



EUROPEAN COMMISSION

Brussels, 13.05.2014
C(2014) 3120 final

<p>In the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus [...].</p>		<p style="text-align: center;">PUBLIC VERSION</p> <p>This document is made available for information purposes only.</p>
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**Subject: State aid SA.29834 (2014/N-2) – United Kingdom
Amendment to the restructuring plan of Lloyds Banking Group**

Sir,

1 PROCEDURE

- (1) By decision of 18 November 2009¹ ("the Restructuring Decision"), the Commission declared a number of State aid measures² granted to Lloyds Banking Group ("LBG") compatible with the internal market. The conclusion was reached on the basis of a restructuring plan for LBG and of the commitments issued by the UK authorities and LBG.

¹ Commission Decision SA. N428/2009, OJ C046, 24.02.2010, p. 1.

² For a full list of the State aid measures approved, see recitals (42) to (69) of the Restructuring Decision.

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UNITED KINGDOM

- (2) Since the Restructuring Decision was adopted, the Commission services, the UK authorities and LBG (directly or via the Monitoring Trustee who was appointed pursuant to the Restructuring Decision) have had frequent exchanges, in the form of meetings, conference calls and exchanges of e-mails and documents.
- (3) On 8 March 2012, the UK authorities notified to the Commission a formal request to amend the Restructuring Decision, in particular concerning the reduction of the scope of the Divestment Business³ in the context of negotiations for its sale. As a result of the then on-going negotiations with a preferred bidder and of initial feedback from the Commission services, the UK authorities subsequently prepared an amended notification to replace the notification of 8 March 2012. Although the UK authorities had prepared that draft amended notification by mid-August 2012, they never formally submitted it to the Commission. The UK authorities ultimately withdrew the notification of 8 March 2012 on 29 April 2014.
- (4) On 1 April 2014, the UK authorities notified to the Commission the formal request to amend the Restructuring Decision which is examined in the present Decision. That request concerns in particular the perimeter and divestment deadline for the Divestment Business.

2 DESCRIPTION

2.1 IMPLEMENTATION OF THE RESTRUCTURING PLAN AND THE COMMITMENTS

2.1.1 Implementation of measures aiming at restoring long-term viability

- (5) LBG is a leading UK bank with a total balance sheet of GBP 847 billion⁴ and total risk weighted assets ("RWA") of GBP 264 billion.
- (6) The main business activities of LBG are retail, commercial and corporate banking, general insurance, life insurance and pension provision.
- (7) A detailed description of LBG's business activities as they existed at the time of the Restructuring Decision can be found in recitals (8) to (37) of the Restructuring Decision.

³ The Divestment Business is a retail banking business that LBG must dispose in accordance with the Restructuring Decision. The same business was identified as the "Divestment Business" in the Restructuring Decision or as Verde business in several documents and official communication. That business was rebranded as TSB on 9 September 2013. The present Decision will refer to TSB throughout for ease of understanding.

⁴ In the present decision, the Commission uses the results published by LBG in its annual report and accounts for full-year 2013.

(8) Key pro forma figures⁵ for end of year from 2009 to 2013 are summarized in Table 1:

Table 1

	2013	2012	2011	2010	2009
Total income net of insurance claims (GBP billion)	18,5	20,5	20,8	24,9	22,5
Underlying profit (GBP billion)	6,2	2,6	0,6	NA	NA
Loss / profit attributable to ordinary shareholders (GBP billion)	(0,8)	(1,5)	(3,0)	(0,3)	2,8
Total balance sheet (GBP billion)	847	934	971	991	1 028
Total loans / customer deposits (in %)	113	121	135	154	169
Wholesale funding	138	170	251	298	326
Risk-weighted assets (GBP billion)	264	310	352	406	493
Core-Tier 1 capital ratio (in %)	14,0	12,0	10,8	10,2	8,1
Tier 1 capital ratio (in %)	14,5	13,8	12,5	11,6	9,6

(9) LBG has successfully deleveraged and de-risked its balance sheet in line with the restructuring plan. As illustrated in Table 1 LBG has improved:

- Its Core-Tier 1 ratio, staying above the 4% threshold as committed in recital (90) of the Restructuring Decision;
- Its underlying profit, which returned to a positive territory reaching GBP 6,2 billion in 2013. That improvement was the result of less reliance on wholesale funding, reduction of non-core activities, better net interest margins and a programme for simplification with the aim of reducing costs. However, it did not give rise to a net profit attributable to shareholders, because the operating profit was offset by several legacy-related costs, in particular GBP 3,5 billion of compensation payments to customers who had bought protection payment insurance and interest rate hedging products, GBP 1,5 billion of costs for simplification and for building TSB and GBP 0,8 billion of other items.
- Its liquidity profile, by reducing (a) its dependence on the wholesale funding market by 58% since 2009 and (b) its loan-to-deposit ratio, which decreased from 169% in 2009 to 113% in 2013.
- Its RWA with a 46% reduction since 2009. Total assets decreased from GBP 1028 billion to GBP 847 billion thanks to an asset reduction programme.

⁵ LBG Group Annual Report and Accounts from 2009 to 2013.

- (10) Under the restructuring plan LBG disposed of or ran down numerous non-core businesses. In that context, LBG had committed to reduce a specific pool of assets by GBP 181 billion.
- (11) As regards the asset reduction commitment mentioned in recital (10), LBG achieved that goal by 31 December 2012, two years earlier than committed. The Monitoring Trustee has also confirmed the completion of the reduction programme in its 13th monitoring report.
- (12) Thanks to LBG's improved situation, its stock market price has returned to a level above the average price at which the UK authorities had bought shares. In those circumstances, the UK authorities have decided to progressively sell their shareholding in LBG. They have reduced their shareholding from 43,4% in October 2008 to 24,9% after a sale of 6% on 17 September 2013 and a further sale of 7,78% on 26 March 2014⁶.

2.1.2 *Implementation of the committed divestment to limit distortion of competition*

- (13) In order to limit distortion of competition in the UK retail market, and in particular in the current accounts and mortgages segments, LBG had committed to divest a package of customers and branches. HM Treasury and LBG had committed that LBG would divest TSB before 30 November 2013⁷.
- (14) The divestment was designed as a retail banking business consisting of: the TSB brand, C&G branches, all C&G savings accounts and certain C&G mortgages associated with C&G branch-based customers; the internet bank Intelligent Finance ("IF") (including brand, customer service agents, customers and accounts), the banking license of Lloyds TSB Scotland, and certain branches of Lloyds TSB in England and Wales (to reach at least 600 branches in total). Originally the business was supposed to include 19,2% of LBG's retail mortgage assets. The business had to have at least a 4,6% share of the personal current account ("PCA") market in the UK⁸. The business was designed to have significantly more customer loans than customer deposits. However, under the committed term sheet, the buyer was to have the right to request a reduction of loan-to-deposit ratio of the divestment business to the level of the loan-to-deposit ratio of the UK retail operations of LBG (which was still well above 100%, so that even in that scenario the divestment business would still have a funding gap).
- (15) Soon after the Restructuring Decision LBG started building TSB and preparing it for sale. First, the different businesses had to be carved out and then they had to be integrated into a single entity to then be transferred to a buyer. Consequently, instead of looking for a buyer immediately after the adoption of the Restructuring Decision and organizing the transfer together with this buyer, LBG chose to first prepare the TSB business for the sale.
- (16) Having prepared the TSB business for sale, LBG then launched a sale process. On 11 June 2011, LBG published an Information Memorandum to the market setting out the description of the business on offer, with financial information as at 31 December 2010. On 14 December 2011, LBG announced that it had entered into

⁶ http://www.ukfi.co.uk/index.php?URL_link=press-releases&Year=2013;

⁷ http://www.ukfi.co.uk/releases/20140326_lloyds%20pricing%20announcement.pdf

⁷ See recital (79) of the Restructuring Decision.

⁸ See recital (98) of the Restructuring Decision.

exclusive negotiation with Co-op Bank as a preferred bidder⁹. On January 2012, the UK authorities informed the Commission that the preferred bidder, just like the two remaining bidders, had requested a reduction of the funding gap in the business¹⁰: Specifically, Co-op Bank requested a zero funding gap in TSB for 2013.

- (17) Overall, during negotiations to acquire TSB, Co-op Bank requested the following changes to the perimeter to eliminate the funding gap and improve profitability:
- removing the funding gap, by removing further mortgage assets of around GBP [10-20]* billion compared to the lower loan-to-deposit-ratio allowed under the committed term sheet¹¹. The mortgages to be removed would be almost exclusively from the C&G intermediary non-relationship channel;
 - removing the IF business, including a projected GBP [5-10] billion of assets and GBP [0-5] billion of deposits as at 31 December 2013 balance sheet. That change would have resulted in a reduction to the PCA market share of TSB from 4,6% to 4,3% as measured at 31 December 2010; and
 - eliminating the surplus liquidity in the business through the removal of GBP [0-5] billion of C&G fixed-rate term deposits and fixed-rate individual savings accounts (together the “C&G fixed-term deposits”) as at 31 December 2013 balance sheet.
- (18) On 8 March 2012 HM Treasury initially requested the Commission to authorize the changes mentioned in recital (17).
- (19) On 24 April 2013, LBG publicly announced that Co-op Bank was no longer interested in purchasing TSB despite a year of intensive discussion. At the same time, LBG announced the divestment of TSB through an Initial Public Offering (IPO) process¹². Accordingly LBG defined a new divestment strategy and timeline. The Board of Co-op Bank explained that its decision to withdraw reflected the impact of the economic environment, the worsened outlook for economic growth and the increasing regulatory requirements on the financial services sector in general, rather than the unattractiveness of the TSB business.
- (20) On 23 September 2013, LBG formally launched the business under the TSB brand, announcing it as a new competitor on the market offering current accounts, savings, mortgages, insurance and loans as well as supporting small businesses with its 631 branches in England, Wales and Scotland¹³. By 9 September 2013, LBG had completed the separation of TSB accounts and from that point onwards TSB has operated with its own management.
- (21) Prior to the IPO, LBG will complete a complex and detailed separation process for TSB, including the implementation of a separation agreement, services agreements, a relationship agreement and the completion of regulatory approval process.

⁹ <http://www.lloydsbankinggroup.com/globalassets/documents/media/press-releases/lloyds-banking-group/2011/2011dec14lbgverdepreferredbidder.pdf>.

¹⁰ [Pursuant to clause 3.7 of the Term Sheet annexed to the Restructuring Decision.](#)

¹¹ [Loan-to-deposit-ratio scenario as set out in Schedule 1 of the original Term Sheet as at end-2013.](#)

* covered by the obligation of professional secrecy.

¹² <http://www.lloydsbankinggroup.com/media/press-releases/2013-press-releases/lloyds-banking-group/verde-update/>

¹³ <http://www.lloydsbankinggroup.com/media/press-releases/2013-press-releases/lloyds-banking-group/lloyds-banking-group-announces-the-launch-of-tsb/>

- (22) The Commission has been regularly informed about the progress of the separation process for TSB.
- (23) The current timetable is to execute the IPO during the summer of 2014. The new target date for the full divestment of TSB is 31 December 2015. LBG will sell only a part of its 100% shareholding in TSB in the IPO and will dispose the residual shareholding over the next twelve to eighteen months, depending on market conditions. As an alternative to the IPO LBG may carry out a whole business sale or tendering procedure as regards its entire interests in TSB, so long as the ownership is disposed by 31 December 2015.

2.1.3 *Implementation of the behavioural commitments*

- (24) As regards to behavioural commitments concerning LBG recorded in the Restructuring Decision (ban on advertising State support, acquisition restriction and a two-year ban on payment of discretionary coupons on hybrid instruments), the Commission, with the support of its Monitoring Trustee, has not identified any breaches to date.

2.2 POSITION OF THE UNITED KINGDOM – REQUEST FOR AMENDMENTS

2.2.1 *Divestment of TSB*

Extend the deadline of TSB divestment

- (25) As a result of the unexpected withdrawal of Co-op Bank, LBG could not complete the TSB divestment before the deadline of 30 November 2013. The UK authorities submit that “*the deadline [was] missed through no fault of LBG*” and so is covered by the situations contemplated in clause 3.3 of the list of commitments annexed to the Restructuring Decision. In line with that clause the UK authorities therefore request the Commission to allow “*an appropriate extension*” to that deadline.
- (26) The UK authorities stress that the withdrawal of Co-op Bank in April 2013 significantly delayed the expected divestment date. In response to the withdrawal of Co-op Bank, LBG accelerated its plan for an IPO of a “bank” instead of the divestment of a “business”.
- (27) The UK authorities therefore propose that the deadline for full divestment should be extended to 31 December 2015¹⁴ with a provision for an automatic extension. The automatic extension provision would be engaged if UK capital markets were in such a condition that an IPO or subsequent offerings could not be achieved in an orderly fashion by 31 December 2015 or would be potentially detrimental to LBG, TSB and the objectives of the Restructuring Decision (in that case the market is considered to be “closed”)¹⁵. The automatic extension would postpone the deadline for six or twelve months as from 31 December 2015 depending on the situation.
- (28) The UK authorities contend that the automatic extension mechanism would ensure that the Commission is not unnecessarily involved in an essentially administrative matter which relates to factors outside the control of LBG or the UK authorities. The use of the two objective and observable triggers would ensure that the

¹⁴ See commitment 3.1 of Annex I.

¹⁵ See commitment 3.2 of Annex I.

mechanism could only be used to extend the deadline if the capital markets were genuinely closed and if there were a good economic argument for delaying the IPO or subsequent tranches of sell-down. The UK authorities further consider that the proposed periods of extension are appropriate: they would allow for the markets to reopen, but would not be so long as to unduly delay the disposal. In the UK authorities' opinion, [...] LBG would have an adequate incentive to proceed with the IPO as soon as possible.

- (29) Under the requested amendment, an extension of the deadline for the full divestment of TSB would also require a corresponding delay in the appointment by the UK authorities of a Divestiture Trustee¹⁶. The UK authorities propose that the commitments relating to the Divestment Trustee should be amended so that the date on which UK authorities must appoint a Divestment Trustee should be 31 December 2015 or the revised date if the automatic extension is triggered, whichever is later¹⁷. That change would be a direct consequence of the inclusion of the automatic extension mechanism.

Reduction of TSB's perimeter

- (30) The UK authorities recall that the commitments recorded in the Restructuring Decision defined the perimeter of TSB which LBG would divest. The modifications envisaged for a trade sale of the TSB to Co-op Bank¹⁸ had the effect of eliminating the funding gap, reducing the riskier mortgage assets and removing other parts of the business that were also non-profitable under prevailing economic conditions.
- (31) The UK authorities ask to be authorised to retain the changes requested at the time by Co-op Bank even if TSB will now be divested through an IPO.
- (32) The reductions which are presented in recital (17) would lead to a global reduction of the total assets from GBP [40-70] to GBP [25-30] billion at the end of 2014 including the enhancements described in recitals (53) to (57). The UK authorities believe that those modifications would reduce the funding risk and enhance returns for TSB. With improved profitability and more stable funding, TSB would be better placed to compete for new customers, expand its balance sheet and maintain a strong capital position to support new lending. Table 2 compares key parameters of the perimeter defined in the Term Sheet annexed to the Restructuring Decision as applied in 2009 and in 2013 with the current proposal of the UK authorities.

Table 2

Perimeter	Term Sheet (application 2009)	Term Sheet (application 2013)	Proposal¹⁹
Assets (range GBP million)	[50-75]	[40-70]	[25-30]
Deposits (GBP million)	[30-40]	[30-40]	[20-25]

¹⁶ See clauses 3.2 and 3.4 of the list of commitments annexed to the Restructuring Decision.

¹⁷ See commitment 3.3 of Annex I.

¹⁸ See recital (17).

¹⁹ [...]

PCA market share (%)	4,6	4,6	[4-5]
Customers	[4-5]million	[4-5]million	[4-5]million
Branches	600+	600+	631
Mortgages (range as % of LBG mortgages)	[10-19,2]% - 19,2%	[10-19,2]% - 19,2%	[5-10]%

- (33) The UK authorities consider that the proposed changes set out in recital (17) would improve TSB's ability to compete and the viability of the divestment process. Removing the mortgage assets specified in recital (17) would reduce TSB's need for wholesale funding. Due to the low interest rate environment, the mortgages to be removed are low quality relative to those that will remain and include approximately GBP [0-10] billion of relatively high risk and low return C&G intermediary non-relationship mortgages. Excluding those mortgages would improve profitability and lower risk profile and capital requirements. HM Treasury considers that TSB would be better able to compete for new, more profitable, mortgage business.
- (34) HM Treasury notes that the exclusion of the IF business would lead to a reduction of the portfolio of PCAs (207,000 as at December 2010) as well as of savings accounts. Accordingly, it would reduce TSB's share of the stock of PCAs to 4,3%, below the 4,6% requirement set out in clause 3.6(c) of the Term Sheet annexed to the Restructuring Decision. However HM Treasury believes that the change ultimately would benefit TSB because removing the IF business as a whole would improve TSB's competitive position.
- (35) HM Treasury also recognises that the commitments annexed to the Restructuring Decision not only sought to ensure the emergence of a viable challenger but also to reduce LBG's balance sheet. To ensure that LBG's balance sheet will be reduced and that LBG does not benefit from the proposed changes to the perimeter of TSB, HM Treasury proposes as compensatory measures that:
- LBG will be required to run-down the IF business and the C&G fixed-term deposits for at least three years;
 - LBG will provide TSB with the option to use hosted marketing rights for the IF's and C&G fixed-term deposits' customers (subject to legal, regulatory, data protection and customer marketing preference constraints) until 31 December 2016; and
 - The C&G brand will be transferred to TSB.
- (36) The UK authorities consider that LBG would not benefit from the reduction in TSB mortgage balances in light of the requirement for LBG to run-down IF credit balances and the C&G fixed-term deposits, the provision of hosted marketing rights commitment and the fact that the assets to be removed are not profitable.
- (37) Instead of including the IF and C&G fixed-rate term deposits in TSB, LBG undertakes to run-down those businesses for at least three years in line with the repayment profile of the IF mortgage and savings book or their contractual maturities in the case of C&G fixed-term deposits. In addition, the C&G brand will

be transferred to TSB at the time of listing and LBG will not use the IF brand to market new products until 31 December 2016.

- (38) The commitment that LBG will provide TSB with hosted marketing rights for the IF and C&G fixed-term deposit customers (subject to legal, regulatory, data protection and customer marketing preference constraints) until 31 December 2016 means that LBG will include wording agreed with TSB in mailings to IF and C&G customers, directing customers to the branch, internet and telephony channels of TSB and identifying TSB as an alternative provider of products which customers may want to consider.
- (39) The UK authorities believe that the commitment set out in recital (38) would allow TSB to market its products to the customers who hold C&G fixed-term deposits and IF accounts, which would mitigate the exclusion of the customers from TSB.
- (40) In addition HM Treasury commits that LBG will upgrade former C&G branches to facilitate the sale of PCAs through those branches.
- (41) HM Treasury believes that LBG's estimation of a future increase of [...] % in TSB's market share for PCAs arising from the introduction of a PCA capability into C&G branches represents [...] even under conservative assumptions, the proposed commitment is likely to be sufficient to offset the reduction in PCA stock compared with the commitment in clause 3.6(c) of the Term Sheet annexed to the Restructuring Decision.
- (42) The size reduction of TSB was necessary to make it less complex, less risky, less demanding in terms of capital, and – above all – profitable. The economic environment had made certain assets and liabilities not profitable. A high proportion of the excluded mortgages are standard variable-rate mortgages, capped at 200 basis points (bps) over the Bank of England base rate. They have a low level of profitability as Bank of England interest rates are at historically low levels. On the other hand, wholesale funding markets had become expensive and scarce, leading to a very competitive savings (deposit) markets in the UK. In that context, C&G fixed-term deposits weigh negatively on the cost of funding of TSB

Recommendations of the Office of Fair Trading

- (43) The Chancellor of the Exchequer announced in his 2013 Mansion House speech²⁰ that he had asked the Office of Fair Trading (“OFT”)²¹ to review the impact of the divestment of TSB on competition in retail banking in the UK, and whether anything could be done to strengthen competition through enhancing the divestments.
- (44) The OFT reported the findings of its review on 11 September 2013²². In relation to the divestment based on the reduced perimeter requested by Co-op Bank mentioned

²⁰ <https://www.gov.uk/government/speeches/speech-by-chancellor-of-the-exchequer-rt-hon-george-osborne-mp-mansion-house-2013>.

²¹ The UK authorities requested the OFT to review the impact that divestments by LBG and Royal Bank of Scotland 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>

²² <https://www.gov.uk/government/news/office-of-fair-trading-reports-to-government-on-lloyds-and-rbs-divestments>.

in recital (17), it identified three areas of concern that could prevent the divestment from competing effectively in the market:

- the business and IT services arrangements with LBG could impair TSB's ability to compete independently in the market;
- TSB's financial position and profitability could dampen its ability to compete and grow; and
- TSB's initial PCA market share fell below the range which had previously been observed in effective competitors in PCA markets.

The OFT recommended a number of enhancements to the divestment to address those concerns. Therefore the UK authorities and LBG agreed to a number of changes to the TSB project to implement the OFT's recommendations and thereby ensure that TSB would be able to compete effectively²³.

- (45) LBG will provide TSB with IT and business services through a transitional service agreement ("TSA") for two and a half years and a long-term service agreement ("LTSA") for seven and a half years. The OFT noted that, without adequate protection for TSB, such an arrangement could compromise the competitiveness of TSB by reducing its flexibility to grow and develop, including its ability to differentiate itself in terms of strategy in the future, for example, through the development of new products and services.
- (46) In order to address those concerns, the OFT recommended (together the "OFT Recommendations") that:
- steps should be taken to ensure that the arrangements would do not: (i) allow LBG to influence TSB's competitive behaviour, (ii) facilitate the coordination of the behaviour between TSB and LBG or (iii) render TSB vulnerable to poor quality of service;
 - a transparent mechanism should be included to determine cost (or a suitable dispute resolution mechanism);
 - an appropriate break clause should be included to allow TSB to terminate the agreement, particularly if TSB were acquired by another bank with its own systems; and
 - an expert and independent monitoring trustee or equivalent should scrutinise the terms of the business and IT services agreements and continuing compliance with those terms.
- (47) As a means of giving effect to the OFT Recommendations, LBG agreed to take a series of steps which are incorporated in clause 3.13.2 of the New Term Sheet. The UK authorities do not propose that those steps replace the OFT Recommendations, and considers that LBG's overriding commitment should be to ensure that the TSA and the LTSA comply with the OFT Recommendations in all eventualities.
- (48) The OFT Recommendations refer, among other things, to the provision of expert independent monitoring of the TSA and the LTSA. The UK authorities propose a two-stage process for that role, as set out in detail in clauses 3.13.3 and 3.13.4 in the new Term Sheet:

²³ Those changes are described in detail in clauses 3.7 and 3.13.2 of the new Term Sheet in Annex 1.

- an extension to the Monitoring Trustee's role to monitor the development and negotiation around the TSA and the LTSA and other agreements prior to first listing under the IPO; and
 - once the TSA and the LTSA contracts have been approved by the Boards of LBG and TSB and executed at the time of the IPO, ongoing compliance will be monitored by a Skilled Person, appointed by the Financial Conduct Authority ("FCA"), pursuant to section 166 of the Financial Services and Markets Act 2000. The Skilled Person will report regularly to the FCA on the operation of the contracts (including the Separation Agreement, Relationship Agreement and any other relevant agreements), having regard to the OFT Recommendations and any other factors which are within the FCA's remit.
- (49) The TSA and the LTSA also contain provisions for separate dispute resolution mechanisms, which provide for the appointment of independent arbiters in case of disputes as to the performance of the contractual terms. In resolving such a dispute, the arbiters will be required to consider the rights and obligations of the parties under the relevant contracts, having regard to the OFT Recommendations and any other relevant FCA principles.
- (50) The UK authorities consider that those new commitments will provide significant protection to TSB and will address the OFT's concerns without insulating TSB from genuine commercial pressures or conferring a competitive advantage other than is necessary to meet the OFT's concerns about TSB's ability to compete effectively in retail banking. Those commitments will also prevent the TSA or the LTSA from facilitating anticompetitive collusion between the parties.
- (51) Regarding TSB's profitability, the OFT recommended strengthening TSB financially with the objective of providing it with a higher income to enable it to invest and grow into its branch network to compete more vigorously in retail banking.
- (52) LBG has agreed to enhance the profitability of TSB through a combination of two measures. Those measures are designed to be consistent with a projected return on equity of [...] ²⁴.
- (53) Firstly, LBG proposed to transfer of the economic benefit of a portfolio of approximately GBP 3,4 billion worth of residential mortgages, expected to deliver incremental profits to TSB of approximately GBP 220 million in aggregate over four years. LBG agreed that those mortgages should be within TSB's risk appetite and that they would also inject additional capital resources that TSB would be required to hold against those assets. Paragraph 3.2.2.12 of the Monitoring Trustee's Preliminary Report on the Financial Enhancements confirms that those commitments have been respected.
- (54) LBG and TSB agreed that TSB would pay LBG cash equal to the fair value of the mortgage portfolio transferred on execution. LBG will also provide an additional facility of an amount equal to the outstanding balance of the mortgage portfolio, but not greater than GBP 2,5 billion, in order to facilitate TSB's funding of the transfer as well as general corporate purposes. The transaction should be designed such that the mortgages will be derecognised on LBG's balance sheet and recognised on TSB's balance sheet. The margin between the interest on the

²⁴ On an agreed pro-forma level of capital (rather than the actual level of capital held by the business) and assuming the mortgage enhancement profits were not reinvested.

mortgage assets and the low cost of the funding line means that TSB will be able to recognise profit from the pool of mortgages, and thus increase its overall profitability.

- (55) Second, LBG agreed to reduce the service charge for the TSA by GBP [20 million] [...].
- (56) In relation to TSB's market share, the OFT recommended that LBG should be required to enhance TSB's ability to reach 4,6% PCA market share within two years from the date of the divestment or IPO. The OFT recommended that TSB's lower initial market share could be mitigated by further strengthening TSB's balance sheet to support faster PCA growth.
- (57) To address the OFT's concern about TSB's initial PCA market share, LBG agreed to provide TSB with a GBP 40 million customer acquisition fund to accelerate plans for acquiring customers and invest further in marketing and branch network development. That amount will be provided to TSB through a subscription of new ordinary shares in TSB from LBG prior to the IPO. That new equity issuance will qualify as Core Tier 1, and will be provided to TSB in addition to the previously committed level of capital.
- (58) Full details of those enhancements are detailed in clause 3.7 of the new Term Sheet attached at Annex 1.

2.2.2 *Other commitments*

- (59) Until the full disposal of TSB, LBG shall not refer to the fact that it enjoys any State support or to the fact that the UK is a shareholder in LBG in any of LBG's advertising²⁵.
- (60) Except to the extent that the cumulative purchase price paid by LBG for all acquisitions is less than GBP [0 – 1,500] million, LBG will not acquire any financial institution or any package of assets and liabilities which together form a business in the UK retail and SME market until the full disposal of the TSB²⁶.
- (61) For a further [...], LBG will not i) acquire any shares in TSB for its own beneficial interest or ii) exercise voting rights equivalent to control of TSB for shares held in the name of clients²⁷.
- (62) LBG 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 basis²⁸.

3 COMPATIBILITY ASSESSMENT

- (63) 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 provided²⁹. In that situation, the aid measures would remain

²⁵ See commitment 8 of Annex 1.

²⁶ See commitment 4.a) of Annex 1.

²⁷ See commitment 4.b) of Annex 1.

²⁸ See commitment 9 of Annex 1.

²⁹ 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;

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 Communication³⁰.

3.1 VIABILITY OF LBG

- (64) The Commission has to assess whether the modifications to the restructuring plan call into question the conclusion reached in the Restructuring Decision as to LBG's ability to restore its viability without needing further State aid.
- (65) As regards the TSB divestment process, the prolongation of the deadline does not affect the viability of LBG. Until it is divested, TSB remains consolidated within LBG. And since, in particular due to the modifications proposed by the UK authorities, TSB is a profitable entity, the prolongation of the deadline does not negatively affect the viability of LBG.
- (66) Due to the absence of interest for TSB from a trade buyer with its own IT platform and headquarter functions, to whom LBG could have transferred the assets and liabilities which constitute TSB, LBG had to build a standalone bank with its own headquarters function, which will be divested through an IPO. That changed strategy significantly increases the cost of divesting the business compared to a sale to a trade buyer. The costs of creation of TSB represented on average 3,7% of the operating expenses of LBG between 2010 and 2013. The remaining expenditure related to creating TSB should represent 2,2% of operating expenses in 2014 and [...] % of LBG's investment costs. They are expected to be 12% of the total costs of creation of TSB, so most of the costs have already been incurred. In view of those figures, the Commission does not consider the remaining cost of development of TSB to be significant given the size of LBG and does not expect them to affect LBG's viability.
- (67) The reduction of TSB perimeter compared to what was initially planned³¹ entails that LBG will retain assets and liabilities, which, in the current economic and financial environment, are not profitable (C&G saving accounts and intermediary mortgages, IF mortgages and accounts). The retention of those assets and liabilities should have a negative impact on LBG. However, the Commission notes that the total reduction of assets represents [1-3] % of LBG assets and the reduction of deposits represents [1-3] % of total LBG deposits. Those assets and liabilities are already incorporated in the results published by LBG and have not affected its strong improvement in underlying profits. Because those portfolios are already in a run-down³² process their impact on future profits should further decrease. The Commission therefore concludes that the retention of those assets and liabilities do not endanger the viability of LBG.

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.

³⁰ 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.

³¹ See recital (17).

³² See recital (35), (37) and (86).

- (68) As regards the improvement of TSB's financial situation following the OFT Recommendations, the Commission notes the commitments described in recitals (51) to (57). Together, the yearly average of those additional measures represent less than [0-5]% of the 2013 underlying profit of LBG³³. Therefore the Commission considers that those measures will not endanger the viability of LBG.
- (69) The Commission therefore does not consider that the amendments proposed by the UK authorities endanger the viability of LBG.
- (70) Leaving aside the effect on the viability of LBG of the changes of TSB, the Commission observes that LBG 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 LBG will be able to restore its profitability and viability without further State aid is still valid.
- (71) The Commission notes favourably that the underlying profit of LBG has improved and has been positive since 2011. The factors behind that improvement are of a structural nature (smaller reliance on wholesale funding, reduction of non-core activities, better net interest margins, smaller impairments and reduction in costs) while the factors behind the net result are more of a one-off nature. The losses attributable to the ordinary shareholders since 2009 come mainly from large settlements for past mis-selling (GBP 3,5 billion in 2013), restructuring costs (GBP 0,8 billion) and costs of creation of TSB (GBP 0,7 billion). In addition, LBG's capital ratios remain in healthy territory as described in recital (9). Therefore the Commission concludes that LBG will be able to restore profitability and viability without further State aid.

3.2 BURDEN-SHARING

- (72) In the Restructuring Decision, the divestment of TSB was taken into account mainly as a measure to limit distortions of competition³⁴. It was not primarily a burden-sharing measure. In addition the reduction of the perimeter of TSB aims at ensuring a successful divestment. In the current economic and financial environment, there was no buyer interested in acquiring the entire perimeter to which the UK had committed in 2009. The reduction therefore does not go against the objective of a successful sale.
- (73) As such, the prolongation of the divestment date of TSB does not affect the burden-sharing assessment of the Restructuring Decision.
- (74) The notified changes therefore do not put into question the burden-sharing assessment made in the Restructuring Decision.

3.3 MEASURES TO LIMIT DISTORTION OF COMPETITION

- (75) Within the Restructuring Decision³⁵, the divestment of TSB was identified as the key measure to address the distortion of competition that the aid measures had created and to tackle the issue of moral hazard.

³³ $((220/4) + (20/4) + 40) / 6200$.

³⁴ See recital (185) of the Restructuring Decision.

³⁵ See recital (185) of the Restructuring Decision.

Reasons for missing the deadline

- (76) The Commission considers that LBG genuinely tried to divest TSB within the timeline to which it committed in 2009.
- (77) As indicated in recital (15), after the adoption of the Restructuring Decision, LBG started to build TSB out of the different business it had committed to divest. It then launched the sale process. The negotiation with Co-op Bank followed rapidly afterwards. During those negotiations, the Commission did not receive any complaint from Co-op Bank that LBG was not genuinely committed to the process. The Commission also did not observe behaviour by LBG showing a lack of willingness to proceed.
- (78) LBG agreed on significant concessions to successfully conclude the sale to Co-op Bank and is not to blame for its collapse. The Commission concludes that LBG 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

- (79) The Commission observes that the UK authorities seek a significant prolongation of the deadline to complete the sale of TSB compared to the deadline defined in the Restructuring Decision. The UK authorities request an amendment to postpone the divestment date from the initial date of 30 November 2013 to 31 December 2015. The current plan is to dispose TSB through an IPO during the summer of 2014. During that IPO, a part of LBG's shareholding in TSB would be divested. The residual shareholding would be divested in further tranches in late 2014 and during 2015. As an alternative to the IPO LBG may carry out a whole business sale or tendering procedure as regards its entire interests in TSB, provided that the ownership is disposed by 31 December 2015.
- (80) The UK authorities also request an automatic extension provision to postpone the deadline by a maximum of six or twelve months as from 31 December 2015, if the UK capital markets are in such a condition that an IPO or subsequent offerings are not achievable in an orderly fashion by 31 December 2015³⁶.
- (81) As regards the length of the requested prolongation, the Commission observes that LBG needed to change its approach after the withdrawal of Co-op Bank, to adapt the whole structure of TSB to the new situation. In the absence of new trade buyers LBG immediately started a complex process of creation and divestment of a fully standalone bank. The Commission considers that the requested prolongation of two years is not excessive in view of the minimum period required for LBG to build that business with its operational and functional capabilities and get all the regulatory approvals for the process. In addition, the close monitoring did not reveal idle time in the carve-out and divestment process, so the Commission considers that LBG has made all efforts to divest as committed and that the delay is not due to lack of diligence on LBG's side.
- (82) The additional two years constitute a significant prolongation of the structural measures to limit distortions of competition contemplated under the Restructuring Decision, but it is a reasonable prolongation considering the situation.

³⁶ See recital (27).

Consequently, the Commission considers that the requested extension is proportionate, given the circumstances of the delay and the enhancements proposed by LBG to comply with OFT Recommendations³⁷ as well as the commitments proposed by the UK authorities³⁸. The enhancements will improve profitability and capacity to grow market share. The commitments include a limitation to acquire financial institutions as explained in recital (113).

- (83) The Commission considers the automatic extension provision to be reasonable given that the conditions embedded in the mechanism ensure that [...]. The Commission considers that such a situation would genuinely represent a case of a "closed market" for an IPO as significant as that for TSB. The extension will be applied [...]. The Commission considers that such a situation would constitute a closed market [...]. The automatic extensions of six or twelve months, depending on the case³⁹, are appropriate extensions in terms of length, to allow for the situation in the market to change and so permit a divestment in an orderly fashion.

On the potential benefit to LBG resulting from the reduction of TSB's perimeter

- (84) As regards to the reduction of the perimeter of TSB, the Commission notes that it means that the divestment of TSB will reduce LBG's share of the PCA market by 4,3% instead of 4,6%. As to the mortgage market, the amended perimeter accounts for [5-10]% of total LBG mortgage balance as of 31 December 2013 compared with [10-19,2]% to 19,2% required in the Term Sheet annexed to the Restructuring Decision.
- (85) Based on mortgage stock as at end-2010, the market share for LBG after divestment of the loan-to-deposit ratio balance sheet allowed under the Term Sheet would have equated to [20-25]%. With the revised perimeter, it is projected that the divestment of TSB will see LBG's mortgage market share at [20-25]% (as at end-2013) due to organic reduction by LBG in that segment. With the run-down of IF, that share should fall to [20-25]%. In view of those elements, the Commission concludes that LBG's market share would not be higher than what was expected at the time of the Restructuring Decision.
- (86) The Commission also observes that as soon as Co-op Bank requested the IF and some C&G business to be excluded from TSB's perimeter in 2012 LBG started the run-down process of those businesses. The 16th Monitoring Trustee report confirms that the run-down of IF and the excluded C&G business is progressing, with a [...] % reduction in assets and a [...] % reduction in liabilities over the period 31 December 2012 to 31 December 2013.
- (87) The Commission considers that LBG will not benefit commercially or competitively from the proposed variations to TSB because of the reasons exposed by the UK authorities (loss-making businesses, committed run-down, hosted marketing rights and PCA sale capability in C&G branches).
- (88) In addition, LBG will have to bear the financial cost of the enhancements to TSB, in the form of the transfer of GBP 220 million of value related to the mortgage portfolio, the transfer of an additional GBP 40 million to acquire customers, the

³⁷ See recitals (53) to (58).

³⁸ See recitals (59) to (62).

³⁹ See commitment 3.2 in Annex 1.

lowering of the cost charged for the IT services by GBP 20 million and the development of PCA capabilities in former C&G branches.

- (89) In conclusion, LBG is not better off or more competitive as a result of all the changes proposed.

On the viability and competitiveness of TSB as a result of the reduction of TSB's perimeter

- (90) To assess the request for a prolongation of the initially committed deadline by two years and the requested reduction of the perimeter, the Commission has to verify whether at the end of that significantly prolonged divestment process TSB will still be a viable and profitable challenger bank, in line with what was concluded in recital (99) of the Restructuring Decision for the initially envisaged divestment. A modification of perimeter and a long divestment process may affect the viability of businesses being sold.
- (91) In that respect, the Commission observes that the 2013 report of the OFT concluded, despite the prolonged divestment timeline, that TSB needed further improvements to fully compete in the retail and mid-corporate banking business in the UK market.
- (92) The Commission has to also verify whether TSB will still be a viable and profitable challenger after the modifications in perimeter and financial enhancements proposed by the UK authorities.
- (93) Because of the economic and financial conditions compared to the initial plan (notably the low interest rate environment) and due to the more demanding regulatory environment, the IF business and C&G intermediary mortgages and fixed-term saving accounts are non-profitable. As a consequence, the removal of IF and C&G increases TSB's profitability, removes the expense of maintaining a legacy and reduces the risk profile of the business by lowering TSB's capital funding requirements. As a result, TSB will be more able to compete for new, more profitable, mortgage business.
- (94) The reduction in the PCA market share should be offset by LBG's (already implemented) commitment to upgrade former C&G branches to facilitate the sale of PCAs through those branches and the provision to TSB of hosted marketing rights in relation to IF and C&G fixed-term deposits customers.
- (95) Accordingly, TSB will enjoy significant opportunities to access those customers without bearing the burden of low profit assets and liabilities.
- (96) In the OFT Recommendations, the OFT expressed concerns regarding the business of TSB and its IT services arrangements with LBG. Regarding TSB's profitability OFT recommended strengthening TSB financially to provide it with a higher income to enable it to invest and develop its branch network to compete more vigorously in retail banking. In relation to TSB's market share it recommended that LBG should be required to enhance TSB's ability to reach 4,6% PCA market share two years from the date of the divestment or the IPO.
- (97) It is worth to mention that the OFT's concerns about the profitability of TSB were [...].

- (98) LBG addressed the OFT's Recommendations by proposing to: i) comply with all the provisions related to the service agreements⁴⁰, ii) strengthen TSB financially by transferring the economic benefit for approximately GBP 220 million of a portfolio of residential mortgages⁴¹ and iii) reduce the annual charge to TSB for the TSA by GBP 20 million⁴². In relation with customer acquisition, LBG will provide an additional GBP 40 million in 2014 to allow TSB to accelerate its plans for customer acquisition⁴³.
- (99) The Commission considers that the enhancements proposed by LBG are of key importance to allow TSB to achieve sufficient profitability and to be able to compete effectively.
- (100) The Commission considers that the combination of the reduced perimeter and the enhancements agreed to comply with OFT Recommendation leave TSB in a better financial position (improved profitability and more stable funding). TSB should be an effective competitor in the market, despite its reduced total balance sheet size. That evaluation is supported by the progress shown by TSB since separation and branch launch in September 2013, given that it achieved a share in excess of [5-10]% of flow of the PCA market for each of the last three months of 2013.
- (101) A Monitoring Trustee has been appointed to communicate to the Commission matters arising from the review of the following agreements:
- The TSA and the LTSA, which are the means by which LBG will provide IT and operational services to TSB;
 - The Relationship Agreement, which governs the relationship between TSB as a listed company and LBG as a shareholder. It is assumed to take effect from admission until LBG is no longer a substantial shareholder (i.e. LBG holds less than 20% of the voting rights of TSB);
 - The Separation Agreement, which governs certain aspects of the relationship between TSB and LBG after admission. The Separation Agreement will contain a number of provisions that if TSB were being divested by way of a private sale would have been included in a share purchase agreement (for example, an indemnity from LBG to TSB for pre-admission conduct issues, restrictive covenants placed upon LBG and a mutual non-solicitation of employees).

The Monitoring Trustee will verify that the agreements are aligned with the recommendations of the OFT described in recitals (46), (51) and (56).

- (102) HM Treasury has endorsed the proposals of LBG⁴⁴ and the several agreements between LBG and TSB⁴⁵. The Monitoring Trustee also confirmed the fairness and the consistency of the agreements to be signed between TSB and LBG (TSA, LTSA and Separation Agreement) with the OFT Recommendations⁴⁶.

⁴⁰ See recital (47).

⁴¹ See recitals (53) and (54).

⁴² See recital (55).

⁴³ See recital (57).

⁴⁴ See recital (98).

⁴⁵ See recital (101).

⁴⁶ [...]

- (103) The Commission also observes that, on the basis of the latest business plan communicated by LBG to the Commission on 3 April 2014, TSB is expected to show a regular growth of income [...] and an increasing level of profitability [...]. On the liquidity side, until [...], the loan-to-deposit ratio should not exceed [...] % and the level of liquidity should be between GBP [...] billion and GBP [...] billion until [...].
- (104) In addition with the commitments relating to the size and the financial shape of TSB, the UK authorities have undertaken a number of behavioural commitments⁴⁷ to ensure the preservation of the value of the activities to be divested. Those specific commitments together with the enhancements already described will ensure that TSB benefits from sufficient resources to develop its strategy.
- (105) The Commission positively notes that LBG will not initiate directed and targeted contact with customers of TSB for the purposes of marketing in relation to any banking business products for a period of two years following completion of the disposal of TSB.
- (106) In addition, LBG will carry on TSB as a going concern in the ordinary and usual course of business as carried on prior to 11 June 2011.
- (107) As already mentioned in recital (101) LBG and TSB have signed specific agreements regarding IT systems. LBG will provide certain IT and business services (including cards processing, ePayment and cheque clearing) to TSB for a limited period of time (covered by the TSA and the LTSA) to ensure a smooth transition and better outcome than would be available without those agreements. The Commission believes that the agreements reached address the OFT's concerns, which it considers valid, by adequately protecting TSB's ability to compete effectively and giving it enough flexibility to grow and develop its business.
- (108) The Commission is of the opinion that the agreements reached between TSB and LBG provide the framework for TSB to be able to be a viable challenger in the market. It places particular emphasis on the TSA and the LTSA regarding the certain key aspects of such development. First, there are sufficient provisions to allow TSB to exit from those agreements at reasonable cost. Second, the conditions in those contracts and the monitoring proposed by the authorities should ensure that TSB receives adequate service and enough flexibility regarding changes in products to support its strategy. Finally, they provide enough transparency in terms of the cost structure.
- (109) Furthermore the Commission positively notes that an independent expert will be appointed by the FCA to monitor and regularly report to the FCA on the ongoing compliance of the operation of the contracts (including the Separation Agreement, Relationship Agreement and any other relevant agreements) with the OFT Recommendations and any other factors which are within the FCA's remit.
- (110) The Commission notes positively that from 1 January 2014 until the first listing under the IPO TSB has had in place an independent Board reporting to the LBG Board, with two existing independent non-executive directors as well as an independent Chairman who was already appointed in February 2014. The Commission considers that the proposed governance arrangements will provide TSB with adequate operational independence from LBG, whilst ensuring that TSB

⁴⁷ See commitments 5, 6 and 7 in Annex 1.

will respect the standard regulatory and legal obligations to its parent/majority shareholder until the IPO is completed.

- (111) The Commission also notes positively that since the beginning of the separation process of TSB (with notably the rebranding), the business has not experienced significant customer attrition⁴⁸.
- (112) The combination of all the elements cited in recitals (90) to (111) supports the conclusion that TSB is and will remain a viable business and will represent a significant new competitor in the market.

Other prolonged behavioural commitments

- (113) The Commission notes positively that UK authorities have also prolonged⁴⁹ the limitation for LBG to acquire financial institutions active in the UK retail and SME market. That commitment is focussed on the market in which the aid beneficiary will be active after restructuring and is a measure limiting distortions of competition. As such, it can be offset against the delayed implementation of the principal structural measure to limit distortions of competition foreseen in the Restructuring Decision.

Conclusion regarding measures to limit distortions of competition

- (114) The Commission concludes that the requested prolongation of the deadline to divest TSB, the requested reduction of the perimeter of TSB, the proposed enhancements of TSB and the associated commitments jointly do not put into doubt the conclusion of the Restructuring Decision that undue distortions of competition are avoided.

3.4 CONCLUSION ON THE COMPATIBILITY UNDER THE RESTRUCTURING COMMUNICATION

- (115) 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.

4 CONCLUSION

The notified amendment to the restructuring plan of LBG and the associated list of commitments do not affect the compatibility of the State aid provided to LBG with the internal market on the basis of Article 107(3)(b) TFEU.

⁴⁸ The Monitoring Trustee noted in its 15th monitoring report that [...]

⁴⁹ As described in recitals (60) and (61).

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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State Aid Greffe
B-1049 Brussels
Fax No: +32-2-296 12 42

Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President

ANNEX 1

Term sheet for UK state aid commitments in respect of LBG

1. Definitions:
 - 1.1. "Banking Business" means any loan, credit card, current account, savings account or mortgage whether acquired in branch or direct. For the avoidance of doubt it excludes any specialist products (including insurance, investment, pensions and protection products) supplied by any non-Retail LBG entity;
 - 1.2. "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 as referred to in (c) has the rights or powers listed in (b); (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);
 - 1.3. "Divestment Deadline" has the meaning set out in clause 3.1 below;
 - 1.4. "Extended Deadline" has the meaning set out in clause 3.2 below;
 - 1.5. "FCA" means the Financial Conduct Authority;
 - 1.6. "Financial Institution" shall mean any company whose principal activities include any Banking Business, broking or investment advice;
 - 1.7. "LBG" means Lloyds Banking Group plc, including its subsidiary and associated companies;
 - 1.8. "HMT" means the Lords Commissioners of Her Majesty's Treasury;
 - 1.9. "Market Metrics" means the tests run to determine if the UK capital markets are in such condition that an IPO, or subsequent tranches of disposal following an IPO, required to dispose of all of the shares in the Divestment Business, would be achievable in an orderly fashion;
 - 1.10. "OFT" means the Office of Fair Trading;
 - 1.11. "OFT recommendations" means the recommendations contained in the letter from the OFT to the Chancellor of the Exchequer dated 11th September 2013, that:
 - a) steps be taken to ensure that the business and IT services agreements do not (i) allow LBG to influence TSB's competitive behavior, (ii) facilitate the coordination of the behavior between TSB and LBG or (iii) render TSB vulnerable to poor quality of service;

- b) a transparent mechanism should be included to determine cost (or a suitable dispute resolution mechanism);
 - c) an appropriate break clause should be included to allow TSB to terminate the contracts, particularly if TSB is acquired by another bank with its own systems;
 - d) an expert and independent monitoring trustee or equivalent should scrutinise the terms of the contracts and continuing compliance with those terms;
- 1.12. "PCAs" means money transmission accounts for individuals, i.e. accounts offering as a minimum: direct debits/standing orders and/or a cheque book; cash and cheque deposits; and cash withdrawals;
- 1.13. "PRA" means the Prudential Regulation Authority;
- 1.14. "Retail" refers to the retail business division of LBG; and
- 1.15. "Skilled Person" means a person appointed by the FCA pursuant to section 166 of the Financial Services and Markets Act 2000.
2. The Commitments set out below are conditional on the European Commission reaching a decision that all State aid received by LBG to date and any State aid that may be provided to LBG in connection with the Capital Raising are compatible with the common market.
3. Divestment Obligation:
- 3.1. LBG must complete the disposal of the Divestment Business (TSB) by no later than 31 December 2015 (the Divestment Deadline”).
- 3.2. In the event that the Divestment Business is planned to be disposed through an initial public offering (IPO) and that Market Metrics and the judgement of the sponsor banks for the IPO indicate that the UK capital markets are in such condition that an IPO, or subsequent tranches of disposal, following an IPO, required to dispose of all of the shares in the Divestment Business, would not be achievable in an orderly fashion as defined by the “Market Metrics” by 31 December 2015, the deadline for the disposal will be automatically extended to the Extended Deadline, which shall be the date:
- a) 12 months from the Divestment Deadline if [...]; or
 - b) 6 months from the Divestment Deadline if [...].
 - c) The Government may also request either a 6 or 12 month extension to the deadline should the UK capital markets remain closed for an extended period due to “exceptional circumstances” which lead to ambiguity or if the Market Metrics are for some reason misleading in the view of LBG and the sponsoring banks, and if both the Government and the Monitoring

Trustee agree that the UK capital markets are not open to facilitate the orderly disposal of the Divestment Business

Two market metrics have been agreed between LBG, the Monitoring Trustee, HMT and the EC. The first metric relates to the total number of IPOs in the Main Market of the London Stock Exchange in the prior six-month period. [...]. The second metric, [...], relates to the last six months performance of the share price of the banks listed on the Main UK Market relative to the FTSE 100. [...]⁵⁰.

- 3.3. The UK Government must appoint a Divestiture Trustee that will dispose of the Divestment Business [...] to a purchaser as envisaged by clause 3.12 below in the event that the disposal of the Divestment Business has not been completed by 31 December 2015, or the Extended Deadline if the conditions in clause 3.2 above, for an automatic extension have been applied.
- 3.4. The following provisions apply to the appointment of the Divestiture Trustee:
 - 3.4.1. the UK Government must propose to the Commission for approval, no later than one month before either:
 - a) 31 December 2015, or
 - b) if the conditions in clause 3.2 for an automatic extension have applied, the Extended Deadline a list of one or more persons whom it proposes to appoint as Divestiture Trustee;
 - 3.4.2. The Divestiture Trustee must be appointed within one week of the Commission's approval in accordance with the mandate approved by the Commission; and
 - 3.4.3. LBG must grant comprehensive powers of attorney to the Divestiture Trustee:
 - a) to effect the disposal of the Divestment Business (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
 - 3.4.4. LBG must provide the Divestiture Trustee with all such co-operation, assistance and information as the Divestiture Trustee may reasonably require to perform its tasks.
- 3.5. The Divestment Business is a retail banking business that was built from:
 - a) the TSB and C&G brands;

⁵⁰ Full details on the functioning of the Market metrics and its application for automatic extensions were included as annex to the notification.

- b) the banking licence of Lloyds TSB Scotland;
- c) the branches, including the Banking Business associated with all branch based Retail personal and SME customers and all branch employees, of Lloyds TSB Scotland (as described in more detail in Schedule 3 of the original state aid Term Sheet). For the avoidance of doubt, however, the Divestment Business shall not include the Lloyds TSB or Lloyds TSB Scotland brands;
- d) the C&G branches and branch employees, some C&G savings accounts and some C&G mortgages associated with C&G branch-based customers (as described in more detail in Schedule 4 of the original state aid Term Sheet);
- e) some supplementary branches, selected by LBG and notified to the Commission on 11th June 2011, predicated on data from 31st December 2010 as confirmed by The Monitoring Trustee including the Banking Business associated with all branch based Retail personal customers and their associated SME business and including all branch employees;
- f) sufficient mortgages as outlined below;
- g) Such back office functions (e.g. HR, risk control) as reasonably required by the buyer, together with an independent financial advisor sales team equal in size to that of C&G at the Relevant Date, but in any event not fewer than 20 full time equivalents.

3.6. As of 30 September 2013 the Divestment Business had a PCA market share of 4.3% and the account numbers and balances shown in Annex 2.

3.7. In relation to the figures provided to the Commission in June 2013:

- a) LBG has strengthened the Divestment Business financially by transferring the economic benefit of a portfolio of residential mortgages of approximately £3.4bn (the “Mortgage Portfolio”). The Mortgage Portfolio is expected to enhance the Divestment Business’ profitability by approximately £220 million in aggregate in the four years from 2014 (being approximately £[...] in 2014, £[...] in 2015, £[...] in 2016 and £[...] in 2017).
- b) LBG and the Divestment Business have agreed a portfolio of residential mortgages, included in the Mortgage Portfolio, that are within the Divestment Business’ risk appetite to deliver the expected £220m of net income based on assumptions agreed between LBG, the Divestment Business, the Monitoring Trustee and HMT.

- c) LBG will reduce the annual charge to the Divestment Business for the Transitional Service Agreement by £20 million [...].
- d) LBG has committed to provide an additional £40 million in a form and time period acceptable to the Divestment Business; and
- e) LBG and the Divestment Business have agreed, and the Monitoring Trustee has confirmed, that these measures are consistent with a projected return on equity of at least [...]% [...], calculated on the basis discussed between LBG and HMT [...] (including capital requirements of IRB (without Basel 1 Transitional Floor), market macro-economic assumptions as at September 2013, excluding fair value accounting and the impact of the additional customer acquisition spend).

3.8. Projected figures before and after the enhancements were presented to the Commission on [...]. LBG will ensure that the final balance sheet and forecasts that are prepared to support the IPO prospectus will be consistent with the figures presented to the Commission on [...] when using the same assumptions, but will reflect any other changes to the balance sheet and financial projections. LBG will ensure that the level of capital resources at admission meets the assumptions [...], and in particular:

- a) will capitalise the Divestment Business with equity at least equal to the greater of [10-20]% RWAs or [0-5]% leverage ratio and with total capital of at least [10-20]% of RWAs, both numbers excluding the additional profits associated with clause 3.7(a) above and the additional capital or income referred to in 3.7(b) above;
- b) The ratios in a) will be calculated on the basis of the Divestment Business' business plan needs at the end of 2015, assuming retained reserves in 2013 [...]
- c) The Divestment Business' Tier 2 capital is calculated as [0-5]% of Dec 2016 IRB risk weighted assets (excluding the Mortgage Bond) and the remainder is provided as CET1 to achieve a target of [10-20]%; and
- d) The December 2015 RWAs are based on the Basel Committee Standardised approach for credit risk, unless business has an advanced treatment IRB waiver in place from the UK Regulatory Authorities prior to admission.

3.9. The Monitoring Trustee will monitor whether the relevant agreements are delivering the announced enhancements and that the final balance sheet and projected P&L is consistent with the above assumptions.

3.10. Subject to clauses 3.10.2 and 3.10.3 below, LBG shall:

- 3.10.1. Agree with the Divestment Business in the event of an IPO or the buyer in the event of a trade sale that, following a reasonable transition period after the full disposal of the Divestment Business, LBG shall not use the brands of the Divestment Business (including as part of the name of another brand) and the buyer of the Divestment Business shall not use the brands of LBG (including as part of the name of another brand).
- 3.10.2. LBG will have license to use C&G brand to allow for contractual Product Run Down of the C&G Fixed Term Deposits and remaining C&G mortgages.
- 3.10.3. Both the Divestment Business and LBG will continue to use the Lloyds TSB brand during the card re-issuance cycle. This process is due to complete in October 2016.
- 3.11. Subject to clause 3.12 below, LBG will dispose of the Divestment Business by way of initial public offering for all of the shares or in a number of tranches in an entity that owns the entirety of the Divestment Business.
- 3.12. As an alternative to the initial public offering, LBG may decide to sell all or part of the Divestment Business to a trade buyer if the buyer:
- a) together with the rest of the Buyer's Group, in combination with the Divestment Business have a PCA market share of no more than 14% in the UK at the date that the sale and purchase agreement is signed (on a stock basis by reference to the number of accounts), calculated by reference to the market size as measured by CACI;
 - b) be independent of LBG and must not be connected to LBG within the meaning of Article 11 of the 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 Divestment Business or relevant part thereof;
 - d) satisfy the PRA and/or FCA 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 maintain and develop the Divestment Business, provided that if the buyer satisfies sub-clause (d) above it shall be presumed also to satisfy this sub-clause (e).

3.13. LBG support to Divestment Business

3.13.1. LBG shall exercise best efforts to support the buyer(s) of the Divestment Business (including, where relevant, any new entity resulting from an IPO as envisaged in clause 3.11 above) in migrating to appropriate infrastructure for the ongoing operation of the business. This support will include reasonable transition support agreements (including an agreement to provide clearing services on market terms and the right to use existing sort codes and account numbers to the buyer for such duration as the buyer may request, as well as other support functions such as telephony and internet for an appropriate period), covering ongoing operations, customer and product migration and staff training.

3.13.2. LBG and the Divestment Business have agreed and will sign Transitional Service Agreements (“TSA”) and Long Term Service Agreements (“LTSA”) (together the “contracts”) that satisfy these requirements and ensure compliance with the OFT recommendations. As a means of giving effect to the OFT recommendations, LBG has agreed terms in the contracts to ensure that:

- a) [...];
- b) [...];
- c) [...];
- d) [...];
- e) [...];
- f) [...] provision for expert independent monitoring trustee(s) or equivalent to scrutinise the terms of the IT services agreement and of continuing compliance by LBG and the Divestment Business of its terms.

3.13.3. Prior to the contracts being approved by and signed on behalf of the Boards of LBG and the Divestment Business, the negotiation of the contracts will be monitored by the Monitoring Trustee, who shall be granted any such access to draft agreements and management of the Divestment Business and their advisors as necessary to meet their remit, as set out in the Terms of Reference for Mazars’ ”specific monitoring procedures”. The FCA, PRA and HMT will also be granted access to the agreements prior to approval by the Boards of LBG and Divestment Business

3.13.4. After the contracts have been signed on behalf of the Boards of LBG and the Divestment Business and have come into effect, implementation / ongoing compliance will be monitored by an implementation monitor (the “Implementation Monitor”).

- a) the Implementation Monitor will be a Skilled Person;
- b) the Implementation Monitor will provide regular reports to the FCA on the operation of the relevant contracts, having regard to the OFT recommendations and any other factors which are within the FCA's remit;
- c) the scope of the Skilled Person's monitoring role will be limited to those activities which come within the FCA's remit, and will be determined by the FCA;
- d) the FCA reserves the right to take supervisory or enforcement action on the basis of such monitoring insofar as these relate to activities within the FCA's remit;
- e) the FCA will review the need for ongoing monitoring on a regular basis; and
- f) the cost of the Implementation Monitor will be met by LBG and TSB.

3.13.5. The contracts also each provide for a dispute resolution mechanism, [...].

3.14. LBG will run-down the business of IF and C&G fixed-term deposits that was excluded from the Divestment Business (the "Run-down Business"). LBG will do everything possible to incentivise the run-down of the Run-Down Business, in particular by offering below average returns (subject to regulatory limitations) and not offering new products. The run-down of the Run-Down Business shall be monitored and reported on by the Monitoring Trustee half-yearly.

3.15. LBG will not repatriate and will keep separate track of the Run-Down Business until 31 December 2016. Additionally the TSB and C&G brands will be transferred to the Divestment Business and LBG will not use the IF brand to market new products until 31 December 2016.

3.16. LBG will update IT platform in ex C&G branches which are included in the Divestment Business to support the sale of PCAs and other retail products.

3.17. LBG will provide the Divestment Business with hosted marketing rights for the Intelligent Finance customers and C&G fixed-term deposit customers (subject to legal, regulatory, data protection and customer marketing preference constraints) until 31 December 2016.

4. LBG shall not acquire:

- a) any financial institutions or any package of assets & liabilities which together form a business in the UK retail and SME market until the date of completion of disposal of the Divestment Business (for clarity, acquisition of single portfolios of assets or liabilities e.g. credit card portfolio, mortgage portfolio, would be outside this restriction) in line

with the agreements reached with the EC in March 2011, save that LBG shall be permitted to make such acquisitions if the cumulative purchase price excluding the assumption of debt paid by LBG for all such acquisitions in this period is less than £ [0-1,500]m and

- b) Until [...], LBG:
 - i) shall not acquire any shares in the Divestment Business for its own beneficial interest, and
 - ii) shall not exercise voting rights equivalent to control of the Divestment Business for shares held in the name of clients.
- 5. LBG shall not initiate directed and targeted contact with customers of the Divestment Business as at completion of the disposal of the Divestment Business, save for those who are also customers of LBG at the time of said contact, for the purposes of marketing in relation to any Banking Business products for a period of two years following completion of the disposal of the Divestment Business.
 - 5.1. Between the 11th June 2011 and the date of the IPO of the Divestment Business:
 - 5.1.1. LBG shall carry on the Divestment Business as a going concern in the ordinary and usual course as carried on prior to 11 June 2011.
 - 5.1.2. LBG shall not initiate any programmes involving directed and targeted contact with customers of the Divestment Business for the purpose of encouraging said customers to leave the Divestment Business.
- 6. LBG shall ensure that from the date of the decision to the time at which a sale and purchase agreement has been signed with respect to the Divestment Business (or, in the case of an initial public offering, until the time that a prospectus has been issued), its management of the Divestment Business is consistent with the commitments in Schedule 6 of the original state aid Term Sheet and that LBG will not actively encourage employees working in the Divestment Business to roles in the rest of the LBG Group.
- 7. From the later of 1 January 2014 or appointment of the independent Chairman of the Divestment Business (TSB) the governance arrangements of the Divestment Business from this time until admission to the London Stock Exchange shall be:
 - a) [...]
 - b) [...]
 - c) [...]
 - d) [...]
 - e) [...]

- f) [...]
 - g) [...]
 - h) [...]
 - i) from admission to the London Stock Exchange onwards the governance arrangements shall be set out in the Relationship Agreement.
8. LBG shall not refer to the fact that it enjoys any state support or to the fact that the UK State is a shareholder in LBG in any of LBG's advertising.
9. Appointment of Monitoring Trustee
- 9.1. LBG shall continue to appoint, subject to Commission's approval, a Monitoring Trustee in charge of the overall task of monitoring and ensuring, under Commission's instructions, compliance with the commitments. (The Monitoring Trustee having previously been agreed under the original State Aid decision dated 18th November 2009).
- 9.2. From the date of the adoption of this decision, the role of the Monitoring Trustee extends to the monitoring of all commitments included in this Term Sheet.
- 9.3. The Monitoring Trustee shall produce reports on the final Agreements to the Commission, and during the negotiation period shall update the Commission regularly and in particular promptly inform the Commission of any disputes between LBG and TSB. In addition, in relation to the contracts the Monitoring Trustee shall promptly inform the Commission in the event that the draft agreements during negotiations fail to reflect the OFT recommendations. LBG and the Divestment Business shall provide and cause its advisors to provide to the Monitoring Trustee all such cooperation, assistance and information as it may reasonably require to perform its tasks, including the possibility to appoint advisors. The Monitoring Trustee shall be remunerated in a way that does not impede the independent and effective fulfilment of its mandate and should have independent and direct access to executives or Board members in LBG or the Divestment Business.
- 9.4. This includes that the Monitoring Trustee shall have immediate and unfettered access to the draft contracts, Relationship Agreement and Separation Agreement and to the senior management of the Divestment Business, and their advisors, and shall be satisfied that the Divestment Business is content with the final agreements.
- 9.5. To complete this role, the Monitoring Trustee shall obtain the opinion of the necessary experts/advisors in particular competition and IP legal advice, and technical IT advice prior to the Agreements being signed. These experts/advisors shall be funded by LBG and the Divestment Business, as agreed between the two parties.

10. The UK Government shall submit regular reports on the measures taken to comply with this decision. The report shall be submitted to the Commission not later than six months after the publication of the Commission's final decision.

ANNEX 2

Divestment Business account numbers and account balances as at 30 September 2013

Product Area	Accounts (000)	Balances (bn)	
		Dr	Cr
PCA	[...]	[...]	[...]
Loans	[...]	[...]	[...]
Mortgages	[...]	[...]	[...]
Cards	[...]	[...]	[...]
Savings	[...]	[...]	[...]