EUROPEAN COMMISSION

Brussels, 14.3.2012
C(2012) 1739 final

Subject: State Aid SA.34218 (2012/N) – UK Credit Easing Schemes

Sir,

1. Procedure

1. On 10 January 2012 the United Kingdom (hereinafter "UK") government pre-notified two credit easing schemes to improve lending conditions of middle-caps and small businesses with an annual turnover below £50 million (hereinafter "SMEs") in the UK, namely, the National Loan Guarantee Scheme (hereinafter "NLGS") and the Business Finance Partnership (hereinafter "BFP").
2. In January and February 2012 the European Commission (hereinafter "the Commission") requested additional information several times. The UK government replied to those information requests in a timely manner and met with the Commission on 23 January and 3 February 2012.
3. On 10 February 2012 the UK government notified the NLGS, seeking approval under Article 107(3)(b) of the Treaty on the Functioning of the European Union (hereinafter "TFEU"). On 10 February 2012 the UK government also notified the BFP for reasons of legal certainty, considering it not to involve State aid.

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2. The measures

2.1. The National Loan Guarantee Scheme

2.1.1. Objective

4. The objective of the NLGS is to reduce the cost of finance for SMEs via financial institutions.[1] To that end, the NLGS will make government guarantees available to participating banks, reducing participating banks' funding costs. Banks are contractually obliged to pass on the lower cost of funding to SME clients in form of discounted loans or grants.

2.1.2. Duration and size

5. State aid approval is initially sought for the NLGS only for the period expiring on 30 June 2012.

6. In total, however, the objective of the UK is that the NLGS will be made available for a window of two years from the start date. The NLGS will therefore be subject to periodic re-notifications to the Commission and may be subject to subsequent modifications.

7. The total size of the NLGS is up to £20 billion of guarantees.

2.1.3. Eligible banks

8. Banks are eligible for participation if they are incorporated in the UK (including UK subsidiaries of foreign institutions), are licensed to take deposits, are regulated by the UK Financial Services Authority or an EU regulator, are considered to be financially viable, have a track record of lending to small businesses and have a significant role in the UK banking system, which is defined as holding more than £500 million in liabilities. In February 2012, […][*] banks and building societies met those criteria, including the top five UK banks, namely Barclays, HSBC, Lloyds, RBS and Santander. Of the latter, RBS and Lloyds are undergoing restructuring; their restructuring plans were approved by the Commission.[2]

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1 For the convenience of the reader, financial institutions are simply referred to as "banks".

* Confidential information

2 Commission decision of 14 December 2009 in case N 422/09 & N 621/09, Restructuring of Royal Bank of Scotland, OJ C 119, 7.5.2010, p. 1, and Commission decision of 18 November 2009 in case N 428/09, Restructuring of Lloyds Banking Group, OJ C 46, 24.2.2010, p. 2.

2.1.4. Eligible debt instruments

9. All unsecured debt that participating banks newly issue or renew, with maturities between one and five years, is eligible for a guarantee under the NLGS, with the exception of debt instruments that qualify as equity.

10. In accordance with established Commission decisional practice, not more than one-third of the overall budget for debt issuance, that is a maximum of £6.67 billion out of £20 billion, will cover debt with maturities between three and five years.

11. Guarantees under the NLGS may also cover debt instruments in currencies other than sterling, in which case the sterling guarantee fee is increased by 5% for those guarantees.[3]

2.1.5. Eligible SMEs

12. All UK businesses with an annual turnover of less than £50 million (including UK incorporated companies and branches of foreign incorporated parents with a genuine business in the UK) may apply for loans at participating banks under the NLGS.

13. The final selection of SMEs applying for loans under the NLGS will be made by participating banks which will be contractually obliged to operate the scheme in a fair and non-discriminatory way, without distorting their normal distribution of lending to businesses.

14. Banks will bear the risk of SMEs not repaying loans under the measure.

15. Firms in difficulties[4] are excluded from participation under the NLGS.

2.1.6. Allocation of guarantees to banks

16. The allocation of guarantees to participating banks will be based on a combination of criteria, which are market share, gross lending, net lending, and ‘capacity to lend under the scheme’, taking the banks' medium-term plans regarding SMEs into account.

17. Minimum allocation thresholds shall reflect the capacity of participating banks to make loans available to eligible SMEs. For the top five UK banks, the minimum allocation will be £500 million, while for smaller participating banks the minimum allocation will be £100 million.

2.1.7. Implementation of the NLGS budget

18. Until 30 June 2012, the UK intends to issue at least a part of the overall NLGS budget and expects to issue guarantees of up to £5 billion.

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[3] The additional fee is applied in order to cover the foreign-exchange risk taken by the UK.

[4] As defined in the Communication from the Commission - Community guidelines on State aid for rescuing and restructuring firms in difficulty, OJ C 244, 1.10.2004, p. 2.

19. Participating banks will disburse loans to SMEs within three months from the date of issuance. Smaller participating banks may contractually provide for a period longer than three months if required by their lower capacity of lending. In any case the total value of the benefit that is passed through to SMEs has to match the value attached to the guaranteed bond. Each bank therefore needs to demonstrate that it has passed through the full benefit of the discount on all of the funding that it is has received over the entire period.

20. Participating banks need to demonstrate that they have successfully disbursed to SMEs at least 70% of the benefit associated with their allocation before they may apply for an additional allocation of guarantees.

2.1.8. Pricing to banks

21. The price that participating banks have to pay for the State guarantees is based on a methodology that shall ensure that the benefit of lower-cost funding is passed to SME clients. Under the NLGS, SMEs will receive loans discounts or grant loans with an economic value of up to 100 basis points (hereinafter "bps") as compared to the usual interest rate and at the same time not exceeding the limits resulting from the *de minimis* Regulation.[5] The NLGS pricing mechanism therefore charges participating banks a fee that is calculated as the difference between the individual current costs of unsecured unguaranteed debt minus the individual cost of debt issuance under the NLGS, less 100 bps, less a handling fee.

22. The indicator for the individual banks' cost of unsecured unguaranteed debt will be the 20-day average 5-year Credit Default Swaps (hereinafter "CDS"), plus the relevant swap rate.

23. For smaller banks for which no CDS data is available, a benchmark CDS spread will be applied that is based on a sample of A-rated UK banks, with adjustments made for credit ratings above and below that A rating. Three baskets will be set for the rating categories AA, A and BBB. For banks that have a rating, the CDS corresponding to their rating category will apply. Banks with no rating will fall in the BBB-rating basket.

24. At the same time, the UK has established that the fees for guarantees under the NLGS must not be lower than the minimum fee derived from the 2011 Prolongation Communication[6]. If a bank does not gain a full 100 bps benefit from the guarantee, the discount that the bank is required to pass through to SMEs is reduced to the actual benefit.

2.1.9. Advantages for SMEs under the NLGS

25. The NLGS foresees two different ways to pass through the reduced refinancing costs for participating financial institutions to SMEs.

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[5] Commission Regulation (EC) No 1998/2006 of 15 December 2006 on the application of Article 87 and 88 of the Treaty to de minimis aid, OJ L 379, 28.12.2006, p. 5.

[6] The Communication on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 356, 6.12.2011, p. 7.

26. One option is that participating institutions will use the reduced financing costs in order to reduce interest rates for SMEs. In that case, the UK authorities have submitted a commitment that participating SMEs will only benefit from interest rate reductions for loans that are in compliance with the *de minimis* Regulation.

27. As a second option, participating SMEs will first be offered a standard bank loan, for the pricing of which banks will apply their specific, previously established and profit-oriented appraisal methodology for creditworthiness of individual debtors outside the measure. In addition, the SMEs will receive a grant of up to EUR 200.000 in line with the *de minimis* Regulation. The UK authorities have committed that those grants will respect all the conditions set out in the *de minimis* Regulation. The grant is financed from the economic advantage resulting from cheaper refinancing costs.

28. The respect of the rules of the *de minimis* Regulation for the aid element contained in loans,[7] as well as the existence and proper application of the bank's profit-oriented appraisal methodology will be part of the auditing requirements for the notified scheme.

29. In order to ensure compliance with the aforementioned conditions, the NLGS foresees administrative safeguards. The NLGS requires that where a bank intends to provide advantageous conditions in line with the *de minimis* Regulation to a SME, it will inform that SME in writing of the prospective amount of the aid (expressed as a fixed sum corresponding to the maximum aid amount to be granted under the NLGS) and of its *de minimis* character, making express reference to the *de minimis* Regulation, and citing its title and publication reference in the Official Journal of the European Union. Prior to granting the advantageous conditions, the bank will also obtain a declaration from the SME concerned about any other *de minimis* aid received during the previous two fiscal years and the current fiscal year that will have to be taken into account by the bank when establishing the *de minimis* amount. Records will be kept for purposes of monitoring and auditing by the UK authorities as well as the Commission services.

2.1.10. Handling fee

30. Participating banks may be entitled to a handling fee, covering additional administrative costs linked to the management of the NLGS, particularly in view of the monitoring requirements. If the handling fee charged by participating banks exceeds […] bps (as a percentage of institutions' allocations), the UK will consult the Commission before agreeing the fee.

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[7] *De minimis* Regulation Article 2 paragraph 4 (a) together with consideration (12).

2.1.11. Ex post monitoring mechanism

31. Participating institutions are required to implement a monitoring system by which they can demonstrate the results achieved and compliance with NLGS rules, in particular that the full discount in bps has been applied to all loans made under the NLGS, but also that the total savings of the banks on the funding costs will be either passed through to SMEs or paid back to the State. The monitoring system must further demonstrate compliance with NLGS rules as regards (i) the rules applied by banks to select eligible SMEs and establish discounts and grants in line with applicable State aid provisions, and (ii) the handling fees.

32. In order to demonstrate compliance with the NLGS, banks will submit to the UK details of the internal process by which the pass-through is achieved and assurance that pass-through is genuine. Monitoring results will also be used for the next-period allocation of guarantees to banks.

33. Participating banks will therefore submit on a monthly basis the total number of loans made respectively drawn down under the NLGS and the total value of loans made under the NLGS. On a quarterly basis banks will submit more detailed information, such as the maximum, minimum, and average size of loans made under the NLGS, stratified by region and company size.

34. The UK will audit compliance with the rules of the NLGS both by analysis of the aggregate level data as well as by sample on-site inspections.

35. If participating banks are found to have breached the terms of the NLGS in relation to the financial benefit, they will be required to repay the benefit that was not passed through, plus a compound interest rate. The compound interest rate would be based on the three-month LIBOR recalculated daily rate and a compounded annual rate. Breaches of more general nature, for example in relation to the SME eligibility criteria, may further result in an exclusion from the NLGS.

2.2. The Business Finance Partnership

2.2.1. Objective

36. The objective of the BFP is to increase the supply of credit through non-bank lending channels to mid-sized businesses[8] and SMEs in the UK, co-investing up to £1 billion in loan funds that directly lend to UK businesses.

[8] The BFP refers to businesses with a turnover of up to £500 million which is higher than the respective threshold under the NLGS. Hence, for the sake of clarity, the term "mid-sized" businesses is used in the BFP but not in the NLGS.

37. Eligible SMEs and mid-size businesses are defined as businesses with an annual turnover of up to £500 million, including UK incorporated companies and branches of foreign-incorporated parents with a genuine business in the UK.

2.2.2. Size and duration

38. The initial budget for investment by the UK will be £1 billion. However, the budget will be reviewed on the basis of demand and it is possible that more money will be allocated, or that the full £1 billion will not be committed.

39. The duration of the BFP is only indicative as it will depend on success of bidding and allocation processes. It is expected that the full amount of investment may not have been committed until 2014 and that it may not have been actually drawn down until around 2016.

2.2.3. Fund management

40. The BFP will be operated by fund managers chosen through a transparent open tender procedure having regard to their record of investment in the area. In addition to banks and building societies, any financial institution within the meaning of the Banking Act 2009 will be eligible to act as a fund manager for the UK's co-investment, including UK subsidiaries of foreign incorporated financial institutions.

41. Fund managers will be selected on the basis of submitted bids, setting out details including their record of investment in that area, proposed approach to origination, private co-investment already identified, target return, and proposed fees.

42. After selection, the UK will commit to invest a certain amount of money, limited to £250 million of investment per fund.

2.2.4. Co-investment together with private co-investors

43. Once selected fund managers have raised sufficient private investment, they may originate loans to eligible businesses.

44. It will be a requirement that the UK will have a minority stake in any fund (i.e. less than a 50% share).

45. Selected fund managers will have full control over the investment decisions, in line with the investment mandate agreed upon with the UK.

46. The UK’s co-investment in loan funds will be *pari passu* with that of private sector investors that are independent from the company receiving the investment.

47. The BFP foresees an exception to the *pari passu* principle with respect to management fees in case of majority stakeholder. The majority stakeholder in any fund may receive a discount on

management fees, in line with commercial practice. The UK will, however, never be less than *pari passu* with market investors committing the same amount of funds at the same time.

3. Assessment

3.1. The National Loan Guarantee Scheme

48. The following assessment of the NLGS' compatibility with applicable State aid rules is made with regard to two possible groups of beneficiaries: namely SMEs on the one hand and participating banks on the other hand.

3.1.1. Presence of aid pursuant to Article 107(1) TFEU to SMEs benefitting from bank loans under advantageous conditions

49. The Commission takes note of the commitment of the UK to respect the *de minimis* Regulation with regards to any aid granted to SMEs under the NLGS. The Commission reminds the UK that it is up to the UK authorities to monitor compliance with all conditions of the *de minimis* Regulation and ensure respect of all provisions of that Regulation. The Commission reserves the right to carry out its own verifications as provided for in Article 3 of the *de minimis* Regulation.

3.1.2. Presence of aid pursuant to Article 107(1) TFEU to participating banks

50. By virtue of Article 107(1) TFEU "any aid granted by a Member State or through 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".

51. The UK does not dispute that the NLGS involves State aid, as it essentially provides participating banks with a selective advantage in form of a government guarantee for the issuance of unsecured debt of between one and five years' maturity. Such guarantee results in lower funding costs and in some cases gives access to wholesale funding to banks which do not have such access in the current difficult market situation. The NLGS thereby supports banks in their lending to SMEs by providing SMEs with access to discounted loans. The NLGS therefore represents a form of public financing, directed at certain beneficiaries engaged in an economic activity affecting trade between Member States, and distorts or threatens to distort competition inside the internal market.

3.1.3. Compatibility of the aid

3.1.3.1. Applicability of Article 107(3)(b) TFEU

52. Insofar as the NLGS contains State aid, it may be compatible with the internal market pursuant to Article 107(3)(b) TFEU as aid given to remedy a serious disturbance in the economy of the Member State, namely the UK.

53. In light of tensions in sovereign debt markets which continue to put the banking sector in the Union under pressure, particularly in terms of access to funding markets, Article 107(3)(b) TFEU remains applicable in the financial sector.[9]

54. In order to deal with measures taken in the context of the current financial and economic crisis, the Commission adopted four communications[10] which provide detailed guidance on the criteria for the compatibility of State support to banks with the requirements of Article 107(3)(b) TFEU. The the Banking Communication in particular sets out that, in line with the general principles underlying the State aid rules of the Treaty, general support measures have to be well-targeted to effectively achieve the objective, proportionate to the challenge faced, and designed in such a way as to minimize negative spill-over effects on competitors[11].

55. On 1 December 2010, the Commission adopted the 2010 Prolongation Communication which essentially sets out that the previous Communications remain in place for as long as the current financial and economic crisis persists.

56. On 1 December 2011, the Commission adopted the 2011 Prolongation Communication[12] which inter alia sets out a revised methodology for ensuring that fees payable in return for guarantees on bank liabilities are sufficient to limit the aid involved to the minimum, with the aim of ensuring that the methodology takes into account the greater differentiation of bank CDS spreads in recent times and impact of the CDS spreads of the Member State concerned.

57. Available evidence suggests the tightening of credit conditions faced by SMEs in the UK has been sharper than in most other European countries. The UK illustrated this situation by

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9 Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 356, 6.12.2011, p. 7.

10 Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (the Banking Communication), OJ C 270, 25.10.2008, p. 8; the 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 (the Recapitalisation Communication), OJ C 10, 15.1.2009, p. 2; the Communication from the Commission on the treatment of impaired assets in the Community banking sector (the Impaired Assets Communication), OJ C 72, 26.3.2009, p. 1, and the 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 (the Restructuring Communication), OJ C 195, 19.8.2009, p. 9.

11 See recital 15 of the Banking Communication, OJ C 270, 25.10.2008, p. 8

12 Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 356, 6.12.2011, p. 7.

referring to a Eurostat survey, showing that the UK SME's rate of unsuccessful loan applications increased from 5.6% in 2007 to 20.8% in 2010[13].

58. The primary objective of the NLGS is to limit the negative effects for the real economy resulting from a recent notable tightening of credit conditions for SMEs, easing the impairment in the flow of credit to that particular part of the real economy. To that end SMEs, which are reliant on banks for external finance, will be given the possibility to obtain loans at more favourable terms and conditions.

59. The root cause for the tightening of credit conditions for SMEs is that banks are still faced with severe strains in bank funding markets, reflected by the fact that UK banks have been largely shut out of senior unsecured funding markets since early summer 2011, and are currently undergoing a process of deleveraging, partly due to the transition to new regulatory requirements. Banks therefore have to feed through their higher funding costs to SME borrowers. The UK has provided evidence that for large, investment grade UK companies the cost of borrowing has increased less than for banks. As SMES can hardly fund themselves directly and rely mainly on banks, that development has resulted in a higher increase of borrowing costs for SMEs than for large corporations. That situation eventually results in a competitive disadvantage for SMEs which are reliant on banks for external finance.

60. The NLGS lowers the funding costs of banks by issuing guarantees on a bank's debt and obligatorily binds usage of the scheme to the condition that participating banks must provide SMEs with loans at reduced interest rates.

61. The NLGS is designed in non-discriminatory way, allowing both UK subsidiaries of foreign banks to participate as well as UK incorporated SMEs which are subsidiaries or branches of other foreign-incorporated parents.

62. The NLGS therefore seems an appropriate means to achieve the objective to address the borrowing problems of SMEs following the increasing cost of funding of banks, and to provide SMEs with the possibility to obtain loans at more favourable terms and conditions, correcting the effect of the financial crisis.

63. As regards necessity, the Commission considers that the scheme is limited to the minimum necessary in scope and time.

64. The size of the NLGS, at £20 billion, is according to the UK approximately equal to around 20-25% of the total aggregate volume of loans made over a two-year period to small business with less than £50 million turnover and therefore considerable lower than the total volume of demand affected by strained conditions.

[13] See Eurostat press release 144/2011: Small and medium-sized enterprises (SMEs): The proportion of unsuccessful loan applications by SMEs has risen with the economic crisis. http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/4-03102011-AP/EN/4-03102011-AP-EN.PDF

65. The NLGS is limited to those SMEs with annual turnover of less than £50 million and therefore well-targeted, aiming at those businesses that are least able to access capital markets or other non-bank sources of funding.

66. While the UK intends to have the NLGS available for a window of two years from the start date, State aid approval is initially sought for the period expiring on 30 June 2012 and the UK will seek to have that approval renewed on a half-yearly basis, in accordance with the Commission's guidance. Its prolongation will be subject to verification as to whether there is still a serious disturbance in the economy of the UK.

67. In sum, the NLGS is therefore deemed to be limited to the minimum necessary in scope and time.

68. The NLGS's objective is to pass on the UK's banks' lower cost of funds to SMEs taking out new loans. The pricing methodology is designed to enable banks to pass through 100 bps of benefit to SMEs but not to retain any additional benefit that could serve to develop other business activities.

69. The fees that banks have to pay for the benefit of the guarantee will not be lower than the minimum fee derived from pricing formula set out in the Annex to the 2011 Prolongation Communication.

70. The rules of the NLGS further set out that in accordance with established decisional practice, not more than one-third of the overall budget for debt issuance can cover issuance with maturity between three and five years.

71. The pricing mechanism as well as the terms and conditions of the NLGS can therefore be considered to be proportionate.

3.1.3.2. Aid to RBS and Lloyds

72. RBS and Lloyds are currently under restructuring, and their respective restructuring plans have been approved by the Commission. Both the restructuring plans of RBS and Lloyds have been found to be suitable to achieve long-term viability.[14]

73. The Restructuring Communication sets out that provision of additional aid during the restructuring period should remain a possibility if justified by reasons of financial stability, and that any additional aid during the restructuring period shall remain limited to the minimum necessary.[15]

74. The NLGS responds to financial stability concerns in the UK, addressing the problems raised by high borrowing costs of SMEs due to shortfall in the wholesale funding market of banks.

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[14] See recital 256 of the Commission decision of 14 December 2009 in case N 422/09 & N 621/09, Restructuring of Royal Bank of Scotland, OJ C 119, 7.5.2010, p. 1, and recital 197 of the Commission decision of 18 November 2009 in case N 428/09, Restructuring of Lloyds Banking Group, OJ C 46, 24.2.2010, p. 2

[15] See point 27 of the Restructuring Communication, OJ C 195, 19.8.2009, p. 9.

In addition the pass-through mechanism ensures that the additional aid to banks remains limited to the minimum.

75. As regards the nature of the measure, the Commission notes that the guarantees issued by the UK under the NLGS are clearly liquidity support and not a recapitalisation or asset relief measure. State support in form of liquidity aid only requires a viability plan when the liquidity support exceeds EUR 500 million and 5% of a bank's liabilities. The terms and conditions of the NLGS comply with that requirement; participating banks exceeding those thresholds will be required to submit a viability review. However, according to the data submitted by the UK neither RBS nor Lloyds will reach the 5% threshold if they participate in the NLGS.

76. The NLGS establishes a pass-through mechanism ensuring that the net effect (of up to 100 bps) stemming from the guarantee is fully passed through to SMEs, while the remainder is skimmed off via guarantee fees. That mechanism ensures that RBS and Lloyds will not be in a position to use the NGLS to develop activities in areas other than lending to SMEs.

77. The pass-through is based on the principle that RBS and Lloyds will pass 100 bps to their SME clients, and any other benefit in form of reduced interest needs to be paid back to the State (minus the handling fee) under the form of a guarantee fee. The pass-through is based on the formula: guarantee fee = individual current costs of unsecured unguaranteed debt minus the individual cost of debt issuance under the NLGS, less 100 bps, less a handling fee. The handling fee will be assessed per bank and is not expected to exceed […] bps. The individual cost of debt issuance under the NLGS will be taken from the market at the date of issuance. The quality of the pass-through is therefore highly dependent on the quality of the evaluation of the individual current costs of unsecured unguaranteed debt.

78. However, as under the current market situation neither RBS nor Lloyds have recently raised unsecured funding, their costs of unsecured unguaranteed funding are at present not directly quantifiable.

79. The NLGS therefore makes use of a proxy that will reflect the cost of unsecured funding, namely the swap rate (considered to be the risk free rate) plus those banks' 20-days average 5-year CDS rate.

80. The Commission has assessed the suitability of the proposed pricing mechanism and the proxy for the cost of unsecured unguaranteed funding, based on market information provided by the UK. The methodology as such is transparent and uses data derived from sufficiently liquid markets. A retrospective comparison of the proxy with previously incurred actual costs of unsecured unguaranteed funding showed that the proxy is a credible indicator which correctly reflects costs of unsecured unguaranteed funding. Out of issuances of RBS, Lloyds and the other three large banks in the UK since July 2011, the proxy does not deviate by more than 10% from the actual issuances in the majority of cases, and on average deviates by less than 3%.

81. Application of the pricing methodology set out in the NLGS will therefore result in fees for RBS and Lloyds that guarantee that RBS and Lloyds will not use reduced funding costs of the NLGS to develop activities other than those targeted by the NLGS, i.e. lending to SMEs.

82. In addition, the eligibility criteria of the NLGS result in more than […] banks and financial institutions being eligible, including the top five banks in the UK. The functioning of the NLGS is not discriminatory and RBS and Lloyds therefore will not benefit more from the NLGS than any other bank.

83. Additional aid to RBS and Lloyds is therefore limited to the minimum, and the distortion of competition is limited. Consequently, participation of those banks in the NLGS does therefore not require that their restructuring plans are modified.

3.1.3.3. Monitoring of aid to banks

84. The Commission further notes that the monitoring system required by the UK will ensure that all terms and conditions of the NLGS are respected. In particular if banks do not pass to SMEs the reduced cost of funding generated by the NLGS, they will have to pay it back to the State, with interest. Non-compliance with the NLGS has therefore adequate financial consequences, and it may in addition lead to the exclusion from the NLGS. Ex post monitoring by the UK will also verify that handling fees are confined to additional administrative costs directly incurred by the operation of the NLGS, and that the actual selection of SMEs by participating banks is in line with the principle that the NLGS is operated in a fair and non-discriminatory way.

3.1.4. Conclusion

85. Based on the above, the NGLS will result in compatible aid to banks and no aid to SMEs. Regarding RBS and Lloyd, the NLGS results in additional aid to the banks, on top of aid measures approved under their restructuring plans. Nevertheless, the distortion of competition resulting from that aid is contained because of the pass-through mechanism put in place, and RBS and Lloyds do not need to submit revised restructuring plans.

3.2. The Business Finance Partnership

86. The objective of the BFP is to increase the supply of credit through non-bank lending channels to mid-sized businesses and SMEs in the UK. The UK submits that the BFP does not imply State aid and is notified only for purposes of legal certainty.

87. The Commission has assessed the BFP in the light of Article 107(1) TFEU.

3.2.1. Presence of aid pursuant to Article 107(1) TFEU

88. In order for the BFP to fall within the scope of Article 107(1) TFEU, there must be an element of State aid. Therefore four cumulative criteria must be met: (i) the measure must involve the use of State resources; (ii) the measure must be conferring an advantage on certain undertaking thus being selective; (iii) the measure must distort competition; and (iv) the measure must be likely to affect trade between Member States.

89. Given that the BFP is investing resources provided by the UK, the Commission concludes that State resources are involved in the notified measure. Based on the reasoning set out in the Risk Capital Guidelines[16] under point 3.2, the Commission considers that potential beneficiaries of a conferred advantage under the BFP are: (i) private co-investors into BFP funds, (ii) BFP management, (iii) the BFP loan funds and (iv) undertakings in which the investment is made.

3.2.2. Potential advantages for private co-investors into BFP funds

90. Under the BFP fund managers will address private investors into BFP funds on a deal-by-deal basis, ensuring that private participation by investors still covers at least 50%. The UK's co-investment in loans funds will be *pari passu*, sharing exactly the same upside and downside risks and rewards and hold the same level of subordination with that of private sector investors into BFP funds.

91. Therefore, given the fact that: (a) private co-investors into BFP funds share exactly the same conditions, including upside and downside risks and opportunities on a *pari passu* basis as does the UK itself and (b) the significant share (at least 50%) that the private investor(s) will have to subscribe, the measure does not reduce private investor´s risk exposure compared to the risk exposure of the UK.

92. Hence the Commission can exclude that private investors into the BFP funds receive an advantage conferred on investors by means of State resources and concludes that there is no State aid within the meaning of Article 107(1) TFEU at the level of the investors investing alongside the UK.

3.2.3. Potential advantages for the BFP fund management

93. As indicated above, the BFP fund managers will be chosen through a transparent open tender procedure having regard to their record of investment in the area and will receive a management fee that will be a market-oriented price ensured by both the competitive bidding process and the presence of private co-investors in the BFP fund. Fund managers will be paid

[16] Community guidelines on State aid to promote risk capital investments in small and medium-sized enterprises, OJ C 194, 18.8.2006, p. 2.

a management fee, which will be deducted from returns before they are passed to-co-investors. This will be a market oriented price ensured by both the competitive bidding process and the presence of private co-investors.

94. The Commission thus concludes that fee paid to fund managers will fully reflect the current market remuneration in comparable situation. Hence, there is no advantage conferred and therefore no State aid within the meaning of Article 107(1) TFEU present at the level of fund managers.

3.2.4. Potential advantages for the BFP loan funds

95. In general, the Commission considers that an investment fund or an investment vehicle is an intermediary vehicle for the transfer of aid to investors and/or enterprises in which investment is made, rather than being a beneficiary of aid itself. In addition, the UK will only enter into minority investment in the loan funds on equal terms with co-investors that are independent from the BFP loan funds invested in and therefore act on market terms. The Commission therefore concludes that under the notified measure, BFP loan funds do not receive an advantage and the conditions for the presence of State aid in the meaning of Article 107 (1) TFEU are not fulfilled.

3.2.5. Potential advantage to undertakings in which investment is made

96. The Commission notes again that the UK will co-invest in funds alongside with private investors that are independent from the company invested in, returns will be shared equally between investors, including the UK; and that co-investors will be equally exposed to defaults. Furthermore, investment decisions will be taken by fund managers, chosen based on an open and transparent competitive selection process, who will have full control over investment decisions in accordance with the investment mandate. The loan fund manager’s decision to invest in certain target companies will therefore be profit-driven and the UK and other co-investors will not be able to influence individual investment choices.

97. Therefore, the Commission considers that there is no advantage conferred to the undertakings in which investment is made.

3.2.6. Conclusion

98. Consequently, the Commission concludes that the notified BFP scheme does not constitute State aid within the meaning of Article 107(1) TFEU.

4. Decision

The Commission has decided not to raise objections against the National Loan Guarantee Scheme until 30 June 2012 as it is compatible with the internal market on the basis of Article 107(3)(b) TFEU.

The Commission has furthermore decided not to raise objections against the Business Finance Partnership scheme as the measure does not constitute aid.

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

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

European Commission
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Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President