



EUROPEAN COMMISSION

Brussels, 14.12.2009
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**Subject: State aid No N 422/2009 and N 621/2009 - United Kingdom
Restructuring of Royal Bank of Scotland following its recapitalisation by
the State and its participation in the Asset Protection Scheme**

Sir,

1 PROCEDURE

- (1) By decision of 13 October 2008, the Commission approved a package of financial support measures to the banking industry in the UK (State aid case N 507/2008)¹. Modifications to this scheme were approved on 22 December 2008 (State aid case N 650/2008)².
- (2) These decisions permitted the UK to implement a recapitalisation scheme, as well as a guarantee facility, for financial institutions, subject to several conditions. The Royal Bank of Scotland (hereinafter RBS) was recapitalised, on 1 December 2008, under the terms of this scheme.
- (3) On 26 February 2009, the UK authorities and RBS announced the bank's intended participation in the Asset Protection Scheme (APS) and the associated recapitalisation of the group by the State³.

¹ OJ C 290, 13.11.2008, p.4.

² OJ C 54, 7.3.2009, p.3.

³ http://www.hm-treasury.gov.uk/press_19_09.htm
<http://www.investors.rbs.com/news/releasedetail.cfm?ReleaseID=367753>

The Rt Hon David MILIBAND
Secretary of State for Foreign Affairs
Foreign and Commonwealth Office
King Charles Street
London SW1A 2AH
United Kingdom

- (4) Following various meetings and telephone conferences between representatives of the Commission, the UK authorities and RBS, the UK submitted a restructuring plan of RBS on 2 June 2009, as required under the terms of the recapitalisation scheme.
- (5) On 10 November 2009, the UK authorities notified an amended RBS aid package⁴.
- (6) On 24 November 2009 the Bank of England (BoE) announced publicly that in the period from October to December 2008 it had extended a Liquidity Assistance (LA) to RBS. On 25 and 26 November 2009 the UK authorities submitted to the Commission more detailed information in this respect.
- (7) Following various exchanges with the Commission and the UK authorities up to 9 December 2009, RBS, in agreement with the UK authorities, and the UK authorities themselves made a number of commitments in a letter dated of 9 December 2009 as regards the implementation of the restructuring plan.

2 DESCRIPTION

2.1 THE BENEFICIARY

- (8) Based in Edinburgh, the Royal Bank of Scotland Group PLC is one of the largest financial services groups in Europe and in the world, with over 40 million private, corporate and institutional customers in 57 countries, a total balance sheet of £2,219 billion⁵ and total risk weighed assets (RWA) of £577.8 billion at the end of 2008. Its main operating subsidiaries are Royal Bank of Scotland and NatWest. Other subsidiaries include Citizens Financial Group (CFG) in the United-States of America (USA), RBS Insurance, Coutts, Ulster Bank Group in Ireland, and Greenwich Capital.
- (9) Since its acquisition in 2000 of NatWest, together with Ulster Bank and Greenwich Capital, RBS has pursued its strategy of external growth with the acquisition in 2004 of Charter One in the USA, and ABN AMRO in 2007 (as part of the three-bank consortium that acquired ABN AMRO)⁶.
- (10) In the UK, RBS enjoys leading positions in a number of markets, including corporate and SME banking, current accounts, merchant acquiring and car insurance. In corporate banking, RBS is the leading brand in England and Wales

⁴ The new RBS aid package was announced on 3 November 2009: http://www.hm-treasury.gov.uk/press_99_09.htm

⁵ In the present decision, the Commission uses the pro-forma results published by RBS in its annual report and accounts for 2008, and interim management statement of Q1 2009. Although the statutory results, including RFS Holdings (RFS Holdings is a vehicle jointly owned by RBS, the Netherlands and Santander, which was used to complete the acquisition of ABN AMRO), represent the audited figures of the Group, the Commission considers that the use of pro-forma figures, which include only those business units of ABN AMRO to be retained by RBS after the forthcoming split of RFS Holding, better reflect the real state of RBS. The audited results cover the entire RFS Holding, including the parts which will be transferred to the Netherlands and Santander.

⁶ In the wake of the split of RFS Holding RBS will retain the following ABN AMRO business units: continuing businesses of Business Unit North America; Business Unit Global Clients and wholesale clients in the Netherlands (including former Dutch wholesale clients) and Latin America (excluding Brazil); Business Unit Asia (excluding Saudi Hollandi); and Business Unit Europe (excluding Antonveneta).

and Scotland. In the USA, RBS has grown to become the tenth largest commercial banking group based on deposits. RBS Greenwich Capital is among the principal suppliers of corporate finance and debt capital markets services across the USA. In Europe, Ulster Bank is a leading player in retail and corporate banking across the island of Ireland. With the acquisition of ABN AMRO, RBS's Global Banking and Markets (GBM) is a leading player in Europe in terms of relationships with large corporates and financial institutions. In Asia, RBS has grown both organically and externally, with its partnership with the Bank of China in 2005, and the acquisition of ABN AMRO enhancing its presence in this region.

- (11) Key pro forma figures⁷ for year end 2008 and 2007 are summarized in the following table:

	2008	2007
Total income (GBP bn)	21,2	32,3
Loss / profit attributable to ordinary shareholders (GBP bn)	(24,1)	6,8
Total assets (GBP bn)	2.218,7	1.595,1
Risk-weighted assets (GBP bn)	577,8	486,1
Tier 1 capital ratio ⁸ (in%)	9,9	7
Total capital ratio (in%)	14,2	11,3
Total loans / customer deposits (in%)	152,3	129

2.2 BUSINESS ACTIVITIES

- (12) The RBS group's ("the group") organisational structure was changed in February 2008, following the acquisition of ABN AMRO, and is organised in the following business divisions: (i) Global Markets, (ii) Regional Markets, and (iii) RBS Insurance. Two additional divisions, Group Manufacturing and the Centre, serve the group.
- (13) Global Markets comprises Global Banking and Markets (GBM) and Global Transaction Services (GTS). Global Markets has as main customers large businesses and financial institutions in the UK, in Europe and globally. GBM is organised around four main businesses: (i) rates, currencies and commodities⁹, (ii) equities¹⁰, (iii) credit markets¹¹, and (iv) asset and portfolio management. GTS ranks among the top five global transaction services providers, offering global payments, cash and liquidity management, as well as trade finance, United Kingdom and international merchant acquiring and commercial card products and

⁷ RBS Group Annual Report and Accounts 2008, p.35 & 36

⁸ The year end 2008 Core Tier 1 and total capital ratio include the £20 billion recapitalisation from the State.

⁹ This activity covers risk management, sales and trading in a broad range of asset classes, currencies and jurisdictions.

¹⁰ This activity covers the origination, trading and distribution of cash and derivative products.

¹¹ This activity covers the origination, trading and distribution of a broad product range that includes corporate and structured debt instruments, financial institutions, leveraged finance, real estate and project finance.

services. It includes the group's corporate money transmission activities in the United Kingdom and the USA. This division mainly operates through RBS and RBS Greenwich Capital.

- (14) Regional Markets is organised around the provision of retail and commercial banking to customers in four regions: (i) the United Kingdom, (ii) the USA, (iii) Europe (outside the UK) and the Middle East, and (iv) Asia. This division also includes the provision of wealth management services.
- (15) UK Retail & Commercial Banking (RBS UK) comprises retail, corporate and commercial banking and wealth management services. It operates through a range of channels including on-line and fixed and mobile telephony, and through two of the largest networks of branches and ATMs in the UK. In the retail market, RBS UK serves over 15 million personal customers through the RBS and NatWest brands. It offers a full range of banking products and related financial services including mortgages, bancassurance products, deposit accounts, and credit and charge cards. RBS UK holds a leading market share in business¹² and commercial¹³ banking (together referred to as SME banking) and in corporate banking. Through its network of relationship managers it distributes a full range of banking, finance and risk management services, including market-leading invoice finance and asset finance offerings. The UK wealth management arm offers private banking and investment services through the Coutts, Adam & Company, RBS International and NatWest Offshore brands.
- (16) US Retail & Commercial Banking provides financial services primarily through the Citizens and Charter One brands. Citizens is engaged in retail and corporate banking activities through its branch network in 12 states in the USA and through non-branch offices in other states. Citizens was ranked the tenth-largest commercial banking organisation in the USA based on deposits as at 30 September 2008.
- (17) Europe & Middle East Retail & Commercial Banking comprises Ulster Bank and the group's combined retail and commercial businesses in Europe and the Middle East. Ulster Bank provides a comprehensive range of financial services across the island of Ireland. Its retail banking arm has a network of branches and operates in the personal, commercial and wealth management sectors, while its corporate markets operations provide services in the corporate and institutional markets.
- (18) Asia Retail & Commercial Banking is present in markets including India, Pakistan, China, Taiwan, Hong Kong, Indonesia, Malaysia and Singapore. It provides financial services across four segments: affluent banking, cards and consumer finance, business banking and international wealth management, which offers private banking and investment services to clients in selected markets through the RBS Coutts brand.
- (19) RBS Insurance sells and underwrites retail and SME insurance over the telephone and internet, as well as through brokers and partnerships. Its brands include Direct Line, Churchill, Privilege, Green Flag and NIG. Through its international division, RBS Insurance sells general insurance, mainly motor, in Spain,

¹² Firms with a turnover up to £1 million.

¹³ Firms with a turnover between £1 million and £25 million.

Germany and Italy. The Intermediary and Broker division sells general insurance products through independent brokers.

- (20) Group Manufacturing comprises the group's worldwide manufacturing operations. It supports the customer facing businesses and provides operational technology, customer support in telephony, account management, lending and money transmission, global purchasing, property and other services.
- (21) The Centre comprises group and corporate functions, such as capital raising, finance, risk management, legal, communications and human resources. The Centre manages the group's capital resources and group-wide regulatory projects and provides services to the operating divisions.
- (22) Income figures per division are summarized in the following table:

In £ billion	2008
UK Retail and Commercial	10.8
Of which	
UK Retail	6.7
UK Commercial	3.2
UK Wealth	0.9
US Retail and Commercial	3.0
Europe and Middle East Retail and Commercial	1.5
Asia Retail and Commercial	0.8
Insurance	5.6
Global Banking and Markets	4.4
Global Transaction Services	2.5
Centre & other	(1.9)
Underlying Income	26.7 ¹⁴

2.3 THE DIFFICULTIES OF THE COMPANY

- (23) The deterioration of the global financial system, which started mid-2007 significantly accelerated after the bankruptcy filing by Lehman Brothers in September 2008. This led to severe dislocation of financial markets and unprecedented levels of illiquidity, to which RBS was particularly exposed.
- (24) RBS took a series of steps during 2008 to restore its capital base. A capital raising was carried out in the spring which involved a £12 billion rights issue. It was completed in June 2008. RBS also made two material disposals during 2008, with the sale of Angel Trains Group and its 50% interest in the Tesco Personal Finance JV.

¹⁴ Net of Bancassurance claims, excludes £7 billion of credit market write-downs and one off items, and includes £5.8 billion of other trading asset write-downs.

- (25) Despite such measures, RBS reported at the end of 2008 a £24 billion net loss, of which £16.2 billion were related to the write-down of the goodwill of the ABN AMRO acquisition¹⁵ and of other intangible assets. In the first half of 2009, the group posted an additional net loss of £1 billion, with impairments rising across the group to £7.5 billion¹⁶.
- (26) When the current global financial and economic crisis unfolded, RBS was heavily exposed because of the combination of :
- Its recent history of high-risk banking, embodied by a rapidly growing balance sheet¹⁷, relying to a significant extent on wholesale funding, with large single name loan exposures and higher risk portfolio of loans and structured/securitized assets;
 - The acquisition of the wholesale activities of ABN AMRO that further weakened RBS's position and generated large losses in 2008.
 - RBS's strategy was primarily orientated at achieving growth and was deliberately opportunistic in seeking growth opportunities, with a prioritisation of absolute profit rather than risk adjusted returns.
- (27) Regarding its loan portfolio, RBS had made aggressive use of its balance sheet, for example by underwriting significant portions of loans, which left it sometimes with large exposures to single names. RBS indicated that its non performing loans rose to 3.5% in the first quarter of 2009, compared with 1.4% a year earlier and an average ratio historically ranging between 2% and 3%. RBS also has a large exposure to property and construction loans (18% of its loan exposure), which are expected to[...]*. In 2008 and in the half year 2009 results, RBS showed impairment losses of respectively £7.4 billion and £7.5 billion.
- (28) In 2008, RBS also recorded market related write-downs of £13.1 billion, comprising credit market write-downs of £7.7 billion (asset backed securities, collateralized debt obligations, monoline exposures, US residential mortgage-backed securities, leveraged loans, etc) and trading asset write-downs of £5.8 billion (structured credit assets, exposure to Lehman Brothers, Icelandic banks, Madoff, etc).
- (29) From a funding and liquidity position, RBS has a relatively high loan-to-deposit ratio (around 150%), which indicates its reliance on wholesale funding¹⁸ to

¹⁵ In October 2007, RBS completed the joint acquisition, together with Fortis and Santander, of ABN AMRO, for a total transaction amount of approximately EUR 70 billion, of which 94% was paid in cash with the balance paid with new RBS shares. The consortium paid three times the book value, even though the liquidity crunch started to hit in the summer of 2007. In addition to the integration challenges faced by RBS, the overall acquisition of ABN AMRO left RBS less well positioned from a solvency and a liquidity perspective to deal with the changed market context in 2008. It effectively led to a doubling of trading asset and credit market-related write-downs, not to mention the goodwill impairment charge of £16 billion which, in addition to the acquisition of ABN AMRO, related also to the acquisition of Charter One in the USA in 2004.

¹⁶ RBS Interim Results for the half year ended 30 June 2009.

¹⁷ As at 1 January 2008 RBS's Core Tier 1 ratio stood at 4% and the multiple of tangible assets to tangible equity was 77 times.

* Covered by the obligation of professional secrecy.

¹⁸ In 2008 RBS was reliant on £343 billion of unsecured wholesale funding under one year duration.

finance its balance sheet. This ratio also increased because of the acquisition of ABN AMRO's wholesale banking business. RBS suffered from significant (mostly wholesale) funding outflows in October 2008, which largely recovered after the government rescue.

- (30) Furthermore, based on the information available at the time of the present decision, RBS's exposure to losses on account of the difficulties faced by Dubai World amounts to \$[...]. However, RBS believes that while \$[...] represents the totality of exposure to Dubai World, any losses incurred by RBS are likely to be less given that there remains considerable uncertainty about the scale of losses that might materialise.

2.4 THE AID MEASURES IN FAVOUR OF RBS

2.4.1 The Capital injections

- (31) On 12 October 2008 the UK notified a package of measures designed to ensure the stability of the UK financial system. The proposed measures fell into two parts:

- A. Bank Recapitalisation Scheme (hereinafter "the Recapitalisation Scheme"): Making available new Tier 1 capital for banks and building societies to strengthen their balance sheets and allow them to restructure their finances, while maintaining their support for the economy as a whole.
- B. Wholesale Funding Guarantee Scheme (hereinafter "the Guarantee Scheme"): Providing a State guarantee for short- and medium-term debt designed to reopen the market for short-and medium-term wholesale funding.

- (32) The UK schemes were approved by the Commission in its decision of 13 October 2008¹⁹.
- (33) RBS's recapitalisation was announced on 13 October 2008²⁰ and completed, in the form of both ordinary shares and preference shares, on 1 December 2008. It was done in the framework of the UK Recapitalisation Scheme. According to the terms of the scheme, the State would subscribe to ordinary shares at a discount to share price immediately prior to the announcement of the transaction, while it would subscribe to preference shares with an interest rate of 12%.
- (34) The State injected approximately £15 billion into RBS through the acquisition of ordinary shares. This gave it a 58% stake in the company. On the same day it subscribed to £5 billion of preference shares.

¹⁹ State aid N 507/2008 "Financial Support Measure to the Banking Industry in the UK", OJ C 290, 13.11.2008, p. 4. The amendments to the scheme were introduced and approved by the Commission's decision State aid N 650/2008 "Modification of the Financial Support Measure to the Banking Industry in the UK, OJ C 54, 7.3.2009, p. 3. The prolongation of the scheme was first approved by the Commission decision N 193/2009, OJ C 145, 25.6.2009 p.3 (until 13 October 2009) and then by the Commission decision of 13 October 2009 State aid N 537/2009 – until the end of 2009 (not yet published).

²⁰ http://www.hm-treasury.gov.uk/press_105_08.htm
<http://www.investors.rbs.com/news/releasedetail.cfm?ReleaseID=339926>

- (35) On 19 January 2009, following the announcement of further losses by RBS, the State made public its intention to convert its preference shares into ordinary shares. As a result, the State now owns approximately 70% of RBS²¹.
- (36) On 26 February 2009 the UK authorities and RBS²² announced a new aid package in respect of RBS.
- (37) An amended aid package was announced on 3 November 2009 which includes an up-front recapitalisation of £25.5 billion, and a five year contingent commitment to subscribe for a additional £8 billion of capital²³ in B shares in the event that RBS's Core Tier 1 capital ratio falls below 5%.
- (38) The proposed up-front recapitalisation will come in the form of B shares. The B shares are non-voting Core Tier 1 capital. They rank pari-passu with ordinary shares in a winding down and for the payment of dividends and they count as Core Tier 1 for regulatory capital purpose. Their issue price is 50 pence. B shares are convertible one-for-one into ordinary shares at any time at HM Treasury's discretion. In total, after the £25.5 billion recapitalisation, the State will have a 84% economic ownership of RBS. The full drawing under the £8 billion contingent recapitalisation would bring the State's holding of RBS economic interest to 86%²⁴.
- (39) The terms of the B shares stipulate that the B shares may be bought back at any time at RBS's option subject to an agreement on price with HM Treasury. However, HM Treasury has made a commitment to the Commission that should RBS request to buyback any B shares, HM Treasury would not agree to it unless the re-purchase price per share is equal to or larger than the greater of (i) 100% of the original issue price in the first three years, 110% in year 4, 120% in year 5 and 130% in year 6 and beyond, and (ii) the stock market price.
- (40) Similarly the terms of the B shares stipulate that the remuneration of the B shares is equal to the dividend paid on ordinary shares²⁵. However in conjunction with the issue of B shares, HM Treasury will be receive one single global "dividend access share". The dividend access share carries a discretionary coupon equal to the higher of (i) 7% of the total issue price of the B shares and (ii) 250% of the ordinary share dividend multiplied by the number of B shares issued to HM Treasury. The dividend access share will receive the above coupon up until the ordinary share price reaches at least 65p on 20 trading days of any 30 day trading period. This dividend is discretionary. If paid, it will be paid regardless of whether part or all of the B shares issued to the State have been converted into ordinary shares and regardless of whether the State still holds any of those converted B shares. Once the price target has been hit, the above dividend will no longer be paid under the dividend access share and the B shares will receive the ordinary share dividend. This mechanism aims at encouraging the conversion of B shares into ordinary shares if the ordinary share price reaches 65p.

²¹ http://www.hm-treasury.gov.uk/press_06_09.htm

²² See footnote 3

²³ The contingent capital will be effected through B shares in several tranches.

²⁴ This does not take into account any B shares issued as fee payment under the APS.

²⁵ The terms of the B shares need to be as close as possible to that of ordinary shares to be viewed as Core Tier 1 capital by the supervisory authority.

- (41) The increase in the first-loss position in the APS (as described in paragraphs (45) and (173) below) also triggered the need for a £8 billion contingent recapitalisation. Such contingent recapitalisation takes the form of an option agreement under which RBS can require HM Treasury to subscribe B shares for an amount up to £8 billion following a trigger event at any time for a period of 5 years. The trigger event is the fall of the Core Tier 1 ratio of RBS below 5%. The terms of the B shares so issued are identical to those described in the foregoing paragraphs. The State, as seller of the option, will receive a remuneration of 4% per annum that can be paid either in cash, B shares or deferred tax assets. The option agreement may be terminated at any time subject to supervisory approval.

2.4.2 *The participation in the impaired assets relief measure*

- (42) The APS is an unfunded guarantee scheme under which the UK government commits to cover 90% of the losses in excess of an initial amount ("the first-loss position") arising from a defined portfolio of assets. The first-loss is to be borne by RBS which is also supposed to support 10% of the additional losses on the covered portfolio. In exchange for this cover, RBS commits (among other things) to pay a fee and to lend to the real economy at agreed levels on commercial terms.
- (43) The main purpose of the measure is to provide a degree of certainty on the amount of future impairments the group might suffer on a portfolio of a wide range of financial assets. Covered assets include in particular corporate and leveraged loans, commercial and residential property loans and structured credit assets and must have been and continue to be economically owned by the bank by 31 December 2008. The scheme covers only the credit risk²⁶ of these assets (i.e. the risk of loss as a result of failure of a counterparty to meet its contractual obligations). Whilst the assets will remain on the bank's balance sheet, safeguards have been put in place so that actions in relation to them will be subject to Treasury controls.
- (44) The specific terms for RBS were initially announced in February 2009²⁷. Following that announcement, extensive due diligence and valuation work was performed by a number of experts using different methodologies to assess the long-term expected credit losses on the portfolio. [...].
- (45) This led the HM Treasury and RBS to adjust the terms of the bank's participation in the APS as follows: the size of the portfolio of covered assets was reduced to £281 billion, the first-loss position was increased to £60 billion (21% of the portfolio notional amount). The fee was converted into an annual fee of £700 million per annum for the first three years reducing to £500 million thereafter for the life of the scheme with a minimum total cumulative fee of £2.5 billion. The original £6.5 billion upfront fee which was planned to be paid in B shares (hence consisting also in a recapitalisation) was converted into a full-fledged recapitalisation as described under recital (37) above.

²⁶ Trigger events are defined as Failure To Pay, Bankruptcy and Restructuring (event leading to an accounting impairment).

²⁷ The terms of the aid package announced in February 2009 were the following: (i) the participation in the Asset Protection Scheme covering £325 billion of impaired assets, with a first-loss piece of £42.2 billion borne by the bank, (ii) a fee to be paid by the company set at £6.5 billion (to be funded by way of B shares to HM Treasury), (iii) an additional up-front capital injection of £13 billion, with an optional capital injection of £6 billion, and (iv) a commitment to forego certain tax allowances.

Exposures (GBP billion)	Reduced Pool
Retail Products	13.4
Residential Mortgages	15.1
Corporate Lending	123.4
Asset Based Finance	14.9
Commercial Real Estate	61.2
Fund Loans	3.3
Securities	40.9
Derivatives	18.6
Total	290.8
Further Asset Exclusions	-9.2
Total	281.6

- (46) The new £281 billion portfolio has not substantially changed in nature and still contains the same number of asset classes. An amount of £[between 15 and 25] billion of losses has already been recognised on this portfolio. Additional impairments of £[between 5 and 15] billion are expected for 2009.
- (47) From a regulatory perspective, in order to determine the impact of the APS on the bank's regulatory capital, both the amount of already incurred losses and of provisions for impairments may be deducted from the first-loss piece, as they reduce the bank's capital whether or not it participates in the APS. From a regulatory point of view, in case of participation in the APS, the unused part of the first-loss has to be fully deducted from capital. This deduction stands at £[between 20 and 30] billion. The capital deduction of this amount, together with the capital requirements necessary to cover the 10% of losses in excess of the first-loss (to be also covered by RBS), means that the participation in the APS will not improve the current capital ratio of the group²⁸.
- (48) The updated terms of RBS's participation in the APS also include an exit fee. If no indemnification has been paid by the State, RBS may terminate its participation at any time by paying a minimum exit fee equal to the greater of (i) £2.5 billion and (ii) 10% of actual capital relief obtained through the scheme (taking into all previous annual fee payments paid by RBS). If payments have been made, termination of the scheme is still possible but upon negotiation with HM Treasury. If not terminated anticipatively, the scheme will mature with the longest dated asset in the portfolio. Any termination will have to be approved by the Financial Services Authority (FSA).
- (49) The annual fee is payable in cash, or with the agreement of HM Treasury in B shares or deferred tax assets. If payable in deferred tax assets, such tax assets will have to have already arisen, and their value independently verified. If deferred tax assets are used for payment a minimum surcharge of 20% will be applied to the fee.

²⁸ The total capital required post APS in the base case is higher (£[between 20 and 30] billion) than what would be required pre-APS for the covered assets (£[between 10 and 20] billion). The bank is allowed under the FSA rules implementing the Capital requirements Directive, to cap the total level of capital required at the pre-APS amount.

2.4.3 *The guarantees*

- (50) RBS is also a significant user of the Credit Guarantee Scheme (CGS), which was also approved under the Commission decision of 13 October 2008 and prolonged until the end of 2009 by the Commission decision of 13 October 2009. As of September 2009, RBS had issued around £[...] billion of State guaranteed debt under the CGS. Since they were granted in the context of the current crisis, the Commission will take this aid into account when assessing the restructuring plan of RBS.

2.4.4 *Liquidity Assistance (LA)*

- (51) As from 7 October 2008 RBS has benefitted from a LA granted by the BoE, which was granted to RBS as an institution in difficulty which could not find the necessary financing on the market. Use of this facility peaked at £36.6 billion on 17 October 2008. From the outset, RBS provided BoE with collateral for the provision of this liquidity in the form of residential mortgages, personal and commercial loans and UK government issued debt, with haircut²⁹ of [...] applied in function of the collateral quality and market value. RBS was charged [...] for the use of LA, which was penal compared to the BoE's normal facilities³⁰. RBS repaid the money by 16 December 2008.
- (52) As from 14 October 2008 HM Treasury provided the BoE with a guarantee in respect of net losses that it might suffer or incur in connection with the BoE's commitment to ensure that the banking system had sufficient access to liquidity, including LA³¹. The guarantee covered any such facilities for a two-month period and ended on 14 December 2008. Operations incurring before 14 October 2008 and after 14 December 2008 (and rollovers of such operations) remained at the risk of the BoE throughout the period of the guarantee. The Treasury's guarantee did not apply retrospectively to these operations. At the end of 13 October 2008 RBS's drawing stood at £[...] billion.
- (53) According to the UK authorities the guarantee was granted in the context of the existing demands on the BoE's balance sheet at that time and was accordingly a measure relating to the domestic arrangements for enabling the BoE to undertake the functions of a central bank in exceptional circumstances. [...]. The UK authorities claim that these were central bank LA operations throughout the duration of the facilities and that the collateral, valuation methodology and return were consistent with best central bank practice. Accordingly, in the view of HM Treasury and the BoE it did not constitute State aid.

²⁹ The range of haircuts applied to loans taken as collateral in the LA was between [...] % and [...] % depending on the quality of the collateral.

³⁰ [...]

³¹ Letter of 23 November 2009 from Alistair Darling to John McFall, Chairmen of the Treasury Select Committee, http://www.hm-treasury.gov.uk/d/letter_chx_to_johnmcfall.pdf. As indicated in this letter, the BoE paid a guarantee fee of 170 basis points to the Treasury.

- (54) The aid measures received or to be received by RBS are summarised in the following table:

Implemented Recapitalisation (announced on 13 October 2008 and completed on 1 December 2008)	£20 billion
Future Recapitalisation (announced on 3 November 2008)	
- Up-front recap in B shares	£25.5 billion
- Contingent capital in B shares	£8 billion
Total recapitalisation	£45.5 billion (£53.5 billion with contingent capital)
Total recapitalisation as % of RWA on 31/12/2008 (£577 billion)	7.8% (9.3% with contingent capital)
Potential additional recapitalisation in B shares	Payment of the APS fee and/or the contingent capital fee in B-shares
Participation to the APS	
- Asset covered	£282 billion, with a first loss position of £60 billion
State guarantees granted under the CGS	£[...] billion (as of September 2009)
Liquidity assistance granted by the BoE between October and December 2008	At the peak, amount of £[...] billion. Fully reimbursed in December 2008

3 THE RESTRUCTURING PLAN

3.1 DESCRIPTION OF THE PLAN

- (55) The restructuring plan assessed in the present decision was notified by the UK authorities on 2 June 2009, with the amendments to the terms of RBS's participation in the APS notified in November 2009 and with the additional commitments made by RBS and by the UK authorities' letter of 9 December 2009.
- (56) According to the plan submitted (whose implementation already started), RBS has completed a full strategic review of each division, and the restructuring plan contains the following aspects.
- (57) RBS has set key risk and return targets to be achieved by 2013. It plans to reach a stand-alone credit rating in the AA category (versus BBB category in 2008), a Core Tier 1 capital ratio over 8% (versus a Core Tier 1 of 4% as at 1 January 2008), a loan to deposit ratio of 100% (versus 156% as at October 2008), reduce its wholesale funding reliance from £343 billion to less than £150 billion, and increase its liquidity reserves up to £150 billion. In terms of return, it targets a return on equity of over 15% (versus -28% in 2008), a cost/income ratio of less than 45% (versus 79% in 2008), and a cost/income net of claims of less than 50% (versus 97% in 2008).

- (58) In the framework of this restructuring plan, RBS has separated its activities into Core and Non-Core divisions, based on the assessment of each activity using five tests³². A new Non-Core Division has been created to manage these Non-Core assets in order to divest them or run them down. It will consist of a reduction of £251 billion of assets from the balance sheet level of December 2008 and a reduction of £110 billion of RWA, knowing that since December 2007 the group has already achieved a reduction of assets (excluding derivatives) of £315 billion on a constant currency basis, consisting mainly of reduction of activities in GBM.
- (59) In combination, already achieved balance sheet reduction, the run-off or disposal of the Non-Core assets and the disposal of Rainbow Business (as described below in (73)) would deliver a [above 20]% (£[...] billion³³) reduction in RBS's balance sheet (on a constant currency basis) from its December 2008 level³⁴, or a [above 40]% reduction in its funded balance sheet³⁵. Overall, when taking into account the additional divestment described in (67) and (68), RBS will run off and sell around £[...] billion of assets, which is equivalent to [above 20]% of its total balance sheet at the end of 2008 and close to [above 40]% of its funded balance sheet at the same date³⁶³⁷.
- (60) RBS will centre on the UK retail and SME and corporate banking business while retaining a more focused global operation. It plans to exit retail and commercial banking markets outside the UK, Ireland and the USA. For its core retail and corporate markets, RBS's strategy is to seek differentiation through tailoring segment specific propositions based on service quality and product strength, rather than seek price leadership.
- (61) According to RBS's restructuring plan, the Global Banking & Markets Division is undergoing the most fundamental change of all RBS business divisions. Due to the ABN AMRO acquisition, GBM's balance sheet increased by 45% to stand at £692 billion (excluding derivatives), and £279 billion of RWA. GBM is therefore the major contributor to the Non-Core division, accounting for 70% of the Non-Core assets. The goal of the restructuring of GBM is to reduce its RWA to £150 billion (reduction of 45%). The following activities have been moved to Non-Core due to their capital intensive and high risk profiles:[...], structured real estate lending, asset finance, leveraged finance lending, project finance lending, illiquid proprietary trading activity, structured credit trading, illiquid structured derivatives, financial structuring group and non-conforming asset backed securities (ABS) origination. These GBM Non-Core businesses will be disposed of or run-off prior to 2013.

³² 15% return on equity in normal markets, proportionate use of balance sheet, risk and funding i.e. less capital intensive, capable of organic growth, connected to existed business of group and existence of a strong customer franchise.

³³ The reduction has been in a limited extent offset by the lending commitments which were required by the UK government. The reduction was also partially offset by the foreign exchange variations.

³⁴ 34% reduction from the 2007 level

³⁵ RBS focuses its balance sheet planning on funded third-party assets which exclude the mark-to-market value of derivatives. Total assets at December 2008 were £2,219 billion of which £1,227 billion were funded third party assets and £991 billion was the mark-to-market value of derivatives.

³⁶ RBS balance sheet is inflated by a high amount of unfunded derivatives products.

³⁷ Respectively 37% reduction of its total balance sheet and 44% reduction of its funded balance sheet when compared to 2007 level.

- (62) The Core businesses of GBM will be the following: Foreign exchanges and options, rates, money markets, commodities, cash equities, debt and equity capital markets, restructuring and advisory. Other businesses will be restructured, such as ABS trading, flow credit trading, equity derivatives, equity financing, prime ABS origination and corporate and financial institutions lending.
- (63) RBS's representation in approximately 40 of the 54 countries in which it currently operates will be significantly reduced or sold, including exiting completely from retail and commercial businesses in nine Asian and Middle Eastern markets, and from wholesale activities in four Asian and four Latin American markets³⁸.
- (64) RBS has launched a programme to reduce costs across the group. It plans to make a [...] headcount reduction³⁹. It has reviewed its remuneration policies and introduced new incentive schemes.
- (65) RBS has replaced its management with the change of its Chairman and Chief Executive, other executive and non-executive directors, as well as 40% of the GBM senior executive team.
- (66) RBS is reviewing its business model to achieve appropriate risk levels, standalone capital position and reduced reliance on wholesale funding. For example, it expects customer deposits to become a more important source of funding, rising from 38% of balance sheet liabilities in 2008 to [...] % of balance sheet liabilities in 2013, and targeting a 100% customer loans/deposit by 2013.
- (67) RBS has already sold and intends to sell businesses in the future. In 2008 it sold Angel Trains Group⁴⁰ and its 50% stake in Tesco Personal Finance JV⁴¹. In 2009 it sold its 4.26% stake in Bank of China for £1.6 billion and in Linea Directa for EUR 400 million. Agreement on the sales of RBS's Asia retail and Commercial Banking (around £ 8 billion of assets) is on-going. It states that it will sell others, such as [...], European invoice finance and RBS asset management. Overall, these businesses account for approximately £[between 15 and 25] billion of assets⁴².
- (68) In addition, RBS has committed to divest other operating businesses, namely RBS Insurance, Global Merchant Services and its stake in RBS Sempra Commodities activities. It has also committed to a contingent divestment as explained below in (72).

³⁸ In total, RBS is in the process of selling assets amounting to £8 billion in Asia, £2.4 billion in Latin America, and €1.5 billion in Europe.

³⁹ At 31 December 2008, RBS had 199,800 Full Time Equivalents.

⁴⁰ Angel Trains is the largest of the three rolling stock leasing companies in the UK and has also a significant presence in the passenger train and freight locomotive leasing markets across Europe. On 6 August 2008, the company completed the sale of Angel Trains Group to a consortium advised by Babcock & Brown for an enterprise value of £3.6 billion.

⁴¹ Tesco Personal Finance ("TPF") was established in 1997 as a joint venture between Tesco Plc and RBS. During this time TPF has built up 5.5 million customer accounts and now offers more than 25 different products. Products are marketed through Tesco's UK stores and internationally in Ireland, Hungary and Poland. In the year to 31 December 2007 TPF reported profit before tax of £206 million, total assets (net of intra-group funding) were £4.5 billion and RWAs were £4 billion. On 28 July 2008, the company announced that it had agreed to sell its 50 per cent shareholding in TPF to its joint venture partner Tesco plc for a cash consideration of £950 million, subject to transaction adjustments. The sale was completed on 19 December 2008.

⁴² Figure based on RBS response to European Commission related to asset sales and run-off, received on 5 October 2009.

- (69) As described in paragraph (19), RBS Insurance portfolio encompasses strong customer franchises and leading market position in the UK⁴³, with a total income in 2008 of £4.4 billion, and a return on equity of 18.3%.
- (70) Global Merchant Services, which is a part of the GTS division described in paragraph (13), is a provider of global card payment services, enabling businesses to accept card payments either at point of sale or over the internet in exchange for goods and/or services. It has a good customer franchise, being fourth globally, first in the UK. It performed well in 2008 with a profit before tax of £276 million, and a return on equity of 140%, with low capital usage.
- (71) RBS Sempra Commodities is a commodities trading business, a partnership between RBS (majority shareholder) and Sempra. The business is active in the trading of physical commodities and innovative financial risk management products in the natural gas, natural gas liquids, power, petroleum and petroleum products, coal, emissions, ethanol and base metal markets.
- (72) If the RBS Core Tier 1 capital ratio⁴⁴ decline to below 5% at any time before 31 December 2014 or if RBS does not achieve its funded balance sheet reduction target⁴⁵ by 31 December 2013, RBS will reduce its risk-weighted assets by a further £60 billion in excess of plan through further disposals of businesses and associated assets as they appear in RBS's results for the first half of 2009.
- (73) RBS further committed to the divestment of the RBS branch-based retail and SME business in England and Wales, and the NatWest branches in Scotland (this is referred to as the "Rainbow Project"). The business represents 318 branches, 1.7 million of the group's retail customers, 230.000 SME customers⁴⁶ representing a 5% UK SME market share of which 10% of UK commercial⁴⁷ market share, over 1000 mid-corporate customers⁴⁸ representing a 5% UK mid-corporate market share, and around 6000 employees, including 850 relationship managers. It is founded upon the network of Williams and Glyn's Bank⁴⁹, a bank acquired by RBS in 1969 and rebranded into the RBS brand in 1985. In addition, the Rainbow entity will include 40 business and commercial banking centres, 2 direct business banking centres, 3 personal relationship manager centres as well as 3 operational centres. In order to serve the mid-corporate customers, the Rainbow corporate servicing will include a principal corporate banking centre in[...].
- (74) Based on the figures provided by RBS, the divested entity will be self-funded, have nearly £20 billion of assets and liabilities and income of £[between 500 and 1000] million.
- (75) RBS highlights, however, the execution risk around the ring-fencing of the Rainbow Business since management, organisation, platforms infrastructure and processes are currently fully integrated with the rest of NatWest and RBS

⁴³ E.g. #1 in Personal lines Insurance and Personal Motor, #2 in General Insurance, Personal Home, #6 in commercial SME.

⁴⁴ Core Tier 1 and RWA being calculated on the basis of the existing regulatory rules.

⁴⁵ Adjusted among others for currency exchange rates variation and calculated on the basis of current accounting practices and current prudential rules.

⁴⁶ Firms with a turnover up to £25 million.

⁴⁷ See footnote 13.

⁴⁸ Corporate customers with a turnover between £25 million to £1 billion turnover.

⁴⁹ The Williams and Glyn's brand will be sold with the rest of the Rainbow package.

businesses. The UK authorities have made a series of commitments aiming at preserving the value of the entity so as to ensure the meaningfulness of the above divestment. A more detailed description of these commitments is presented in part 3.3 below.

(76) The main divestments are summarised in the table below (in £ billion):

	Asset Dec 2008*	%RBS Assets	RWA Dec 2008	%RBS RWA Dec 2008	Income 08**	%RBS	Income 1H09	%RBS
<i>RBS</i>	<i>1227</i>	<i>100,0%</i>	<i>578</i>	<i>100,0%</i>	<i>20599</i>	<i>100,0%</i>	<i>14791</i>	<i>100,0%</i>
INSURANCE	11	0,9%	0	0,0%	4430	21,5%	2165	14,6%
GLOBAL MERCHANT SERVICES	1	0,1%	2	0,4%	552	2,7%	264	1,8%
RAINBOW ***	20	1,6%	18	3,1%	944	4,6%	411	2,8%
RBS Sempra Commodities	18	1,5%	11	2,0%	765	3,7%	454	3,1%
Asia Retail and Commercial	8	0,7%	6	1,1%	761	3,7%	331	2,2%
Total divestitures	59	4,8%	38	6,5%	7452	36,2%	3625	24,5%

* Funded assets (assets excluding market-to-market derivatives)

** 2008 income as reported in 2009 interim results

*** Rainbow numbers are preliminary estimates

(77) Finally, it can be observed that already in 2008, RBS took a series of steps to shore up its capital base, including a £12 billion rights issue in June 2008.

3.2 FSA'S ASSESSMENT OF THE BANK'S ABILITY TO REACH VIABILITY UNDER A BASE AND A STRESS SCENARIO

(78) RBS has submitted a base and a stress scenario with the aim of demonstrating its ability to achieve long-term viability following the implementation of the restructuring plan described above. The objective was to evaluate both the solvency and the liquidity positions of RBS under a base and a stress cases, and to validate their compliance with the FSA capital requirement framework in both cases.

(79) According to the FSA⁵⁰, all the banks that have received State aid should maintain at least, a Core Tier 1 ratio of 4%, after applying stress tests. This means that under the base case, banks are expected to have a Core Tier 1 capital above the [...] % level.

(80) Parts 3.2.1 and 3.2.2 below describe the analysis made by the FSA regarding the base case scenario and the stress case scenario prepared by RBS. The FSA has assessed the assumptions made by RBS and run its own stress case, but using the same macroeconomic assumptions. When necessary, it applied additional haircuts in order to reflect its more conservative approach. In addition to the aim of

⁵⁰ http://www.fsa.gov.uk/pages/Library/Communication/Statements/2009/bank_capital_.shtml.

checking the compliance with the FSA capital framework, the FSA's goal was to determine whether RBS participation in the APS was necessary from a capital adequacy and viability perspectives.

3.2.1 *Base case scenario*

- (81) For the base case, RBS has modelled its own macro-economic scenario based on its economic forecasts as at May 2009. The scope of the base case takes into account the restructuring plan through the disposal of the Non-Core assets over a five year period, the revised funding strategy to achieve a [...] % loan-to deposit ratio by 2013, and the disposal of the Rainbow Business. It however excludes the divestments of RBS Insurance, the RBS Sempra Commodities business and GMS, as well as the contingent divestment, which were all announced for the first time only in November 2009 (these new divestments were taken into account in the stress test described later in this decision).
- (82) In its assessment of the RBS base case, the FSA has used RBS projections, and has run a top-down review of the scenario, the RWA figures, the pre-provision income, the impairments and write-downs, and has compared RBS macro-economic assumptions with an FSA-derived consensus of independent forecasters. It has evaluated on a pre- and on post-APS participation the viability of the group.
- (83) The general economic outlook portrayed in the RBS base case reflects a [...] in gross domestic product (GDP) compared to previous post-war recessions and a relatively weak recovery. In terms of rate of unemployment, RBS predicts a [...] rate of increase and overall high rate of unemployment above [...] % throughout the period, peaking in [...] above [...] %. The residential house prices are projected to fall [...] % from their peak, and prices are expected to be [...] in 2013.
- (84) Under its projected base case, RBS forecasts a loss before tax of £[...] billion in 2009, £[...] billion in 2010, and then [...] in 2011, up to [...] billion in 2013.
- (85) Without APS, the RBS's analysis under its base case scenario shows Core Tier 1 ratios [...]. With APS, the Core Tier 1 ratios [...].
- (86) The FSA analysis highlights that the funding position of RBS [...] having improved considerably since the beginning of 2009. Outstanding government guaranteed issuance remains [...] at £[...] billion under the CGS. In addition, the current BoE Special Liquidity Scheme (SLS)⁵¹ usage is £[...] billion.[...]. [...] believes that although the APS transaction has no direct impact on the group's liquidity position, it should provide confidence to the market.
- (87) In conclusion, according to the FSA assessment, RBS would not meet the regulatory capital framework under a base case scenario without the APS, but is viable under a base case scenario with the APS, provided the bank performs in accordance with its strategic plan.

⁵¹ See footnote 30.

3.2.2 Stress case scenario

- (88) RBS has modelled its stress case on the basis of the macro economic scenario determined by the BoE which is referred to as the "stress scenario"(or [...]) for the valuation of the APS⁵². It assumes the participation of RBS in the APS under the revised terms announced on 3 November 2009⁵³. Its scope also includes the restructuring plan and the disposal of the Rainbow Project, RBS Insurance, the stake in RBS Sempra commodities, Global Merchant Services, and –upon a breach of Core Tier 1 capital ratio trigger - a further £60 billion of RWA.
- (89) To assess RBS's capital position, the FSA has undertaken a detailed analysis in accordance with its guidance on the use of the stress test⁵⁴, [...]. Under the FSA rules, RBS has to comply with the Core Tier 1 4% regulatory requirement under a stress scenario.
- (90) [...].
- (91) The FSA overall conclusion is that the APS and the associated aid measures⁵⁵ announced on 3 November 2009 enable RBS to meet the FSA capital requirements as it projects the group's Core Tier 1 capital ratio to remain above 4% throughout the 5-year forecast period. This conclusion is based on the FSA's own detailed analysis of the firm's position, which is more conservative than RBS's own analysis.

3.3 COMMITMENTS OF THE UK AUTHORITIES

- (92) The UK authorities have undertaken a number of commitments related to the implementation of the restructuring plan, in particular the scope of the divestment of the operating businesses, as well as regarding behavioural measures to ensure the preservation of the value of the activities to be divested. These commitments also aim at addressing the issues of burden-sharing and limitation of the distortion of competition resulting from the State support. These commitments are supposed to ensure that planned restructuring measures, including the divestment of the operating businesses, would be meaningful and that they will be implemented in a most efficient way and as quickly as possible, without harming the financial standing of RBS. The commitments by the UK authorities have been presented in the document called *Term sheet for UK State aid commitments in respect of RBS*, (hereinafter referred to as "the term sheet"). These commitments are summarized here below.

⁵² See footnote 97

⁵³ See recital (37)

⁵⁴ <http://www.fsa.gov.uk/pages/Library/Communication/PR/2009/068.shtml>

⁵⁵ According to the FSA, without the APS, the £25.5 billion recapitalisation and the £8 billion contingent capital, RBS would have a shortfall of £[...] billion of capital under a stress case scenario

Commitments related to the disposal of the certain businesses

- (93) The UK authorities have committed that RBS shall :
- divest its entire ownership interest in each of the following businesses: RBS Insurance⁵⁶, Global Merchant Services⁵⁷ RBS Sempra Ownership Interest⁵⁸ and Rainbow Business, (as described respectively in paragraphs (69), (70), (71), (73) and ;
- (94) The UK authorities have committed that RBS will approach potentially interested buyers for the operating businesses by no later than 31 December 2011 and it will complete the disposal of the divestment businesses by no later than 31 December 2013. For RBS Insurance, RBS must by the later date reduce its interest to a level below that at which it would be considered to exercise control of the business and dispose of its entire interest in RBS Insurance by 31 December 2014. For Global Merchant Services, if so requested by a purchaser, or if it is necessary in the event of an initial public offering to preserve the viability of the business, RBS may divest its interest such that RBS retains no more than a 20% ownership interest in each of the Global Merchant Services businesses.
- (95) In the event RBS Core Tier 1 capital ratio declines to below 5% at any time before 31 December 2014, or RBS falls short of its existing funded balance sheet reduction targets for 31 December 2013 by £30 billion or more, the UK authorities have committed that RBS will reduce its RWA by a further £60 billion in excess of plan through further disposals of assets or businesses, so-called the "contingent divestment"⁵⁹.
- (96) However, subject to any extension granted by the Commission, if the disposals of the operating businesses, including the contingent divestment (if triggered), have not been completed by the dates specified in (94), the UK government will

⁵⁶ The holding company of RBS Insurance is RBS Insurance Group Limited which has the following key subsidiaries: (i) Direct Line Insurance plc, (ii) Churchill Insurance Company Limited, (iii) UK Insurance Limited ("UKI"), (iv) the National Insurance and Guarantee Corporation Limited ("NIG"), (v) Direct Line Life Insurance Company Limited, (vi) Direct Line Insurance S.p.a (Italy), (vii) Headrow Reinsurance Limited (Guernsey), (viii) Green Flag Limited (provider of motor roadside assistance services), (ix) RBS Insurance Services Limited, (x) Direct Line Versicherung A.G (Germany).

⁵⁷ The GMS Business includes the following businesses: the acquiring business in National Westminster Bank; the acquiring business in Ulster Bank; RBS Lynk Incorporated; WorldPay GmbH; Bibit B.V. and its subsidiaries Bibit France SARL, Bibit SL (Spain), Bibit Payments KK (Japan), Bibit Inc., and the following non-trading subsidiaries: Payplus B.V., Bibit Internet Payments Ltd, and Bibit Internet Billing Services N.V.; WorldPay Limited (Jersey), WorldPay Limited UK, WorldPay Inc, WorldPay Pte (Singapore) which is a trading company; Payment Trust Canada Limited and Payment Trust Limited.

⁵⁸ RBS Sempra Commodities acts as a holding company for the following principal subsidiaries: Sempra Energy Trading LLC (Delaware); Sempra Energy Solutions LLC (California); Sempra Oil Trading Pte. Ltd. (Singapore); RBS Sempra Commodities Holdings IV B.V. (Netherlands); RBS Sempra Commodities Cooperatief W.A.; RBS Sempra Energy Europe Espana S.L. (Spain); RBS Sempra Energy Trading Holdings Sarl (Switzerland); RBS Sempra Energy Europe (Hungary); RBS Sempra Energy Europe d.o.o. (Serbia); RBS Sempra Energy Trading Mexico (Mexico); RBS Sempra Products Limited (UK); RBS Sempra Metals Group Limited (UK); RBS Sempra Metals Far East Limited (Hong Kong); Canadian Choice Energy Corp. (Ontario); Henry Bath & Son Limited (UK).

⁵⁹ The "contingent divestment" means further disposals of identifiable businesses and associated assets as they appear in the RBS accounts for the first half of 2009 such that the contingent divestment results in at least a £60 billion reduction in the RWAs of the RBS group.

appoint a Divestiture Trustee that will dispose of the businesses at no minimum price⁶⁰. The same condition applies to the contingent divestment if it is triggered.

- (97) RBS shall conduct a tendering procedure for the sale of the Rainbow Business and RBS Insurance which will be adequately publicised. As far as the law permits, bidders will be granted direct access to all appropriate information in the due-diligence procedure.
- (98) As an alternative to the sale of the operating businesses (described above) by tender, RBS may at its sole discretion choose to dispose the divestment businesses by way of an initial public offering for the shares in an entity that owns the operating business.
- (99) The UK authorities commit that the buyer of Rainbow Business must:
- together with the rest of the buyer’s group, in combination with the Rainbow Business, have a market share of no more than 14% in the UK SME market (on a number of customers basis), prior to the signing of the sale and purchase agreements relating to the sale of the Rainbow Business to the buyer. The buyer must be independent of RBS and must not be connected to RBS within the meaning of Article 11 of Commission Regulation (EC) No 2790/1999 on the application of Article 81(3) of the EC Treaty to categories of vertical agreements and concerted practices⁶¹.
 - satisfy the relevant competition authorities that it is in a reasonable position to satisfy all the necessary conditions imposed by the relevant competition authorities as part of any merger control process and by other authorities for the acquisition of the Rainbow Business or relevant part thereof.
 - satisfy the FSA as to the adequacy of its financial resources (both in respect of liquidity and capital), the competency and experience of the leadership, the adequacy of its risk and control standards, the adequacy of its attitude to customers in terms of fair customer treatment, adequate service and fair pricing, and the long-term viability, success and sustainability of the entity, assessed by reference to (amongst other things) its business plan.
 - have sufficient resources and incentive to maintain and develop the Rainbow Business.
- (100) Each of the Operating Businesses and Contingent Divestment can be disposed of in parts or as a whole. Although it is expected that RBS will dispose of the Rainbow Business as a single entity, if the Commission is satisfied⁶² that the disposal of the Divestment Business in parts would be equally effective in

⁶⁰ To this end the UK government will propose to the Commission for approval, no later than one month before the deadlines specified a list of one or more persons whom it proposes to appoint as Divestiture Trustee. The Divestiture Trustee will be appointed within one week of the Commission's approval in accordance with the mandate approved by the Commission. RBS will grant comprehensive powers of attorney to the Divestiture Trustee.

⁶¹ OJ L 336, 29.12.1999, p. 21.

⁶² In such case, the UK authorities will need to obtain an approval following an official notification of a proposed modification of the restructuring plan approved by present decision.

improving competition than would have achieved by the disposal of the Rainbow Business as a whole, RBS may dispose the Rainbow Business in such parts rather than as a whole.

- (101) RBS shall, if requested, exercise best efforts, on reasonable commercial terms, to support the buyer(s) of the Rainbow Business in migrating to appropriate infrastructure for the on-going operation of the business. This support will include reasonable transition support agreements (including if relevant an agreement to provide clearing services on market terms and in relation to the transferring customers that are associated with branches that are being divested, the right to use existing sort codes and account numbers, as at the date of transfer, for such duration as the buyer may request), covering ongoing operations, customer and product migration and staff training.
- (102) With a view to ensuring the continued economic viability, marketability and competitiveness of the Rainbow Business, RBS shall appoint a person to manage the Rainbow Business (the “Hold Separate Manager”) no later than 6 months after the date of the present decision and shall ensure that the Hold Separate Manager operates independently. The Hold Separate Manager⁶³ will oversee the management of the Rainbow Business in its best interests, in common consultation with RBS and as monitored by the Monitoring Trustee. RBS will provide adequate support by carrying on the Rainbow Business as a going concern in particular as regards the provision of services⁶⁴ to the Rainbow Business on an equivalent basis to those being provided to the wider RBS UK Retail banking and SME banking businesses.
- (103) Between the date of the present decision and completion of the disposal of the operating businesses:
- RBS shall carry on the Rainbow Business as a going concern in the ordinary and usual course as carried on prior to the Relevant Date.
 - RBS shall ensure that from the date of the present decision to the time at which a sale and purchase agreement has been signed with respect to each Business (or, in the case of an initial public offering, until the time the prospectus has been issued), RBS will not actively target employees working within the relevant Business to transfer to roles outside of the relevant Business.

Behavioural commitments not related to disposal of businesses

- (104) The UK authorities have committed that neither RBS nor any of its direct or indirect subsidiaries shall pay investors any dividends or coupons on existing hybrid capital instruments (including preference shares, B shares and upper and lower tier-2 instruments) from a date starting not later than 30 April 2010 and for a period of two years thereafter or exercise any call rights in relation to the same until the end of this two-year period, unless there is a legal obligation to do so.

⁶³ The Hold Separate Manager can be the current CEO (or other senior employee) of the Rainbow Business.

⁶⁴ Sales and Service delivery; sales and service standards and procedures; staff policies and procedures and associated investment in staff training; RBS Group Policy framework and associated internal controls standards; product and marketing aspects of the businesses, support services.

[...] ⁶⁵, if any, shall be exempt from this prohibition. New hybrid capital instruments shall not be subject to the ban on dividend or coupon payments or call options, [...]. RBS certifies that the payment of dividends or coupons on new securities will not create a legal obligation to make any dividend or coupon payments on RBS' existing hybrid capital instruments (including preference shares, B shares and upper and lower tier-2 instruments) and therefore that the payment of dividends or coupons on any such new securities will not reduce the effect of the commitment not to pay discretionary dividends or coupons on such existing securities.

- (105) In addition, the existing hybrid capital instruments which are retained in ABN AMRO Group after separation is complete (the "ABN Instruments") shall be subject to the restriction on the payment of dividends and coupons on hybrid capital instruments and on the exercise of any call rights, unless in any such case there is a legal obligation to do so, for two years after the proposed capital restructuring of RFS Holdings B.V. (that is intended to take place soon after separation) and following the expiry of any "pusher" periods following separation and such capital restructuring. RBS certifies that the payment of dividends or coupons on these securities issued by the ABN AMRO Group in the period until the starting date of the two year period will not create a legal obligation to make any dividend or coupon payments on the RBS Instruments and therefore that the payment of dividends or coupons on the ABN Instruments will not reduce the effect of the commitment not to pay discretionary dividends or coupons on the RBS Instruments.
- (106) The UK authorities have committed that RBS, from 1 January 2010 until 31 December 2013 should be at the leading edge of implementing the G20 principles, the FSA Remuneration Code and any complementary remuneration provisions accepted by the UK government from the Walker Review, that are implemented in regulations.
- (107) The UK authorities have committed that until 31 December 2012 RBS will ensure that its overall annual position in the Global All Debt League Table ⁶⁶ is no higher than fifth.
- (108) The UK authorities have committed that RBS (i) shall not acquire any financial institutions and (ii) shall not make any other acquisitions whose purpose is to expand RBS's activities outside of its business model, until the later of 31 December 2012 and the date on which the last of the operating businesses has been divested ⁶⁷. However, RBS shall be permitted to make such acquisitions if

⁶⁵ RBS will use its reasonable endeavours to develop and, subject to market conditions and requisite approvals, implement a plan to continue the improvement and optimisation of its capital base in a manner which is consistent with the principles of burden sharing.

⁶⁶ Global All Debt League Table is a single aggregate measure comprising all bonds globally and all syndicated loans globally. It excludes self-led, self-funded, money market, short term deals and other debt not eligible for inclusion under Dealogic standard industry criteria for published league tables. The table is measured by deal volume in US Dollars and using Dealogic Strategy Manager.

⁶⁷ Save in the case of the contingent divestment and that in the case of RBS Insurance it will be sufficient for the purposes of this clause for RBS to have divested to a level below that at which RBS would be considered to exercise control of RBS Insurance within the meaning of Article 3(2) of Council Regulation (EC) No 139/2004 Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (the EC Merger Regulation), OJ L 24, 29.01.2004, p. 1.

the cumulative purchase price excluding the assumption of debt paid by RBS for all such acquisitions in this period is less than £[between 0 and 1500] million.

- (109) RBS shall not refer to the fact that it enjoys any State support or to the fact that the UK is a shareholder in RBS in any of RBS's advertising.

Commitments related to the monitoring

- (110) The UK authorities have committed that RBS shall appoint, subject to Commission's approval, a monitoring trustee in charge of the overall task of monitoring and ensuring, under Commission's instructions, compliance with the commitments⁶⁸. For that purpose the UK shall propose to the Commission for approval, no later than three months from the date of this decision, a list of one or more persons whom it proposes to appoint as monitoring trustee. The monitoring trustee shall be appointed within one week of the Commission's approval in accordance with the mandate approved by the Commission and shall report to the Commission on a quarterly basis as to RBS's compliance with the commitments.
- (111) The UK authorities have also committed to submit regular reports on the measures taken to comply with this decision. The first report will be submitted to the Commission not later than six months after the adoption of this decision. Thereafter, the UK authorities will report at six-monthly intervals.

4 ASSESSMENT OF THE AID

4.1 EXISTENCE OF AID

- (112) Article 107(1) TFEU⁶⁹ provides that any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

The capital injections

- (113) The Commission observes that the State recapitalisation of £20 billion completed in December 2008 was granted in the framework of a scheme. The Commission has already concluded that this scheme constituted State aid in its decision of 13 October 2008 authorising this scheme⁷⁰. The recapitalisation of £20 billion therefore constitutes State aid.

⁶⁸ The monitoring trustee shall be remunerated by RBS in a way that does not impede the independent and effective fulfilment of its mandate.

⁶⁹ 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 (TFEU). 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.

⁷⁰ See footnote 19.

- (114) As indicated above, RBS will benefit further from an additional recapitalisation of £25.5 billion by way of B shares before the end of the year 2009, as well as a five year contingent commitment of the State to subscribe for an additional £8 billion of capital in the event that RBS's Core Tier 1 falls below the 5% threshold. These new measures have not yet been assessed and approved in a Commission decision.
- (115) The Commission agrees with the position of the UK that the £25.5 billion recapitalisation and the contingent capital constitute aid to RBS within the meaning of Article 107 (1) TFEU. They will allow the beneficiary to get the required capital and therefore to comply with the FSA regulatory framework. This gives an economic advantage to the beneficiary and strengthens its position compared to that of its competitors in the UK (some of which are subsidiaries of foreign banks) and in other Member States and must therefore be regarded as distorting competition and affecting trade between Member States. The advantage is selective since it only benefits the beneficiary of the new aid package and is provided through State resources.
- (116) The Commission also considers that RBS could not have raised such a large amount of fresh capital on the market in current circumstances without State support. In other words, it can be considered that only the State is able to offer such a large recapitalisation in the current circumstances, since it is not subject to prudential requirements and has access to unlimited resources as a tax authority. There are also other elements demonstrating that both the up-front recapitalisation and the contingent capital would not have been provided by a market economy investor. Regarding the £ 25.5 billion recapitalisation in the form of B shares, the Commission recalls that the B shares have some feature of ordinary shares and some feature of hybrid capital instruments. The B shares converts one for one in ordinary shares at the option of the holder, but their issue price is 50 pence compared to a stock market price which is currently below that level. A market economy investor would have therefore not purchased the shares at such a high price, especially since large capital increases recently announced from other banks were carried out at a substantial discount to the stock market price, in order to convince investors to participate despite the current uncertain environment. When compared to hybrid capital instruments, the B shares offer a coupon which is well below the yield observed on similar instruments⁷¹. In conclusion, in current market circumstances, a private investor would not have accepted to participate in a recapitalisation in the form of B shares. As regards the contingent capital, it does not exist as such on the market⁷². There is no indication available that the market would be ready to make such a commitment and even less that it would accept the remuneration of 400 basis points charged by the State. Finally, the Commission recalls that a market economy investor expects a reasonable return on his investment⁷³ and if a firm is in difficulty and acts in an industry

⁷¹ There is also no indication that the conversion option included in the B shares has such a high value that, combined with the coupon, it gives a total yield on the B shares which is in line with the yield observed for comparable hybrid capital instruments on the market.

⁷² The new capital instruments issued by Lloyds Banking Group contain a contingent conversion feature which is similar, but it is part of the instrument and is not traded separately.

⁷³ Joined Cases T-228/99 and T-233/99 *Westdeutsche Landesbank Girozentrale* [2003] ECR II-435, para. 314

experiencing particular difficulties it is normally not justified to assume a reasonable return⁷⁴.

- (117) The Commission concludes that the £25.5 billion recapitalisation and the £8 billion contingent recapitalisation constitute State aid.

The participation in the APS

- (118) The APS is manifestly financed by State resources. It was open to banks having a certain size and by design was interesting only for banks which were in deep difficulty and in particular in deep shortage of capital. It is therefore a selective measure. It favours RBS by indemnifying losses which would exceed the first-loss position and by improving capital ratios in the stress scenario, allowing thereby the group to pass the FSA stress test. This selective advantage to RBS distorts competition and affects trade between Member States, as discussed previously in respect of the capital injections.

- (119) The purpose of the APS is to restore the stability in the financial sector by using public funds to compensate banks for losses to occur on a specific portfolio of assets and hence providing a degree of certainty of the impact of the current crisis on the bank's capital. In the current state of financial markets (and even more so at the time of the announcement of the measure), no market operator would be able to guarantee the size proposed. In this respect, it is recalled that the *Communication from the Commission on the treatment of impaired assets in the Community banking sector*⁷⁵ (the Impaired Asset Communication) states in footnote (2) to point 15 that a guarantee is presumed to constitute State aid when the beneficiary bank cannot find any independent private operator on the market willing to provide a similar guarantee. The Communication observes that even if a market investor could provide a guarantee of this size, it would not accept the annual fee charged by the State. That fee represents less than 0.32% of the amount covered (i.e. £700 million divided by £221 billion)⁷⁶. On that basis, the Commission concludes that RBS's participation in the APS does constitute State aid.

The guarantees

- (120) The Commission observes that the credit guarantee facilities used by RBS were granted in the framework of a scheme (the CGS). The Commission has already concluded that this scheme constituted State aid in its decision of 13 October 2008 authorising this scheme⁷⁷. The use of the CGS by RBS up to £[...] billion therefore constitutes State aid.

⁷⁴ The Commission indicated its position in various Communications, e.g. the Application of Article 92 and 93 of the EEC Treaty to public authorities' holding (Bulletin EC 9-1984), point 3.3; and Communication on public undertakings in the manufacturing sector, OJ 1993 C 307/3.

⁷⁵ OJ C72, 26.03.09

⁷⁶ This is for instance very close to the 5 year Credit Default Swap spread of the Dutch State, which is AAA rated. The risk of payment under the APS is manifestly higher, which demonstrates that the premium can not be considered to be a market price.

⁷⁷ See footnote 19

The support within the Liquidity Assistance extended by the Bank of England

- (121) The Commission notes that from 7 October 2008 to 16 December 2008 RBS benefitted from the LA extended by the BoE. The Commission also notes that on 13 October 2008, HM Treasury announced that it will provide recapitalisation to RBS, and as from 14 October 2008 the BoE received a guarantee by HM Treasury for net losses deriving from a part of this facility.
- (122) The *Communication from the Commission on application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crises*⁷⁸ (the Banking Communication) indicates in point 51 that in dealing with acute liquidity problems of some financial institutions, Member States may wish to provide them with liquidity support, with the provisions of public funds (including funds from the central bank). In this Communication the Commission clarifies that the provision of central banks' funds to the financial institutions may be found not to constitute aid when a number of conditions are met, such as: i) the financial institution is solvent at the moment of the liquidity provision and the latter is not part of a larger aid package; ii) the facility is fully secured by collateral to which haircuts are applied, in function of its quality and market value; iii) the central bank charges a penal rate to the beneficiary; and iv) the measure is taken at the central bank's own initiative, and in particular is not backed by any counter-guarantee of the State.
- (123) The Commission observes that when the LA was granted on 7 October 2008, RBS was a solvent financial institution, not breaching any regulatory capital requirements⁷⁹, and the LA facility was not part of a larger aid package. Furthermore, as described in recital (51) the LA was fully secured by collateral to which a large haircut was applied, the BoE charged a penal rate and it was not counter guaranteed by the State.
- (124) The Commission therefore considers that the part of the ELA granted until 13 October 2008 was part of the normal monetary operation of a central bank and does not constitute State aid.
- (125) The Commission then observes that on 13 October 2008 HM Treasury announced that it would provide recapitalisation to RBS of £20 billion and thus it would become a majority shareholder in the group. Other aid measures partially targeted at RBS, such as the CGS, were announced. The Commission also notes that on 14 October 2008, HM Treasury guaranteed the BoE for any net losses for operations of LA occurring between 14 October 2008 and 14 December 2008 (and rollovers of such operations).
- (126) Therefore as from 13 October 2008 any extension of the LA for RBS, including the rollovers of operations of LA granted before 13 October 2008 and not covered by the State guarantee, has to be considered as part of larger aid package (point 51, i) of the Banking Communication) and as a central-bank operation counter-guaranteed by the State (point 51, iv) of the Banking Communication). Given the systemic importance of RBS for the UK financial sector and the entire economy

⁷⁸ OJ C 270 of 25.10.2008, p. 8

⁷⁹ On 30 June 2008 and 31 December 2008, RBS reported a Core Tier 1 ratio of respectively 5.7% and 5.9% and a total regulatory capital ratio of respectively 13.1% and 14.2%. Recapitalisation measures were announced on 13 October 2008 to prevent a potential breach in regulatory capital at year end 2008.

and given the importance of rescuing the bank, it is impossible to consider that the BoE acted independently of the rest of the large aid package. This is reflected in the fact that as of 14 October 2008 and until 16 December 2008 the BoE benefited from the guarantee for a part of the LA facilities granted to RBS.

- (127) The Commission notes that the LA was granted individually to RBS and it has not been a facility provided by BoE to all eligible institutions. [...]. BoE clearly admitted⁸⁰ that it acted at that time as 'lender of last resort' to financial institutions in difficulty. Thus, the Commission considers that the LA was clearly a selective measure providing RBS with an advantage it could have not obtained on the market. As the recapitalisation and the APS, this measure distorts competition and affects trade between Member States by preventing RBS from defaulting on its obligations and from exiting the market. The Commission recalls that, by virtue of the guarantee of 14 October 2008, the State would have to intervene in case of default of RBS, thus engaging State resources. In addition, given the announcement by the HM Treasury of 13 October 2008 to provide recapitalisation to RBS, the LA operations as from this date were clearly part of the aid package. The Commission therefore considers that in this case the part of the LA provided by the BoE to RBS as from 13 October 2008, including any roll-overs of the earlier LA operations, needs to be considered as a selective support imputable to the State and thus it should be considered as State aid.

4.2 COMPATIBILITY OF THE AID WITH THE INTERNAL MARKET

4.2.1 *Application of Article 107(3)(b) TFEU*

- (128) Under Article 107(3)(b) TFEU, the Commission may decide that aid is compatible with the internal market if it is intended '*to remedy a serious disturbance in the economy of a Member State*'.
- (129) Given the global nature of RBS's banking activities, given that RBS is one of the leading "high street" banks in the UK especially in the retail, SME and corporate segments, given the significance of its lending activities for the UK economy, and given its intense financial relationships with other banks, the Commission accepts that RBS is a systemically relevant bank. The Commission, therefore, concludes that the collapse of RBS would entail a serious disturbance for the UK financial sector and thus the UK economy. The aid must therefore be assessed under Article 107(3)(b) TFEU.

4.2.2 *The framework for evaluating compatibility*

- (130) As indicated above, the recapitalisation aid announced on 13 October 2008 and completed in December 2008 was granted in the framework of a scheme. It was therefore already authorised as emergency aid. The decision of 13 October 2008 authorising the scheme provides that the beneficiary banks will have to submit a restructuring plan within six months. In line with the Commission's *Communication on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition*⁸¹ (the Recapitalisation Communication), paragraph 27 of the decision of 22 December 2008 amending the scheme provides

⁸⁰ <http://www.bankofengland.co.uk/publications/other/treasurycommittee/financialstability/ela091124.pdf>

⁸¹ OJ C 10, 15.1.2009, p.2.

that no restructuring plan needs to be submitted for recapitalisation aid to firms which are fundamentally sound. The Commission considers that this exemption from the obligation to submit a restructuring plan introduced by the decision of 22 December 2008 does not apply to the present case, given the relative amount of aid received and the scale of the difficulties experienced by RBS. The UK does not invoke that exemption either. It should therefore be concluded that RBS is obliged to submit a restructuring plan. The present decision accordingly assesses whether the recapitalisation aid received is compatible as restructuring aid based on the notified restructuring plan.

- (131) As regards the new recapitalisation of £25.5 billion and the five-year contingent recapitalisation commitment of £8 billion, they have not yet been authorised by the Commission. Therefore, the Commission will first assess whether their terms are in line with the requirements laid down in the Recapitalisation Communication. The Commission will then assess whether these measures constitute compatible restructuring aid based on the notified restructuring plan.
- (132) As regards RBS's participation in the asset relief scheme set up by the UK, it will have to be assessed under the Impaired Asset Communication. It provides guidance as for the methodologies concerning the valuation of the impaired assets, the necessary remuneration of the State for the asset relief and the procedural steps that are to be followed as well as the criteria that will be used to evaluate the State aid given to the banks as a result. The Commission will then assess whether it constitutes compatible restructuring aid based on the notified restructuring plan.
- (133) As regards the aid in the form of the LA, in line with point 52 of the Banking Communication, it has to be assessed whether it is a compatible rescue aid on the basis of the Community Guidelines on State aid for rescuing and restructuring firms in difficulty ("the Rescue and Restructuring Guidelines")⁸². It lasted only two months and was fully reimbursed in December 2008. As such, it therefore does not form part of the restructuring package but will however be taken into account when calculating the total aid received by RBS.
- (134) As regards the assessment of the restructuring plan, the Commission has explained how it will assess such restructuring on the basis of Article 107(3)(b) TFEU in its *Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules*⁸³ (the Restructuring Communication). Even if the decision approving the UK recapitalisation scheme made reference to the Rescue and Restructuring Guidelines, point 49 of the Restructuring Communication makes clear that all aid notified to the Commission before 31 December 2010 will be assessed as restructuring aid to banks pursuant to the Restructuring Communication instead of those Guidelines.
- (135) As regards the applicability of the Restructuring Communication, the Commission observes that point 4 of that Communication clarifies that it does not set new criteria which trigger the obligation to submit a restructuring plan but relies on the Commission's previous Communications. As indicated above, RBS

82 Cf. OJ C 244 of 1 October 2004, p. 2. Reference to these Guidelines was made in paragraph 54 of the decision of 13 October 2008 on the recapitalisation scheme.

83 OJ C 195 of 19.08.2009, p. 9.

was already obliged to submit a restructuring plan on the basis of the decision of 13 October 2008 authorising the UK recapitalisation scheme. Moreover, the Commission considers that RBS should, in line with point 4 of the Restructuring Communication, submit a restructuring plan, since it has received State aid which altogether exceeds 2% of its RWA. The Commission observes that 2% of RBS's total RWA amounts to £11.5 billion, while the recapitalisation of the bank alone amounted to £45.5 billion, i.e. 7.8% of its RWA⁸⁴.

4.2.3 Compatibility of the new recapitalisation measures under the Recapitalisation Communication

Compatibility of the £25.5 billion recapitalisation and potential APS fee in the form of B shares

- (136) The new recapitalisation of £25.5 billion will take the form of the issue of B Shares. For regulatory purposes, the terms of the B shares are very close to those of ordinary shares to ensure their status as Core Tier 1 capital. Their compatibility with State aid rules has to be analysed together with the terms of the dividend access share and of the UK commitment letter on buy-back. On that basis, the Commission views the recapitalisation in the form of B shares as compliant with the requirements of the Recapitalisation Communication.
- (137) The Recapitalisation Communication, by referring to the Recommendations of the Governing Council of the European Central Bank, states that for recapitalisation of fundamentally sound banks in the form of core capital a remuneration of 600 basis points above the relevant risk-free rate⁸⁵ would constitute the minimum remuneration to find the aid compatible. Point 44 of the Recapitalisation Communication indicates that for non-fundamentally sound banks the remuneration should be higher⁸⁶. As described in section 4.2.6.3, the Commission considers that RBS's viability has been ensured thanks to a large amount of aid, which represents a high percentage of its RWA. In this context, the Commission considers that the remuneration for non-fundamentally sound banks should apply, i.e. a remuneration above the one requested for fundamentally sound banks. This higher remuneration compensates the State for the higher risk taken in RBS recapitalisation compared to the recapitalisation of a fundamentally sound bank.
- (138) As regards the recapitalisation in the form of B shares, the Commission notes that the pricing of the dividend access share is the greater of (i) 7% of the issue price of the B shares or (ii) 2.5 times any dividend paid on the ordinary shares times the number of B shares issued to the State⁸⁷. In addition, the B shares are convertible, at the option of the State, into ordinary shares at the initial conversion price of 50 pence and at any time. These instruments therefore include an embedded option whose value should be added to the remuneration. At the request of the

⁸⁴ As described in recital (234), the total restructuring aid (excluding guarantees) represents between 11.3% and 19.6% of RBS's RWA year end 2008.

⁸⁵ At the time of writing the present decision, the yield on ten year Gilt is around 3.5%.

⁸⁶ Footnote 2 to point 46 of the Recapitalisation Communication indicates that a return in excess of 10% is adequate for such banks.

⁸⁷ Under the terms of the dividend access share, the state will receive the remuneration just described until the ordinary share price reaches 65 pence (which level represents a potential 30% capital gain for the State in case of conversion of its B shares in ordinary shares). In other words, when the stock market price reaches 65 pence, the State will lose definitively the entitlement to the special dividend and will only receive per B share a dividend equal to the one of the ordinary shares.

Commission, the UK authorities have priced this option for all annual maturities from 1 to 5 years⁸⁸. For these maturities, the value of such option ranges respectively from 12% to 7% per annum. However, the cost of funding should be deducted, which ranges respectively from 0.6% to 2% per annum. Therefore, taking into account the 7% coupon on the dividend access share and deducting the cost of funding, the total remuneration of the B shares is at least 12%, which is higher than 600 basis points above the risk free rate⁸⁹. The Commission therefore considers that the combination of the coupon of 7% with the option to convert in ordinary shares gives a remuneration to the State which is compatible with the Recapitalisation Communication.

- (139) Additionally, the Commission relies on the written commitment by the State to not accept any buy back offer from RBS unless the price for such buy back is the greater of (i) 100% of the original issue price in the first three years, 110% in year 4, 120% in year 5 and 130% in year 6 and beyond, and (ii) the stock market price as it would be if the B share were converted into ordinary shares. The Commission views this commitment as an incentive for the bank to redeem as early as possible, as required by the Recapitalisation Communication.
- (140) The Commission notes that the issue price (50p) of the B shares is currently above the share price of RBS. This basically means that the B shares have a less dilutive effect than a standard ordinary share issuance or rights issue, which goes against the concept of burden sharing. However, whilst the terms of the B shares, taken on their own, are close to ordinary shares, when combined with the dividend access share and the commitment letter on buy-backs they include hybrid-like features which the Commission views as adequate to compensate for the less dilutive effects.
- (141) The Commission therefore considers that the £25.5 billion recapitalisation is compatible with the requirements of the Recapitalisation Communication.
- (142) It should be noted that the Commission assesses the terms of the B shares in the overall framework and taking into account all the measures and commitments embedded in the restructuring plan. Critical to the analysis of the compatibility of the B shares is the adequate implementation of the measures and the respect of the commitments taken.
- (143) The same assessment of the compatibility of the terms of the B shares would apply for the potential payment of the APS fee by RBS in the form of B shares, as described further in recital (161).

Compatibility of the contingent recapitalisation

- (144) As indicated above, the Recapitalisation Communication, by referring to the Recommendations of the Governing Council of the European Central Bank, states that for banks presenting a higher risk the State should request a remuneration for core capital higher than 600 basis points to find this aid compatible.

⁸⁸ The pricing of the option was done as of 30 October 2009 which is the last trading day before the agreement between HM Treasury and the group.

⁸⁹ As indicated in footnote 86, the Commission also views positively that the total remuneration is above 10%.

- (145) However, in the case of the contingent capital, the group does not receive cash, i.e. it is an unfunded transaction, except if the Core Tier 1 ratio drops below 5% and the capital has to be provided. Since it is an unfunded transaction, the group should only pay a risk premium. In addition, the contingent capital does not improve the current capital ratio of the bank, since it becomes Core Tier 1 capital only if the Core Tier 1 ratio trigger is breached. The only advantage to the group is that it allows it to pass the FSA stress test and therefore to meet with the FSA capital framework requirement.[...] ⁹⁰.
- (146) In addition, the Commission reiterates that the recapitalisation will only occur if the Core Tier 1 ratio hits the 5% trigger level. However a deterioration of the group's Core Tier 1 ratio even above the trigger of 5% will have serious consequences for the group (for example, in terms of ratings and ability to raise funding). Therefore it is likely that the bank will not take the risk of letting the capital ratio deteriorate and will engage alternative capital raising measures before its Core Tier 1 ratio reaches 5% (level which it may or may not ultimately reach). The contingent divestment which will also be triggered upon a triggering of the contingent recapitalisation constitutes another incentive for the group to view this contingent capital recapitalisation as an ultimate back stop solution. This further decreases the probability that the contingent capital will be activated.
- (147) On the basis of the foregoing considerations, and in particular the fact that the contingent capital does not improve the current capital ratio of the group and the probability of it being triggered is limited, the Commission accepts a remuneration lower than the 600 basis points threshold. .

4.2.4 Compatibility of the terms of RBS' participation in the APS with the Impaired Assets Communication

- (148) The Commission assesses impaired assets relief measures under Article 107(3)(b) TFEU on the basis of the Impaired Assets Communication. The Impaired Assets Communication sets out criteria for the compatibility of such measures with the internal market. These criteria comprise (i) the appropriate identification of the problem and disclosure, (ii) the appropriateness of the remuneration and burden sharing, (iii) the eligibility of assets, (iv) the valuation of eligible assets, (v) the management of assets subject to relief measures and (v) the requirement of the assessment of a restructuring plan by the Commission.

Transparency and ex-ante disclosure

- (149) The Impaired Assets Communication requires that any bank participating in an asset relief scheme should (i) provide full ex-ante transparency and disclosure of impairments on the assets to be covered by the scheme and (ii) follow up any application to the scheme by a full review of that bank's activities and balance sheet with a view to assessing the bank's capital adequacy and its prospect for a return to future viability.
- (150) The Commission is satisfied that full ex-ante disclosure and transparency has been achieved. The terms and conditions of the APS require RBS to give access to all information on its covered asset pool to HM Treasury and its advisers. Furthermore, a thorough two phase due diligence process of the covered assets

⁹⁰ This probability has been quantified by the UK at [...] % to [...] %.

has been executed pre-accession by a third party independent reviewer which has been reviewed by the Commission.

- (151) Furthermore, impairments and the valuation process performed by the UK and its experts have been disclosed and validated by a letter from the FSA addressed to the European Commission on 26 November 2009.
- (152) As for the review of RBS's activities and ensuring the group's return to long-term viability, the Commission is also satisfied that the viability assessment in both the base and the stress case performed by the FSA and reviewed by the Commission (which takes into account the provisions of the APS) has adequately assessed the bank's capital position and prospects for viability (see section 3.2).

Burden Sharing

- (153) The principle of burden sharing as set out in the Impaired Assets Communication requires that banks ought to bear the losses associated with impaired assets to the maximum extent. Therefore, the assets should be transferred at a price that matches or stays below the real economic value. In the case of guarantee scheme, this would be achieved by insuring that the first-loss piece is sufficiently large so that it covers at least the long term expected losses on the covered assets.
- (154) The assessment of the appropriateness of the first-loss position is the result of the review of the valuation exercise undertaken by the UK and its advisers and reviewed and validated by the Commission (see paragraphs 169 to 174 below). In the case of RBS participation in the APS, the Commission has found that the first-loss position [...] £60 billion adequately covers the expected credit losses on the covered assets⁹¹. Therefore, the Commission is satisfied that the cover extended by the State is not beyond the real economic value of the assets.
- (155) Additional - albeit more limited - burden sharing is achieved by the fact that the group will bear 10% of the losses in excess on the first-loss position.
- (156) The Impaired Assets Communication also explains that burden sharing is achieved through an adequate remuneration of the scheme. The Impaired Assets Communication states indeed that any pricing of asset relief must include a remuneration for the State that takes account of the risks of future losses exceeding those that are projected in the determination of the "real economic value", i.e. the size of the first-loss piece in the present case. Annex 4 to the Impaired Assets Communication further clarifies that asset relief schemes are somewhat comparable to capital injections and their remuneration could be "inspired" by the remuneration that would have been required for recapitalisation measures to the extent of the capital effect of the proposed asset relief, taking into account the usually higher risk exposure of the State under impaired asset measures and the absence of liquidity element in case of guarantee.

⁹¹ The expected losses on the covered assets under base case macro economic scenario were estimated at £[...] billion. The sizing of the first loss to £60 billion adds an additional level of comfort to ensure that any shortcomings in the valuation exercise inherently embedded in such an extensive and large asset scheme are appropriately addressed.

- (157) As mentioned in paragraph (47) above, the participation of RBS in the APS has no immediate effect on the group regulatory capital as a result of the increase of the first-loss position from the initially announced £42.2 billion to £60 billion⁹². However, the Commission has found that a remuneration of the scheme was still necessary to comply with the Impaired Assets Communication's objectives for burden sharing. [...]. Secondly, whilst no capital relief is achieved in the FSA base case scenario over the five year forecast period, some relief is obtained from the APS under the FSA stress tests. It is recalled that the FSA capital framework will only be satisfied if the stress case requirements are met over the five years forecast period. So the regulatory capital relief gained in the stress case is an immediate benefit for the group as it otherwise would not have passed its regulatory capital requirement altogether and would have had to raise further capital.
- (158) HM Treasury and the FSA simulated the impact of the APS on the group's regulatory capital over the next five years in both the base and the stress case. In the stress case, the APS provided capital relief from [...] peaking at £[...] billion in [...]. The average regulatory capital relief obtained from [...] to [...] was £[...] billion.
- (159) The proposed remuneration of £700 million per annum for the first three years (starting in January 2009) and £500 million thereafter represents on average [...] % of the annual capital relief obtained in the stress case from [...] to [...] ⁹³. The Impaired Assets Communication sets out that impaired asset measures remuneration should be inspired by the remuneration that would have been required for recapitalisation measures with equivalent effects on regulatory capital. As indicated previously, in case of recapitalisation, the Recapitalisation Communication requires the payment of a risk premium higher than 600 basis points above the risk free rate for banks presenting a higher risk. Taking into account the unfunded nature of the State guarantee under the APS, which entails that only the risk premium should be considered, this shows that the remuneration of the APS is below the one required for recapitalisation under the Recapitalisation Communication. However considering that the participation to the APS does not improve current capital ratio and does not provide any capital relief in a base case but only in a stress case, the Commission concludes that this remuneration lower than the one requested for plain recapitalisation is satisfactory to address burden sharing concerns under the Impaired Assets Communication.
- (160) The Commission also views positively the combination of the non amortisation of the annual fee and the minimum exit fee equal to the larger of (i) £2.5 billion (taking into account all prior annual fee payments) and (ii) 10% of any capital relief achieved (taking into account all prior annual fee payments). The non-amortisation provides an exit incentive while the exit fee ensures that the bank is

⁹² The effect of the APS on regulatory capital requirement is determined by FSA rules. For the purposes of calculating the impact of a participation in the APS on the regulatory capital, the scheme will be treated as a synthetic securitisation under BIPRU 9, which represents the FSA's implementation of the Capital Requirements Directive rules on securitisation. Under the FSA's securitisation framework, the regulatory capital requirement is the sum of the capital required to cover the first loss position (which is a 100% capital deduction, net of write downs and losses already taken by the bank on the portfolio), and to cover the additional 10% of losses absorbed in excess of the first loss.
<http://www.fsa.gov.uk/pubs/international/birpu9.pdf>

⁹³ [...]

not able to exit the scheme in the first years without having to pay any significant remuneration for the large advantage received.

- (161) Both the annual and the exit fee are payable in cash or with the approval from HM Treasury in deferred tax assets or in B shares. The Commission views the conditions attached to the payment in deferred tax assets (i.e. independent validation of the value of such tax assets and 20% surcharge) as necessary and appropriate to preserve the burden sharing objective of the payment. In the case of a payment of B shares, that method of payment would constitute additional aid which has been taken into consideration in the assessment under the Restructuring Communication, as described in section 4.2.6 below.

Alignment of banks' incentives with public policy objectives.

- (162) Under section 5.3, the Impaired Assets Communication requires that within an impaired asset relief measure, banks' incentives be aligned with public policy objectives, through (i) a 6 month maximum enrolment window, (ii) mechanisms to ensure that banks most in need to participate do participate and (iii) appropriate behavioural constraints to, among other things, limit the impact on competition.
- (163) The Commission finds the RBS's participation in the APS compatible with the requirements of section 5.3 of the Impaired Assets Communication. The entrance window was less than 3 months, short enough to avoid banks unduly delaying their participation in the scheme. In addition the institutions eligibility criterion was wide and objective enough to ensure that banks most in need would be able to participate⁹⁴.
- (164) Furthermore, RBS's participation is subject to a number of behavioural commitments. First of all, as announced in February 2009 for RBS, the participation in the APS is subject to identifiable lending commitments⁹⁵. Further, RBS has committed to a number of additional commitments in the context of the restructuring plan as described above in section 3.3, recitals (106), (108) and (109).

Eligibility of assets

- (165) The Impaired Assets Communication indicates that when determining the range of eligible assets for relief, a balance needs to be found between meeting the objective of immediate financial stability and the need to ensure the return to normal market functioning. The Impaired Assets Communication further sets out that this would plead in favour of a pragmatic approach including elements of flexibility.
- (166) The assets covered in the APS in RBS case include a wide spectrum of assets beyond those commonly referred to as toxic assets. Covered assets include residential mortgages, consumer finance, corporate bonds, corporate loans, lease

⁹⁴ The Commission notes that the two banks which decided to participate to the APS, were among the institutions which also received some of the largest aid packages, so as such among the ones most in need of financial support measures.

⁹⁵ RBS has committed to increase its lending to homeowners and businesses (meeting RBS's normal commercial terms) by £25 billion for the period until March 2010. Similar increases are targeted for the 12 month period thereafter.

finance, project finance, leveraged finance, commercial real estate loans, structured credit assets and derivatives.

- (167) The Commission observes that contrary to other banks, RBS difficulties do not stem from a well identified group of very risky financial products. They stem from the accumulation of risky loans in different entities of the group. This accumulation of risky loans is the result of the less than prudent originating and risk management policies applied across the board to the group's entities. They are also symptomatic of the group's aggressive expansion policy in the years preceding the current crisis.
- (168) Therefore, to achieve the objective of shoring up RBS's balance sheet by providing certainty on the level of future impairments, the measure had to be wide ranging, covering different asset classes, to include all the assets likely to generate higher levels of losses and impairments as a result of their nature (i.e. more risky assets such as structured credits, derivatives, leveraged finance, commercial real estate) or as a result of the way and of the time when they had been originated (including certain types of mortgages and consumer assets for example). While the measure covers a large pool of assets, it is far from covering all the assets appearing in the balance sheet of the bank: it has been limited to the assets most likely to generate significant losses and destabilize the bank, as reflected by the significant expected losses in each of the asset classes covered by the APS.
- (169) The Commission position is further comforted in that opinion by the fact that a high level of losses and impairment has already been taken in the portfolio⁹⁶ which clearly highlights the impaired nature of the portfolio.
- (170) The Commission therefore concludes that the assets covered by the APS are eligible under the Impaired Assets Communication.

Valuation

- (171) Regarding the valuation, the Impaired Assets Communication notes in section 5.5 that a correct approach to valuation is of key importance to prevent undue distortions of competition. Accordingly, the Commission has carefully scrutinized the valuation and in particular the underlying general methodology. It received technical assistance from external valuation experts.
- (172) The Commission views the valuation undertaken by HM Treasury and its experts as an extensive and in-depth exercise. This valuation exercise aimed at determining the expected credit losses likely to arise on the covered assets in a base case and a number of stress cases⁹⁷. To do so, HM Treasury hired a panel of three experts tasked with estimate such expected losses for each sub-portfolio of

⁹⁶ £[between 15 and 25] billion of losses have already been recognised on the covered assets at the end of 2008 and further impairments and write-downs of £[between 5 and 15] billion will be recorded in 2009.

⁹⁷ HM Treasury's advisers were asked to value expected losses of covered assets under 4 macro economic scenarios provided by the Bank of England ([...]). Macro economic indicators used were GDP, unemployment, income, house price inflation and interest rates. The Bank of England determined stress multipliers for each stress case (applied on the result of the base case) which were used in one set of methodologies. In the other set of methodologies, the advisors derived their own default and loss given default assumptions from the macro economic scenarios provided by the Bank of England.

assets so that for each sub-portfolio of assets, two independent valuations using two different methodologies would have been provided under each macro economic scenario⁹⁸.

- (173) That exercise was performed on the initially identified portfolio as announced in February 2009. The outcome of the exercise was expected losses ranging from £[...] billion in a base case to £[...] in a stress case, and up to [...] billion in an extreme stress scenario. [...]. Such overhaul included a reduction in the scope of the covered assets to £281.6 billion and an increase in the first-loss position. On the reduced portfolio of £281.6 billion, the range of expected losses extended from £[...] billion in the base case to £[...] billion in Scenario 3⁹⁹. The first-loss position was set at £60 billion.
- (174) The Commission analysed and benchmarked the methodologies and assumptions underpinning the valuation made by the experts of the UK authorities against (i) previous asset relief measured reviewed by the Commission and (ii) independent external reports and forecasts¹⁰⁰.
- (175) For each sub-portfolio, the Commission has found that at least one if not both (in most cases) valuation methodology was reasonable given proper assumptions to adequately assess expected credit losses. Regarding assumptions, the Commission has found assumptions in the base case as broadly adequate but not conservative enough to provide a "buffer" to compensate for the uncertainties due to the approximations which can not be avoided in the valuation of such a large and diversified portfolio of assets¹⁰¹. The fact that the first-loss piece has been set £[...] billion higher than the expected losses calculated by the experts of the UK authorities under the base case seems an appropriate buffer to compensate for the uncertainty stemming from these approximations.
- (176) On this basis, the Commission believes that the first-loss of £60 billion adequately covers the amount of expected credit losses to be generated by the covered assets.

Management of assets subject to asset relief measures

- (177) In point 46, the Impaired Assets Communication explains that it is necessary to ensure clear functional and organisational separation between the beneficiary bank and its impaired assets, notably as to their management, staff and clientele, in order to prevent conflict of interest and facilitate the bank's focus on the restoration of viability.

⁹⁸ In light of the very large number of individual asset included in the scheme, assets were pooled together by homogeneous asset classes. The valuation was undertaken on such a sub-portfolio basis. Individual asset assessment was not carried out.

⁹⁹ [...].

¹⁰⁰ The following external data sources were used in the Commission's assessment (among others): rating agencies reports and forecasts as well as investment banks' research material.

¹⁰¹ A portfolio approach such as the one used to assess the expected losses in the case of RBS impaired asset measure necessarily implies a greater use of assumptions, extrapolation and other approximation compared to approaches which value assets individually. Such portfolio approaches do therefore inherently embed a greater degree of imprecision which is difficult to quantify. That being said, this degree of imprecision is not necessarily synonymous of a lower valuation. In some instances, when valuing portfolios experts have a tendency to air on the side of caution and use more conservative assumptions.

- (178) The Commission believes that in the case of a guarantee of the size and scope of APS, a complete segregation of the covered assets (which remain on RBS balance sheet) and of the staff managing them would be difficult and potentially damaging to the objective of minimising the expected losses¹⁰². Therefore, there is no requirement for portfolio managers to be dedicated to the management of covered assets or to otherwise keep covered assets separated from the bank's other assets. However, the Commission believes that HM Treasury has put in place adequate safeguards to prevent conflict of interest and ensure losses on the covered assets are reduced to the minimum. Such safeguards include, in particular, adequate independent oversight and supervision rules, conflict of interest resolution policies and a right for HM Treasury to step in to potentially take over the management of covered assets if needed. Additionally, the Commission views the 10% vertical slice of losses in excess of the first-loss kept by RBS as an incentive to maximise recoveries on defaulted assets and hence minimising losses.

Conclusion and follow up measures

- (179) RBS's participation in the APS is to be analysed in the broader framework of RBS restructuring and viability plans. Whilst the APS is key to the bank business plan and return to long-term viability, the Commission view is that it is part and parcel of all the other measures simultaneously put in place by the group and that its ultimate compatibility with EU rules is subject to their adequate implementation. On that basis, the Commission has found that the terms of RBS's participation in the UK APS are compliant with the requirements of the Impaired Asset Communication.

4.2.5 Compatibility of the LA granted from 13 October under the Banking Communication

- (180) The Commission recalls that, as set out in the Banking Communication, the liquidity support for financial institutions from public resources (including the central bank) when constituting aid, can be found compatible, according to the principles of the Rescue and Restructuring Guidelines. First in order to be eligible for rescue aid the beneficiary must be in difficulty. In this case given its tight liquidity position, RBS was in difficulty and had to resort to LA.
- (181) The additional conditions for finding rescue aid compatible are laid down in point 25 of these Guidelines.
- (182) As regards the nature of the measure, it was in the form of liquidity support, as required by point 25(a) of the Guidelines. As regards the interest rate charged, the UK authorities have provided information demonstrating that the total cost of the facility for RBS was well above the interest rate charged for all the other normal liquidity facility offered on a permanent basis to all banks by the BoE. It was also at all times above the Libor rate by a margin of at least [...] basis points¹⁰³, which

¹⁰² In light of the scope of the scheme, segregating all assets would require profound organisational changes which would distract the bank from the primary objective of restoring viability. Furthermore, assigning some portfolio managers specifically to covered assets might result in the loss of key expertise and could be a source of de-motivation for staff.

¹⁰³ In October and November 2008, the spread between the BoE official rate and the Libor rate was exceptionally large by historical standards. This means that in normal times the penalty premium applied by the BoE on the LA to RBS would have resulted in a spread above Libor much higher. This is what happened at the end of November and in December 2008.

given the exceptional circumstances on the money market at the time is considered sufficient. The Commission also notes that RBS had to pay [...] for the LA facility, [...]. Furthermore in its earlier decisions¹⁰⁴ the Commission considered as adequate[...]. Second, the Commission notes that the LA operations were secured against high quality collateral, to which "margins" ("haircut") were applied against the risk of falls in the price of the collateral. This shows that it was comparable to the interest rate observed for loans to healthy banks, as sought by point 25(a) of the Rescue and Restructuring Guidelines. The requirements of Point 25(a) of the Guidelines are therefore met with. The Commission notes that this LA has been provided to RBS by the BoE who acted as 'lender of last resort', in that the group could no longer obtain on the market the liquidity it needed immediately to be able to fulfil its obligations. The Commission considers that the BoE would not have extended such an exceptional measure to the benefit of RBS had it not been necessary for the bank's liquidity. In addition, the size of LA facility was monitored on a daily basis and drawing were controlled to ensure that the facility would only cover the minimum necessary for the bank to be able to fulfil its lending operations. This demonstrates that the group was in difficulty and that the aid was limited to the minimum necessary to allow the bank to operate during the analysed period. The requirements of point 25(b) and (d) of the Rescue and Restructuring Guidelines are therefore fulfilled.

(183) The Commission notes that the LA has been fully repaid by RBS by 16 December 2008. Point 25(c) of the Guidelines is therefore complied with.

(184) Finally, as regards the "one time, last time" principle referred to in point 25(e) of the Rescue and Restructuring Guidelines, RBS did not receive rescue or restructuring aid before the start of the global financial crisis in 2007 and the other aid measures received by RBS as from 13 October 2008 are part of the same restructuring package. Therefore, without taking position on whether this provision is applicable to case approved under 107(3)(b) in the context of the current crisis, the Commission observes that, if it were applicable, this provision would be complied with.

(185) The Commission therefore considers that this measure constituted compatible rescue aid.

4.2.6 *Compatibility under the Restructuring Communication*

(186) The Restructuring Communication lays down three cumulative conditions for finding a restructuring measures compatible: (i) a restructuring plan must be submitted and implemented, which is capable of restoring the bank's long term viability, (ii) aid must be limited to the minimum necessary and an appropriate own contribution to restructuring must be provided by the aid beneficiary, and (iii) measures must be taken to limit distortions of competition to the minimum and to ensure a competitive banking sector. The measures notified by the UK authorities are assessed under these three conditions in the next sections of the present decision.

¹⁰⁴ The Commission decision of 4 December 2007 Rescue aid to Northern Rock, OJ C 43, 16.2.2008, p.1; the Commission decision of 31 July 2008 rescue package for Roskilde Bank, OJ C 238 17.9.2008, p. 5.

4.2.6.1 The restoration of viability

- (187) For assessing a restructuring plan the Commission makes sure that the Member State provides a comprehensive and detailed restructuring plan which provides complete information on the business model and which restores the bank's long-term viability.
- (188) Point 10 of the Restructuring Communication requires that the restructuring plan identifies the causes of the bank's difficulties and the bank's own weaknesses (as described in section 2.3), and outlines how the proposed restructuring measures remedy the bank's underlying problems. In its restructuring plan, RBS spells out the causes of its difficulties and has identified key targets to restore viability by 2013, by doubling the Core Tier 1 capital ratio to 8%, creating a £251 billion Non-Core division of which the assets will be run off, decreasing the tangible equity leverage ratio from around 42 times to around 25 times, decreasing the loan to deposit ratio to around 100%, increasing the maturity matching for wholesale funding and the liquidity buffer up to £150 billion, and reducing dramatically the group's reliance on wholesale funding.
- (189) RBS's restructuring plan includes a fundamental change to RBS's risk profile and a permanent risk reduction, changing the strategy of the group by focusing on high quality, stable and diversified profit streams, with full cost and capital allocations at business unit level, and maintaining a goal of AA category rating as the centrepiece of the strategy. This will ensure new management discipline focussing on stable risk adjusted return rather than absolute profit growth. As indicated in recital (65) above, besides the replacement of the Chairman and the Chief Executive Officer, a majority of the former management team has been replaced, including the Chief Financial Officer. In addition, a new head of Restructuring and Risk who is now member of the group's Executive Committee, has been appointed.
- (190) Each business division is being restructured along the five tests as mentioned in footnote 32 and with the objective of scaling back its activities focussing on its core business. The plan sets out equity requirements for each business, which is based on the RWA adjusted to reflect their different risk characteristics: [...] % for UK Retail, Wealth, Citizens and Ulster, [...] % for UK corporate and [...] % for GBM. It will centre on UK banking activities with tighter, more focused global operations.
- (191) One of the fundamental changes concerns GBM, which was the main source of losses for RBS in 2008. The planned actions, which are already under execution, aim at re-sizing and re-focusing GBM. It plans to exit heavy risky activities and niche segments, focus on major financial centres and scale back presence elsewhere, exit illiquid products and proprietary trading, and finally to introduce new risk management disciplines and undertake substantial operating cost reductions. Following the restructuring, the balance sheet will be less focussed on GBM and more focused on its UK-based activities. GBM will require considerably less asset, capital and risk intensity in generating its future income than it was the case in the recent past. In addition, GBM envisages a workforce reduction of over [...] full time equivalents, which represents approximately [...] % of the 2008 total workforce. Overall, GBM will account for [...] % of the RWA of the group (core operations only) in 2013, UK Commercial and Corporate [...], US Retail and Commercial [...], UK Retail [...], Wealth [...], and

Ulster [...]%. The measures envisaged by the restructuring plan therefore indicate that RBS is adapting to the lessons learned from the crisis and from its own mistakes, in line with point 11 of the Restructuring Communication.

- (192) These restructuring measures also illustrate that, as envisaged by point 12 of the Restructuring Communication, RBS's plan is mainly based on internal measures and includes withdrawal from activities which would remain structurally loss-making in the medium-term.
- (193) The Restructuring Communication also provides that the restructuring plan should demonstrate how the bank will restore its long-term viability without State aid as soon as possible. In particular, the bank should be able to generate appropriate return on equity, while covering all costs of its normal operations and complying with the relevant regulatory requirements. In particular, point 13 of the Restructuring Communication indicates that long-term viability is achieved when a bank is able to cover all its costs including depreciation and financial charges and provide an appropriate return on equity, taking account of the risk profile of the bank.
- (194) The Commission considers that the plan, which includes capital projection over the restructuring period under base case as well as under stress scenario, and the participation in the APS demonstrate how RBS will show adequate profitability at the end of the restructuring period, allowing it to cover all its costs including depreciation and financial charges and provide an appropriate return on equity of over 15%. The Commission notes that the projections provided are based on reasonable underlying macroeconomic assumptions. In particular, as outlined in the assessment of the FSA, the participation in the APS, together with the restructuring plan will allow RBS to comply with the relevant regulatory requirements even in stress scenarios with a protracted global recession in line with point 13 of the Restructuring Communication.
- (195) A comparison of the key economic indicators under the base case with other independent projections indicates that RBS's own forecasts show overall an appropriate level of conservatism. According to the FSA, RBS's forecasts for 2009 and 2010 profits are realistic about both [...] and [...] as it starts to reshape its business. In addition, performance in the year to date of RBS supports the view that its forecast for 2009 with an operating profit before impairments¹⁰⁵ of £[...] billion is conservative, while RBS has already delivered for the first half of 2009 pre-impairment operating profit of £8.5 billion ([...]%) of the annual forecasted performance).
- (196) As regards the stress test macroeconomic assumptions used by RBS and given by the Bank of England, they are deemed to be sufficiently severe to be considered as a stress scenario. Therefore, the Commission considers that stress scenario presented (as described in part 3.2.2) indeed demonstrates that the bank will be able to return to viability even if the situation on the market deteriorates as compared to generally assumed market conditions.
- (197) A key milestone for the return to viability, RBS's participation in the APS will protect the overall capital position of RBS, in particular in case of stress. As described above in recitals (47) and (157), although the participation in the APS

¹⁰⁵ On a post APS basis

will not provide any capital relief in a base case, it provides capital relief in the stress case from [...] to [...]. [...]. Under the stress test, by reducing the level of impairment, the APS will allow a return to profitability [...] in [...].

- (198) As explained above, the Commission considers that the assumptions for these analyses are reliable and sufficiently prudent to allow the conclusion that the restructuring measures undertaken by the group, including its participation in the APS, will be sufficient to ensure its long-term viability.
- (199) Finally, the information submitted by the UK authorities indicates that the funding position of the group [...] having improved considerably since the beginning of the year. In this respect, the Commission notices that the group still relies significantly on the UK government-guaranteed debt issuance scheme (CGS), which is currently planned to expire at the end of the year¹⁰⁶, and on the BoE's SLS, which respectively provided it with £[...] billion and £[...] billion of funding, according to the information available to the Commission. The Commission considers, however, that the implementation of the group's funding plan which involves a significant restructuring of the balance sheet to reduce the group's exposure to liquidity risk, as well as its targets in terms of loan to deposit (100%) and increased liquidity reserves (£150 billion) will ensure RBS with a conservative funding profile with a greater alignment of asset and liability maturities.
- (200) In conclusion, the thorough analysis run by the supervisory authority and the degree of conservatism built in when assessing the capital needs of RBS to pass the FSA capital framework, and the measures foreseen in the restructuring plan give sufficient comfort to the Commission that the implementation of the restructuring plan will lead to the restoration of the long-term viability of the group.

4.2.6.2 Own Contribution by the beneficiary (burden sharing)

- (201) The Restructuring Communication indicates that, in order to limit the distortions of competition and to prevent moral hazard, (i) the restructuring costs should be limited while (ii) the aid amount should be limited and a significant own contribution is necessary.

Limitation of the restructuring costs

- (202) The Restructuring Communication indicates in point 23 that the restructuring aid should be limited to cover the costs which are necessary for the restoration of viability.

¹⁰⁶ The UK authorities have notified early December 2009 a two-month prolongation of the CGS. In the notification, HM Treasury commits that in the period from 1 January 2010 to 28 February 2010 the limit on the issue by RBS of new CGS guaranteed debt will be £[...] billion. In such a case, it cannot be excluded that the Commission would, after an assessment of the situation on the financial markets, authorise this prolongation in a decision. If it is the case the participation of RBS for an additional 2 months for an amount comparable to current use should be considered to be covered by the present decision. Furthermore, the Commission considers that the participation of RBS up to 30 June 2010 or for an amount comparable to current use will be also covered by the present decision. Any participation of RBS beyond 30 June 2010 for an amount superior to what has been observed until now is not covered by the present decision and would need to be notified by the UK authorities.

- (203) The Commission considers that this requirement is satisfied in the present case for the reasons set out below.
- (204) The Commission first considers that the £20 billion recapitalisation of December 2008 was necessary to improve the bank's capital ratios and to improve its ability to absorb losses. The group had indeed to face in 2008 a loss before write-down of goodwill and other intangible assets of £7.9 billion and £16.2 billion of goodwill impairments, which, absent the recapitalisation, would have brought its Core Tier 1 ratio below the 4% regulatory requirement.
- (205) The Commission also observes that the participation in the APS as well as the new recapitalisation measures (upfront recapitalisation of £25.5 billion and the £8 billion contingent capital) were actually recommended by the FSA- an independent supervisory authority- as part of its assessment of the viability of the group. It indeed identified a capital shortage of £[...] billion in case of stress¹⁰⁷. The new aid package was a condition for RBS to pass the FSA capital framework.
- (206) In addition, the Commission notes that RBS will also run off or divest much of its past risky activities (including the sale of [...], European invoice finance and RBS asset management), which contributes to reduce the need for capital and liquidity in the future, i.e. it reduces the resources needed to restore viability over the long term.
- (207) The Commission also notes positively the commitment of the UK authorities that the beneficiary will not acquire any financial institutions and shall not make any other acquisitions to expand RBS's activities until the later of 31 December 2012 and the date on which the last of the operating businesses has been divested¹⁰⁸, nor to restart any activities that the it only carries on by virtue of the Non-Core division. This gives additional assurance that the restructuring plan and costs will be focused on restoring the viability of the core existing activities and that the group will not use its own resources or the State support for non-focused internal growth or for external growth.
- (208) Finally, RBS is committed to be at the leading edge in terms of implementing the G20 principles and the FSA code of conduct on bonuses and remuneration. This will guarantee that the total amount distributed (distributed as dividend or as bonuses) by the group is consistent with good risk management and that individual compensation practices provide the right incentives to focus on sustainable revenue growth. It will also prevent any market distorting remuneration practices.
- (209) On the basis of the above elements, the Commission concludes that the restructuring costs are limited to the minimum necessary. This ensures that the State aid is not directly or indirectly used to finance market-distorting activities not linked to the restructuring process.

Limitation of the amount of aid, significant own contribution

- (210) The Restructuring Communication indicates that, in order to keep the aid limited to a minimum, the banks should first use their own resources to finance the

¹⁰⁷ See footnote 2855. This will be achieved by the £25.5 billion recapitalisation, £8 billion of contingent capital, and £[between 5 and 15] billion from the APS capital relief in stress case.

¹⁰⁸ See recital (108), referring to the term sheet listing the commitments by the UK authorities.

restructuring. The costs associated with the restructuring should not only be borne by the State but also by those who invested in the bank. This objective is achieved by absorbing losses with available capital and by paying an adequate remuneration for State interventions.

- (211) The Commission has to verify whether the aid amount is limited to the minimum necessary. In this respect, the Commission notes positively that before taking up any State support, RBS carried out in June 2008 a capital raising exercise of £12 billion rights issue to increase its tight capital ratio which was heavily under stress due to the crisis.
- (212) As regards the £20 billion recapitalisation completed in December 2008, the shares were offered to the shareholders but were not subscribed. The State only purchased the shares not subscribed by the market. This ensures that the aid is limited to the minimum and that alternative financing could not be found on the market.
- (213) As regards the new aid package, according to the FSA assessment, RBS would have to raise additional £[...] billion if it would not take up the new aid package in order for RBS to be compliant with the regulatory capital framework. Given the extraordinary amount needed¹⁰⁹, alternative financing could not be found on the market, and the new aid package was the necessary means to ensure regulatory compliance and long term viability. Furthermore, the UK has adjusted in November 2009 the terms of the APS by increasing RBS's first-loss piece from £42.2 billion to £60 billion in order to bring it in line with the burden sharing requirements put forward in the Impaired Asset Communication. These elements ensure that the aid from the new package is limited to the minimum.
- (214) The UK authorities also committed that if in the future the group is able to raise Core Tier 1 capital on the market, the group will, as far as the FSA allows it, reimburse some B shares and/or cancel the contingent capital. The Commission considers this commitment as appropriate to ensure that if RBS's access to capital is improved in the future, it is used to reduce the aid and does not provide the group with excess capital (compared to what is needed to implement the restructuring plan) which could be used for distortive activities.
- (215) As regards the contribution of RBS to the financing of the restructuring costs, the Commission observes that RBS has undertaken a number of divestments over the past eighteen months, with the sale of Angel Trains Group, its 50% stake in Tesco Personal Finance JV, its 4.26% stake in Bank of China, Linea Directa and RBS's Asia Retail and Commercial Banking for a total of approximately £15 billion of assets (1% of its balance sheet). Furthermore, the UK authorities have committed to divest RBS Insurance, GMS, and Sempra Commodities businesses, all of which contribute to covering the restructuring costs. The group will also sell the Rainbow Business as described previously on the UK SME and mid-corporate market. A final contingent divestment is also foreseen in case the balance sheet reduction targeted is not met by the end of the restructuring period or RBS's Core Tier 1 falls below 5% and triggers the need for the additional recapitalisation of £8 billion ("contingent capital"). The Commission considers that these measures contribute to compliance with point 24 of the Restructuring Communication, which requires that

¹⁰⁹ For illustration, the current capital raising exercise undertaken by Lloyds Banking Group aims at raising £20.5 billion, of which £13.5 billion by way of a right issue, the largest ever launched in the UK.

banks should first use their own resources to finance restructuring, by, for instance, the sale of assets.

- (216) As regards the contribution of the existing shareholders, the Commission considers positively the fact that in exchange for its £20 billion recapitalisation in the group, the State received shares issued at a discount compared to the stock market price at the time of the announcement. This allowed it to own around 70% of RBS. This means that the aid did not wholly protect RBS's shareholders against the consequences of the group's past losses. On the contrary, they have been strongly diluted by the State recapitalisations. In that way, they bore the consequence of the losses registered by RBS. In addition, in case of conversion of the B shares in ordinary shares, it will lead to a further dilution of the existing shareholders.
- (217) Finally, as regards the contribution of the subordinated debt holders, the Commission notes positively that RBS will comply with the Commission's policy on Tier 1 and Tier 2 capital instruments set out in point 26 of the Restructuring Communication¹¹⁰. As described in recital (104) above, RBS will not pay investors any coupon on capital instruments or exercise any call option rights in relation to those instruments for a two year period unless there is a legal obligation to do so. The Commission accepts that the start of this two year period could be delayed until 30 April 2010 in order to[...].
- (218) The commitment not to pay coupon during two years does not apply for newly issued securities. The Commission accepts that the absence of a commitment by RBS not to pay coupons on newly issued instruments, in order to permit the group to raise fresh hybrid capital on the market, in line with point 26 of the Restructuring Communication. The Commission notes that RBS committed that the payment of coupons on new instruments will not create a legal obligation to make any coupon payments on RBS's existing lower Tier 2, upper Tier 2 or Tier 1 securities.
- (219) Furthermore, RBS commits not to pay coupons on any newly issued securities offered in exchange for any existing securities instrument, which the Commission considers necessary to avoid a circumvention of the prior commitment not to pay coupon on existing hybrid securities. However, existing securities affected by the coupon ban can be exchanged for newly issued instruments not affected by the coupon ban if and only if the newly issued instruments are [...].
- (220) Regarding the existing securities instruments retained in ABN AMRO group, RBS committed to stop paying coupon for a period of two years starting only after the legal de-merger and separation of the ABN AMRO group¹¹¹. RBS has confirmed that the payment of the coupons on these existing ABN AMRO securities will not trigger any coupon payments in the other entities of the RBS group. The Commission observes that if RBS immediately stops to pay coupon on the ABN AMRO group instruments, it will prevent the demerger of the later group, which is a pre-condition for integrating the businesses acquired from this group. Since this integration is an important part of the restructuring plan, the Commission considers

¹¹⁰ Cf. MEMO/09/441 of 8 October 2009 - Commission recalls rules concerning Tier 1 and Tier 2 capital transactions for banks subject to a restructuring aid investigation.

¹¹¹ More precisely, at the end of the 12 month period during which coupon payments is compulsory due to the fact that the demerger takes the form of a distribution in kind to shareholders.

that it is acceptable for these securities to delay the starting date of the two-year period during which coupons will not be paid.

- (221) On the basis of the above elements, the Commission concludes that the beneficiary, its shareholders and its debt holders provide for a significant own contribution to the restructuring costs.
- (222) As regards the adequacy of the remuneration of the State interventions, the Commission has reached the following conclusions.
- (223) First, the Commission considers that the State will receive an adequate remuneration for the capital injected in the group. This assessment was carried out in the decision of 13 October 2008 approving the UK recapitalisation scheme. The State purchased the shares¹¹² at a discount to the stock market price prevailing at the time of the announcement of the recapitalisation. This is in line with the requirement laid down in the Annex to the Recapitalisation Communication concerning recapitalisation in the form of ordinary shares. As regards the £25.5 billion of B shares that will be subscribed before the end of the year as part of the new aid package, as assessed above in section 4.2.3, their remuneration is in line with the requirement laid down in the Recapitalisation Communication. Finally, the remuneration of the contingent capital of £8 billion was also considered adequate.
- (224) Second, as concluded in recital (159), the APS first-loss tranche and yearly fee provides adequate mechanisms to address burden sharing issues, as well as a positive exit incentive.
- (225) Third, the Commission also considers that, as concluded in the decision of 13 October 2008 approving the CGS scheme, RBS will pay an adequate remuneration for the State guarantees on medium-term liabilities. This fee is also in line with the requirements laid down in the Banking Communication.
- (226) The Commission concludes that the State interventions are adequately remunerated. This contributes to ensuring that the aid is limited to the minimum and that the group and the existing shareholders bear the largest part possible of the restructuring costs.
- (227) On the basis of the above elements, the Commission concludes that the restructuring plan of RBS ensures that the restructuring costs are limited to the minimum necessary, that the aid is limited to the minimum (notably because it is adequately remunerated) and that the beneficiary, its shareholders and its debt holders provide for a significant own contribution to the restructuring costs. The plan thus complies with section 3 of the Restructuring Communication.

4.2.6.3 Limiting distortions of competition and ensuring a competitive banking sector

- (228) The Restructuring Communication requires that the restructuring plan contains measures limiting distortions of competition and ensuring a competitive banking sector. In this context, it should also address moral hazard issues and ensure that State aid is not used to fund anti-competitive behaviour.

¹¹² Purchase price net of the underwriting fee received by the State.

- (229) The Restructuring Communication indicates in point 30 that the measures to limit the distortion of competition created by the aid should be tailor-made to address the distortions identified on the markets where the beneficiary bank operates following its return to viability after restructuring. The Commission in its assessment should take as a starting point the size, scale and scope of the activities of the bank. Furthermore, the nature and the form of the measures will depend on the amount of aid and the conditions and circumstances under which it was granted and on the characteristics of the markets on which the bank will operate.
- (230) The Restructuring Communication notes in point 31 that when assessing the amount of aid and the resulting distortions, the Commission has to take into account both the absolute and relative amount in relation to the beneficiary's RWA.
- (231) In this respect the Commission notes that, with the £45.5 billion of recapitalisation, which can be considered as 100% of aid since the group could not have raised that capital on the market, RBS receives an amount of aid equal to 7% of its RWA at the end of 2008.
- (232) As regards the aid amount included in the APS, the Commission notes that footnote 2 to paragraph 20(a) of the Impaired Assets Communication defines the aid amount in an asset relief measure as the difference between the transfer value of the assets and the market price. It is very difficult to estimate the market value of the covered assets as most of them are loans which are not traded. A rough estimation of the market value of the covered assets has been derived by observing the market price of securitization of loans. This estimation is between [...] % and [...] % of their nominal value. If the transfer price is considered to be the nominal value of the assets decreased by the first-loss piece which is borne by the bank, it gives, on the basis of the definition laid down in the Impaired Assets Communication, an amount of aid embedded in the APS in the region of £[...] billion to £[...] billion. This figure must be treated with caution. Indeed, it is observed that there is no transfer of the assets to the State since the assets are not purchased. They remain in RBS's balance sheet and RBS must continue to fund them. The Commission notes therefore, that the above calculation may tend to overestimate the aid amount. The Commission also observes that, without the APS, the group would have needed only around £[between 5 and 15] to [between 5 and 15] billion additional capital on top of the £25 billion recapitalisation and the £8 billion contingent capital. On the other hand, this additional capital would have not protected the bank against the tail risk, i.e. the risk of large unexpected losses on the covered assets. In conclusion, the Commission considers that the aid amount is between £[between 5 and 15] billion and £60 billion.
- (233) Finally, the group will receive £8 billion of contingent capital. Normally, for companies in financial difficulties, which have no access to market funding, and in particular in a situation of a wide-spread crisis, the aid element of State capital injections equals to the nominal value of the recapitalisation. However, considering the specific circumstances of the contingent capital, namely a contingent commitment from the State to subscribe for an additional £8 billion of capital only in the event that RBS's Core Tier 1 capital ratio falls below 5%, the Commission recognises that the distortive effect of the £8 billion recapitalisation is more limited than in normal recapitalisations of companies in financial difficulties.
- (234) It will bring the total restructuring aid (excluding the guarantees) between £65.5 billion and £113.5 billion. The cumulative effect of the measures, both implemented

and proposed, will greatly boost RBS' capital ratios. Both capital injections and impaired asset relief measures together represents between 11.3% and 19.6% of RBS's RWA year end 2008. In addition the group may receive additional recapitalisation aid if the fee for the APS and/or the contingent capital is paid in B shares.

- (235) In addition the Commission recalls that RBS has also obtained aid in the form of State guarantees under the CGS. As for companies in financial difficulty, if the bank is not able to raise sufficient non-guaranteed debt to cover all its funding needs, the Commission considers that the aid element of such guarantees might go up to the level of their nominal value¹¹³. It was manifestly the case when RBS started to use the CGS. In these circumstances, the distortive effect of such guarantees might be better assessed by comparing the guaranteed debt to the overall funding of the bank, which in case of RBS corresponded on 31 September 2009 to only about [...] %¹¹⁴.
- (236) Finally, the Commission recalls that the group received rescue aid from 13 October 2008 in the form of the LA. However, it was fully reimbursed by mid-December and therefore lasted only two months.
- (237) The Commission concludes that RBS has received a high amount of aid in the form of recapitalisation and in the form of an asset relief measure¹¹⁵.
- (238) As regards the position of RBS on the UK market¹¹⁶, the Commission notes that the group is one of the market leaders in the UK retail banking¹¹⁷, and is the market leader in the SME and mid-corporate markets. The SME market is concentrated in the UK, with the four largest banks (RBS, Lloyds Banking Group, Barclays and HSBC) having a combined market share of around 90%. In Great Britain, RBS has an average [20-30] % market share of the segment of small businesses with annual turnover of under £1 million, and has an approximate [20-30] % share for businesses with annual turnover of between £1 million and £ 25 million ("commercials"). RBS serves over [20-30] % of the corporate customers with a turnover between £25 million and £1 billion ("mid-corporate"). In Northern Ireland, RBS is a leading bank with its subsidiary Ulster Bank for both personal and SME customers. The Commission therefore concludes that the position of the

¹¹³ Cf Commission decision Commission Decision in case C 9/2008 of 4 July 2008 *SachsenLB*, not yet published, Commission decision of 29 May 2009 in case N 264/2009; Rescue aid to *HSH Nordbank AG*, OJ C 179, 1.8.2009, p. 1, Commission Decision of 7 May 2009 in case N 244/2009 *Commerzbank*, OJ C 147, 27.6.2009, p. 4.

¹¹⁴ Total guarantees as of September 2009/total funded liabilities (excluding equities) as of September 2009

¹¹⁵ Compared to RWA and even more in absolute terms, the aid received by RBS is for instance higher than the aid authorised in favour of Lloyds Banking Group (Commission decision of 18 November in State aid case N428/2009, not yet published), ING (Commission decision of 18 November in case N528/2008, not yet published), KBC (Commission decision of 18 November in case C18/2009, not yet published) or Commerzbank (Commission Decision of 7 May 2009 in case N 244/2009 *Commerzbank*, OJ C 147, 27.6.2009, p. 4).

¹¹⁶ Cf. PriceWaterhouseCoopers, Market review, July 2009, submitted by the UK authorities.

¹¹⁷ RBS owns a branch infrastructure (RBS & NatWest) of 1900 branches within the UK, with a client base of 19 million retail customers. It has a high market share on certain segments of the UK retail banking market which is in any case quite concentrated. Its market share of personal current accounts was [15-25] %, with the four largest players having 75% of the market.

group on the UK market, in particular in certain segments and certain regions, is very significant¹¹⁸.

- (239) As regards its position in financial markets activities, RBS remains one of the top players in providing banking services to international corporations and institutions, as illustrated in global league tables¹¹⁹. However, these markets are more fragmented than the UK retail and corporate market. The financial markets activities are provided from the GBM division, which increased greatly in size with the acquisition of ABN AMRO, but which was the source of a large part of the group's difficulties.
- (240) As recalled by the Restructuring Communication, where banks compete on the merits of their products and services, those which accumulate excessive risk and/or rely on unsustainable business models will ultimately lose market share and, possibly, exit the market while more efficient competitors expand on or enter the markets concerned. State aid prolongs past distortions of competition created by excessive risk-taking and unsustainable business models by artificially supporting the market power of beneficiaries. In this way it may create moral hazard for the beneficiaries, while weakening the incentives of the non-beneficiaries to compete, invest and innovate. In this context, measures to limit competition distortions due to State aid play an important role.
- (241) The Commission observes that RBS has taken excessive risks in the past, both in its internal lending and trading policy as in its acquisition policy. This is illustrated by the huge trading asset and credit market-related write-downs and the massive goodwill impairment charge. It is also illustrated by the broad range and huge amount of assets which will be covered under the APS. Thanks to the aid measure, the group was able to survive and keep its leading position on many markets. The aid therefore goes against the normal functioning of the market and against the principles of competition, thereby providing the wrong incentives. The Commission therefore considers that measures are necessary to limit the distortions of competition. This is particularly the case on markets where the aid allows the bank to keep its leading position. The aid allowed RBS to maintain its high market shares, in particular on certain segments of the markets which were already concentrated and featured low switching rates among customers¹²⁰. Consequently, measures are necessary in order to remedy this distortion of competition created by the aid.
- (242) The Commission considers that the restructuring plan by RBS, including the compensatory measures described in part 3.3, entails sufficient structural and behaviour measures to address the distortions of competition and tackling the issue of moral hazard.
- (243) First, the Commission notes that the adequate remuneration of the State support granted to RBS (as assessed in recitals (222)-(226)) contributes to limiting the distortion of competition created by the aid.

¹¹⁸ As regards other areas in Europe, RBS is a challenger to the big two players in the Republic of Ireland.

¹¹⁹ Global League Tables are rankings of investment banks in terms of the dollar volume of deals they work. Most of them are tabulated by a financial information tool, such as mergermarket, Dealogic, Thomson Financial or Bloomberg.

¹²⁰ This is relevant for the SME and commercial segments.

- (244) Second, as described in part 3.3 above, the Commission observes that RBS will divest the Rainbow Business which represents 14% of the group's UK based network, 1.8 million of the group's personal customers, a market share of 5% on the SME and mid-corporate markets. With one banking brand (Williams & Glyn's), a critical mass of SME and mid-corporate customers, geographically well spread branches, no funding gap (loans to deposits ratio of around 100%), and assets up to £20 billion, the divested entity has a significant size and is likely to constitute a viable business in the future that can compete in the SME and mid-corporate banking business in the UK. The Commission considers that the divestment of the Rainbow Business adequately addresses the distortion of competition created by the aid and is an appropriate means of increasing competition on the concentrated UK banking market, since the Rainbow Business will constitute a sufficiently attractive target for some competitors wishing to enter the UK market or expand their presence there.
- (245) The Commission notes positively the behavioural commitments provided by the UK authorities and described in more detail in part 3.3 above. The commitments such as the appointment of a hold separate manager, a monitoring trustee and the non-solicitation of the clients of the divested entity will ensure that this entity is not hollowed out and remains viable. Furthermore, in case the business is not sold by 31 December 2013, after that date, the Commission can make sure that the business is sold with the help of a divestiture trustee who can sell the business at no minimum price. All these elements are appropriate to ensure that the entity will be viable and sold, and therefore will reduce RBS's size and add competition to the UK banking market.
- (246) To ensure that such divestment does not result in the strengthening of another leading player, what would not reduce the high concentration rate on the SME and mid-corporate markets and not stimulate competition, the Commission notes the commitment that the buyer's market share in the SME may not exceed 14% after the purchase of the divested entity. The Commission also notes positively the condition that the buyer will have to be vetted by the FSA and have the sufficient resources and incentive to maintain and develop the divested entity. The 14% market share ceiling has been based notably on the OFT analyses¹²¹. Both, this ceiling as well as the required approval by the FSA ensure that the planned divestment of the Rainbow Business would lead to increased competition on the concentrated UK banking sector by introducing a challenger or reinforcing a small existing player.
- (247) As regards Ulster Bank, the Commission notes that no divestment was possible that would [...]. For that reason, since the Irish markets are much smaller than the Great Britain market where a significant divestment is planned, and given the sufficiency of other divestments and run-offs, the Commission can accept the absence of divestiture in those markets.
- (248) In addition to the sale of the Rainbow Business, the Commission observes that RBS has committed to the sale of additional businesses and assets which amounts to £60 billion of RBS's RWA in case its targeted balance sheet reduction is not achieved by the end of the restructuring period or if its Core Tier 1 ratio falls below the 5% level. The Commission considers that the balance sheet reduction target,

¹²¹ OFT report on the anticipated acquisition by Lloyds TSB of HBOS, 24 October 2008; OFT report on the SME banking, August 2007

which aims at limiting the size of the group by withdrawing from some market segments, is necessary to further limit distortion of competition that the aid measures have created. Therefore, if RBS fails to reduce its balance sheet as committed in its restructuring plan and thus fails to become smaller and withdraw from the market segments listed in its restructuring plan, additional measure is necessary to limit distortion of competition. Furthermore, the Commission notes that the group commits to implement the contingent divestment if its Core Tier 1 ratio falls below 5%. It is recalled that in the latter case it will receive the contingent capital. The Commission considers that this mechanism will ensure that if the group receives additional recapitalisation in the form of £8 billion of contingent capital, there will be a further reduction of the size of the group limiting the distortion of competition created by the aid. The contingent divestment responds adequately to this concern by committing to an additional material divestment.

- (249) As regards GBM market activities, the restructuring plan indicates that they will undergo a fundamental review, with significant downsizing. The Commission also notes positively the sale of RBS Sempra Commodities, which will reduce the GBM's scope by withdrawing from the commodities business. Finally, the commitment to cap RBS's global position no higher than fifth in the debt activities, including global bonds and syndicated loans for a three-year period, ensures that RBS does not expend aggressively on that market thanks to the aid received.
- (250) In addition, RBS already sold or committed to sell its stakes in Tesco Personal Finance, in Bank of China, as well as its subsidiaries Linea Directa, Angel Trains, the Asian retail and commercial network, RBS Insurance, and its ownership interest in GMS and Sempra Commodities. Overall, RBS will run off and sell around £[between 550 and 650] billion of assets (including the Rainbow Business), which is equivalent to [between 20 and 30]% of its total balance sheet at the end of 2008 and close to [between 40 and 55]% of its funded balance sheet at the same date¹²². The realised and envisaged divestments represented income equivalent to [...] % of the group's income in 2008. The Commission considers that a reduction of that size adequately addresses the issue of moral hazard and prevents the creation of perverse incentives.
- (251) Moreover, the UK authorities have also committed to an acquisition ban (as described in recital (108) above)¹²³. This prevents RBS from using the State aid and its State-supported operations to purchase competitors or to grow externally at the expense of other financial institutions.
- (252) Finally, the UK authorities commit that RBS will refrain from referring to the fact that it enjoys any State support or to the fact that the UK government is a shareholder in RBS in any RBS advertising.
- (253) On the basis of the above elements, the Commission considers that the scale and nature of measures proposed by RBS are sufficient and adequate to address the distortions of competition created by the aid, including moral hazard.

¹²² RBS balance sheet is inflated by a high amount of unfunded derivatives products.

¹²³ Cf Commission Decision of 7 May 2009 in case N 244/2009 Capital injection into Commerzbank, OJ C 147, 27.6.2009, p. 4, at para. 111.

(254) At the same time, the Commission notes that according to the commitments by the UK authorities the buyer of the divested entity must have sufficient resources and incentive to maintain and develop the divested entity, which gives an assurance that the business will continue to be run as a going concern. Furthermore the Commission notes that the lending commitments given by RBS to the UK government at the beginning of 2009 regarding the retail and SME customers will be maintained at the same level. To conclude, the Commission considers that sufficient measures have been undertaken to ensure that the divestment would have no negative impact on the supply of lending for the UK retail and SME customers.

4.2.7 Monitoring

(255) The UK authorities have committed to submit regular reports on the measures taken to comply with this decision. The first report will be submitted to the Commission not later than six months after the adoption of this decision, as sought by point 46 of the Restructuring Communication. Thereafter, the UK authorities will report at six-monthly intervals. In addition, the restructuring plan and the commitments provided by the UK authorities foresee a monitoring trustee who will assist the Commission in monitoring the implementation of the restructuring plan and various provisions therein.

4.3 CONCLUSION ON THE COMPATIBILITY UNDER RESTRUCTURING COMMUNICATION

(256) The Commission concludes that the restructuring plan and the associated commitments are appropriate to enable RBS to restore its long-term viability, sufficient in respect to burden-sharing and appropriate and proportional to offset the distortions of competition created by the aid measures. The Commission therefore considers that the submitted restructuring plan and the associated commitments fulfil the criteria of the Restructuring Communication. The recapitalisation of £20 billion, which was already approved as emergency aid, the participation in the APS including the possibility to pay the fee in B shares¹²⁴, the forthcoming recapitalisation of £25.5 billion transaction, the contingent capital of £8 billion, the guarantees already issued and planned (see footnote 106) in the context of restructuring of RBS can therefore be considered as compatible restructuring aid on the basis of Article 107(3)(b) TFEU Treaty.

5 CONCLUSION

(257) The Commission has accordingly decided to consider the State recapitalisation of RBS of £20 billion, the participation in the UK impaired asset scheme (APS) including the possibility to pay the fee in B share, the forthcoming recapitalisation of £25.5 billion in B shares, the contingent recapitalisation of £8 billion, the guarantees already issued and planned (see footnote 106) in the context of the restructuring of RBS and the liquidity assistance provided to RBS by the Bank of England from October to December 2008 to be compatible with the internal market.

¹²⁴ See recital (161)

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Your request 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

Neelie KROES
Member of the Commission