on new issuance of CGS-guaranteed debt by RBS of [...];
(b) a limit on new issuance of CGS-guaranteed debt by Northern Rock plc of [...];
(c) no new issuance of CGS-guaranteed debt by LBG.

The UK authorities have committed to include in the reports also recent data on the cost of comparable (nature, volume, rating, currency, etc) non-guaranteed and guaranteed debt issuances.

IV. Assessment

4.1 Existence of State aid

As set out in Article 107(1) TFEU 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 shall, in so far as it affects trade between Member States, be incompatible with the internal market, save as otherwise provided.

For the reasons indicated in its decisions in the above-mentioned cases N 507/2008, N 650/2008, N 193/2009 and N 537/2009, the Commission considers that the Schemes constitute State aid. The notified prolongation and additional commitments do not affect that finding. The Schemes, with the notified changes, remain State aid within the meaning of Article 107(1) TFEU.

4.2 Compatibility of the Schemes

For reasons indicated in the original decision⁸ and reiterated in the subsequent decisions, the Commission found the Schemes to be compatible with the internal market under Article 107(3)(b) TFEU, as they met the relevant criteria of appropriateness, necessity and proportionality.

Given that the notified extension and additional commitments make no change to the substance of the Schemes, it is only necessary to assess whether the finding of compatibility holds true also of in view of the extension of the Schemes’ validity and the additional commitments provided by the UK.

---

⁷ “New guaranteed debt” in this paragraph excludes rolled over CGS guaranteed debt.
⁸ N 507/2008, mentioned above.
(23) The Commission acknowledges that the global financial crisis is still ongoing and accepts that the functioning of the UK financial system remains seriously affected. The Commission further accepts that this is liable to cause a serious disturbance to the UK economy and that the Schemes are necessary to remedy this. As markets are unlikely to have returned to normal before the end of 2009, the Commission considers that the contemplated prolongation from 1 January 2010 to 28 February 2010 is appropriate and necessary to remedy this situation.

(24) Furthermore, the Commission notes that the extension is limited in time to two months which will limit the potential distortion of competition. In addition, the Commission positively notes the tightening of the conditions for accessing the schemes, as stated in point 16, and the additional commitment to set limits on new issuances of CGS guaranteed debt by RBS and Northern Rock plc and also the additional commitment that there will be no new issuance of CGS guaranteed debt by LBG as stated in point 17 of this decision. Any further extension will require the Commission’s approval and will have to be based on a review of the developments in financial markets and the Schemes’ effectiveness. This change is therefore proportionate to the purpose of the Schemes.

(25) In assessing the request for the prolongation of this guarantee scheme, the Commission has to balance its positive effects for financial stability with the distortions of competition and the delay in the return to a normal functioning of the financial markets that the prolongation entails. Guarantee schemes should contain minimum exit incentives, and a gradual alignment to market conditions should take place in order to minimise negative spill-over effects on competitors and other Member States.

(26) The evolution of the market situation and the reduction of the risk premia for unguaranteed debt has brought about a first step towards an alignment with market conditions, whilst providing an exit incentive for the sounder institutions. While more convergence towards market conditions may be necessary to further reduce distortions across banks in the internal market and avoid the risk of State aid dependence, the still fragile recovery suggests that banks should retain for the time being the possibility of accessing government guarantees schemes under the present conditions.

(27) On balance, the Commission considers that the prolongation of the State guarantee scheme under the present conditions is compatible with the internal market.

(28) The Commission recalls that, as indicated in the Annex to the Restructuring Communication, any restructuring plan should contain all State aid received as individual aid or under a scheme during the restructuring period and all such aid needs to be justified as satisfying all criteria prescribed by the Restructuring Communication (i.e. return to viability, own contribution by the beneficiary and limitation of competition distortion). Accordingly, once a Member State is under an obligation to submit a restructuring plan for a certain aid beneficiary, the Commission needs to take a view in its final decision as to whether any aid granted

---

9 OJ C 195, 19.08.2009
10 Point 8 of the Restructuring Communication.
during the restructuring period satisfies the criteria required for the authorisation of restructuring aid\textsuperscript{11}. To this end an individual \textit{ex ante} notification is necessary.

(29) The Commission furthermore recalls that according to paragraph 16 of the Restructuring Communication, if aid not initially foreseen in a notified restructuring plan is necessary for the restoration of viability, this additional aid cannot be granted under an approved scheme but needs to be subject to individual \textit{ex ante} notification and any such further aid will be taken into account in the Commission’s final decision on that bank.

(30) The Commission consequently finds that the notified changes to the Schemes are compatible with the internal market under Article 107(3)(b)TFEU.

V. Conclusion

The Commission finds that the Schemes constitute State aid within the meaning of Article 107(1) TFEU.

Since the Schemes satisfy the conditions for aid under Article 107(3)(b) TFEU, they are compatible with the internal market. The Commission has accordingly decided not to raise any objections to the prolongation of the Schemes from 1 January 2010 until 28 February 2010 included.

If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://ec.europa.eu/community_law/state_aids/state_aids_texts_en.htm.

Your request specifying the relevant information should be sent by registered letter or fax to:

European Commission  
Directorate-General for Competition  
State Aid Greffe  
rue Joseph II, 70  
B-1049 Brussels  
Fax No: +32-2-296 12 42

Yours faithfully,  
For the Commission

\textsuperscript{11} See Decision of 18 November 2009, \textit{Restructuring of Lloyds Banking Group}, point 197.