EUROPEAN COMMISSION

Brussels, 28.06.2010
C (2010) 4397

Subject: State aid N 254/2010 - Ireland
Extension of the ELG scheme until 31 December 2010

Sir,

I. PROCEDURE

(1) On 17 June 2010, Ireland submitted a notification to extend and amend the Credit Institutions Eligible Liabilities Guarantee scheme (the "ELG Scheme"). The extended scheme will amend the existing ELG scheme[1], which resulted from the amendment of the Credit Institutions Financial Support scheme (the "CIFS Scheme"), approved on 13 October 2008[2]. On 31 May 2010, The Commission approved an extension of the ELG Scheme until 30 June 2010[3].

II. DESCRIPTION

1. The existing guarantee scheme: the ELG Scheme

Rationale and context

(2) In response to the exceptional turbulence in the world financial markets, Ireland has approved and implemented since 2008 two guarantee schemes, the CIFS Scheme and

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1 Commission Decision of 20.11.2009 Guarantee scheme for banks in Ireland, in case N 349/2009, OJ C 72/2010 of 20.03.2010 and prolonged in Commission Decision of 31.05.2010 Prolongation of the Eligible Liabilities Guarantee Scheme, in case N 198/2010.

2 Commission Decision of 13.10.2008 Guarantee scheme for banks in Ireland, in case NN 48/2008, OJ C 312/2008 of 06.12.2008

3 Commission Decision of 31.05.2010 Prolongation of the Credit Institutions Eligible Liabilities Guarantee Scheme, in case N 198/2010, not yet published.

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the ELG Scheme, designed to restore the stability of the financial system and to remedy a serious disturbance in the Irish economy.

(3) The aim of the CIFS Scheme was to guarantee, for a period not exceeding two years, all deposits and certain liabilities of six systemically important Irish credit institutions[4] and certain banking subsidiaries of systemic importance in Ireland with a significant and broad presence in the domestic economy[5]. The ELG Scheme amended the CIFS Scheme, seeking to provide the participating institutions with access to medium-term State-guaranteed funding (with maturities of up to five years) and thereby lengthen the debt maturity profile of the banks' liabilities guaranteed.

Beneficiaries of the guarantees under the ELG Scheme

(4) Eligibility for the ELG Scheme is open to systemically important and solvent credit institutions incorporated in Ireland or a subsidiary of such a credit institution (including Irish subsidiaries of credit institutions established in another Member State) having a broad-based retail "Main Street" business in Ireland and which: (i) apply to join the ELG Scheme; (ii) enter into an eligible liabilities guarantee scheme agreement with the Finance Minister; and (iii) have received a participating institution certificate in accordance with the ELG Scheme rules.

Eligible liabilities under the ELG Scheme

(5) Eligible liabilities which may be covered by the guarantee under the ELG Scheme in accordance with its terms and conditions are:

- deposits (to the extent not covered by deposit protection schemes in the State (other than the CIFS Scheme) or any other jurisdiction);
- senior unsecured certificates of deposits (CD);
- senior unsecured commercial paper (CP);
- other senior unsecured bonds and notes; and
- other forms of senior unsecured debt which may be specified by the Irish Finance Minister, consistent with EU State aid rules and the Banking Communication (2008/C 270/02) and subject to prior consultation with the Commission.

(6) In respect of deposits (to the extent not covered by deposit protection schemes other than the CIFS Scheme), the guarantee under the ELG Scheme applies to deposits incurred by a participating institution from the time it becomes a participating institution.

(7) The guarantee may be applied to stand-alone eligible liabilities or to eligible liabilities issued under issuance programmes, in each case approved by the Finance Minister. In the case of issuance programmes, participating institutions may apply for the eligible

[4] Allied Irish Banks, Bank of Ireland, Anglo Irish Bank, Irish Life and Permanent, Irish Nationwide Building Society and the Educational Building Society.

[5] In particular, the Minister stated that Ulster Bank, First Active, Halifax Bank of Scotland (Ireland), KBC Bank and Postbank Ireland Limited would be eligible for the scheme.

liabilities guarantee to apply to all eligible liabilities issued under a particular programme. Under the scheme, participating institutions may issue debt securities or take deposits on an unguaranteed basis.

Temporal scope

(8) On 20 November 2009 the Commission approved an issuance period up to 1 June 2010 inclusive. The issuance period was prolonged on 31 May 2010 until 30 June 2010.

(9) The guarantee under the ELG Scheme may apply to eligible liabilities which:

- are incurred during the issuance period; and
- have a maturity of up to five years.

(10) The total volume of guaranteed liabilities under the ELG Scheme with a maturity longer than three years cannot exceed one-third of the total volume of guaranteed liabilities (excluding deposits) under the ELG Scheme.

Remuneration

(11) Each participating institution pays a fee in respect of each guaranteed liability, corresponding to the recommendations of the Governing Council of the ECB on government guarantees of 20 October 2008.

(12) The fee payable in relation to a guaranteed liability with a maturity greater than one year is based on a per annum rate of 0.50% of the principal amount of the guaranteed liability plus either:

a. 100% of the participating institution's median five-year credit default swap ("CDS") spread during the period from 1 January 2007 to 31 August 2008; or

b. 100% of the median five-year CDS spread during the period from 1 January 2007 to 31 August 2008 for euro area credit institutions in the same credit rating category as the participating institution (or the lowest rating category if such participating institution has no rating),

whichever is lower.

(13) The fee payable in relation to a guaranteed liability with a maturity of up to one year is based on a per annum rate of 0.50% of the principal amount of the guaranteed liability.

2. Operation of the ELG Scheme up to 14April 2010

(14) The ELG Scheme was commenced on 9 December 2009. According to the Irish authorities, the ELG Scheme has made an important contribution to assisting the covered institutions in meeting their funding needs in stressed market conditions.

(15) The following credit institutions have applied for and have been certified as participating institutions under the ELG Scheme to date:

- Irish Life and Permanent plc
- Irish Permanent (IOM) Limited
- Bank of Ireland
- Bank of Ireland Mortgage Bank
- The ICS Building Society ,a subsidiary of Bank of Ireland
- Bank of Ireland (IOM) Limited
- Allied Irish Banks, p.l.c.
- AIB Group (UK) p.l.c.
- AIB Bank (CI) Limited
- AIB Banks North America Inc.
- Anglo Irish Bank Corporation Limited
- Anglo Irish Bank Corporation (International) plc.
- EBS Building Society
- Irish Nationwide Building Society
- Irish Nationwide (IOM) Ltd.

(16) The total liabilities covered by the ELG Scheme, as of 14 April 2010, are shown in Table 1 of the Annex to this decision. The total amount of EUR 153,040 million, which includes deposits, is divided into: Retail and corporate deposits (net of DGS[6]) ([…][*]); Interbank deposits ([…]); senior unsecured debt ([…]). The relevant data is shown in that Annex.

(17) The breakdown per institution (including deposits) is the following: Allied Irish Bank ([…]); Anglo Irish Bank ([…]); Bank of Ireland ([…]); EBS Building Society ([…]); Irish Life & Permanent ([…]); Irish Nationwide Building Society ([…]); Postbank Ireland Limited ([…]).

(18) The breakdown per institution (excluding deposits) is the following: Allied Irish Bank ([…]); Anglo Irish Bank ([…]); Bank of Ireland ([…]); EBS Building Society ([…]); Irish Life & Permanent ([…]); Irish Nationwide Building Society ([…]); Postbank Ireland Limited ([…]).

3. Amendment to the existing ELG Scheme

Temporal scope

[6] Deposit Guarantee Scheme.

[*] Confidential information

(19) Under the proposed extension of the ELG Scheme, the issuance window under the ELG Scheme would be extended to 31 December 2010 inclusive for all eligible liabilities, with the exception of CP and CD with a maturity of less than three months, interbank deposits, corporate deposits with a maturity of less than three months.

(20) The issuance window under the ELG Scheme for CP and CD with a maturity of less than three months, interbank deposits, corporate deposits with a maturity of less than three months would be extended to 29 September 2010 inclusive[7].

Remuneration

(21) Under the proposed modification of the ELG Scheme, the fees payable for eligible liabilities incurred under the ELG Scheme from 1 July 2010 onwards will increase to at least the following levels above the pricing formula recommended by the ECB in October 2008:

- 20 basis points for participating institutions with a rating of A+ or A[8],
- 30 basis points for participating institutions rated A-[9], and
- 40 basis points for participating institutions rated below A-.

Participating institutions without a rating will be considered to belong to the category of banks with a BBB rating[10].

(22) For ease of administration, the method of calculating the fee payable under the ELG Scheme with regard to deposits and debt liabilities whose maturity is under one year will be amended. Under the new method, fees are calculated at the end of the quarter on an average of short-term debt balances for the previous three month-ends, rather than from the day the debt is issued, as was provided for under the original rules of the ELG Scheme. With regard to debt issuance with a maturity greater than one year, the original rules are unchanged.

(23) According to the Irish authorities, the amendment for deposits and debt liabilities with a maturity of less than one year simplifies the calculation and does not alter the amount of fees charged under the ELG Scheme.

III. THE POSITION OF IRELAND

(24) The Irish authorities consider that the prolongation and modification of the ELG Scheme is required in order to preserve financial stability, to safeguard the Irish financial system, to remedy a serious disturbance in the Irish economy caused by the

[7] This would bring the termination date of the issuance window for these Eligible Liabilities in line with the termination date of the CIFS Scheme, as in Commission Decision of 13.10.2008 Guarantee scheme for banks in Ireland, in case NN 48/2008, OJ C 312/2008 of 06.12.2008

[8] Or A1 and A2 depending on the rating system employed.

[9] Or A3 depending on the rating system employed.

[10] In the case of divergent assessments by different rating agencies the relevant rating for the calculation of the fee increase should be the higher rating. The material time for the rating in the determination of the guarantee fee is the day on which the guarantee is granted in relation to a specific bond issuance by the beneficiary.

impact of the global financial crisis on the financial position of participating institutions and to underpin the flow of credit to the economy.

(25) The Irish Central Bank and the Irish Financial Regulator are of the view that any significant scaling back of the scope of the ELG Scheme, and, in particular, a removal of the guarantee of CP and CD with a maturity of less than three months, interbank deposits, and corporate deposits with a maturity of less than three months, could have a significant negative impact on market sentiment towards credit institutions in Ireland […]. In particular, according to the Irish Central Bank, an extension of the guarantee for liabilities of less than three months is necessary in the context of the ongoing investor caution and pending the normalization of funding conditions for banks in Ireland and to allow for the transition to a more balanced funding profile as soon as market conditions permit.

(26) Ireland undertakes to maintain the commitments made since the introduction of the guarantee scheme which have been taken into account by the Commission in its decision of 31.05.2010 under case N 198/2010.

(27) As mentioned above, Ireland undertakes to charge beneficiary banks a guarantee fee[11] that is higher than under the pricing formula recommended by the ECB in October 2008 at least by

- 20 basis points for banks with a rating of A+ or A[12],
- 30 basis points for banks rated A-[13], and
- 40 basis points for banks rated below A-. Banks without rating will be considered to belong to the category of banks with a BBB rating[14].

(28) Ireland undertakes to present a viability review for every bank that is granted guarantees on new or renewed liabilities as from 1 July 2010 and for which at the time of the granting of new guarantees the total outstanding guaranteed liabilities (including guarantees accorded before 1 July 2010) exceed both a ratio of 5% of total liabilities and the total amount of EUR 500 million. The viability review will be communicated to the Commission within three months of the granting of guarantees and will comply with the principles set out in the Restructuring Communication[15]. In particular, it will cover the solidity of the funding capacity of the bank concerned; where necessary and in any event where requested by the Commission in case of doubt, a liquidity stress test will be carried out. No separate viability review has to be presented for banks that are already in restructuring or obliged to present a restructuring plan or subject to a pending viability review at the time new guarantees are granted.

[11] The new pricing is set out in detail in the notification.

[12] Or A1 and A2 depending on the rating system employed.

[13] Or A3 depending on the rating system employed.

[14] In the case of divergent assessments by different rating agencies the relevant rating for the calculation of the fee increase should be the higher rating. The material time for the rating in the determination of the guarantee fee is the day on which the guarantee is granted in relation to a specific bond issuance by the beneficiary.

[15] OJ C 195, 19.8.2009, p.11, point 8 in conjunction with section 2.

(29) In addition to the existing commitments concerning reporting obligations, Ireland undertakes to submit to the Commission a concise mid-term review on the operation of the guarantee scheme by 15 October 2010 at the latest.

IV. ASSESSMENT

(30) In its decision of 31 May 2010, the Commission concluded that the guarantee scheme constitutes State aid within the meaning of Article 107(1) TFEU. However it found that the measures were compatible with the internal market under Article 107(3)(b) TFEU, because they were apt to remedy a serious distortion of the Irish economy. To this end, the Commission had assessed the appropriateness, necessity and proportionality of the measure.

(31) The Commission observes that the extension of the scheme is a response to the continuing financial difficulties that Ireland, as most Member States, continues to experience. Since the objective of the measure is to provide short- and medium-term financing to financial institutions[…], it is important to ensure the availability of the guarantee scheme as long as the global financial crisis continues.

(32) Although access to funding for banks has gradually improved in most funding markets over the past year and is no longer a systematic and generalized problem, markets have not yet fully returned to entirely normal functioning. Against this background and taking into account the residual fragility of recovery process and the possibility of setbacks in that process, the continuation of a guarantee scheme can be deemed necessary to ensure financial stability as confirmed by the Central Bank of Ireland and the Irish Financial Regulator. The Commission therefore considers that the prolongation of the scheme for a further six months (or until 29 September 2010 for debt liabilities of less than three months maturity, interbank deposits and corporate deposits with maturity of less than three months) is appropriate and necessary to remedy a serious disturbance of the Irish economy.

(33) On the basis of the above, the notified prolongation of the guarantee scheme does not alter the Commission's previous assessment in the decisions of 20 November 2009, and the prolongation decision of 31 May 2009.

(34) As regards the specific features of the guarantee scheme, in assessing the request for the prolongation the Commission has to balance its positive effects for financial stability with the distortions of competition and the delay in the return to a normal functioning of the financial markets that the prolongation entails. Guarantee schemes should contain minimum exit incentives, and a gradual alignment to market conditions should take place in order to minimise negative spill-over effects on competitors and other Member States.

(35) The gradual stabilization of the market situation and the resulting reduction of the risk premium for unguaranteed debt have brought about a first step towards an alignment with market conditions, whilst providing an exit incentive for the sounder institutions. Lower-rated banks for which bond issuances with a government guarantee still hold considerable economic benefits have become the prime users of guarantee schemes.

(36) It is necessary to minimise distortions across banks in the internal market and avoid the risk of State aid dependence. There should therefore be an adjustment of the terms on which banks may retain for the time being the possibility of accessing government guarantees schemes.

(37) On the basis of these considerations, the prerequisites for the compatibility of guarantee schemes with Article 107(3)(b) TFEU that have been established by the Banking Communication[16] and the Commission's subsequent decisional practice continue to apply but need to be complemented by requirements aimed at achieving two objectives.

(38) First, banks should be incentivized to scale down or terminate their recourse to government guarantees by means of pricing rules that bring the funding costs of beneficiary banks closer to market conditions and thereby reduce distortions of competition. This should be achieved by an increase in the guarantee fee[17] in comparison with the ECB recommendations of October 2008 that amounts at least to 20 basis points for banks with a rating of A+ or A[18], 30 basis points for banks rated A-[19], and 40 basis points for banks rated below A-[20].

(39) Second, the use of guarantee schemes should not enable banks with structural weaknesses in their business models to postpone or avoid the necessary adjustments. To this end, the Member State concerned should present a viability review for any bank that requests new guarantees under a scheme which take or keep the total amount of the bank's outstanding guaranteed liabilities above 5% of the bank's total liabilities and above the absolute amount of EUR 500 million. The viability review should be presented on the basis of the parameters established in the Restructuring Communication within three months of the granting of the guarantees[21]. The viability review will either confirm the bank's long-term viability without State support or show that farther-reaching restructuring is required.

(40) In addition, the Irish authorities have argued that there is a need to maintain the guarantees on CP and CD with a maturity of less than three months, interbank deposits, and corporate deposits with a maturity of less than three months until 29 September 2010, in order to enable a smooth transition towards lengthening the liabilities incurred by the beneficiary institutions. In paragraph 52 of its decision of 20 November 2009 on the ELG Scheme, the Commission considered, in line with the opinion of the European Central Bank of 9 November 2009, that Ireland should terminate guarantees for bank debt with a maturity of less than three months as soon as the market conditions allow it to do so.

[16] The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis. Official Journal C 270, 25.10.2008, p.8

[17] For liabilities of all eligible maturities.

[18] Or A1 and A2, depending on the rating system employed.

[19] Or A3, depending on the rating system employed.

[20] Banks without rating will be considered as having a BBB rating.

[21] Except where the bank concerned is already in restructuring or subject a pending viability review on the basis of a restructuring or viability plan; in those circumstances the award of additional State aid will be assessed within the framework of the ongoing restructuring/viability review process.

(41) The Commission accepts the argument advanced by Ireland and it considers that the limited extension until 29 September 2010 of this feature of the ELG Scheme is necessary as the market conditions at present do not allow for the termination of the guarantee on short-term maturities. At the same time, the Commission considers it an important step towards stabilization of the Irish financial market that after 29 September 2010 the ELG Scheme will no longer include guarantees on short-term maturities.

(42) The Commission considers that the notified extension until 31 December 2010 of the ELG scheme complies with the requirements set out in paragraphs 38 and 39, and given also the considerations of paragraphs 40 and 41, find the extension compatible with the internal market-

(43) As regards the combination of this guarantee scheme with other aid measures, as indicated in the Annex to the Restructuring Communication[22], any restructuring plan should contain all State aid received as individual aid or under a scheme during the restructuring period and all such aid needs to be justified as satisfying all criteria prescribed by the Restructuring Communication (i.e. return to viability, own contribution by the beneficiary and limitation of competition distortion). Accordingly, once a Member State is under an obligation to submit a restructuring plan for a certain aid beneficiary, the Commission needs to take a view in its final decision as to whether any aid granted during the restructuring period satisfies the criteria required for the authorisation of restructuring aid. To this end an individual *ex ante* notification is necessary.

(44) Furthermore, the Commission recalls that based on point 16 of the Restructuring Communication, if aid not initially foreseen in a notified restructuring plan is necessary for the restoration of viability, this additional aid cannot be granted under an approved scheme but needs to be subject to individual ex ante notification and any such further aid will be taken into account in the Commission’s final decision on that bank.

(45) In addition to the above, Ireland agrees to provide the Commission with a concise mid-term review of the operation of the scheme by 15 October 2010 in addition to the pre-existing reporting requirements and to complement its future reports on the operation of the scheme with updated available data on the cost of comparable (nature, volume, rating, currency, etc.) non-guaranteed and guaranteed debt issuances[23]. This will allow the Commission to assess the appropriateness, necessity and proportionality of possible further prolongations of the scheme beyond 31 December 2010 and the conditions for such prolongations. Any further prolongation will require the Commission's approval and will have to be based on a review of the developments in financial markets and the scheme's effectiveness.

V. DECISION

[22] OJ C 195, 19.08.2009.

[23] See point 23 of the Commission decision of 12 December 2008.

The Commission finds that the notified measure is compatible with the internal market, in the period from 1 July 2010 to 31 December 2010, and has accordingly decided not to raise objections.

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State Aid Greffe
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B-1049 Brussels
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Yours faithfully,

For the Commission

Joaquín ALMUNIA
Vice-President of the Commission

Annex

[…]