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Client briefing
June 2011

UK Credit Guarantee Scheme – opening the door to buybacks of guaranteed debt

On 8 June 2011, HM Treasury announced amendments to the rules of the UK Government's Credit Guarantee Scheme, permitting eligible institutions to repurchase UK Government guaranteed debt in certain circumstances. As well as providing UK banks and financial institutions with a welcome opportunity to manage their liability profiles, it also signals the continued restoration of confidence in the UK banking sector.

Key Issues

Restrictions lifted on the repurchase of Guaranteed Debt

Allows UK banks to save on costly guarantee fees and actively manage their liability profiles

Consistent with regulatory approach in other EU jurisdictions

Amendments to the UK Credit Guarantee Scheme

The UK Credit Guarantee Scheme (the "**Scheme**") was implemented in October 2008 as one of a range of initiatives intended to support the UK banking sector in recovering from the effects of the financial crisis. Although closed to new issuance since February of last year, the Scheme did not previously contemplate that any guaranteed liabilities could be repurchased.

The changes announced this week allow UK banks and building societies which have issued guaranteed debt under the Scheme, to repurchase and cancel outstanding debt instruments ahead of their scheduled maturity date. The ability of financial institutions to benefit from these amendments will be subject to the payment of a break fee to HM Treasury, and the satisfaction of certain other conditions.

Conditions and Procedures for Repurchase

The detailed rules of the Scheme, and details of the recent amendments, have been published by the UK Debt Management Office. Financial institutions interested in using the buyback facility must, in the first instance, consult with HM Treasury and obtain outline approval for the size of any proposed buybacks, bearing in mind the relevant institution's overall funding needs and objectives. Assuming that any such approval is forthcoming, the relevant institution must then submit a form of cancellation request, asking HMT to issue an "Interim Cancellation Certificate". This certificate will specify the aggregate principal amount of guaranteed debt instruments for which formal approval for the repurchase and cancellation has been given, and the time period within which any such repurchase and cancellation must be carried out.

Once the Interim Cancellation Certificate has been granted, the relevant financial institution may then complete the repurchase and cancellation, subject to the specified limits. Once the transaction completes, the Debt Management Office will require same-day notification, in the form of a confirmation from an appropriate third party such as a trustee or paying agent, stating that they have effected the cancellation.

HM Treasury has indicated however that the use of the buyback facility will come at a cost to the institutions wishing to participate.

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The UK government will require payment of 15 per cent of the future guarantee fees that would otherwise have been payable on the cancelled portion of the debt, together with a fee to cover any applicable foreign exchange losses accruing to HM Treasury in respect of foreign currency obligations. This does however still leave scope for significant cost savings compared to the full guarantee premium that would otherwise have been payable. For debt issued under the current rules, this premium would be levied at a per annum rate of 50 basis points plus 100% of the institution’s (or appropriate group entity's) median five-year Credit Default Swap (CDS) spread during the twelve months to 1 July 2008, as determined by HM Treasury, together with a discretionary increase to reflect the Government's costs for guaranteeing non-sterling denominated liabilities to the extent applicable.

The Changes in Context

The lifting of the restriction on buybacks is consistent with the approach already taken in other jurisdictions, including Germany and the Netherlands, where issuers such as Bayerische Landesbank and ABN AMRO have already taken the opportunity to buy back some of their sovereign guaranteed debt earlier this year.

Perhaps unsurprisingly, the Chancellor of the Exchequer was also quick to herald the wider strategic significance of the UK government's decision, announcing "*That the Government is able to do this shows that the UK banking sector is clearly on the mend. It is in everyone's interest that banks return to stability, and that as they do they are able to lessen the amount that they depend upon the taxpayer*".

As we highlighted in our earlier briefing "*Tougher conditions for EU State guarantees from 1 July 2010*" these measures are part of a wider policy objective at both the national and European level, intended to phase out state support for EU financial institutions and facilitate a return to normal market conditions. The increased confidence of policy-makers in the stability of the financial system is a welcome step, and the extent to which UK institutions are willing and able to take advantage of the new buyback facility will undoubtedly be observed with interest.

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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