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**Subject: State aid SA.38304 (2014/N) – United Kingdom
Amendment to the restructuring plan of Royal Bank of Scotland**

Sir,

1 PROCEDURE

- (1) By decision of 14 December 2009¹ ("the Restructuring Decision"), the Commission declared a number of State aid measures² granted to Royal Bank of Scotland ("RBS") compatible with the internal market. The conclusion was reached on the basis of the restructuring plan and of the commitments issued by the UK authorities and RBS.
- (2) Since the Restructuring Decision was adopted, the Commission services, the UK authorities and RBS (directly or via the Monitoring Trustee appointed pursuant to the Restructuring Decision) have had frequent exchanges, in the form of meetings, conference calls and exchanges of e-mails and documents.

¹ Commission Decision SA. N422/2009 and N621/2009, OJ C119, 07.05.2010, p. 1.

² For a full list of the State aid measures approved, see recitals (31) to (77) of the Restructuring Decision.

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UNITED KINGDOM

- (3) On 6 February 2014, the UK authorities notified to the Commission a formal request to amend the Restructuring Decision, in particular concerning the divestment deadline for the business identified in that decision as "Rainbow" and the terms of the Dividend Access Share ("DAS").

2 DESCRIPTION

2.1 IMPLEMENTATION OF THE RESTRUCTURING PLAN AND THE COMMITMENTS

2.1.1 Implementation of measures aiming at restoring long-term viability

- (4) Based in Edinburgh, RBS is one of the largest financial services groups in the world, with over 24 million private, corporate and institutional customers. At the end of 2013 it had a total balance sheet of GBP 1 027 billion³ and total risk weighed assets ("RWA") of GBP 385 billion.
- (5) A detailed description of RBS's business activities as they existed at the time of the Restructuring Decision can be found in recitals (8) to (22) of the Restructuring Decision.
- (6) Key pro forma figures⁴ for end of year from 2008 to 2013 are summarized in Table 1:

Table 1

	2013	2012	2011	2010	2009	2008
Total income (GBP billion)	19,4	25,7	27,7	32,6	29,4	20,5
Operating profit (GBP billion) ⁵	(2,3)	3,5	1,8	2,1	(6,2)	(6,9)
Loss / profit attributable to ordinary shareholders (GBP billion)	(9,0)	(5,9)	(2,0)	(1,1)	(3,6)	(24,3)
Total balance sheet (GBP billion)	1 027	1 312	1 507	1 454	1 523	2 219
Risk-weighted assets (GBP billion)	385	460	439	465	438	578
Core Tier 1 capital ratio (in%)	10,9	10,3	10,6	10,7	11,0	5,9
Tier 1 capital ratio (in%)	13,1	12,4	13,0	12,9	14,4	9,9
Total loans / customer deposits (in%)	94	100	108	118	135	151

- (7) Recitals (57) and (58) of the Restructuring Decision recorded several key risk and return targets which RBS committed to achieve by 31 December 2013. As illustrated in Table 1 RBS successfully achieved or exceeded the following targets:
- a Core Tier 1 capital ratio over 8%,
 - a loan-to-deposit ratio below 100% (which stood at 156% as at October 2008),

³ In the present decision, the Commission uses the results published by RBS in its annual report and accounts for full-year 2013.

⁴ RBS Group Annual Report and Accounts from 2008 to 2013.

⁵ The operating profit between 2009 and 2012 include Direct Line Group, which is not the case for the 2013 operating profit.

- a reduction of its wholesale funding reliance from GBP 343 billion to less than GBP 150 billion (GBP 108 billion in 2013),
 - an increase of its liquidity reserves up to GBP 150 billion (GBP 146 billion in December 2013 and GBP 151 billion in September 2013),
 - a reduction of GBP 251 billion of assets from the balance sheet level of December 2008 and,
 - a reduction of GBP 110 billion of RWA since December 2008.
- (8) However despite the large-scale deleveraging and risk reduction, RBS did not return to profitability because – amongst other reasons – of very large fines and settlements and the macro-economic environment in the world (and in Ireland in particular) that was less favourable than expected in 2009. To tackle that problem and to improve its capital position RBS announced in November 2013⁶ further measures, namely:
- the divestment of Citizens by the end of 2016,
 - the intensification of the management action to reduce RWA through the creation of an internal bad bank, and
 - additional costs reduction targets.

Those new measures were confirmed and amplified with the publication of the 2013 full annual result⁷ and the announcement of an in-depth rationalising and cost-cutting plan.

- (9) While RBS recorded an operating profit of GBP 2,5 billion in 2013 excluding the impact of the internal bad bank reduction, it booked very substantial charges for a variety of conduct-related issues, including litigation relating to LIBOR⁸ manipulation (which had occurred in 2007 and after), mis-selling of Payment Protection Insurance (which had occurred in 2005 and after), interest rate swaps (which had occurred in 2005 and after) and the packaging of residential mortgage-backed securities (which had occurred between 2005-2008). As regards those one-off items RBS considers that almost all of those costs can properly be described as legacy costs, arising from events and actions in the run-up to the financial crisis⁹.
- (10) Thanks to its improved situation, RBS has been able to discontinue certain aid measures:
- Thanks to its improved liquidity position, RBS no longer relies on State guarantees to fund itself on the wholesale market¹⁰. RBS participated in the UK's Credit Guarantee Scheme and on 11 May 2012, RBS made its final repayment of funding under that scheme. HM Treasury received total fees of GBP [...] from RBS since the start of the scheme.

⁶ <http://investors.rbs.com/~media/Files/R/RBS-IR/annual-reports/full-q3-ims-2013-03-05.pdf>

⁷ http://investors.rbs.com/~media/Files/R/RBS-IR/download/announcements/Full_Annual_Results_2013_27_2_14.pdf

⁸ London Interbank Offered Rate.

⁹ See RBS Group Annual Report and Accounts 2013. pp. 3 and 6.

¹⁰ http://investors.rbs.com/~media/Files/R/RBS-IR/download/announcements/Full_Annual_Results_2013_27_2_14.pdf

¹⁰ See recital (86) of the Restructuring Decision, where the measure is described.

- RBS publicly announced on 17 October 2012¹¹ its agreement with HM Treasury to exit the government's Asset Protection Scheme ("APS") on the next day. The APS was a guarantee on the second-loss tranche of a large portfolio of impaired assets¹². While it was under the APS, RBS paid a cumulative amount of GBP 2,5 billion for its participation in the APS. The government had agreed in 2009 to cover 90% of the losses exceeding GBP 60 billion on a portfolio of GBP 282 billion of assets when RBS entered into the APS. On 18 October 2012, the date on which RBS effectively exited the APS, the level of covered assets had decreased to GBP 105 billion¹³, in line with the decrease of non-core assets. Since the first-loss tranche of GBP 60 billion borne by RBS was far from being fully utilised, the added value of the APS had strongly decreased.
 - The State had made a five-year contingent commitment to subscribe for an additional GBP 8 billion of contingent capital in B shares in the event that RBS's Core Tier 1 capital ratio fell below 5%¹⁴. RBS announced on 16 December 2013¹⁵ that, after having received approval from the Prudential Regulatory Authority, it had terminated that contingent capital facility. Following the termination of the contingent capital facility after four years, the annual fee of GBP 320 million was no longer payable for the fifth year.
- (11) The only still outstanding aid measure is the GBP 45,5 billion recapitalisation in ordinary shares and B shares. The UK government currently holds 3,964 billion ordinary shares in RBS, as well as 51 billion non-voting B shares and the DAS. As of 28 June 2013, HM Treasury held 64,8% of the ordinary shares in RBS and its economic interest was 80,8% (both rounded to the nearest 0,1%).

2.1.2 Implementation of the committed divestments

- (12) The list of commitments of the Restructuring Decision included the divestment of several businesses, including Global Merchant Services, RBS Sempra, and RBS Insurance. The first two of those divestments were completed ahead of the relevant deadlines (31 December 2011) recorded in the Restructuring Decision. As regards RBS Insurance (now rebranded as Direct Line Group), RBS was able to sell its residual shareholding in February 2014 ahead of the deadline of 31 December 2014 recorded in the Restructuring Decision.
- (13) In order to limit distortion of competition in the UK small and medium-sized enterprises and mid-corporate market, RBS had also to divest a package of customers and branches which was designated as "Rainbow"¹⁶. HM Treasury and RBS had committed that RBS would divest Rainbow before 31 December 2013.
- (14) RBS started marketing Rainbow immediately after the Restructuring Decision and signed a sale agreement with Santander UK in August 2010.

¹¹ <http://www.rbs.com/news/2012/10/rbs-exits-uk-governments-asset-protection-scheme.html>

¹² See recital 45 of the Restructuring Decision.

¹³ <http://hsprod.investis.com/ir/rbs1/ir.jsp?page=news-item&item=1183909882655691>

¹⁴ See recital 37 of the Restructuring Decision.

¹⁵ http://www.investors.rbs.com/ir/rbs/jsp/sec_filings_item.jsp?source=1587&ipage=9277944

¹⁶ Recital (94) of the Restructuring Decision.

- (15) On 15 October 2011¹⁷ and 30 November 2011¹⁸ the Commission approved the acquisition of Rainbow by Santander UK under EU merger control rules.
- (16) [...]
- (17) On 12 October 2012¹⁹ RBS publicly announced that Santander UK had pulled out from its agreed purchase.
- (18) Following the decision of Santander UK to withdraw from the purchase of Rainbow, RBS promptly initiated a new divestment process, seeking new bids while also drawing up plans to conduct an initial public offering ("IPO").
- (19) RBS considered [...] detailed bids in summer 2013[...]. Following a competitive process, the RBS board formally approved the terms of a transaction with "Comet" on 25 September 2013²⁰. Under the terms of that pre-IPO investment, Comet purchased GBP 600 million of exchangeable interest-bearing bonds that can convert into a maximum 49% stake in the Rainbow business when the IPO occurs.
- (20) Prior to the IPO, RBS still needs to complete a complex and detailed separation process for Rainbow, including the implementation of a new technology platform, the completion of regulatory approval process and the transfer of staff and customers. That processes will necessarily take longer than the previous plan (a transfer of front and middle office assets into Santander UK's platform without building a new technology platform or headquarter functions). The Commission has been regularly informed about the progress of the separation process for Rainbow.
- (21) The target date for the legal separation is [...]. [...]. The IPO is planned to occur [...]2016. RBS will sell only a part of its 100% shareholding in Rainbow in the IPO and will dispose the residual shareholding over the next 12-18 months, depending on market conditions.

2.1.3 Implementation of the behavioural commitments

- (22) As regards to behavioural commitments concerning RBS (ban on advertising State support, acquisition ban, two-year ban on payment discretionary coupons on hybrid instruments), the Commission, with the support of its Monitoring Trustee, has not identified any breaches to date.

2.1.4 B shares and the DAS

- (23) When the UK authorities injected GBP 25,5 billion of equity capital to stabilise RBS's balance sheet²¹, they had already injected GBP 20 billion of equity capital and so already held 70,3% of the voting shares in RBS. Their voting shareholding had to remain below 75% in order to avoid a delisting of the bank's shares, which would have caused value destruction and left them with fewer exit options.
- (24) The recapitalisation of GBP 25,5 billion was made 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. They count as Core

¹⁷ http://europa.eu/rapid/press-release_IP-10-1343_en.htm

¹⁸ http://europa.eu/rapid/press-release_IP-11-1483_en.htm?locale=en

¹⁹ <http://www.rbs.com/news/2012/10/statement-on-disposal-of-uk-branch-based-business.html>

²⁰ Comet is the consortium led by Corsair and Centerbridge that entered into the Investment Agreement with RBSG, RBS plc, NatWest plc and others on 27 September 2013. See generally <http://www.rbs.com/news/2013/09/return-of-williams-glyns-moves-closer.html>

²¹ As mentioned in recital (37) of the Restructuring Decision.

Tier 1 for regulatory capital purpose. Their issue price was GBP 0,50 (now equivalent to GBP 5 following a reverse split of the ordinary shares) and one B shares was convertible into one ordinary shares (now, following a reverse split of the ordinary shares, 10 B shares are convertible into one ordinary share) at any time at HM Treasury's discretion.

- (25) 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 buy back 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.
- (26) The terms of the B shares also stipulate that the remuneration of the B shares is equal to the dividend paid on ordinary shares. The B shares could not have enjoyed any preferential dividend, as they would then not have qualified as Core Tier 1 capital. However, the UK authorities wanted to obtain preferential dividend on B shares as well as ensuring a Core Tier 1 qualification of the B shares. To reconcile those requirements, HM Treasury received a single global "dividend access share" ("DAS") separately but in conjunction with the issue of B shares. The DAS carries a discretionary dividend equal to the higher of:
- (i) 7% of the total issue price of the B shares (GBP 25,5 billion) and
 - (ii) 25% of the ordinary share dividend multiplied by the number of B shares issued to HM Treasury (corresponding to 250% of the ordinary dividend before the reverse split mentioned in recital (24)) less the fair market value of the aggregate amount of any dividends paid on B shares and/or on any ordinary shares issued on conversion of the B shares.

That dividend is discretionary and non-cumulative. However, if it is 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.

The dividend on the DAS must be paid before any dividend is paid on ordinary shares. The application of those terms means that RBS would be required to pay a minimum dividend of GBP 1 785 million (i.e. 7% of GBP 25,5 billion) on an annual basis to HM Treasury before it is able to pay the first penny of dividends on its ordinary shares and B shares.

The DAS should receive the agreed remuneration until the ordinary share price reaches at least GBP 6,50 on 20 trading days of any 30-day trading period ("knockout trigger"). Once the knockout trigger has been hit, the DAS definitively expires and so that dividend on the DAS will no longer be paid. The B shares held by the State will thereafter only receive the ordinary share dividend. That mechanism aims at encouraging the conversion of B shares into ordinary shares if the ordinary share price reaches GBP 6,50.

Since RBS did not return to profitability and does not have excess capital which could be distributed²², no dividend has ever been paid under the DAS. The share

²² See Table 1.

price has remained far below GBP 6,50 and so the DAS has not expired.

2.2 POSITION OF THE UNITED KINGDOM – REQUEST FOR AMENDMENTS

2.2.1 Divestment of Rainbow

- (27) As a result of the termination of the agreement with Santander UK, RBS was no longer able to complete the Rainbow divestment before the deadline of 31 December 2013. The UK government contends that the inability of RBS to complete [...] the UK government therefore requests the Commission to allow “*an appropriate extension*” to that deadline.
- (28) The UK authorities propose that, given the current timeline to separation and the IPO and the risks remaining in that process, RBS should be allowed to proceed to an IPO before 31 December 2016 and dispose of its entire interest in Rainbow by 31 December 2017²³.
- (29) The UK authorities recall that the commitments recorded in the Restructuring Decision defined the perimeter of Rainbow which RBS would divest. They included the requirement that at the “first marketing date” the business should include SME customers comprising 5% of UK market share and mid-corporate customers comprising 5% of UK market share. RBS commenced formal marketing of Rainbow on 17 December 2009. The Monitoring Trustee’s second report dated October 2010 confirmed that business offered for sale met those requirements, with [3-7]% of UK SME customers and [3-7]% of the mid-corporate market. Rainbow therefore met the market share tests as of the first marketing date.
- (30) The UK authorities underline that the Monitoring Trustee’s reports have consistently confirmed that RBS has complied with the requirement to ensure RBS preserves the Rainbow business in the period up until divestment, as assessed against both qualitative and quantitative metrics. [...] The 14th Monitoring Trustee report notes that as of October 2013 Rainbow held [3-7]% of UK market share for SMEs and [3-7]% for mid-corporates.
- (31) The UK authorities stress that [...] parties have incentives to make Rainbow successful and attractive [...]. The direct involvement of Comet in the governance of Rainbow also supports that view. The governance arrangements and business strategy must, of course, remain within any constraints required by regulators.
- (32) The success of Rainbow and its impact on competition will depend on a healthy corporate book. Rainbow’s existing management have described to the Commission their strategy to [...]. In light of the extended timetable for the divestment of Rainbow, the UK notes that RBS commits to target growth of its corporate customer base, in the form agreed with the Commission²⁴.
- (33) The viability of Rainbow is also supported by the several commitments relating to the protection of the business until the full disposal²⁵.

2.2.2 Amendment to the DAS

- (34) In December 2009, at the time of the second capital injection, the terms of the DAS and the restrictions relating to the B shares were intended to ensure that HM Treasury would receive an adequate remuneration for its investment (preferential

²³ See commitment 3.2 of Annex I.

²⁴ See commitment 5.3 (B) of Annex I.

²⁵ See commitments 5.1, 5.2, 5.4, 5.5 of Annex I.

dividend ahead of residual holders of ordinary shares and adequate profit from the sale of the State shareholding). The DAS was estimated to be worth GBP 4,2 billion to HM Treasury given the circumstances and expectations at the time.

- (35) However, the macroeconomic and regulatory environment has not developed as envisaged in 2009. Profitability levels, regulatory capital requirements and funding costs are all more challenging for banks operating today than they were expected to be when the DAS was designed. In particular, the expectation that RBS would return to significant profit from 2011 onwards and have excess capital to distribute has not materialised. Partly as a result of those factors, the share price of RBS continues to underperform.
- (36) At the time the B shares were issued the DAS helped the State to achieve many of its key objectives in relation to RBS, including:
- the injection of a substantial amount of equity that was critical to the stabilisation and rescue of the bank;
 - the retention of a meaningful level of private ownership and a relatively fluid market for the RBS shares;
 - ensuring that management would not be led to make excessive dividend payments (which would have damaged RBS's capital position); and
 - putting in place an incentive structure in relation to HM Treasury ownership of the B shares which was consistent with returning RBS to private ownership as soon as possible.
- (37) Although the DAS was originally intended to provide value to and protect the interests of the UK government, it has become a serious impediment to the ability of the UK government to realise maximum value from its far larger holding of ordinary and B shares. If left unaltered, the DAS is likely to remain an obstacle to the UK government realising value from its RBS shareholding for several years, given that the share price of RBS remains significantly below the knockout trigger of GBP 6,50.
- (38) The UK authorities recall that it was originally expected that once RBS returned to profit and restored its capital position, it would start paying dividends both on the DAS and ordinary shares, until such time as its share price rose to GBP 6,50. Due to the circumstances described in recital (35), RBS has yet to reach a position where it has excess capital. However, even when it does reach such a position, [...], there is a strong possibility the DAS will not function as originally intended, but rather will act as a dividend blocker.
- (39) The terms of the DAS mean that the maximum share of any dividend payment which minority shareholders can receive is 11,6%, compared to their 19,5% economic ownership. That percentage of 11,6% is only achieved when the total dividend payment is above GBP 2,6 billion. Below that level, the proportion going to minority shareholders diminishes rapidly. For example, at a GBP 2 billion pay-out, minority shareholders receive only 3,8% of the dividend payment. The RBS board may struggle to justify dividend payments in those circumstances, especially payments of less than GBP 2,6 billion. The DAS may therefore delay the point at which dividends can resume.
- (40) Because the payment of a dividend by RBS is discretionary whereas the cancellation of the DAS will be automatic if the GBP 6,50 trigger is met, there is no certainty that RBS will pay a DAS dividend in a reasonable timeframe. If there

were no payment related to the DAS, the instrument would have no value to the UK government in terms of expected revenues.

- (41) The UK authorities consider that obtaining an agreed payment from RBS in exchange for retiring the DAS would avoid that risk of absence of remuneration on the DAS, secure them a fair return and provide increased certainty to both sides.
- (42) In that respect HM Treasury and RBS have reached an agreement to end the DAS. RBS will retire the DAS for GBP 1,5 billion. Doing so will bring clarity to the prospect of dividends for ordinary shareholders, improve the market price and the speed at which the State could be able to exit its RBS shareholding.
- (43) The transaction agreed with RBS consists of the following changes to the terms of the DAS:
- Rather than HM Treasury being entitled in perpetuity to a yearly discretionary priority dividend, the DAS will be cancelled once a total of GBP 1,5 billion has been cumulatively paid as DAS dividend. That mechanism would provide certainty about the price of the DAS, effectively agreeing up-front the price at which RBS can retire the DAS.
 - The GBP 6,50 knockout trigger will be removed. As a result, if the share price exceeds GBP 6,50 the State will continue to be entitled to the DAS cumulative dividend of GBP 1.5 billion. That removal of the knockout trigger would provide certainty to the government that the agreed price would be received at some point. That modification is critical to protecting the interests of the government. Removing the knockout trigger means that the DAS cannot expire without any payments having been made. It also eliminates any incentive for RBS to postpone paying a DAS dividend beyond the date when its prudential position would normally permit a dividend payment.
 - The provision that the RBS may not declare or pay ordinary dividends or [...] until the DAS dividend has been paid in full will be retained.
- (44) The general effect of those changes would be that the government would forego the right to an uncertain and unquantifiable income stream from the DAS in exchange for a certain and fixed one-off payment or series of payments.
- (45) The UK authorities submit that the replacement of the DAS by a total priority dividend of GBP 1,5 billion would not involve new State aid since that amount is higher than the current valuation of the DAS (which they contend is [...] at [...] 2013).

2.2.3 *Other commitments*

- (46) In addition to the commitments related to the divestment of Rainbow and the settlement of the DAS, HM Treasury also proposes that RBS must:
- dispose of RBS Citizens by 31 December 2016, by way of an IPO (and, if required, subsequent disposal tranches) or a whole business sale or tendering procedure²⁶,
 - [...] ²⁷

²⁶ See commitment 3.2 (C) of Annex I.

²⁷ See commitment 4.3 of Annex I.

- (47) Until the full disposal of Rainbow 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 advertising²⁸.
- (48) Except to the extent that the cumulative purchase price (excluding the assumption of debt) paid by RBS for all acquisitions is less than GBP [0–1 500] million, until the last date of completion of disposal between Rainbow and Citizen RBS:
- will not acquire any financial institutions or any package of assets and liabilities that together constitutes a business equivalent to a financial institution; and
 - will not make any other acquisitions the purpose of which is to expand RBS's activities outside of its business model²⁹.
- (49) RBS shall maintain the mandate of the Monitoring Trustee, who will remain in charge of the overall task of monitoring and ensuring, under the Commission's instructions, compliance with the commitments. The Monitoring Trustee will provide reports to the Commission on a half yearly basis³⁰.

3 ASSESSMENT

3.1 EXISTENCE OF NEW AID IN THE DAS AMENDMENT

- (50) At the time of the Restructuring Decision the UK authorities received the DAS as component of remuneration in addition to the possible remuneration in the form of dividends potentially payable on the capital. The Commission must assess if the modifications of the terms of the DAS constitutes a transaction which provides a further advantage to RBS.
- (51) First, it should be recalled that the existence of State aid in a capital injection is not determined solely by the amount of capital injected but are also affected by the level of remuneration which the State can expect. Because the Commission assumes that a recapitalisation measure will be executed by the Member State in line with the description which the latter has notified to it, the Commission can therefore presume that the remuneration payments will be made under the notified conditions and so they normally do not affect the aid amount. A later agreement to lower the size of the previously agreed remuneration payments could give rise to an additional advantage to the undertaking which was recapitalised. Such an advantage would be equivalent to a forbearance of the State to claim in full the payment of its financial rights under the initial conditions. Against that background, the Commission must establish if there would be a new advantage to the aid beneficiary resulting from the agreement by the UK authorities to change the terms of the DAS, allowing RBS to repay the DAS on different conditions than those initially notified by that Member State and approved by the Commission.
- (52) In the case of the DAS, remuneration takes the form of a preferential remuneration ahead of ordinary shareholders. However, that dividend is discretionary and non-cumulative. RBS has thus some discretion vis-à-vis the UK government in respect of whether or not to pay a dividend on the DAS.

²⁸ See commitment 6 of Annex I.

²⁹ See commitment 4.1 of Annex I.

³⁰ See commitment 7.1 of Annex I

- (53) Where the Commission examines if there is an advantage for the purposes of Article 107(1) of the Treaty in such a context, it must assess whether, in similar circumstances, a private investor would have made an amendment of the same characteristics, having regard in particular to the information available and foreseeable developments at the date of the agreement between HM Treasury and RBS. The Commission observes that HM Treasury based its negotiation on the valuation of the existing DAS performed by [...] on the basis of information available as of [...] 2013. In July 2013³¹ the UK authorities informed the Commission services about their intention to renegotiate the DAS. From then, they kept the Commission services closely informed about the evolution of their negotiations. On 1 November 2013, HM Treasury publicly announced³² that the negotiation on the repayment of the DAS was in an advanced stage. The Commission can therefore confirm that the UK authorities negotiated the amendment of the DAS with RBS at the end of October 2013 and therefore it is acceptable to take as a reference point the valuation of the DAS made on [...] 2013 by [...] provided that valuation is credible.
- (54) It should be assessed whether the amendment provides an advantage to RBS by reducing the present value of the future payments it would have to make to the State under the original terms of the DAS.
- (55) As the DAS is not traded, there is no public market price and a model needs to be used for its valuation. The model should incorporate:
- assumptions on RBS's future profitability and capital position and,
 - assumptions on the evolution of the market price of the shares in RBS and on when it would hit the GBP 6,50 knockout trigger.
- (56) Since paying the DAS dividend is not compulsory, RBS management has the choice between (a) paying dividends on the DAS and ordinary shares and (b) retaining earnings until the market price for the shares in RBS hit the knockout trigger. Minority shareholders would receive a proportionally lower dividend with the DAS in place. Indeed, RBS would have to first pay GBP 1,8 billion under the DAS before it could distribute anything to ordinary shareholders. The DAS is therefore likely to make RBS management less inclined to pay dividends, given that such payments are discretionary, that directors (who are responsible for proposing payment of any dividend) have a fiduciary duty to all shareholders and that if the stock price increases so as to hit GBP 6,50 the DAS would be extinguished automatically. It is recalled that until now RBS has made no distribution.
- (57) As a shareholder owner of 80,5% of the shares of RBS, the State is adversely affected by the non-distribution of dividends.
- (58) The [...] model values the DAS using a convertible bond style valuation model. That model is appropriate given that the combination of the DAS and the B shares is equivalent to a convertible bond. One can value that convertible bond and then deduct the value of the B shares to obtain the value of the DAS. It is possible to calculate a theoretical effective cancellation trigger date for the payments under the DAS based on market inputs (current share price, stock volatility and risk spread). That valuation then takes account of the possible fluctuations of the share price to

³¹ Notification received on 31 July 2013.

³² <https://www.gov.uk/government/news/rbs-bad-bank-review-published>

derive a so-called "survival probability"³³ of the DAS for the respective payment dates. The value of the convertible bond is based on the present value of the conversion value of the B shares and cash flows from DAS dividend payments. For the dividend payments the model estimates the capital threshold at which RBS would be likely to pay dividends based on a range of market forecasts weighted by their respective probabilities of occurrence. More precisely, the model assumes that RBS will have no incentive to pay the DAS dividend until it has accumulated significant excess capital.

- (59) On the basis of different models for the DAS valuation used by the market participants, the Commission observes a wide range of estimations reflecting the volatility of the multiple assumptions used:

Range of model estimates of the DAS value	
[...] (for HM Treasury)	[...] GBP 1,5 billion (March 2013) GBP 1,8 billion (March 2012) GBP 2,3 billion (March 2011) GBP 2,5 billion (March 2010)
[...]	[...]
[...]	[...]

- (60) The model used as a reference for the transaction between HM Treasury and RBS comes from [...]. It has been regularly used by UK Financial Investment ("UKFI"), which manages the State's holdings in RBS, and HM Treasury for the DAS valuation. The result of the DAS valuation by the [...] model has been published in the UKFI and HM Treasury annual reports³⁴. The Commission considers it consistent to use that model as a tool to value the existing DAS given that it is the historical model on which the financial communication of the UK authorities has been based. The Commission also analysed the assumptions used by [...] in its model and found no manifest errors.
- (61) Under the DAS amendment HM Treasury accepts the GBP 1,5 billion payment to be spread over time within specific conditions. RBS will not declare or pay ordinary dividends or [...] until the DAS dividend has been fully repaid. Within the agreed transaction schedule RBS will make an immediate payment of GBP 320 million to the UK authorities and will pay them the remaining amount before 31 December 2015. If RBS is unable to complete the payment before 31 December 2015 then the unpaid balance would escalate by 5% each year until 31 December 2020 and by 10% per year thereafter.
- (62) Whatever the sequencing and timing of the GBP 1,5 billion cumulative payment, the present value of the cash flows never fall below the value of GBP [0 - 1 500] million, which is the best estimate of the value of the existing DAS.
- (63) The Commission therefore considers that the proposed amended payment schedule is consistent with what a private investor would have accepted. The payment

³³ That is to say, a probability that the DAS will not be cancelled due to the knockout trigger being reached.

³⁴ <http://www.ukfi.co.uk/images/dynamicImages/file/UKFI%20Annual%20Report%20year%20end%2031%20March%202012.pdf>
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212752/hmtreasury_annual_report_and_accounts_201213.pdf

sequencing and timing does not reduce the present value of the future payment by RBS.

- (64) The Commission concludes that the DAS amendment does not give rise to the existence of an additional advantage to RBS. It therefore does not give rise to additional aid to RBS.

3.2 COMPATIBILITY ASSESSMENT

- (65) A restructuring decision can in principle be amended by the Commission where the modification is based on new commitments which can be considered equivalent to those originally provided³⁵. In that situation, the existing aid measures would remain compatible on the basis of Article 107(3)(b) of the Treaty if the overall balance of the original decision remains intact. In order to preserve the original balance, the altered commitments should not negatively affect the viability of the aid beneficiary, with the overall set of commitments remaining equivalent in terms of burden-sharing and compensatory measures taking into account the requirements of the Restructuring Communication³⁶.

3.2.1 Viability of RBS

- (66) The Commission has to assess whether the modifications to the restructuring plan call into question the conclusion reached in the Restructuring Decision as to RBS's ability to restore its viability without needing further State aid.
- (67) The Commission observes that the payment of the GBP 1,5 billion under the DAS amendment is not compulsory, i.e. it is not a debt. As with the existing form of the DAS, it is a discretionary distribution, subject to the approval of the Prudential and Regulation Authority. The requirement for such approval ensures that any such payment to the State will be made only when the capital position of RBS so allows. It will therefore not endanger the viability of RBS.
- (68) As regards Rainbow, the prolongation of the deadline does not affect the viability of RBS. Until it is divested, Rainbow remains consolidated within RBS. Rainbow is a profitable entity. As such, the prolongation of the deadline does not affect the viability of RBS.
- (69) The fact that RBS will now build a standalone bank with its own headquarter function and IT platform represents a significant increase of the cost of creating Rainbow. However, given the size of RBS, the costs of development of the new IT platform represented on average [...] % of the operating costs through the last four years. The remaining Rainbow expenditure should represent [...] % of overall restructuring costs over 2014 to 2017 and so the Commission considers the remaining cost of development not to be significant and they will not affect RBS's viability.
- (70) The Commission therefore does not consider that the amendments proposed by the UK authorities endanger the viability of RBS.

³⁵ For other similar decisions see, for instance, SA.29833 KBC – Extension of the target date of certain divestments by KBC and Amendment of restructuring commitments, OJ C 135, 9.5.2012, p. 5 : SA.29833 KBC – Accelerated phasing-out of the State Protection measure and amendments to the KBC restructuring plan, OJ C 163, 8.06.2013, p. 1; SA.34539 Commerzbank – Amendment to the restructuring plan of Commerzbank, OJ C 177, 20.06.2012, p. 20.

³⁶ Commission 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, OJ C 195, 19.8.2009, p. 9.

- (71) Leaving aside the effect on the viability of RBS of the changes of Rainbow and of the DAS, the Commission observes that RBS has not restored its profitability, contrary to the forecasts of the restructuring plan approved in 2009. The Commission has therefore to assess whether its conclusion that RBS will be able to restore its profitability and viability without further State aid is still valid.
- (72) The Commission notes that the operating profit of RBS has improved since the Restructuring Decision and that RBS's capital ratios remain in healthy territory as described in recital (7). The losses attributable to the ordinary shareholders since 2008 come mainly from the accumulation of large one-off items as fines and settlements for past misconduct and misselling, restructuring costs and higher than expected losses on non-core assets and on Irish assets.
- (73) On 1 November 2013 and on 27 February 2014, RBS announced additional measures to improve its financial position. They included:
- The creation of an internal “bad bank” to manage the run-down of a pool of GBP 29 billion of assets with high capital intensity by 31 December 2013. RBS will target a reduction of assets to GBP 23 billion by 31 December 2014, to between GBP 15 billion and GBP 11 billion by 31 December 2015 and to less than GBP 6 billion by 31 December 2016;
 - New costs reduction targets;
 - The divestment of Citizens, RBS's US banking subsidiary. A partial IPO is now planned for 2014 and RBS intends to fully divest the business by 31 December 2016.

In that respect the Commission notes that the new commitment of the UK authorities which provides that RBS will fully divest Citizens by 31 December 2016 should improve the capital position of RBS.

- (74) Following the 2013 full year financial communication the Commission notes positively that the core operating profit remains positive at GBP 3,2 billion of profit. That result does not take into consideration the one-off items, claims and the legacy business. In parallel and in line with its restructuring plan RBS continued to decrease its administrative expenses (decrease by 2,5% in 2013).
- (75) As regards the liquidity position of RBS the Commission observes that the loan-to-deposit ratio is now at 94%, which far under the initial target of 100%. That situation is accompanied by reduced dependence on wholesale funding (GBP 108 billion compared to GBP 150 billion in 2012). Finally the net stable funding ratio increased to 122% compared to 117% in 2012. The additional measures mentioned in recital (8) will also contribute to strengthen the capital position of RBS.
- (76) The Commission notes positively the prolongation of the commitments to limit RBS acquisitions³⁷ which contribute to ensure that RBS will focus on its profitable core business.
- (77) The Commission considers that the announced measures should allow RBS to return to profitability.

3.2.2 *Burden-sharing*

- (78) In the Restructuring Decision, the divestment of Rainbow was taken into account as a measure to limit distortions of competition. It was neither a burden-sharing

³⁷ As described in recital (48).

measure³⁸ nor a measure limited restructuring costs. As such, the prolongation of the divestment date of Rainbow does not affect the burden-sharing assessment of the Restructuring Decision.

- (79) As regards the DAS amendment it does not involve new aid. Accordingly, it does not affect the burden-sharing assessment³⁹.
- (80) The Commission also takes note of the new commitment of the UK authorities for RBS to divest Citizens⁴⁰. That divestment increases the own contribution of RBS to the restructuring plan and avoids a possible need for further State aid⁴¹.
- (81) The notified changes therefore do not put into question the burden-sharing assessment made in the Restructuring Decision.

3.2.3 *Measures to limit distortion of competition*

- (82) Within the Restructuring Decision⁴², the divestment of Rainbow was identified, amongst other divestments, as a key measure to address distortion of competition that the aid measures had created and to tackle the issue of moral hazard.
- (83) The Commission observes that RBS achieved the committed divestment of GMS, SEMBRA and RBS Insurance ahead of the deadlines in the commitments recorded in the Restructuring Decision.

Reasons for missing the deadline

- (84) The Commission considers that RBS has genuinely tried to divest Rainbow within the timeline to which it committed in 2009.
- (85) RBS started marketing Rainbow immediately after the Restructuring Decision. The signature of a contract with Santander UK followed rapidly afterwards. During the following negotiations, the Commission did not receive any complaint from Santander UK that RBS was not genuinely committed to the process. The Commission also did not observe behaviour by RBS showing a lack of willingness to proceed.
- (86) The Monitoring Trustee also concluded that RBS had made significant efforts to achieve a successful conclusion of the sale to Santander UK and is not to blame for its collapse⁴³. The Commission concludes that RBS has genuinely tried to divest the business as soon as possible and in line with the deadline it undertook in 2009. It is a positive element in the Commission's assessment of the request of the UK authorities.

Proportionality of the requested extension

- (87) The Commission observes that UK authorities seek a significant prolongation of the deadline to complete the sale of Rainbow compared to the deadlines with which they committed to comply with in 2009. The UK authorities request an amendment to postpone the initial divestment date from 31 December 2013 to 31 December 2017. More precisely, RBS will proceed to an IPO before 31 December 2016 and dispose of its entire interest in Rainbow by 31 December 2017. As an alternative to

³⁸ See recital (244) of the Restructuring Decision.

³⁹ As concluded in recital (64).

⁴⁰ As mentioned in recital (73).

⁴¹ See commitment 3.2 (C) of Annex I.

⁴² See recital (288) of the Restructuring Decision.

⁴³ Monitoring report to the European Commission of 1 November 2012).

the IPO RBS will also have the possibility of a whole business sale or tendering procedure as regards its entire interests in Rainbow, [...] ⁴⁴.

- (88) As regards the length of the requested prolongation, the Commission observes that RBS needed to change its approach after the withdrawal of Santander UK, to adapt the whole structure of Rainbow to the new situation. In the absence of new trade buyers RBS started a complex process of creation and divestment of a new bank. Therefore the Commission considers that the requested prolongation of four years is not excessive in view of the minimum period required for RBS to build that business and get all the approvals for the process. However, given that the additional four years marks a significant prolongation of the structural measures contemplated under the Restructuring Decision to limit distortions of competition, the Commission will need to ensure that the greater latitude given to RBS as a result of that additional period is offset by other measures which will limit distortions of competition during the same period.

Preservation of viability and competitiveness of Rainbow

- (89) In order to assess the request for a prolongation of the initially committed deadline by four years, the Commission has to verify whether Rainbow, as concluded in recital (244) of the Restructuring Decision, will still be a viable and profitable challenger bank at the end of that significantly prolonged divestment process. Long divestment processes may affect the viability of businesses being sold.
- (90) In that respect, the Commission observes that the 2013 report of the Office of Fair Trading ("OFT")⁴⁵ concluded, despite the prolonged divestment timeline, that Rainbow 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.
- (91) The OFT assessment is also consistent with the market share of Rainbow⁴⁶ and validated by the Monitoring Trustee, which confirms that its size is still significant and that Rainbow will be able to constitute a credible challenger in the UK market.
- (92) The Commission also observes that, on the basis of the latest business plan communicated by RBS to the Commission on 31 January 2014, Rainbow is expected to show [...] and a [...]. On the liquidity side the loan-to-deposit ratio is [...] which corresponds to [...].
- (93) As regards the size of the business the UK authorities have undertaken a number of commitments related to the scope of the divestment of the operating businesses⁴⁷, as well as behavioural measures to ensure the preservation of the value of the activities to be divested⁴⁸. Those specific commitments will ensure that Rainbow benefits from sufficient resources to develop its strategy.
- (94) As already mentioned in recital (69) RBS built Rainbow a new IT system which is, for the most part, contemplated to be a clone of the RBS infrastructure. The new platform will be hosted by a third independent party at market conditions. Rainbow

⁴⁴ See commitment 3.2 (A) of Annex I.

⁴⁵ The UK authorities requested the OFT to review the impact that Lloyds Banking Group and RBS' divestments would have on competition in retail and small and medium-sized banking in the UK and whether anything could be done to strengthen competition through enhancing the divestments. <https://www.gov.uk/government/news/office-of-fair-trading-reports-to-government-on-lloyds-and-rbs-divestments>

⁴⁶ As noted in recital (19).

⁴⁷ See Schedule 1 of the Annex 1.

⁴⁸ See commitments 4.2, 5.1, 5.2, 5.4 and 5.5.

will have the full control over the platform, and will be able to adapt to its new strategy.

- (95) The Commission also notes positively the direct involvement of the Comet investors⁴⁹ in the management and the conduct of the new strategy of Rainbow. That situation supports the view that Rainbow is economically attractive, increases the probability that it will grow according to the new business plan and decreases the likelihood that RBS will – intentionally or not – neglect Rainbow's development while RBS continues to control it.
- (96) Furthermore, as long as the new investor is involved in Rainbow, RBS must comply with the terms of the Investment Agreement to [...]. In that context the Commission also takes into consideration the other commitments related to the new budget and the monitoring of specific metrics to ensure the preservation of the business prior to the divestment⁵⁰.
- (97) The Commission also notes positively that since the beginning of the separation process of Rainbow (with notably the William and Glynn rebranding) RBS did not experience significant customer attrition. The Monitoring Trustee noted in its 12th monitoring report that "[...]" and also confirmed in its 15th monitoring report that "[...]".
- (98) The combination of all the elements cited in recitals (92) to (97) supports the conclusion that Rainbow is and will remain a viable business and will represent a significant new competitor in the market.

Other prolonged behavioural commitments

- (99) The Commission notes positively that UK authorities have also prolonged⁵¹ the limitation for RBS to acquire financial institutions. That prolonged ban 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. The Commission can therefore conclude that the greater latitude given to RBS as a result of the additional period to divest Rainbow is sufficiently offset by other measures which will limit distortions of competition during the same period.

Conclusion

- (100) The Commission concludes that the requested prolongation of the deadline to divest Rainbow and the associated commitments do not put into doubt the conclusion of the Restructuring Decision that undue distortions of competition are avoided. Even with the new timeline the Commission considers that Rainbow will be viable and will increase competition in the UK market.

3.3 CONCLUSION ON COMPATIBILITY UNDER RESTRUCTURING COMMUNICATION

- (101) In conclusion, the Commission considers that the amended commitments are equivalent to the original ones in terms of restoration of viability, burden-sharing and mitigation of competition distortions. The replacement of the original commitments by the new commitments does not alter the compatibility of the aid with the internal market as concluded by the Restructuring Decision.

⁴⁹ See commitment 5.3 of Annex I.

⁵⁰ See commitment 5.1 to 5.5 of the Annex I.

⁵¹ As described in recital (48).

4 CONCLUSION

The notified amended list of commitments, and in particular the DAS amendment, does not constitute aid. They also do not affect the compatibility of the State aid provided to RBS with the internal market on the basis of Article 107(3)(b) TFEU.

If this letter contains confidential information which should not be disclosed to third parties, 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 should be sent by registered letter or fax to:

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

Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President

ANNEX I

TERM SHEET FOR UK AID COMMITMENTS IN RESPECT OF RBS

1. DEFINITIONS

- 1.1. "Balance Sheet Target Level" means a reduction in the funded assets of the RBS Regulatory Group, as shown in the published audited consolidated pro forma balance sheet of the RBS Regulatory Group for the year ending 31 December 2013 (the "2013 Balance Sheet"), to £[...] or less.
- 1.2. "Businesses" or "Divestment Businesses" means the Rainbow Business, the residual shareholding in RBS Insurance (named Direct Line) and RBS Citizens. "Business" or "Divestment Business" shall be construed accordingly.
- 1.3. "Buyer's Group" means (a) the buyer; (b) those undertakings in which the buyer, directly or indirectly: (i) owns more than half of the capital or business assets; (ii) has the power to exercise more than half the voting rights; (iii) has the power to appoint more than half the members of the supervisory board, the administrative board or bodies legally representing the undertakings; or (iv) has the right to manage the undertakings' affairs; (c) those undertakings which have in the buyer the rights or powers listed in (b); (d) those undertakings in which an undertaking referred to in (c) has the rights or powers listed in (b); and (e) those undertakings in which two or more undertakings as referred to in (a) to (d) jointly have the rights or powers listed in (b).
- 1.4. "Comet" means the consortium led by Corsair and Centerbridge that entered into the Investment Agreement with RBSG, RBS plc, NatWest plc and others on 27 September 2013.
- 1.5. "Divestiture Trustee" has the meaning set out in clause 3.5.
- 1.6. "Decision Date" means the date of the European Commission decision(s) referred to in clause 2.
- 1.7. "FCA" means the Financial Conduct Authority of the United Kingdom.
- 1.8. "Financial Institution" means [...].
- 1.9. "Investment Agreement with Comet" means the Investment Agreement signed by the RBS with the Investors on the 27 September 2013 relating to the Rainbow deal, [...].
- 1.10. "Investors" means the new investors named in the Investment Agreement with Comet.

- 1.11. "Hold Separate Manager" has the meaning set out in clause 3.11.
- 1.12. "Monitoring Trustee" has the meaning set out in clause 7.1.
- 1.13. "PRA" means the Prudential Regulation Authority of the United Kingdom.
- 1.14. "Rainbow Business" means the business described in Schedule 1.
- 1.15. "RBS" means The Royal Bank of Scotland Group plc, a public company incorporated in Scotland with registered number SC045551 and whose registered office is at 36 St Andrew Square, Edinburgh, Scotland EH2 2YB.
- 1.16. "RBS Group" means RBS including its subsidiaries from time to time.
- 1.17. "RBS Regulatory Group" has the same meaning as "Regulatory Group" as set out in clause of the Acquisition and Contingent Capital Agreement dated 26 November 2009.
- 1.18. "Recapitalisation" means the Acquisition of the B Shares for £25.5 billion by HM Treasury as set out in the Acquisition and Contingent Capital Agreement dated 26 November 2009.
- 1.19. "SME market" means the market in the United Kingdom for the provision of banking services to business and commercial customers with an annual turnover of up to £25 million and "SME" shall be defined accordingly.
- 1.20. "RBS Citizens" means RBS Citizens Financial Group Inc, a US subsidiary of RBSG.
- 1.21. "Transitional Board", expected to be known as the Williams & Glyn Management Advisory Committee, refers to the definition given in the terms of the Investment Agreement with Comet.

2. CONDITIONALITY

The commitments set out below are conditional on the European Commission reaching a decision or decisions that the amendments to the restructuring decision of 14/12/2009 in relation to Rainbow and to the DAS do not affect the conclusion of compatibility with the internal market of the initial State aid received by RBS.

3. DIVESTMENT OBLIGATION

3.1. RBS will:

- (A) divest its entire interest in each of the Rainbow Business and RBS Insurance; and
- (B) divest its entire interest in RBS Citizens.

3.2. RBS must dispose of the Businesses in accordance with the following provisions:

- (A) RBS must proceed to initial public offering before 31 December 2016 and dispose of its entire interest in the Rainbow Business by 31 December 2017. As an alternative to the initial public offering RBS will also have the possibility of a whole business sale or tendering procedure as regards its entire interests in Rainbow, providing [...].
 - (B) RBS must dispose of its entire remaining interest in RBS Insurance by 31 December 2014.
 - (C) RBS must dispose of RBS Citizens by way of an initial public offering (and, if required, subsequent disposal tranches) or a whole business sale or tendering procedure by 31 December 2016.
- 3.3. In the event that RBS Citizens is planned to be disposed through an initial public offering (IPO) and that market metrics in the judgement of the sponsor banks for the initial public offering indicate that the US capital markets are in such condition that an initial public offering, or subsequent tranches of disposal, following an initial public offering, required to dispose of all of the shares in RBS Citizens, would not be achievable in an orderly fashion or at a fair value as defined by the market metrics by 31 December 2016, the deadline for the disposal will be automatically extended by a period of 12 months.

The market metrics defining whether a sale could or could not be achieved in an orderly fashion or at fair value through an initial public offering and subsequent tranches are set out in Schedule 4. These market metrics are to be regularly monitored by the sponsor bank and reported on by the Monitoring Trustee.

- 3.4. [...].
- 3.5. Subject to any extension granted by the European Commission [...], or resulting from clause 3.3, the UK Government must appoint a trustee that will, within [...] of appointment, dispose of the Business(es) (and in the case of the Rainbow Business to a purchaser as envisaged by clause 3.9 below), if the disposal of the Business(es) has not been completed by the dates specified in clauses 3.2 above (the “Divestiture Trustee”).
- 3.6. The following provisions apply to the appointment of a Divestiture Trustee:
- (A) subject to any extension granted by the European Commission [...] or resulting from clause 3.3, the UK Government must propose to the European Commission for approval, no later than one month before the deadlines specified in 3.2 as appropriate a list of one or more persons whom it proposes to appoint as Divestiture Trustee;
 - (B) the Divestiture Trustee must be appointed within one week of the European Commission’s approval in accordance with the mandate approved by the European Commission;

- (C) RBS must grant comprehensive powers of attorney to the Divestiture Trustee:
- a) to effect the disposal of the relevant Business(es) (including the necessary powers to ensure the proper execution of all the documents required for effecting the disposal); and
 - b) to take all actions and declarations which the Divestiture Trustee considers necessary or appropriate to achieve the disposal, including the appointment of advisors to assist with the disposal;
- (D) RBS must provide the Divestiture Trustee with all such co-operation, assistance and information as the Divestiture Trustee may reasonably require to perform its tasks; and
- (E) the Divestiture Trustee shall be remunerated by RBS and in a way that does not impede the independent and effective fulfilment of the Divestiture Trustee's mandate.

3.7. [...].

3.8. When it was offered for sale in early 2010, the Rainbow Business met the size described in the term sheet of commitments referred to in the December 2009 Restructuring Decision. When it was again offered for sale in 2012, the Rainbow Business met the size described in Schedule 1 below.

3.9. In case of sale through a tendering procedure as it is described in clause 3.7 the buyer of the Rainbow Business must:

- (A) together with the rest of the Buyer's Group, in combination with the Rainbow Business, have a market share of less than 14% in the SME market, measured by number of customers served in the UK and by reference to the most recent pH annual survey (or, should pH cease to publish relevant figures, as calculated by a comparable successor provider of market information) issued prior to the signing of the sale and purchase agreement relating to the sale of the Rainbow Business to the Buyer;
- (B) be independent of RBS and must not be connected to RBS within the meaning of Article 11 of the European Commission Block Exemption Regulation No 2790/1999 regarding vertical agreements;
- (C) 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;
- (D) satisfy the PRA (or its successor body) 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; and

(E) have sufficient resources and incentive to keep and develop the Rainbow Business provided that if the buyer satisfies sub-clause 3.9(D) above it shall be presumed also to satisfy this sub-clause 3.9(E).

3.10. RBS shall, if requested, exercise best efforts to support, on reasonable commercial terms, the buyer(s) of the Rainbow Business (including, where relevant, any new entity resulting from an initial public offering as envisaged in clause 3.2(A) above) in migrating to appropriate infrastructure for the ongoing operation of the business. This support will include reasonable transitional 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 for the buyer to continue 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.

3.11. As long as the Investment Agreement with Comet is applicable and with a view to ensuring the continued economic viability, marketability and competitiveness of the Rainbow Business, [...].

The CEO will oversee the management of the Rainbow Business in its best interests, in common consultation with RBS and consistent with i) regulatory requirements, ii) RBS operating and governance policies and iii) the board of RBS's fiduciary duties to RBS's shareholders and as monitored by the Monitoring Trustee appointed in accordance with clause 7 below.

In case of termination of the Investment Agreement before the initial public offering and with a view to ensure 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 termination of the Investment Agreement and shall ensure that the Hold Separate Manager operates independently. The Hold Separate Manager must remain appointed until the completion of the disposal of the Rainbow Business. The Hold Separate Manager can be the CEO in place (or other senior employee) of the Rainbow Business. The Hold Separate Manager will oversee the management of the Rainbow Business in its best interests, in common consultation with RBS and consistent with the board of RBS's fiduciary duties to RBS's shareholders and as monitored by the Monitoring Trustee appointed in accordance with clause 7 below. For the avoidance of doubt, the appointment of the Hold Separate Manager shall not preclude the Rainbow Business from having access to infrastructure and personnel of RBS where appropriate for the efficient conduct of the Rainbow Business, nor shall it preclude the transfer of information between the Rainbow Business and the remainder of RBS.

3.12. RBS Citizens can be disposed of in parts or as a whole. [...].

4. RESTRICTIONS ON FURTHER ACQUISITIONS AND BUSINESS ACTIVITIES

4.1. Except to the extent that the cumulative purchase price (excluding the assumption of debt) paid by RBS for all acquisitions as specified in (A) or (B) below, is less than £[0 – 1 500] million, RBS:

(A) will not acquire any Financial Institutions or any package of assets and liabilities that together constitutes a business equivalent to a Financial Institution, until the date of completion of disposal of the Divestment Businesses; and

(B) will not make any other acquisitions the purpose of which is to expand RBS's activities outside of its business model, until the date on which the last of the Businesses has been divested.

4.2. RBS will not acquire any ownership interest in the Rainbow Business in the [...] years after the full divestment of that business.

4.3. [...].

5. CONDUCT IN RELATION TO THE BUSINESSES

5.1. RBS shall procure that, for a [...] period following the full disposal of the Rainbow Business, no member of the RBS Group shall canvass or solicit the custom of any person who is a customer of the Rainbow Business immediately before completion of the disposal, in relation to products or services carried on by the Rainbow Business immediately before completion of the disposal. This clause shall not apply to any such customer who independently approaches any member of the RBS Group without any prior (and direct) inducement from a member of the RBS Group. Further, it shall not prevent any member of the RBS Group canvassing or soliciting the custom of any person in relation to any activity outside the Rainbow Business, provided that no member of the RBS Group shall canvass or solicit the custom of any such person in relation to activities that compete with the Rainbow Business. Furthermore, it shall not prevent any member of the RBS Group from undertaking generalised marketing campaigns where such campaigns are not specifically targeted at the customers of the Rainbow Business but which may also include customers of the Rainbow Business.

5.2. RBS shall be entitled to transfer to a retained branch of the RBS Group any person who is both a customer of the Rainbow Business and an employee of any member of the RBS Group (other than an employee transferring with the Rainbow Business).

5.3. As long as the Investment Agreement with Comet is applicable:

(A) RBS shall provide the appropriate support to enable the CEO of Rainbow to carry on the Rainbow Business as a going concern in the ordinary and usual course as carried on prior to the Decision Date and to manage it according to the business preservation metrics described in Schedule 2, in common consultation with RBS and consistent with i) regulatory requirements, ii) RBS operating and governance policies and iii) the board of RBS's fiduciary duties to RBS's shareholders; and

(B) RBS shall provide the appropriate support to the CEO of Rainbow so that the management of the Rainbow Business is consistent with the corresponding budget (e.g. as attached for 2014 in schedule 3), but nothing in this provision will prevent any reorganisation or restructuring of the Rainbow Business in preparation for disposal in accordance with the provisions of this term sheet.

[...].

5.4. Between the Decision Date and the completion of the disposal of a Divestment Business, RBS shall not initiate any programmes involving directed and targeted contact with customers of the relevant Business for the purpose of encouraging said customers to leave the relevant Business. For the avoidance of doubt, RBS shall be permitted to initiate programmes which involve direct and targeted contact with such customers where the purpose of such contact is to promote products and services of RBS that do not form part of a Divestment Business.

5.5. From the Decision Date to the time at which a prospectus has been issued for the Business (or if relevant, until the time at which a sale and purchase agreement has been signed), RBS will not actively target employees working within the relevant Business to transfer to roles outside of the relevant Business.

6. REFERENCES TO STATE SUPPORT

Until the full disposal of Rainbow, RBS shall not refer to the fact that it enjoys any State support or to the fact that the UK State is a shareholder in RBS in any of RBS's advertising.

7. MONITORING TRUSTEE

7.1. RBS shall maintain the mandate of a trustee in charge of the overall task of monitoring and ensuring, under European Commission's instructions, compliance with the commitments (the "Monitoring Trustee"). Monitoring Trustee reports will be provided to the Commission on a half yearly basis.

7.2. In case of a change of Monitoring Trustee the United Kingdom shall propose to the European Commission for approval, no later than one month before the expected date of appointment, a list of two or more persons, selected after a competitive tender procedure, whom it proposes to be appointed as Monitoring Trustee. The Monitoring Trustee shall be appointed within one week of the European Commission's approval in accordance with the mandate approved by the European Commission and shall report to the European Commission on a half

yearly basis as to RBS's compliance with the commitments. The first report will be submitted to the European Commission no later than six months after Monitoring Trustee appointment.

- 7.3. RBS and Rainbow shall provide and cause their advisors to provide to the Monitoring Trustee all such co-operation, assistance and a direct access to all information as it may reasonably require to perform its tasks, including the possibility to appoint advisors. The Monitoring Trustee shall be remunerated by RBS in a way that does not impede the independent and effective fulfilment of its mandate.

8. ENFORCEMENT AND REPORTING

- 8.1. HM Treasury will ensure that RBS complies with the commitments in this term sheet.
- 8.2. HM Treasury will submit half-yearly reports on the measures taken to comply with the commitments in this Term Sheet.

SCHEDULE 1 DESCRIPTION OF THE RAINBOW BUSINESS

- 1.1. The Rainbow Business is the RBS branch-related Retail and SME business in England and Wales, and the NatWest branch-related Retail and SME business in Scotland, along with the Direct SME business and, to the extent transfer is within the control of RBS, the accounts and assets pertaining to and services provided to certain mid-corporate customers (where a 'mid-corporate customer' is a customer who has turnover of between £25 million and £1 billion per annum), subject to clause 1.5 below.
- 1.2. The banking business associated with customers being transferred (i.e. the provision of loans, debit cards, credit cards, current accounts, overdrafts, savings accounts and mortgages subject to paragraph 1.5) will be transferred.
- 1.3. In addition to the banking business outlined at paragraph 1.2, the Rainbow Business includes the following assets:
- i. Leasehold or freehold interest in 308 RBS branches and sub-branches in England and Wales, and 6 NatWest branches and sub-branches in Scotland.
 - ii. Further Banking Infrastructure, including leasehold or freehold interests in buildings to be utilised as:
 - 40 Business and Commercial Banking Centres.
 - 4 Corporate Banking Centres
 - 2 Direct Business Banking Centres

- 3 Personal Relationship Manager Centres; and
 - 4 Operational Centres.⁵²
- iii. Approximately 6,000 employees, including approximately 850 relationship managers, or appropriate number as a result of any efficiency improvements that may have taken place between the Decision Date and divestment date; and
- iv. Arrangements for the supply of certain products/services on reasonable commercial terms by RBS or a subsidiary as defined in agreement with a potential purchaser/investor, for a transitional period from the divestment date as defined in agreement with a potential purchaser/investor.

1.4. The Rainbow Business includes the following intangible assets: the Williams & Glyn's brand. For the avoidance of doubt, the Rainbow Business shall not include the RBS, NatWest, Drummonds or Child & Co brands.

1.5. For the avoidance of doubt, the Rainbow Business shall not include:
[...].

SCHEDULE 2: RAINBOW BUSINESS PRESERVATION METRICS

[...].

SCHEDULE 3: RAINBOW 2014 BUDGET

[...]

SCHEDULE 4: RBS CITIZEN METRICS FOR AN AUTOMATIC EXTENSION

An automatic prolongation of 12 months of the deadline of 31 December 2016 can be granted if, at any date between 1st January 2015 and 31st December 2016, at least one of the two following sets of indicators is met:

[...]

⁵² Certain of the centres referred to in 1.3(ii) may be contained in the same site.