EUROPEAN COMMISSION

Brussels, 15.7.2011
C(2011) 5177 final

Subject: State aid SA.33296 (2011/N) – Ireland
Emergency recapitalisation in favour of the merged entity Educational Building Society / Allied Irish Banks plc

Sir,

The Commission wishes to inform Ireland that, having examined the information supplied by your authorities, it has decided to approve the measure referred to above for the entity resulting from the merger of Allied Irish Banks plc ("AIB") and the Educational Building Society ("EBS") (such merged entity "the Bank" or "AIB/EBS").

1 PROCEDURE

1.1 Allied Irish Bank plc

(1) On 12 May 2009, the Commission approved a EUR 3.5 billion capital injection into AIB in the form of Core Tier 1 New Preference Shares[1].

(2) Following this initial capital injection, AIB submitted an initial restructuring plan on 13 November 2009 followed by a number of exchanges. An updated restructuring plan was submitted on 4 May 2010 which again was followed by a number of exchanges between the Commission and Ireland.

[1] Commission Decision in Case N 241/2009, *Capital injection into Allied Irish Bank*, OJ C 223, 16.09.2009, p. 2

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(3) On 21 December 2010, the Commission approved[2] a EUR 9.8 billion capital injection in the form of ordinary shares to be undertaken in two stages (i) EUR 3.7 billion to be injected by 31 December 2010 and (ii) EUR 6.1 billion to be injected in February 2011.[3] This amount of capital injection was the result of a combination of factors : (i) the results of the first Prudential Capital Assessment Review announced on 31 March 2010 ("PCAR 2010"), (ii) increased haircuts on assets transferred to NAMA[4] and (iii) the new minimum regulatory capital requirement that the Irish Central Bank had decided to impose on Irish domestic credit institutions in the context of the Programme for Support agreed on 28 November (hereinafter the Programme) between the Irish Government, the Commission and the International Monetary Fund ("IMF"), in liaison with the European Central Bank ("ECB").

(4) The first instalment of the approved recapitalisation was injected by the Irish State at the end of December 2010. However the second injection was postponed pending the results of the elections which took place in Ireland at the end of February. The newly elected government decided to wait for the results of the March 2011 Prudential Capital Assessment Review/Prudential Liquidity Assessment Review (PCAR/PLAR)[5] exercise (see below (28) and (30)) before injecting the second instalment. As a matter of fact the second injection never took place.[6].

1.2 *Educational Building Society ("EBS")*

(5) By decision of 2 June 2010[7] the Commission temporarily authorised a recapitalisation of EBS as emergency aid subject to the condition that Ireland would submit an in-depth restructuring plan for EBS before 30 June 2010. A restructuring plan was submitted by the Irish authorities on 31 May 2010.

(6) On 11 October 2010, the Commission decided[8] to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union (hereinafter "TFEU") with regard to the restructuring plan submitted by Ireland, since the Commission had doubts as to the compatibility of that restructuring plan and the associated aid measures with the internal market in the light of the *Commission's Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current financial crisis under the State aid rules*[9] (hereinafter "the Restructuring Communication").

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[2] OJ C76, 10.03.2011p.4.

[3] The gross capital injections were respectively EUR 3.9 billion and EUR 6.3 billion, including each EUR […] billion of fees repaid by AIB to the Irish government.

[4] National Asset Management Agency

[5] In the context of the Programme, the March 2011 PCAR/PLAR was an even more in-depth stress test of the Irish banking system.

[6] The Commission decision allowed the recapitalisation as a rescue measure for 6 months subject to the submission of an updated restructuring plan. This restructuring plan has not yet been submitted and will be submitted at the end of July. The second instalment of the recapitalisation was not paid in February.

[7] See Commission Decision in Case N160/2010, *Capital support measures in relation to EBS*, OJ C 217, 11.08.2010, p. 2.

[8] OJ C 300, 6.11.2010, p.17-36.

[9] OJ C195, 19.8.2009, p. 9.

1.3 Joint Procedure

(7) In addition to the results of the PCAR/PLAR exercise (see (25) and (30) below), the Irish Finance Minister announced on 31 March 2011 that the Irish banking system was to be reorganised around 2 pillar banks, Bank of Ireland and Allied Irish Bank plc. He also announced that in that context EBS would be merged into AIB to constitute this second pillar institution.

(8) On 5 July 2011, Ireland notified to the Commission a combined rescue package for the merged AIB/EBS ("AIB/EBS") entity of up to EUR 13.1 billion.

2 DESCRIPTION OF THE MEASURE

2.1 The beneficiaries

2.1.1 Allied Irish Banks plc

(9) A detailed description of AIB is provided in Section 2.1 of the Commission decision concerning the first recapitalisation of the Bank of 12 May 2009[10]. A short summary and update is provided below.

(10) AIB is with Bank of Ireland one of the two largest banks in Ireland. It is a diversified financial services group which offers a full range of personal and corporate banking services with an emphasis on the Irish retail banking market (in terms of market share in Ireland, it has approximately: […][*]% of personal current accounts, […]% of mortgages, […]% of savings and […]% of SME current accounts). As of 5 July 2011 [92.50% - 93.50%]% of AIB share capital is held by the Irish State.

(11) Following the completion of a far reaching divestment programme of its foreign subsidiaries, its operations are now concentrated in Ireland. In […] 2010, AIB initiated the sale process of its UK business, but as it proved more challenging than expected, AIB opted to halt the process altogether and to perform a strategic review of its UK operations instead. As of today, AIB remains active in the UK.

(12) According to its annual report for the year ended 31 December 2010, AIB had total assets of EUR 145.2 billion and total liabilities of approximately EUR […] billion, which included inter alia customer deposits (EUR 52.4 billion), deposits by central banks and banks (EUR 49.9 billion) and debt securities in issue (EUR 15.6 billion). As of the same date, AIB's total gross loan book was approximately EUR 96 billion. The loan to deposit ratio was 165%.

(13) AIB, like the main other Irish banks, was very exposed to its home market and in particular to the property market. From 2002 to 2008, AIB's exposure to the property market grew rapidly fuelled by the Bank's easy access to wholesale funding. This left the Bank in a very vulnerable position when the global financial crisis hit and the Irish real estate bubble burst.

(14) The subsequent material deterioration in the financial position of AIB led it to participate in all the sector-wide support measures put in place by the Irish State in

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[10] Commission Decision in Case N 241/2009, *Capital injection into Allied Irish Bank,*

[*] Confidential information

order to safeguard the stability of the financial system in the State. As of 5 July 2011, AIB had participated in the following sector wide State support measures:

(i) The Credit Institutions Financial support Scheme (CIFS) from 24 October 2008 to 29 September 2010[11];

(ii) The Eligible Liabilities Guarantee Scheme (ELG) from 21st January 2010[12];

(iii) An asset relief measure consisting of the transfer of commercial property and development loans to the National Asset Management Agency ("NAMA") from 12 February 2010[13]. As of July 2011, EUR 19.63 Billion of assets have been transferred to NAMA at an average discount of 55% (consideration paid of EUR 8.9 Billion). Of the total amount earmarked to be transferred to NAMA, only EUR 1.2 billion is still to be transferred,[…].

(15) In addition to the above, on 11 February 2009, the Government announced the decision to inject EUR 3.5 billion into AIB in the form of preference shares (the 2009 Preference Shares). The 2009 Preference Shares are Core Tier 1 non-cumulative perpetual preference shares in the Bank with a fixed annual dividend of 8% (or the right to shares in lieu) and with detachable warrants to acquire further ordinary shares in AIB (the “Warrants”). The 2009 State Investment was approved by the Commission under EU State aid rules on 12 May 2009[14].

(16) Following the results of first PCAR exercise announced on 31 March 2010, a greater than expected discount on the assets transferred to NAMA and the increased minimum regulatory capital requirement in the context of the Banking Sector part of the Programme for Support for Ireland, the Irish government injected EUR 3.7 billion in ordinary shares and converted the EUR 3.5 billion of Preference Shares at the end of December 2010 (see (3) above).

2.1.2 Educational Building Society

(17) EBS is Ireland's largest building society and prior to the crisis was the eighth largest institution operating in Ireland. Building societies are mutual organisations which have no shareholders but instead are owned by their members, who are also their clients. Their objective is to collect deposits and provide loans. Profits are used to adapt interest rates to the advantage of the members, or are accumulated as reserves.

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11 See Commission Decision in Case NN48/2008, Guarantee Scheme for Banks in Ireland, OJ C 312, 06.12.2008, p. 2.

12 See Commission Decision in Case N349/2009, Credit Institutions Eligible Liability Guarantee Scheme, OJ C 72, 20.3.2010, p. 6, subsequently prolonged until 30.6.2010 through the Commission's Decision in Case N198/2010, Prolongation of the Eligible Liabilities Guarantee Scheme, OJ C 191, 15.7.2010, p. 1 and again extended until 31.12.2010 through the Commission Decision in Case N254/2010, Second Prolongation of the Eligible Liabilities Guarantee Scheme, OJ C 238, 03.09.2010, p. 2.

13 Commission Decision in Case N 725/2009, *Irish asset relief – NAMA*, OJ C 94, 14.4.2010, p. 10.

14 See Commission Decision in Case N241/2009, *Capital injection into Allied Irish Bank*, OJ C 223, 16.09.2009, p. 2.

(18) EBS offers traditional retail banking products to its members (savings and mortgages) in line with its goal as a building society. It also has a treasury department offering boutique services to corporate clients, professional firms and credit unions. From 2005, it expanded its activities in commercial property lending.

(19) EBS is active in Ireland, where it has a branch network of 14 branch offices, 42 tied branch agents and 43 branch agents who also offer the products of EBS' competitors.

(20) According to its annual report for the year ended 31 December 2010, EBS had total assets of EUR 20.0 billion and total deposits of approximately EUR 18.8 billion, which consisted of customer deposits (EUR 9.4 billion), deposits by banks (EUR 5.8 billion) and debt securities in issue (EUR 3.6 billion). As of the same date, EBS' total loan book was approximately EUR 16 billion. The loan to deposit ratio was 175%. EBS' loan book consists of: residential lending, buy to let, commercial lending, land and development and associated loans.

(21) In 2010, the deterioration of the institution's financial position became apparent after an in-depth assessment of its loan book. In particular, although EBS has a relatively limited exposure to land and property development loans compared to other financial institutions, due to the fact that it only accelerated its activity in that segment from 2005, it has had to take large impairments on this loan book due to the deep crisis in the sector and excessive risk taking. Further, like all Irish domestic credit institutions EBS' access to funding gradually deteriorated and ultimately reached a complete shut down.

(22) These difficulties led EBS to participate in the following system wide support measures put in place by the Irish State:

(i) The Credit Institutions Financial support Scheme (CIFS) from 24 October 2008 to 29 September 2010[15];

(ii) The Eligible Liabilities Guarantee Scheme (ELG) from […] February 2010[16];

(iii) An asset relief measure consisting of the transfer of commercial property and development loans to the National Asset Management Agency ("NAMA") from 12 February 2010[17]. As of July 2011, EUR 0.83 billion of assets have been transferred to NAMA at an average discount of 60% (consideration paid of EUR 0.3 billion).

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15 See Commission Decision in Case NN48/2008, Guarantee Scheme for Banks in Ireland, OJ C 312, 06.12.2008, p. 2.

16 See Commission Decision in Case N349/2009, Credit Institutions Eligible Liability Guarantee Scheme, OJ C 72, 20.3.2010, p. 6, subsequently prolonged until 30.6.2010 through the Commission's Decision in Case N198/2010, Prolongation of the Eligible Liabilities Guarantee Scheme, OJ C 191, 15.7.2010, p. 1 and again extended until 31.12.2010 through the Commission Decision in Case N254/2010, Second Prolongation of the Eligible Liabilities Guarantee Scheme, OJ C 238, 03.09.2010, p. 2.

17 Commission Decision in Case N 725/2009, *Irish asset relief – NAMA*, OJ C 94, 14.4.2010, p. 10.

(23) In addition to the above system-wide measures, EBS benefitted from a capital injection of EUR 875 million, split between a EUR 100 million capital injection through the issuance of Special Investment Shares (SIS) and a further capital injection of up to EUR 775.[18] Through the issuance of the Special Investment Shares the State took control of the EBS and as a result EBS was effectively nationalized by the Irish authorities.

(24) Following a decision by the Minister, a comprehensive process to identify third party interest in an acquisition of EBS was commenced on […] 2010. A preferred bidder was appointed in February 2011 but subject to further extensive clarifications on the proposed bid. Following further analysis of the offer, the Minister ultimately decided to terminate the sales process on 30 March 2011.

2.2 The events triggering the merger of AIB and EBS and the proposed measure

The Financial Measures Programme Report

(25) On 28 November 2010, the Irish Government announced that the Programme had been agreed with the Commission and the IMF, in liaison with the ECB. Included in the Banking Sector part of the Programme was the requirement to undertake for four Irish domestic institutions[19] a second extensive and comprehensive forward looking prudential capital assessment (PCAR) as well as a prudential liquidity assessment (PLAR).

(26) The PCAR exercise was undertaken to determine the recapitalisation requirements of the participating credit institutions if they were to meet regulatory capital needs in both a base case and a stress case scenario for the period 2011 to 2013. The base case and the stress case capital targets were respectively 10.50% and 6.0% core tier 1 capital ratio. For this exercise, the Irish Central Bank relied on an extensive loan loss analysis of the banks' loan book performed by external experts. Two buffers were imposed by the Central Bank on top the capital needs determined through the exercise, a regulatory capital buffer in the form of equity and one in the form of contingent capital, expected to cover any unexpected losses beyond those determined by the stress test exercise.

(27) The PLAR exercise was aimed at determining the capital needs that will arise for the same four banks as they embark on a deleveraging path in order to meet a range of target funding ratios. The main target funding ratio is a 122.5% loan to deposit ratio to be reached by the banks by 2013 and which is a requirement under the Irish Programme for Support. For the PLAR exercise, the Irish Central Bank also relied on input from external advisers.

(28) The results of the combined PCAR/ PLAR (including the regulatory buffers) were announced on 31 March 2011 through the publication of the Financial Measures Programme Report (the FMPR). For the Irish banking system as a whole, the outcome was a capital increase of EUR 24 billion, of which EUR 3.0 billion will be injected in the form of contingent capital, the remainder being in the form of common equity. Out of the 24 billion, EUR 13.3 billion were identified for AIB (broken down as EUR 11.9 billion in common equity and EUR 1.4 billion in contingent capital) and EUR 1.5 billion for EBS (broken down as EUR 1.3 billion in common equity and EUR 0.2

[18] The actual capital injection was split into SIS for a nominal amount of EUR 625 million and EUR 250 million in promissory note format.

[19] AIB, EBS, IL&P and BoI.

billion in contingent capital). For the combined entity, the recapitalisation needs following the PCAR / PLAR exercises are EUR 13.2 billion in common equity and EUR 1.6 billion in contingent capital. The EUR 13.2 billion includes a regulatory capital buffer in the form of equity imposed by the Central Bank of EUR 1.4 billion.

(29) Under the terms of the Programme, the participating credit institutions have to prepare recapitalisation plans to comply with the additional capital specified by the PCAR/PLAR and the required amount of capital has to be in place by the end of July 2011.

(30) On 31 March 2011, the Irish Finance Minister also announced the restructuring of the whole Irish banking sector organised around two universal full-service banks as its core pillars. He announced that Bank of Ireland will be the first pillar bank and that AIB and EBS would be combined to form the second pillar bank.

(31) On 26 May 2011, the Minister, AIB and EBS signed an acquisition agreement providing for the acquisition by AIB of EBS (following its conversion into a private company and receipt of all requisite regulatory approvals). Under the terms of this agreement, EBS will be a fully owned subsidiary and will benefit from the full support of AIB while continuing to operate under the EBS brand. The merger of the two entities will involve the demutualisation of EBS and its conversion into a fully licensed bank, followed by the acquisition by AIB of its share capital for a nominal consideration. Following merger control clearance on 27 June 2011, the merger was completed on 1 July 2011.

The AIB and EBS Liability Management Exercises (LMEs)

(32) On 31 March 2011, the Irish Finance minister also announced that subordinated debt holders would be required to contribute to the recapitalisation of the banks involved in the PCAR/PLAR. As a result, in May 2011, AIB and EBS launched liability management exercises on all their remaining outstanding subordinated liabilities. On 14 June 2011, AIB announced preliminary results of its offers dated 13 May 2011 to purchase for cash certain of its tier 1 and tier 2 Capital instruments. The core tier 1 capital accretion for AIB arising from the 13 May 2011 LME to date is approximately EUR 1.6 billion. A further core tier 1 capital accretion may arise once the final results are known, which is expected to occur in July 2011.

(33) On 31 May 2011, EBS launched a LME comprising the purchase of certain of its subordinated floating rate notes and the modification of the terms and conditions of those subordinated notes. On 31 May 2011, EBS also announced that it had received a written direction[20] from the Minister to modify the terms of two other series of subordinated notes to allow for their early redemption. The core tier 1 capital accretion for EBS to arise from both the LME and the redemption of the further two series of notes (the "LMEs") is expected to be approximately EUR 0.1 billion and will be used to partly meet the combined AIB/EBS PCAR requirements.

[20] This right exists under the Credit Institutions Stabilisation Bill 2010. This Bill puts in place a special resolution regime aimed at providing the State with the proper powers and legislative tools necessary to complete the recapitalisation and restructuring measures spelled out in the Banking System Programme

2.3 The measure

(34) The notified measure ("'the Recapitalisation Measure") concerns: (i) the placing to the National Pensions Reserve Fund Commission (NPRFC) of ordinary shares of AIB/EBS for an amount of EUR 5 billion (the Placing), (ii) a capital contribution by the Irish Finance Minister in cash for an amount of up to EUR 6.5 billion (the Capital Contribution) and (iii) an issue by AIB/EBS to the state of EUR 1.6 billion of contingent capital notes (the Contingent Capital Contribution). The measure aims at meeting the recapitalisation needs identified by the PCAR/PLAR exercise (EUR 13.2 billion in common equity and EUR 1.6 billion in contingent capital).

Table 1 – Recapitalisation of AIB/EBS

Placing	EUR 5 bn
Capital contribution (may be reduced by end July 2011)	EUR 6.5 bn
Contingent Capital Contribution	EUR 1.6 bn
STATE CONTRIBUTION	**EUR 13.1 bn**
Capital accretion AIB LME	EUR 1.6 bn
Capital accretion EBS LME	EUR 0.1 bn
LME contribution (can increase by end July 2011)	**EUR 1.7 bn**
Total Capital raising	**EUR 14.8 bn**

Source: AIB & EBS notification

The Placing

(35) Under a placing agreement, the Irish state will purchase ordinary shares of AIB/EBS for an amount of EUR 5 billion. The State investment will be financed by the assets of the NPRFC. The subscription price will be EUR 0.01 per ordinary share. This will result in the NPRFC's ordinary shareholding in AIB/EBS increasing to 99.8%[21].

The Capital Contribution

(36) The intended investment by the Minister under the Capital Contribution will be made prior to the end of July 2011 once the Placing and the LMEs have been completed. The Capital Contribution will be financed in cash by the Exchequer, the NPRF or a combination of the two. Such amount will be credited to the bank's reserves.

(37) The Capital Contribution will be the difference between the total recapitalisation needs in common equity of EUR 13.2 billion less the amount of the Placing and less the amount of core tier 1 capital accretion achieved through the LMEs. As noted above, the core tier 1 capital accretion through LMEs to date is approximately EUR 1.6 billion for AIB/EBS and EUR 0.1 billion for EBS. The maximum amount of the capital contribution is therefore EUR 6.5 billion, however it may be reduced further once the LMEs have been completed.

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[21] The NPRFC also financed AIB previous recapitalisations and is the holder of the shares issued in that context.

The Contingent Capital Contribution.

(38) The Contingent Capital Contribution will be in the form of contingent capital notes (the "Contingent Capital Notes"). It will be financed by the Exchequer, the NPRF or some combination of the two. The Contingent Capital Notes will be subordinated tier 2 debt instruments with a five year and one day maturity, and a cumulative value of EUR 1.6 billion. They will convert immediately and mandatorily in their entirety into ordinary shares in the event that a capital deficiency[22] or a non viability event[23] occurs.

(39) Following a conversion event, the Contingent Capital Notes will be immediately converted into a fixed number of ordinary shares determined by dividing the principal amount of each Contingent Capital Note by the conversion price of EUR 0.01 per ordinary share. Ordinary shares issued pursuant to the conversion of the Contingent Capital Notes will be issued directly to the holder of the Contingent Capital Notes and shareholders will not have pre-emption rights or the opportunity to subscribe for any such issue of ordinary shares.

(40) The Contingent Capital Notes carry a fixed mandatory interest rate of 10% of the issue price per annum, payable annually. The Minister may, where he remains the holder of 100% of the contingent capital notes, in order to facilitate the sale of the Contingent Capital Notes to third party investors increase the interest rate to a new level determined by an independent remarketing agent nominated by the Minister, not exceeding 18% per annum. In addition, AIB/EBS shall provide, at the request of the Minister, sufficient disclosure to allow for the Contingent Capital Notes to be listed and to be sold to third party investors. AIB/EBS will have the option prior to any such sale of the contingent capital notes being completed and settled to source third party investors at a potentially lower interest rate, but only if it has sourced sufficient investors to purchase an amount equal to the principal amount paid by the Minister for the contingent capital notes on overall better terms. The Minister shall have discretion as to whether to sell to such investors. It is expected that AIB/EBS will seek to obtain a listing for the contingent capital notes […].

(41) The Contingent Capital Notes will rank junior to unsubordinated obligations of AIB/EBS and *pari passu* with all other dated subordinated obligations of AIB/EBS which qualify as Tier 2 Capital for regulatory purposes (if any).

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[22] A capital deficiency event will occur where AIB/EBS's adjusted core tier 1 capital ratio falls below 8.25% or, following the implementation of the Capital Requirements Directive IV (OJ l 329 14/12/2010) in Ireland, AIB/EBS's common equity tier 1 ratio falls below 8.25% or, if the Central Bank, in its sole discretion, notifies AIB/EBS that it has determined that the AIB/EBS Group's financial and solvency condition is deteriorating in such a way that a fall below the ratios described above is likely to occur in the short term. No conversion will occur following one of the events above if, notwithstanding AIB/EBS's capital ratio being below 8.25%, the Central Bank, at the request of AIB/EBS, has agreed, in its absolute discretion, that a conversion will not occur because it is satisfied that actions, circumstances or events have had, or imminently will have during the following 90 days, the effect of restoring AIB/EBS's capital ratio to a level above 8.25% that the Central Bank deems to be adequate at such time.

[23] A non-viability event shall be deemed to occur at the earliest of the following events: (i) If the Central Bank in its sole discretion determines that a conversion of the Contingent Capital Notes (together with the conversion or write off of holders' claims in respect of any Tier 1 Securities or Tier 2 Securities of AIB/EBS that, pursuant to their terms or by operation of laws, are capable of being converted into equity or written off at that time) is required in order to prevent AIB/EBS from […] failing to meet its minimum capital adequacy requirements; or, (ii) AIB/EBS has received an irrevocable commitment of extraordinary support from the public sector (beyond customary transactions and arrangements in the ordinary course) that has, or imminently will have, the effect of improving AIB/EBS's capital adequacy and, without which, […] failed to meet its minimum capital adequacy requirements.

(42) No fees will be charged in respect of the Placing, the Capital Contribution or the Contingent Capital Contribution (other than the coupon). However, AIB/EBS has agreed to pay the costs and expenses (including the costs and expenses of their legal financial or other professional advisers if any) of each of the Minister, the NPRFC and the NTMA, as well as any stamp taxes incurred in connection with the Recapitalisation Measure. AIB/EBS will also pay the debt and expenses associated with the listing of the Contingent Capital Notes should that occur.

(43) Similar to the 2010 Recapitalisation Measures, 2009 State Investment and ELG Scheme, AIB/EBS will be subject to behavioural conditions under the terms and conditions of the Recapitalisation Measures[24].

3 POSTION OF IRELAND

(44) Ireland accepts that the measure constitutes State aid. It is of the view that the measure is compatible with the internal market on the basis of Article 107(3)(b) of the Treaty on the Functioning of the European Union (hereinafter "TFEU") as it is necessary to remedy a serious disturbance in the Irish economy. In particular Ireland submits that the measure is (i) appropriate and well targeted; (ii) necessary and limited to the minimum amount necessary; and (iii) proportionate as designed to minimize negative spill-over effects on competitors.

(45) *Appropriate and well-targeted*. Ireland submits that AIB/EBS is systemically important for the maintenance of stability of the financial system in Ireland. It is one of the two largest banks in the State, with 182 main branches, 86 outlets and 14 business centres in Ireland and approximately 14 255 staff worldwide. It has a balance sheet size in excess of EUR 145 billion and accounts for a significant share of customer deposits and lending in the Irish economy.

(46) Further, Ireland stresses that the purpose of the Recapitalisation Measures is to ensure compliance by AIB/EBS with the regulatory capital requirements set by the Central Bank under the FMPR. The Placing and the Capital Contribution will involve the injection of equity capital into AIB, which is the most efficient and straight forward method to shore up a bank's capital. The purpose of the Contingent Capital Contribution is to provide an additional capital buffer to protect against the emergence of unexpected large losses after the PCAR 2011 period, i.e. after 2013. The Contingent Capital Notes will only convert into ordinary shares in the event that a capital deficiency or a non-viability event occurs, as set out in (38) above.

(47) For these reasons, Ireland submits that the Recapitalisation Measures are appropriate and well-targeted to their objectives.

(48) *Necessary and limited to the minimum amount*. Ireland submits that the Recapitalisation Measures are limited in size to what is necessary to ensure compliance by AIB/EBS with the Central Bank's new target capital ratios under the PCAR/PLAR

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24 They include in particular measures related to the payment of bonuses and to promote the availability of credit, the restructuring plan for AIB/EBS, the payment of dividends and reserves, corporate governance, remuneration/fees, consultation on matters of public interest, the use of proceeds of the State investment under the Recapitalisation Measures, references to the State investment under the Recapitalisation Measures for promotional purposes; and material acquisitions, disposals, investments, realisations, reorganisations, restructurings or other material transactions, other than in the ordinary course of the Bank's banking business.

of a minimum capital target of 10.5% Core Tier 1 in the base scenario and 6% Core Tier 1 in the stress scenario, plus allowing for additional protective buffers both in equity and contingent capital forms.

(49) Further, Ireland points out that any capital generated by the Bank under the LME measures being undertaken will reduce the level of capital to be invested by the State under the Recapitalisation Measures. The subscription price for the Placing will be EUR 0.01 per ordinary share, which represents a discount of circa 95% on the official closing price of an AIB/EBS ordinary share on the Enterprise Securities Market of the ISE on 31 March 2011, when the Central Bank announced the Bank's additional capital requirements under the PCAR/PLAR. Ireland states that this subscription price will result in the NPRFC’s ordinary shareholding in AIB/EBS increasing to 99.8%, which will ensure a very significant level of dilution of existing shareholders.

(50) As for the remuneration, Ireland submits that the Contingent Capital Notes carry a fixed mandatory interest rate of 10% of the issue price per annum, payable annually. Ireland also presents that, although there are no associated fees payable by AIB/EBS in respect of the Recapitalisation Measures (other than the coupon on the Continent Capital Notes), AIB/EBS will be required to pay the costs and expenses of each of the Minister, the NPRFC and the NTMA as well as an amount equal to any stamp duty taxes incurred in connection with the Recapitalisation Measures. The Governor issued a letter regarding the necessity of the Recapitalisation Measures to safeguard the financial stability of the Bank on 29 June 2011.

(51) Ireland concludes that the Recapitalisation Measures are limited in amount and form to achieve their objectives.

(52) *Proportionate*. Ireland submits that the behavioural constraints imposed by the terms and conditions of the Recapitalisation Measures, together with the commitments made by the Bank under previous State aid schemes, contain an extensive range of safeguards against possible abuses and distortions of competition.

(53) Furthermore, a restructuring plan in respect of AIB was submitted to the Commission under EU State aid rules on 13 November 2009. AIB subsequently adjusted the content of its restructuring plan to reflect the new capital requirements announced by the Financial Regulator under the PCAR in March 2010 and a revised version of the restructuring plan was submitted to the Commission in May 2010 in that context. The Irish authorities commit that a further revised restructuring plan, which will take into account the implemented elements of the 2010 Recapitalisation Measures and the Recapitalisation Measures that are assessed in this decision, and include an update on the financial position of the Bank, will be submitted to the Commission by the end of July 2011[25].

4 ASSESSMENT

4.1 Existence of State aid

(54) The Commission first has to assess whether the measure constitutes State aid within the meaning of Article 107(1) TFEU. According to this provision, 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. In this context, it can be observed that Ireland does not dispute that the measure constitutes State aid.

[25] The submission of a revised restructuring plan is an obligation under the terms of the Banking Sector Programme of the Irish Programme for support.

(55) In this case State resources are involved as the measure is entirely financed by the State.

(56) The Commission also has to assess whether the measure confers a selective advantage on the beneficiary of the aid. The measure is selective as it solely benefits AIB/EBS.

(57) The measure furthermore confers an advantage on AIB/EBS as it allows the entity to absorb the future expected and potentially "under stress" losses on all its loan assets as well as the losses to stem from the bank's deleveraging process. As such the measure will allow AIB/EBS […] to engage in a likely costly deleveraging process. Although several banks in Ireland and in the EU have benefited from State aid in the course of the ongoing financial crisis, most have received less support in proportion of their risk weighted assets. Of the remaining Irish domestic institutions in operation on the domestic market, the merged AIB/EBS entity will be the one which will have received the largest amount of State support (EUR 21.175 billion in recapitalisations only, excluding the aid contained in the ELG and in the NAMA schemes).

(58) The proposed recapitalisation would not have been provided by a market economy investor expecting a reasonable return on his investment. First of all, part of the remuneration is in the form of a capital contribution meaning that the State injects funds into the Bank's reserves without any expected remuneration. Secondly, the ordinary shares that the State will receive through the Placing do not carry any fixed remuneration and the Irish authorities did not provide evidence that the State […].

(59) The measure is also able to affect trade between Member States as AIB/EBS is competing on, amongst others, the Irish retail savings markets, the Irish mortgage lending markets and the Irish and UK commercial lending markets. In the Irish market, some of AIB/EBS's competitors are subsidiaries of foreign banks, while in the UK market AIB/EBS competes with both UK-based banks and the subsidiaries of foreign banks active on the UK market.

Conclusion

(60) Due to the above considerations, it is found that the measure fulfils all conditions laid down in Article 107(1) TFEU and, therefore, those measures qualify as State aid to AIB/EBS.

4.2 Compatibility of the aid

(61) As regards compatibility of the aid provided to AIB/EBS with the internal market, the Commission first needs to determine whether the aid can be assessed under Article 107(3)(b) TFEU, i.e. whether the aid remedies a serious disturbance in the economy of Ireland. Subsequently, once the applicable legal basis has been determined, the Commission has to assess whether the measure at issue is compatible with the internal market.

4.2.1 Legal basis for the compatibility assessment

(62) Article 107(3)(b) TFEU provides for the possibility that aid falling within the scope of Article 107(1) TFEU can be regarded as compatible with the internal market where it "remedies a serious disturbance in the economy of a Member State".

(63) Market conditions deteriorated all over the world since the last quarter of 2008. Ireland in particular has been severely hit by the financial and economic crisis. The economic

downturn combined with the fall in property prices and the exposure of the Irish banks to land and property development loans have led to significant impairments for Irish banks. Irish banks have furthermore been faced with difficulties in obtaining funding and capital from the markets due to the uncertainty associated with the property market in Ireland, the future economic development and the pressure on the sovereign. The worsening of the situation has been such that Ireland requested on 28 November 2010 support from the Commission and the IMF in liaison with the ECB.

(64) Given the current state of distress of the Irish banking system and the dramatic impact, it has had on the overall economic situation of the country, the measure may be examined under Article 107(3)(b) TFEU.

4.2.2 Compatibility assessment

(65) In line with point 15 of the Banking Communication[26], in order for an aid or aid scheme to be compatible under Article 107(3)(b) TFEU it must comply with the general criteria for compatibility[27]:

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 were 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.

c. *Proportionality***:** The positive effects of the measure must be properly balanced against the distortions of competition, in order for the distortions to be limited to the minimum necessary to reach the measure's objectives.

(66) The Recapitalisation Communication[28] further elaborates on the three principles of the Banking Communication and states that recapitalisations can contribute to the restoration of financial stability. In particular the Recapitalisation Communication states that recapitalisations may be an appropriate response to the problems of financial institutions […].[29]

4.2.2.1 Compatibility with the Banking and Recapitalisation Communications

a. Appropriateness of the measure

(67) This recapitalisation measure for AIB/EBS directly results from the PCAR/PLAR. The FMPR details and implements the capital requirements imposed by the Irish financial regulator in line with the terms of the Programme. It will allow the Bank to comply with its new regulatory capital requirements and provide additional capital

[26] *The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis*, OJ C 270, 25.10.2008, p.8. as amended by Communication from the Commission on the application, after 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 329, 7.12.2010, p.7 ("the 2011 Communication").

[27] See paragraph 41 of Commission decision in Case NN 51/2008 *Guarantee scheme for banks in Denmark*, OJ C 273, 28.10.2008, p.2.

[28] Commission Communication Recapitalisation of financial institutions in the current financial crisis, OJ C 10, 15.1.2009, p.2 as amended by the 2011 Communication.

[29] Recapitalisation Communication, paragraph (6).

buffers in both an expected and a stress economic scenario. The injection of equity capital is the single most efficient and straight forward measure to shore up one bank's capital and the injection of contingent capital notes will also ensure that the additional capital will only be injected if a capital deficiency or a non viability event occurs.

(68) Stress test exercises similar to the PCAR are also performed at the European level in the form of the European Banking Authority ("EBA") stress tests which a number of European banks also have to perform and which may also result in increases in common equity capital. While the Irish PCAR exercise is distinct from the EBA stress test, it incorporates much of the methodology and parameters used by the EBA. The Irish exercise therefore is appropriate to keep Ireland in line with industry wide standards in Europe.

(69) AIB/EBS has been identified as the second pillar banking institution in Ireland around which the entire Irish banking sector will be rebuilt. A strong capitalisation of the bank is therefore necessary for it to be able to absorb expected and to some extent unexpected losses, engage in the necessary deleveraging process and convince private investors of its long term viability to restart the flow of private funding towards the Irish banking system. The amount of the recapitalisation proposed is the result of the PCAR/PLAR exercise which aimed at fulfilling the above objectives. For those reasons, the measure is appropriate.

b. Necessity – limitation of the aid to the minimum

(70) According to the Banking Communication, the aid measure must, in its amount and form, be necessary to achieve the objective. That implies that the capital injection must be of the minimum amount necessary to reach the objective. In this context, the amount of the measure directly stems from the PCAR/PLAR exercise and that as such it will ensure that AIB/EBS will fulfil the requirements of the Financial Regulator in line with the terms agreed by Ireland in the context of the Programme. It is true that the capital will be provided *ex ante* for the deleveraging plan to cover the losses that will be realised in the period until the end of 2013, thus AIB/EBS might temporarily have capital in excess of its immediate requirements. However, the amount of capital needed has been established in the context of the Programme in order to allow AIB/EBS to achieve the deleveraging target of 122.5% loan-to-deposit ratio as required under the Programme. Therefore it is ensured that the aid may be used only for the sake of achieving this target and cannot be used for activities outside the deleveraging plan. The proposed amount of recapitalisation is then limited to the minimum necessary to meet such requirements.

(71) Further, the amount of the recapitalisation is the net amount of necessary equity capital once all LMEs have been completed. The LMEs concern all remaining outstanding subordinated debt liabilities of AIB and EBS. This means that the maximum capital contribution will have been extracted from subordinated debt holders.

(72) The terms of the Programme for Support also include the principle of a claw back mechanism to return any excess capital once all the targets of the Programme have been reached. The injection of recapitalisation in the form of a capital contribution will make the extraction and redistribution to the State of such excess of capital an easier process and therefore ensure that the aid is strictly limited to the minimum necessary.

(73) The purchase price per ordinary share is equal to EUR 1 cent, thus maximising the dilution of existing private shareholders. The Commission observes that the level of dilution obtained with such price per share is very significant as current shareholders will be diluted to 0.2%.

(74) Further, the terms of the Contingent Capital Notes provide that they will only be converted into ordinary shares if the core tier 1 capital ratio of the Bank falls below 8.25% which is below the current minimum regulatory capital requirement of 10.50% common equity[30]. Therefore, the conversion into equity will only occur if the Bank is in clear financial distress. Further, if the Contingent Capital Notes have not been converted by their 5th anniversary they will mature and be repaid to the State, ensuring therefore that the aid they represent is also repaid. Finally, the terms of the Contingent Capital Notes also allow for a mandatory re-pricing and an increase in the interest rate[31] they carry, to facilitate their sale at no or limited loss (and therefore the repayment of the aid) to a third party prior to their maturity date.

(75) In conclusion, the measure is necessary in both its amount and form to achieve the objectives of limiting the disturbance in the Irish banking system and economy as a whole.

Remuneration of the aid

(76) The aid granted by the Irish authorities to AIB/EBS is in the form of the Placing of ordinary shares, a Capital Contribution and a Contingent Capital Contribution. The Capital Contribution is a payment to the reserves of the bank and as such will not carry any remuneration. […].

(77) Under the terms of the remuneration of the contingent capital instruments, the State will receive a mandatory remuneration of 10.0% per annum. However, the market for contingent capital instruments is in its infancy. The contingent capital instruments which have been issued to date have very few if any comparable features. Further, whilst the bank will pay some of the costs incurred by the State with the recapitalisation measures, the State will not receive any fees of any sort.

(78) Consequently, the Commission recognises that the remuneration of the proposed recapitalisation measure is low. Paragraphs 15 and 44 of the Recapitalisation Communication explain that lower remuneration in duly justified cases can be accepted in the short-term for distressed banks on the condition that the lower remuneration will be reflected in the restructuring plan. […] The Recapitalisation Measure is a crucial element in the complete overhaul of the entire Irish banking system. As the second pillar institution of this overhauled banking system, AIB/EBS will have to go through an equally far reaching and in-depth restructuring process. This restructuring process will be presented in the restructuring plan that AIB/EBS is required to submit by 31 July 2011 under the terms of the Programme for Support. Consequently it is justified that a very low remuneration is paid for the measure. That approach is in line also with the Commission's previous decisional practice[32].

c. Proportionality – measures limiting negative spill-over effects

(79) In spite of the relatively narrow margin of manoeuvre of the Irish authorities (dire situation of most of the other Irish credit institutions and of the sovereign itself), the transaction has several features that limit the negative spill-over effects:

[30] Among other triggers see footnotes 19 and 20 for full description of triggers.

[31] Up to a cap of 18.00% per annum.

[32] The same approach was taken in point 64 of Commission decision in Case N 356/2009, Recapitalisation of Anglo Irish bank, OJ C 235, 30.9.2009.

(80) *<u>Dilution</u>*: the transaction will dilute existing shareholders to 0.2%. This level of dilution is very material and the burden sharing with ordinary shareholders at close to maximum.

(81) *<u>Burden Sharing with Subordinated Bondholders</u>*: The LME process will have ensured that the maximum burden sharing has also been obtained from subordinated bondholders as the Bank will have performed LMEs on all its outstanding subordinated debt. Through the LME process, subordinated bondholders will have substantially contributed to raising capital for the bank.

(82) *<u>Restructuring Plan:</u>* AIB/EBS will provide an updated restructuring plan at the latest by 31 July 2011 which will reflect the massive State aid injected in the bank, and the lack of appropriate remuneration for this aid.

(83) *<u>Behavioural measures:</u>* AIB/EBS had already proposed a number of behavioural measures as a result of its participation in the Irish guarantee schemes and of the 2009 and 2010 Recapitalisations, to help tackle potential competition distortion effects. In light of the state of the Irish economy and banking system and of the systemic importance of AIB, the Commission is of the view that these measures are sufficient to address the distortion of competition caused by the aid during the rescue period. This is however without prejudice to additional measures to address distortion of competition that may be attached to the restructuring plan of the bank.

(84) The above elements are thus found to be sufficient to consider the measure as proportionate.

Conclusion

(85) The Commission thus concludes that the measure is: (i) appropriate; (ii) necessary; (iii) that the fact that the capital injection is unlikely to be adequately remunerated by AIB/EBS is justified under the circumstances; (iv) AIB/EBS is under the obligation to submit a revised restructuring plan; and (v) there are sufficient measures limiting the negative spill-over effects for other competitors. The Commission can therefore approve the measure as rescue aid.

4.2.2.3 Viability review and restructuring plan

(86) The 2011 Communication states in paragraph 14 that as of 1 January 2011 a restructuring plan will be required from every beneficiary of a new recapitalisation. The Banking System Programme part of the Programme for Support stipulates that the Irish authorities will submit a revised restructuring plan for AIB/EBS before the end of July 2011.

CONCLUSION

- The Recapitalisation Measures including a (i) a Placing of EUR 5 billion in ordinary shares, (ii) a Capital Contribution of up to EUR 6.5 billion and (iii) a Contingent Capital Contribution of EUR 1.6 billion by the State constitutes State aid pursuant to Article 107(1) TFEU.

- The rescue aid in favour of the merged Allied Irish Bank/Education Building Society entity fulfils the requirements of Article 107(3)(b) TFEU and is found to be temporarily compatible with the internal market for reasons of financial stability. The rescue aid in favour of the merged Allied Irish Bank/Education Building Society is accordingly approved for six months or, if Ireland submits a restructuring plan within the period prescribed in the next point, until the Commission has adopted a final decision on the restructuring plan of the bank.

- Ireland should submit a revised in-depth restructuring plan by 31 July 2011, which takes into account the further aid provided to the merged Allied Irish Bank/Education Building Society and the substantial size of the aid – in terms of % of RWA – granted to the bank.

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:

http://ec.europa.eu/eu_law/state_aids/state_aids_texts_en.htm

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

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Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President