



EUROPEAN COMMISSION

Brussels, 22.12.2008  
C(2008) 8984 final

**Subject: State Aid N650/2008 – UK  
Modifications to the Financial Support Measures to the Banking Industry in  
the UK**

Sir,

## **I. PROCEDURE**

1. On 12 October 2008 the UK notified a package of measures designed to ensure the stability of the financial system, which was approved on 13 October<sup>1</sup>. On 18 December 2008, the UK notified several changes to the Credit Guarantee and Recapitalisation schemes, which formed part of this package of measures.

## **II. DESCRIPTION**

### **1. The objective of the Original Scheme**

2. In response to the exceptional turbulence in world financial markets, the UK brought forward a package of measures (hereinafter referred to "the scheme") designed to restore stability to the financial system and to remedy a serious disturbance to the economy of the UK. These measures had as their objective restoring confidence and encouraging healthy inter-bank lending, through the provision of liquidity, the recapitalisation of the financial sector and provision of state guarantee to new debt issuance.

---

<sup>1</sup> OJ C/290/2008 – Financial Support Measure to the Banking Industry in the UK N 507/2008

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

Commission européenne, B-1049 Bruxelles – Belgique  
Europese Commissie, B-1049 Brussel – België  
Telefón: 00-32-(0)2-299.11.11.

3. The proposed measures fell into three parts:
  - A. Bank Recapitalisation Scheme (hereinafter "The Recap Scheme"): Making available new Tier 1 capital for banks and building societies to strengthen their balance sheets and permit 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 of short and medium term debt insurance designed to reopen the market for short and medium term wholesale funding, thus addressing the problems of banks which are fundamentally sound but which, due to the current financial crisis, are unable to refinance their wholesale funding as it matures.
  - C. Short-Term Liquidity Measures: The provision of short term liquidity, mainly by extending the collateral accepted for sterling and US dollar money market operations.

## **2. The Beneficiaries**

4. Eligible institutions, for the amended scheme, remain sufficiently capitalised UK incorporated banks (including UK subsidiaries of foreign institutions) which have substantial business in the UK and building societies. A UK incorporated bank has a "substantial business" for this purpose if it is eligible to sign up for the Bank's Standing Facilities in accordance with its Framework for the Bank of England's Operations in the Sterling Money Markets (i.e. with eligible liabilities above £500 million).

## **3. Description of the changes to the Guarantee and Recap Schemes**

5. The UK has proposed the following changes to the Guarantee Scheme.
6. The UK will, as of 1 January 2009, also guarantee debt instruments issued in Japanese Yen, Australian dollars, Canadian dollars and Swiss francs. Previously, the eligible debt was limited to instruments in sterling, US dollar or Euro.
7. The fee payable on guaranteed liabilities will be based on a per annum rate of 50 basis points plus 100% of the institutions' median five-year Credit Default Swap (CDS) spread during the period 2 July 2007 to 1 July 2008. This fee will apply retrospectively to all guaranteed issues under the original scheme since its launch on 13 October 2008. Previously, the median CDS spread for each institution was based on the 12 month period ended on 7 October 2008. The different reference period for the calculation of the median CDS spread has the effect of lowering the guarantee fee.
8. As in the original Guarantee Scheme, the initial term of the instruments guaranteed under the amended scheme will remain no longer than three years. However, participating institutions will now be able to roll over the guarantee on some individual instruments for an additional two years, ending in April 2014. The proportion of the guaranteed liabilities that can be rolled over in this fashion shall not exceed one third of the overall limit for allocations of guaranteed liabilities (or £88.33 billion).
9. The UK has proposed the following change to both the Recap and Guarantee Schemes.

10. The requirement that the balance sheet growth of participating institutions be limited to certain thresholds, as set out in point 12 (g) of the original decision, no longer applies to those banks that can be considered as fundamentally sound.
11. The UK has proposed the following change to the Recap Scheme.
12. Participating banks that are fundamentally sound need not provide a restructuring plan but may instead provide a report that illustrates that they remain fundamentally sound and how they plan to repay state capital. In the original scheme all banks, which had benefited from structural measures which lasted beyond the duration of the scheme, had to provide a restructuring plan.
13. Otherwise, the conditions of the scheme remain unchanged.

### **III. POSITION OF THE UK**

14. In line with the original decision, the UK authorities accept that the amended scheme contains State aid elements. The UK authorities claim that the scheme is compatible with the common market because it is necessary to remedy a serious disturbance in the British economy pursuant to Article 87(3)(b) of the EC Treaty.
15. The UK submits that, in view of market developments, it was necessary for them to adjust the formula that determines the fees paid by participating institutions for use of Government guarantees. This will reduce the cost of the scheme and bring it more into line with those in other countries. The UK intends that these changes will support the provision of credit to the UK economy.
16. With regard to possibility to extend the guarantee on some instruments for an additional two years, the UK is of the view that this will enable participating institutions to better manage the transition from guaranteed to wholly unsupported funding. Allowing only some guarantees to be rolled over will stagger this adjustment, thus preventing the entirety of the guaranteed instruments coming up for refunding on the market at the same time. Furthermore, the extension of eligible currencies is intended to further widen the investor base in UK banks and building societies.
17. The commitments of the UK remain the same as in the original decision, except for two changes.
18. Firstly, the UK authorities will no longer undertake to impose the balance sheet restriction set out in 12 (g) of the original decision for the beneficiaries of the Guarantee Scheme.
19. Secondly, with regard to the possibility to rollover the guarantee for an additional two years, the UK commits that the proportion of the guaranteed liabilities that can be rolled over in this fashion will be limited to one third of the overall guarantee allocation.

### **IV. ASSESSMENT**

#### **1. State aid character of the Amended Scheme**

20. As set out in Article 87(1) EC, 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 common market.

21. Similar to the original scheme, the Commission agrees with the position of the UK that the amended scheme for eligible institutions constitute aid to the institutions concerned pursuant to Article 87 (1) EC.

## **2. Compatibility of the Amended Guarantee and Recap Schemes**

### **a) Application of Article 87(3)(b) EC**

22. The Commission found the original scheme to be compatible with the common market under Article 87(3)(b) EC of the EC Treaty. Given that this amended scheme is practically identical to the original scheme, and the situation on the financial markets has not improved, it is only necessary to assess whether this is still the case in view of the aforementioned amendments.

### **b) Assessment of the Amendments to the Guarantee and Recap Schemes**

23. The UK proposes to extend the material scope of the guarantee to cover instruments issued in Japanese Yen, Australian dollars, Canadian dollars, Swiss francs and any other such currencies as may be determined by the Treasury. The Commission does not consider this as problematic, as it helps to further increase the possible sources of funding for UK banks.
24. The UK proposes to extend the temporal scope of the guarantee, from three years to five. In cases to date, the Commission has been of the view that the duration of a guarantee should be as short as possible and has only approved guarantees with a duration beyond three years where this longer duration has been duly justified and was limited in size. Under the current scheme, all participating banks have only been able to issue guaranteed debt of a duration limited to three years, which means that in three years time, a significant amount of debt could come up for refinancing within six month period. The possibility to rollover some of the guaranteed debt for an additional period of up to two years is intended to address the concern that the participating banks will face difficulties, due to the sheer volume of debt coming due for refinancing in this six month period. Allowing them to rollover up to one third of their guaranteed debt is aimed at staggering the refinancing needs of UK banks over a longer period and thus ensuring a more orderly return to normal market financing. Therefore, the Commission finds that the extension of the temporal scope of the guarantee to be justified.
25. Regarding the UK proposal to change the reference period for the calculation of the median CDS spreads for the participating banks, the Commission notes that this will lower the guarantee fee (by around 22 basis points on average according to the UK authorities). The recent practice of the Commission has been to consider the recommendations of the ECB as the benchmark for an appropriate guarantee fee. In the new reference period chosen by the UK to calculate the median five year CDS spread, CDS spreads were higher than in the period chosen by the ECB. As a result, the guarantee fee charged by the UK will remain above the floor accepted in other cases and can thus be considered appropriate.
26. The amended scheme no longer includes behavioural constraints in the form of a limitation of the expansion of the balance sheet of the participating banks. This is in line

with the revised guidance of the Commission, which was set out in footnote 18 of the recent 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"<sup>2</sup>. This paper states that balance sheet growth restrictions are not necessary for the recapitalisation of fundamentally sound banks, which also applies in principle to guarantee schemes. There are no indications that the absence of such limitations would lead to undue distortions of flows of funds between Member States.

27. Finally, the UK will no longer provide a restructuring plan for beneficiary banks of the Recap scheme that are fundamentally sound but instead will provide a report, in line with the Recapitalisation Communication, that illustrates that they remain fundamentally sound and how they plan to repay state capital. This is also in line with the revised guidance of the Commission, which was set out in point 40 of the aforementioned Communication on recapitalisation.
28. On the basis of the above, the Amended scheme of the UK can be considered compatible with the Common market.

## V. DECISION

The Commission concludes that the notified amended scheme is compatible with the Common market and has accordingly decided not to raise objections against it, since it fulfils the conditions to be considered compatible with the EC Treaty.

If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of this letter. Your request specifying the relevant information should be sent by registered letter or fax to:

European Commission  
Directorate-General for Competition  
State Aid Greffe  
Rue de la Loi/Wetstraat, 200  
B-1049 Brussels  
Fax No: +32-2-296 12 42

Yours faithfully,

For the Commission

Neelie Kroes  
Member of the Commission

---

<sup>2</sup> [http://ec.europa.eu/competition/state\\_aid/legislation/recapitalisation\\_communication.pdf](http://ec.europa.eu/competition/state_aid/legislation/recapitalisation_communication.pdf) - Published on 8 December 2008