EUROPEAN COMMISSION

Brussels, 14.1.2009
C(2009) 134 final

Subject: **State aid N 9/ 2009 – Recapitalisation of the Anglo-Irish Bank by the Irish State**

Sir,

I. PROCEDURE

(1) On 21st December 2008, the Irish Government announced its intention to inject €1.5 billion (the "measure at issue") into Anglo-Irish Bank Corporation plc ("Anglo" or the "Bank") under the Irish Government's bank recapitalisation program, subject to shareholders' approval and approval by the European Commission under State aid rules. On 8th January 2009, the Irish Government formally notified to the Commission the measure at issue.

II DESCRIPTION OF THE MEASURE

1. The Beneficiary

(2) Anglo-Irish Bank has a balance sheet size in excess of €100 billion (approximately 50% of GDP) and accounts for a significant share of customer deposits and lending in the Irish economy. Anglo is a focused business bank with a private banking arm. The Bank provides business banking, treasury and wealth management services. It is not a universal bank and its stated approach is niche rather than broad market. In terms of its business model, Anglo-Irish Bank can be categorised as a "monoline" bank specialising in commercial and real estate lending. The Bank's main strategy is to lend on a senior first secured basis to clients against investments and development property assets in each of its three core markets: Ireland, the UK and the US. Each of its customers deals directly with a dedicated relationship manager and a product specialist. Lending comprises approximately 70% of the Bank's total assets of approximately €100 billion. These lending assets are split geographically as follows: 57% in Ireland, 29% in the UK and 13% in the US.

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(3) Anglo has locations in Ireland, the UK, the United States, Jersey and the Isle of Man. Its shares are quoted on the Dublin and London stock exchanges. The Irish Financial Regulator is the lead regulator.

(4) Anglo-Irish Bank's funding model is heavily reliant on wholesale lending, the availability of which has diminished very substantially on account of the dislocation of international credit markets. Anglo Irish Bank has approximately […][*]of term debt maturing in 2009. Anglo Irish Bank's loan book is approximately €72 billion and it is heavily exposed to commercial investment property (c. €40 billion) and, more crucially, to the development sector (c. €20 billion).

(5) According to its preliminary results for the year ended 30th September, 2008, the Bank had a balance sheet total of €101,321 million. Anglo Irish Bank results were a profit before tax of €784 million for 2008, but included significantly increased collective and specific impairment provisions, totalling €724 million. Treasury losses account for a further €155 million impairment provision. Anglo Irish Bank reported actual impaired loans of €957 million (131 basis points of its loan book) for 2008. The market views these provisions as too conservative and the market consensus estimate is an average of 200 basis points of the Bank's loan book (€1.4 billion per annum). However, according to a report on the financial position of the six main domestic institutions participating in the Guarantee Scheme (the "PwC Report") carried out by PricewaterhouseCoopers for the Irish Financial Regulator (the "Financial Regulator"), Anglo Irish Bank's current capital position could withstand provisions substantially in excess of market estimates. Profits before impairments in 2009 are projected by Anglo Irish Bank at approximately €1.6 billion.

(6) […] the key risk currently faced by Anglo Irish Bank is liquidity risk, which the Financial Regulator is closely monitoring on a daily basis. Since the end of November 2008, Anglo Irish Bank has experienced outflows both in terms of corporate and retail deposits. Accordingly, the Bank has had to increase its level of borrowing from the interbank market […] to manage this funding gap[1].

(7) According to the Financial Regulator, Anglo Irish Bank is currently in compliance with regulatory capital requirements. Its current Tier 1 capital amounts to c. €7.2 billion, which is more than 8% of risk-weighted assets, and its Core Tier 1 capital ratio stands at 5.9%), but it is lower than many European peers. According to the Financial Regulator, Anglo Irish Bank has a strong requirement for additional Core Tier 1 capital in order to reassure the market regarding its capacity to fully provide for anticipated losses on its loan book. Market feedback is that there would be little if any private investment in an ordinary share rights issue or preference share issue by Anglo Irish Bank.

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[*] Covered by the obligation of professional secrecy.

[1] In addition to the €1.5 billion Government injection, other measures being put in place to enhance the liquidity position of the bank going forward include the approval of an asset covered securities bank, which will increase its access to ECB borrowings, and additional undrawn committed facilities from two credit institutions.

(8) Anglo 5 Yr Senior debt CDS data are higher than the average for the sector and than any of its peers in Ireland separately for the 7th January (latest figure), 18th December 2008 (directly before the announcement of the measure by the Irish government), the average between January 2007 and August 2008 (comprising the pre-crisis period) and average between January 2008 and August 2008, as illustrated in the table below[2]:

	5 Year Senior CDS (bps)				
	Anglo	AIB	BoI	IL&P	Average
07-Jan-09	394	205	266	264	282
18-Dec-08	396	205	231	254	272
Average 2-Jan-08 to 31-Aug-08	248	119	136	171	169
Average 2-Jan-07 to 31-Aug-08	127	64	70	89	88

(9) As to its rating, Anglo is rated A1 by Moody's and has been on negative watch since 17 October, while S&P's A- rating was put on negative watch on 5 November this year.

2. The events triggering the Measure

(10) According to the Irish government, the decision to inject €1.5 billion into Anglo was taken in the light of the impact of the current global financial crisis on Anglo and recent corporate governance developments at Anglo. The measure at issue aims both at ensuring that the Bank's capital ratio levels meet the expectations of international investors and at facilitating lending to the real economy.

(11) Anglo is one of the financial institutions covered by the Irish Guarantee Scheme for financial institutions ("the Guarantee Scheme"), which was adopted under the Credit Institutions (Financial Support) Act, 2008 (hereafter the "Act"), and approved by the Commission under State aid Rules on 13th October, 2008. The liabilities covered under the Guarantee Scheme were those liabilities existing at close of business on 29th September, 2008 or at any time thereafter, up to and including 29th September, 2010, in respect of the following: (i) all retail and corporate deposits (to the extent not covered by existing deposit protection schemes in the State or any other jurisdiction); (ii) interbank deposits; (iii) senior unsecured debt; (iv) asset covered securities; and (v) dated subordinated debt (Lower Tier 2), excluding any intra-group borrowing and any debt due to the European Central Bank arising from Eurosystem monetary operations. It is estimated that the total covered liabilities under the Guarantee Scheme amount to approximately €65 bn.

(12) Despite its coverage under the Guarantee Scheme, market perceptions concerning the inadequacy of Anglo's capital ratio levels have led to deterioration in investor sentiment with regard to Anglo. The Bank's shares have experienced a significant deterioration in value from around €5 in early October, 2008 to the position of €0.171 on 31st December, 2008 with a market capitalisation of €129.95 million. Over the previous 12 months, the Bank traded as high as €10.94, with a market

[2] Annex 7 of the Notification, Source Merrril Lunch Estimates.

capitalisation of €8,327.74 million. As a result, Anglo's shares have lost more than 98% of their value over the last 12 months.

(13) The primary objective of the Guarantee Scheme was to address the loss of confidence in interbank lending markets that led to liquidity difficulties for even fundamentally sound banks. The Guarantee Scheme was successful in stabilising the liquidity position of Anglo Irish Bank which, along with the other main banks in Ireland, was at the time at substantial risk of liquidity runs. However, the Guarantee Scheme, which addresses liquidity difficulties, is not designed to address problems with the capital adequacy of capital ratio levels of banks. The market perception of Anglo Irish Bank is that, notwithstanding increased provisioning, it has underprovided for its loan risks in the light of the significant deterioration in the property market, and the share price has fallen sharply accordingly.

(14) In addition to difficulties caused by the global financial crisis, the deterioration in the financial position of the Bank has been accelerated by difficulties that rose with regard to the corporate governance of the Bank. On 18th December, 2008, the chairman of the bank resigned, followed by the bank's non-executive director its the chief executive, because of temporary transfers of top management loans with Anglo to another bank prior to Anglo's year end over eight years. The Irish Financial Regulator has launched an inquiry into the events surrounding the corporate governance developments at Anglo and has instigated a review of the treatment of directors' loans in the financial institutions covered by the Guarantee Scheme. These events were widely commented in the Irish press.

3. The decision to intervene

(15) In these circumstances, the Irish Government, in consultation with the Governor of the Central Bank of Ireland (the "Governor") and the Financial Regulator, decided that it was necessary for the State to take measures in relation to Anglo in order to avoid further deterioration in the financial situation of the Bank, which, in turn, would represent a threat to the stability of both the financial system in the State and the wider economy. In particular, according to the Irish Government, a loss of confidence in Anglo could undermine confidence in the Irish financial sector as a whole, which is very dependant upon international finance through wholesale money markets. This would constitute a serious risk of a systemic crisis in the Irish financial system, which, in turn, would have significant negative spill-over effects into the wider economy. For these reasons, on 21st December, 2008, the Irish Government announced the decision to take the measure at issue. The main objective of the capital injection into the bank is to ensure that Anglo is adequately capitalised to preserve financial stability and to ensure that the Bank's capital ratio levels meet the expectations of international investors.

(16) A further objective pursued by the State is to facilitate lending to the real economy. The measure at issue is part of a wider Government recapitalisation programme, the object of which is to ensure that the financial system in Ireland is capitalised to meet the everyday financial needs of individuals, businesses and the overall economy. In the Government announcement on 21st December, 2008, the Minister for Finance (the "Minister") stated that "it is appropriate as part of the agreed recapitalisation programme that the banks should further build on the commitments given in the banks guarantee scheme through specific credit policies targeted at small medium enterprises, first time buyers and consumers generally.

The banks will be expected to contribute to the economy in a verifiable manner in relation to credit and in relation to the maintenance of a payments system which is socially inclusive". On account of Anglo Irish Bank's specific business model, which is specialised in commercial property lending and property development finance, not all of the elements of the agreed credit package will directly impact on Anglo Irish Bank, at least initially. However, according to the Irish Government, given the requirement to prepare a restructuring plan within a six month period as part of the recapitalisation initiative, future changes in the business model and strategic direction of Anglo Irish Bank are likely […]. Moreover, the Irish Government expects the public policy objectives underlying the decision to recapitalise systemically important banks in Ireland to guide and inform the lending activities of Anglo Irish Bank, subject, of course, to the requirement to safeguard its financial position and long-term commercial sustainability.

4. The Measure

(17) The Measure at issue is a €1.5 billion capital injection into Anglo in the form of non-cumulative perpetual preference shares. The Financial Regulator has confirmed that the Shares will be treated as Core Tier 1 Capital for regulatory capital purposes. The State investment will boost Anglo's Core Tier 1 capital ratio from 5.9% to 7.7%, and its Tier 1 capital ratio will increase from 8.4% to 10.1%.

(18) The Shares have a fixed dividend of 10% payable annually at the discretion of the Bank and in priority to dividends on ordinary shares. Dividends on the Shares are payable in cash, or if not able to pay in cash, in ordinary shares on the basis of the average daily closing price over the previous 30 trading days.

(19) The Shares are a hybrid form of Core Tier 1 capital. While they are deeply subordinated, non-cumulative and only have a discretionary dividend, they are also non-dilutive and, in relation to dividends, they rank in priority to ordinary shares. The Shares will carry 75% of the voting rights in Anglo.

(20) Redemption is at Anglo's discretion. While the Bank can repurchase the Shares at par for up to five years, after that period, Shares can be repurchased at 125% of par. Dividends on ordinary shares are not allowed where a dividend on the Shares is not paid to the State.

(21) Under the terms and conditions of the State investment, Anglo has committed to draw up and submit within six months a restructuring plan which will be submitted to the Commission for assessment and approval.

(22) The terms and conditions of the State investment also envisage management and board changes at Anglo and Government representation on the Board of Directors of the Bank.

(23) In addition, in the context of the Government's recapitalisation program, Anglo has agreed to a series of conditions in relation to sustaining lending to the real economy and the maintenance of a payments system which is socially inclusive. These conditions are focused on SMEs and individuals. They include increased capacity for lending to SMEs and first time buyers, a new code of practice for business lending and increased assistance for householders in arrears on mortgage repayments, including a commitment not to seek enforcement action or

repossession for at least six months. According to the Irish authorities, such measures do not entail any selective advantage to undertakings. In case these measures would entail elements of State aid, the Irish authorities committed to notify them to the Commission separately for assessment under the State aid rules.

(24) Finally, Anglo continues to be subject to the behavioural conditions and transparency and reporting conditions that may be imposed under paragraphs 24 to 50 of the Guarantee Scheme. In particular, Anglo Irish Bank has been required to prepare and submit a strategic report to the Department setting out how it proposes to align the future direction of the Bank to meet the objectives of the Guarantee Scheme, as well as regular reports describing the progress made in complying with these objectives. In this respect, the following measures can be mentioned:

- Board of Directors: Anglo Irish Bank has appointed two directors representative of the public interest nominated by the Minister to its board;
- Remuneration: Anglo Irish Bank has provided a plan for review by the Covered Institutions Remuneration Oversight Committee (CIROC) under the Guarantee Scheme on the proposed structure of the remuneration packages of the directors and executives of the bank so as to comply with the requirements of the Guarantee Scheme;
- Ban on dividends until further notice;
- Prohibition of buy-backs without prior approval;
- Prohibition of funding initiatives without prior consultation;
- Prior consultation in relation to public disclosures concerning its assets;
- Prohibition on advertising on the basis of the Guarantee Scheme;
- Corporate Social Responsibility arrangements;
- Controls over recourse to interbank deposits;
- Requirements for quarterly compliance certificates in relation to the terms and objectives of the Guarantee Scheme; and
- Risk management arrangements to guard against technical default under the Guarantee.

(25) The table below summarizes the terms and conditions of the State investment, including details of the instruments used:

Size	EUR 1.5 billion
Form of Security	Core Tier 1 non-cumulative preference shares with voting rights
Transferability	Non-transferable
Dividend	Fixed dividend of 10% payable, at the discretion of the bank, annually on 16 January. Dividends payable in cash. If not able to pay in cash then paid in the form of ordinary shares. Calculated on the basis of unpaid dividend divided by the share value. Share value is calculated based on the average daily closing price over the 30 trading days preceding the dividend declaration date. Payment of dividends made in priority to dividends on ordinary shares
Term	Perpetual, no step-up
Redemption	Redemption at the Bank's option Anglo can repurchase at par for 5 years and thereafter at 125% of par, subject to replacement of capital and Irish Financial Regulator approval Replacement capital needs to be Core Tier 1
Ranking	Pari passu to ordinary share capital on liquidation and with other preference shares/securities for dividends
Dividend Stopper	Yes, if cash preference share dividend is unpaid
Voting rights	Full voting rights as long as preference shares outstanding Voting rights to represent 75% of total voting rights
Other Items	Management and board change Board will have Government representation Submission of restructuring plan after six months in line with European Commission Recapitalisation Communication Sustained lending to the real economy Other behavioral, transparency and reporting conditions imposed under the guarantee scheme

(26) An Extraordinary General Meeting ("EGM") of the Bank in relation to the State investment is scheduled on 16th January, 2009 and, subject to shareholder approval at the EGM, the State investment is anticipated to take place on 20th January, 2008.

4. Position of Ireland

(27) The Irish Government notes that current global financial crisis has led to a sudden and dramatic increase in the market's perception of the risks contained in banks' balance sheets. Consequently, international capital market expectations in relation to capital levels for financial institutions have risen significantly. In particular, markets and rating agencies have increasingly focussed on the adequacy of Tier 1 capital and Core Tier 1 capital.

(28) According to the Irish Government, Anglo is a fundamentally sound institution. The decision to inject € 1.5 billion € in Anglo was taken in the light of the impact of the current global financial crisis on Anglo and recent corporate governance developments at Anglo, which together have led to a serious deterioration in the financial position of the Bank. The objectives of the State investment are to ensure that Anglo is adequately capitalised to preserve financial stability, to ensure that the Bank's capital ratio levels meet the expectations of international investors and to facilitate lending to the real economy.

(29) The Irish Government accepts that, in the current market circumstances, the State investment may contain elements of State aid. However, it is of the view that the State investment is compatible with the Common Market on the basis of Article

87(3)(b) of the EC Treaty as it is necessary in order to remedy a serious disturbance in the Irish economy.

(30) The Irish Government, together with Anglo have provided following commitments

- Anglo commits that it will refrain from mass marketing invoking the Measure as an advantage in competitive terms.
- Anglo has committed to draw up and submit within six months a restructuring plan, in the sense of the Commission's Communication on recapitalisations[3], which will be submitted to the Commission for assessment and approval.

III. ASSESSMENT

1. Existence of State Aid

(31) According to Article 87 (1) EC, State aid is any aid granted by a Member State or through state resources in any form whatsoever which distorts, or threatens to distort, competition by favouring certain undertakings, in so far as it affects trade between Member States.

(32) Given that the Anglo-Irish Bank is active in the financial sector, which is open to intense international competition, any advantage from State resources to Anglo-Irish would have the potential to affect intra-Community trade and to distort competition. This conclusion is reinforced by the fact that the activities of Anglo Irish are not confined to Ireland but that the Bank is also active in the UK, the United States, Jersey and the Isle of Man. Since the Irish Government invests € 1.5 billion € to the bank, it is also clear that the measure is imputable to the Irish State and that if any advantage is granted through the measure, State resources are involved.

(33) Finally, it has to be examined whether the measure leads to a selective advantage to Anglo Irish for it to constitute a State aid.

(34) The Irish authorities explained that, in view of the rising international capital market expectations in relation to capital levels for financial institutions and the corporate governance difficulties to which Anglo Irish was recently faced, a State intervention was necessary for the bank to reinforce its capital position.

(35) The Commission shares the view […] that, in the current market circumstances and given its situation Anglo Irish could not have raised such financing in such time frame at comparable conditions. This view is reinforced by the fact that public policy considerations, and in particular the willingness to avoid a further deterioration in Anglo's financial position which would represent a threat to the stability of the financial system and to increase lending to the real economy, have determined the State intervention, rather than the possible return for the State as an investor.

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[3] Commission Communication on "The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition", adopted on 05.12.2008, available on: http://ec.europa.eu/competition/state_aid/legislation/specific_rules.html#financial

(36) The Commission therefore comes to the conclusion that the measure provides a selective advantage to Anglo and that it constitutes State aid in the sense of Article 87(1) EC.

2. Compatibility of the aid with the common market

Compatibility under 87(3)(b) EC Treaty

(37) Article 87(3)(b) EC Treaty enables the Commission to declare aid compatible with the Common Market if it is "to remedy a serious disturbance in the economy of a Member State. The Commission recalls that the Court of First Instance has stressed that Article 87(3)(b) EC Treaty needs to be applied restrictively and must tackle a disturbance in the entire economy of a Member State[4].

Conditions for compatibility under Article 87(3)(b) of the EC Treaty

(38) In line with the Commission Communication on "The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis" ("the Communication on the financial crisis")[5], in order for an aid or aid scheme to be compatible under Article 87(3)(b) EC Treaty, it must comply with general criteria for compatibility under Article 87(3) EC Treaty, viewed in the light of the general objectives of the Treaty and in particular Articles 3(1)(g) and 4(2), which imply compliance with the following conditions[6]:

a. *Appropriateness*: The aid has to be well targeted in order to be able to effectively achieve the objective of remedying a serious disturbance in the economy. This would not be the case if the measure is not appropriate to remedy the disturbance.

b. *Necessity*: The aid measure must, in its amount and form, be necessary to achieve the objective. That implies that it must be of the minimum amount necessary to reach the objective, and take the form most appropriate to remedy the disturbance. In other words, if a lesser amount of aid or a measure in a less distortive form (e.g. a temporary and limited guarantee instead of a capital injection) were sufficient to remedy a serious disturbance in the entire economy, the measures in question would not be necessary. This is confirmed by settled case law of the Court of Justice.[7]

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4 Cf. in principle case Joined Cases T-132/96 and T-143/96 Freistaat Sachsen and Volkswagen AG Commission [1999] ECR II-3663, para. 167. Confirmed in Commission Decision in case C 47/1996, Crédit Lyonnais, OJ 1998 L 221/28, point 10.1, Commission Decision in Case C28/2002 Bankgesellschaft Berlin, OJ 2005 L 116, page 1, points 153 et seq and Commission Decision in Case C50/2006 BAWAG, OJ L 83 of 26.3.2008, point 166. See Commission Decision of 5 December 2007 in case NN 70/2007, Northern Rock, OJ C 43 of 16.2.2008, p. 1, Commission Decision of 30 April 2008 in case NN 25/2008, Rescue aid to WestLB, OJ C 189 of 26.7.2008, p. 3, Commission Decision of 4 June 2008 in Case C9/2008 SachsenLB, not yet published.

5 Commission Communication on "The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis", adopted on 13.10.2008, OJ C 270 of 25.10.2008, pages 8–14.

6 Cf. Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, OJ C 273 of 28.10.2008, at point 41.

7 Cf. Case 730/79, *Philip Morris* [1980] ECR 2671. This line of authority has recently been reaffirmed by the Court of Justice in. Case C-390/06, *Nuova Agricast v Ministero delle Attività Produttive* of 15 April 2008, where the Court held that, "As is clear from Case 730/79 […], aid which improves the financial situation of the recipient undertaking without being necessary for the

c. *Proportionality*: The positive effects of the measures must be properly balanced against the distortions of competition, in order for the distortions to be limited to the minimum necessary to reach the measures' objectives. This follows from Article 3 (1) g EC Treaty and Article 4 (1) and (2) EC Treaty, which provide that the Community shall ensure the proper functioning of an internal market with free competition. Therefore, Article 87 (1) EC Treaty prohibits all selective public measures that are capable of distorting trade between Member States. Any derogation under Article 87(3)(b) EC Treaty which authorises State aid must ensure that such aid must be limited to that necessary to achieve its stated objective.

(39) The fourth chapter of the Communication on the financial crisis[8], as well as the Communication on recapitalisations[9], then translate these general principles into conditions specific for recapitalisation schemes. The principles contained therein apply *mutatis mutandis* also to individual cases. In the next paragraphs, the Commission will therefore assess the compatibility of the notified measure with these criteria.

Appropriateness of the measure to remedying a serious disturbance in the economy

(40) Following the introduction of the Guarantee Scheme, the Irish authorities commissioned PricewaterhouseCoopers to prepare a report on the financial position of the institutions participating in the Guarantee Scheme (the "PwC Report"). The PwC Report concluded that the capital positions of each of the institutions reviewed, including Anglo, was in excess of regulatory requirements as of 30th September, 2008 and that, under a number of stress scenarios, capital levels in each of the institutions will remain above regulatory minimum levels in the period to 2011. The Central Bank and Financial Regulator also shares the view that Anglo Irish Bank is currently fully in compliance with regulatory capital requirements.

(41) However a letter from the Governor of the Central Bank of Ireland and Financial Regulator to the Minister dated 18th November, 2008 summarising and commenting on the conclusions of the PwC Report indicates that […]. On that basis and bearing in mind the volatility of the economic and financial environment the Board of the Central Bank and the Financial Services Authority of Ireland support the measure at issue which aims at strengthening the capital position of Anglo Irish bank.

(42) The Commission acknowledges that rising international capital market expectations in relation to capital levels for financial institutions, in the context of the current crisis, can make it necessary also for banks that meet the regulatory solvency ratios to further strengthen their capital ratios.

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attainment of the objectives specified in Article 87(3) EC cannot be considered compatible with the common market […]."

8 Commission Communication on "The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis", adopted on 13.10.2008, OJ C 270 of 25.10.2008, pages 8–14.

9 Commission Communication on "The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition", adopted on 05.12.2008, available on: http://ec.europa.eu/competition/state_aid/legislation/specific_rules.html#financial

(43) In the present market circumstances, it is doubtful whether Anglo could have raised this capital on the private market. Indeed, despite its coverage under the Guarantee Scheme, market perceptions concerning the inadequacy of its capital ratio levels have led to deterioration in investor sentiment with regard to Anglo. The Bank's shares have experienced a significant deterioration in value from around €5 in early October, 2008 to the position of €0.171 on 31st December, 2008 with a market capitalisation of €129.95 million. Over the previous 12 months, the Bank traded as high as €10.94, with a market capitalisation of €8,327.74 million. As a result, Anglo's shares have lost more than 98% of their value over the last 12 months.

(44) As to its rating, Anglo is rated A1 by Moody's and has been on negative watch since 17 October, S&P's A- rating was put on negative watch on 5 November last year.

(45) In addition to difficulties caused by the global financial crisis, the deterioration in the financial position of the Bank has been accelerated by difficulties with regard to its corporate governance (see § 9 above).

(46) Anglo's funding model is heavily reliant on wholesale lending, the availability of which has diminished very substantially on account of the dislocation of international credit markets. Anglo Irish Bank has approximately […]of term debt maturing in 2009. Anglo Irish Bank's loan book is approximately €72 billion and it is heavily exposed to commercial investment property (c. €40 billion) and, more crucially, to the development sector (c. €20 billion).

(47) Moreover, while Anglo Irish Bank results were a profit before tax of €784 million for 2008, they included significantly increased collective and specific impairment provisions, totalling €724 million. Treasury losses account for a further €155 million impairment provision. Anglo Irish Bank reported actual impaired loans of €957 million (131 basis points of its loan book) for 2008. The market views these provisions as too conservative and the market consensus estimate is an average of 200 basis points of the Bank's loan book (€1.4 billion per annum).

(48) In these circumstances, the Irish Government, in consultation with the Governor of the Central Bank of Ireland (the "Governor") and the Financial Regulator, decided that it was necessary for the State to take measures in relation to Anglo in order to avoid further deterioration in the financial situation of the Bank, which, in turn, would represent a threat to the stability of both the financial system in the State and the wider economy.

(49) Indeed, Anglo Irish Bank is one of the six core banks in the State. Anglo Irish Bank has a balance sheet size in excess of €100 billion (approximately 50% of GDP) and accounts for a significant share of customer deposits and lending in the Irish economy.

(50) Further deterioration in Anglo's financial position could represent a threat to the stability of both the financial system in the State and the wider economy. In this respect, it is important to note that the Irish financial sector is very dependant upon international finance through wholesale money markets. Therefore, a loss of confidence in Anglo could undermine confidence in the Irish financial sector as a whole, thus entailing a serious risk of a systemic crisis in the Irish financial system, with significant negative spill-over effects into the wider economy. In a

letter dated 8th January, 2009, the Governor has confirmed the systemic importance of Anglo Irish Bank to maintaining the stability of the financial system in the State.

(51) Therefore, the Commission considers that a public sector capital intervention in Anglo Irish is a necessary and appropriate means to strengthen the bank's capital base with the aim of restoring market confidence in the Irish financial sector, thus avoiding the risk of a serious disturbance of the entire Irish economy.

Limitation of the aid to the strict necessary

(52) Capital interventions must be done on terms that minimise the amount of aid. This relates to the amount of the measure as well as to the conditions at which it is provided.

(53) As regards the total amount of the recapitalisation, the injection of €1.5 billion represents 1,75% of risk weighted assets of the bank[10]. The measure will help the Anglo-Irish Bank to improve its core Tier 1 capital ratio from 5,9 to 7,7% and its tier 1 capital ratio from 8,4 to 10,1%. The Commission notes that the size of the recapitalisation in terms of proportion of risk-weighted assets of the bank remains below the indicator of the Communication on recapitalisation of banks[11], and levels of capitalisation reached after the State intervention are in line with previous Commission decisions[12].

(54) The Commission also notes that the State guarantee on the balance sheet of the Anglo-Irish Bank, in line with the Commission decision approving the Irish guarantee scheme for banks[13], has not proved sufficient in the above market and bank-specific circumstances (as shown in particular by market share collapse exacerbated by corporate governance problems), and needed to be supplemented by strengthening the bank's capital base.

(55) Taking the above into account, the Commission is satisfied that this capital injection of €1.5 billion is the minimum necessary to remedy concerns about the stability of the Anglo-Irish Bank and thus the Irish financial system.

(56) As regards the remuneration of the measure, the Commission acknowledges that setting the remuneration as high as the current clearing levels would restrain the financial institutions from using such measures. Moreover, it is the Commission's

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10 According to its preliminary results for the year ended 30th September, 2008, the Bank had a balance sheet total of €101,321 million.

11 See the reference to a positive evaluation by the Commission of a capital injection that would not exceed 2% of the banks' risk weighted assets, cf. Annex to the Commission Communication on "The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition", C(2008) 8259 final, of 05.12.2008.

12 See, for example, Commission decision of 18.12.2008 in case N 602/2008 *KBC* Belgium, where the core Tier 1 capital ratio increased to 8.2% and Tier 1 to 10.7% following State recapitalization, the Commission decision of 10.12.2008 in case N 611/2008 SNS Reaal, where the Tier 1 capital ratio of SNS Bank NV increased to 10%, or the Commission decision of 13.11.2008 in case N528/2008 *ING* NL, where the Tier 1 ratio increased to 10% after recapitalization.

13 Commission decision of 13.10.2008 in case NN 48/2008, *Guarantee scheme for banks in Ireland*.

intention to adjust to long term market conditions and not to impose the current unfavourable conditions on the financial institutions today.

(57) In its Communication on recapitalisations, the Commission accepts as a minimum remuneration based on the Eurosystem methodology of 20 November 2008. This methodology takes account of the banks' risk profile and involves the calculation of a price corridor with an average required rate of return of 7% on preferred shares with features similar to those of subordinated debt and an average required rate of return of 9,3% on ordinary shares relating to Euro area banks[14]. The Communication distinguishes between fundamentally sound banks, for which the methodology above applies and distressed banks, for which remuneration should normally be higher.

(58) In the case at hand, in line with the Communication on recapitalisations, the Commission must take into account the type of capital provided and the risk profile of the bank in order to evaluating the adequacy of the State capital remuneration, the Commission.

(59) As far as the bank's risk profile is concerned, the following indicators are relevant (see the annex to the Communication): capital adequacy, size of recapitalisation, current CDS spreads, current rating of the bank and its outlook.

(60) In this context, the Commission notes positively the relatively small size of the recapitalisation, i.e. below 2% of the bank's risk weighted assets, the fact that the bank meets regulatory capital ratio requirements, and the PwC report' finding that the bank could maintain them even under a number of stress scenarios.

(61) However, the Commission also notes the letter from the Central Bank and Financial Regulator to the Minister dated 18th November, 2008 indicating that […]. The Commission also notes that this study is (at this stage) not complemented by an assessment of the prospective capital adequacy of the bank by the Financial Regulator or other evaluation of the bank's exposure to various risks (such as credit risk, liquidity risk, market risk, interest rate and exchange rate risks), the quality of the asset portfolio, the sustainability of its business model in the long term and other pertinent elements, in line with the Recapitalisation Communication.

(62) Also the risk profile of the bank, as revealed by its CDS spreads and ratings, is relatively high (see §8 above). Its riskiness, as measured by the CDS spreads on 5 years senior debt, is perceived by the markets above those of its Irish peers and stays well above the average for the European banking sector. For example, Itraxx index for the period 10.9.2007 till 10.10.2008 reveals an average CDS spread on 5 year senior debt for EU banks of 74 b.p., while it reaches 243 b.p. on average for Anglo for the period 10.9.2007 till 10.9.2008[15]. The levels preceding the current crisis are lower but even the low values at the beginning of the period for Anglo are still above the sector average (60 b.p. for Anglo on 17.10.2007 while sector low for the period was 20 on 15.10.2007).

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[14] See the application of this methodology in the recent Commission decisions of 10.12.2008 in the case N 611/2008 *Aid to SNS REAAL N.V.* and of 18.12.2008 in case N 602/2008 *KBC* Belgium.

[15] Source: Bloomberg, Itraxx financials CDS series 8

(63) Finally, Anglo is rated A1 by Moody's and has been on negative watch since 17 October. S&P's A- rating was put on negative watch on 5 November this year.

(64) As to the type of capital provided, the Commission notes that in the case at hand, the instruments that will be used to make the State investment are non-cumulative perpetual preference shares in the Bank with voting rights. The Shares are a hybrid form of Core Tier 1 capital. While they are deeply subordinated, non-cumulative and only have a discretionary dividend, they are also non-dilutive and, in relation to dividends, they rank in priority to ordinary shares.

(65) As regards the overall position of the State in relation to its investment in the bank, the Commission notes positively that the capital injection will give the State 75% of voting rights in the company. The Commission also notes that the probability of return for the State through dividends increases through a combination of their payment in cash or ordinary shares.

(66) On the basis of the above the Commission does not share the view of the Irish authorities that the bank remains fundamentally sound. However, given the size of the capital injection, the specific characteristics of the Shares, and the banks' risk profile as outlined above, the Commission finds that a discretionary remuneration of 10% per annum, which is above the minimum price corridor for fundamentally sound banks, is consistent with the Recapitalisation Communication.

(67) In line with the Communication on recapitalisations, it is also necessary to ensure that there are sufficient incentives to redeem the State participation when the market will so allow. In the case at hand, such incentive provided through the level of remuneration is further complemented by redemption clauses. While redemption is at Anglo's discretion and the Bank can repurchase the Shares at par for up to five years, after that period, shares can be repurchased at 125% of par. This provides an incentive for Anglo to redeem the Shares during the initial five year period. In addition, replacement capital must be Core Tier 1, which should ensure that the State investment is replaced with private equity investment in Anglo.

(68) Moreover, there is a restrictive dividend policy while the State holds the shares: dividends on ordinary shares are not allowed where a dividend on the shares is not paid to the State. This encourages the Bank to redeem the State capital injection as soon as possible, while also providing the Bank with the flexibility to incentivise private equity investment through the payment of dividends on ordinary shares where a dividend is paid to the State on the Shares.

(69) In the case at hand, the Commission considers that the terms and conditions of the State investment, together with the terms and conditions already imposed on Anglo under the Guarantee Scheme, contain safeguards against possible abuses and distortions of competition (see §24 above). In particular, the Commission views positively the commitment of the bank to refrain from mass marketing of the measure.

(70) Finally, the Commission considers that the submission of a restructuring plan is needed to secure the proportionality of the aid and to limit possible distortions of competition. It notes that the Irish authorities have committed to notify a restructuring plan of the Anglo-Irish Bank within 6 months.

(71) In view of the corporate governance difficulties to which the bank was recently faced, the Commission further notes positively the management and board changes imposed on the bank, the fact that the Board will have Government representation and the voting rights attached to the State's preferred shares.

3. Conclusion

(72) Therefore, the Commission can conclude that the measure conforms to the conditions laid down in the Communication on the financial crisis and the Communication on recapitalisations.

IV. DECISION

(73) The Commission comes to the conclusion that the provision of capital by the Republic of Ireland in the conditions described above constitutes State aid pursuant to Article 87(1) EC Treaty.

(74) The Commission considers that this measure fulfils the conditions to be considered compatible with the Common Market pursuant to Article 87(3)(b) EC Treaty. Consequently, the Commission raises no objection against the notified aid and authorizes it as emergency intervention in the face of the current financial crisis for a period of 6 months.

(75) The Commission takes note of Ireland's commitment to notify a restructuring plan to the Commission within six months from the recapitalisation[16].

If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of this letter 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.
http://ec.europa.eu/community_law/state_aids/index.htm.

[16] In line with the requirements under point 44 of the Commission Communication on recapitalizations.

Your request should be sent by registered letter or fax to:

- European Commission
  Directorate-General for Competition
  State aid Greffe
  Rue de la Loi/Wetstraat, 200
  B-1049 Brussels
  Fax No: (+32)-2-296.12.42

Yours faithfully,

For the Commission

Neelie KROES
Member of the Commission