EUROPEAN COMMISSION

Brussels, 26.6.2009
C(2009) 5185 final

Subject: State aid N356/2009 – Recapitalisation of Anglo-Irish Bank by the Irish State

Sir,

I. PROCEDURE

(1) On 29 May 2009, the Irish Government announced its intention to provide up to € 4 billion (the "measure at issue") of capital to Anglo Irish Bank Corporation Limited (hereinafter, also "the Bank" or "Anglo") under the Irish Government's bank recapitalisation programme (the "Recapitalisation Programme"), subject to State aid approval.

(2) Following a number of preliminary contacts, the Irish authorities formally notified to the Commission the measure at issue on 15 June 2009.

(3) Following the announcement of the proposed recapitalisation and its notification by the Irish authorities, the Commission received approximately 60 complaints from individuals on the proposed recapitalisation, which it forwarded to the Irish authorities for their response.

II DESCRIPTION OF THE MEASURE

1. The Beneficiary

(4) Anglo Irish Bank is one of the six core banks in Ireland. It has a balance sheet size of almost €90 billion (nearly 50% of Irish GDP) and accounts for a significant share of customer deposits and lending in the Irish economy.[1] The Bank lends to a wide range of customers, providing funds for investment and employment in such areas as retail,

[1] The total number of customers with loans in Anglo Irish Bank is approximately [...]*, of whom the Irish customers who owe money to the bank are approximately […]. The total number of retail depositors in Anglo Irish Bank is approximately 300,000, of whom 72,000 are Irish customers. The total number of corporate deposits held in Anglo Irish Bank is approximately 12,000, of whom approximately 3,500 are Irish customers.

* Confidential information also indicated below as […]

Mr Micheál MARTIN
Ministry of Foreign Affairs
St. Stephen's Green 80
Dublin 2
Ireland

office, leisure, health care, tourism and other services. It is also a significant lender to the construction and development sector, which forms a very important part of its balance sheet.

(5) The Bank came into State ownership on 21 January 2009 following the signing into law of the Anglo Irish Bank Corporation Act 2009.[2] Prior to suspension from listing on 16 January 2009, the Bank's shares were quoted on the Dublin and London stock exchanges. The Financial Regulator is the lead regulator. Anglo has locations in Ireland, the UK, the United States, Jersey and the Isle of Man. Anglo is a focused business bank with a private banking arm and provides business banking, treasury and wealth management services. It is not a universal bank and its stated approach is niche rather than having a broad market presence. In terms of its business model, Anglo can be categorised as a "monoline" bank specialising in commercial and real estate lending. Its 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.

(6) According to the Irish authorities, Anglo Irish Bank is of key importance to the maintenance of stability of the Irish financial system. In a letter dated 27 May, 2009, the Governor of the Central Bank of Ireland has confirmed the systemic importance of Anglo to maintaining the stability of the financial system in the State.

(7) According to the Bank's Interim Report for 6 months up to 31 March 2009 (hereinafter, the 'Interim Report'),[3] Anglo registered a balance-sheet total of € 88.5 billion and a loss of € 3,782 million. Lending (loans to customers and to banks) was € 72.3 billion and comprises approximately 82% of the Bank's total assets. These lending assets are split geographically as follows: € 43.3 billion (60%) in Ireland, € 18.7 billion (26%) in the UK and € 10.3 billion (14%) in the US. The divisional lending balance by sector comprises: € 54.6 billion in investment, business and other (76%), € 8.9 billion in commercial development (12%), € 8.8 billion in residential development (12%).

(8) Investment, business banking and other lending across the group totals € 54.6 billion and comprises investment property lending across all sectors including retail, office, leisure and industrial, together with business lending to the SME and corporate sector and lending for personal investment. Development lending totals €17.7 billion or 24% of the book, inclusive of €10.6 billion of land bank assets.

(9) The Interim Report shows that Anglo Irish Bank's capital position has continued to progressively deteriorate since nationalisation, as greater impairment provisions against capital are required to cover the losses that are being realised on the Bank's loan book.[4] In particular, the deterioration in the Bank's capital position has been

---

2 See Commission decision of 16 February 2009 in case N61/2009, 'Change of Ownership of Anglo Irish Bank', not yet published.

3 See the Interim Report 2009 (http://www.angloirishbank.com/Investors/Reports/Interim_Reports_2009/Interim_Report_2009.pdf).

4 The significant deterioration in economic and market conditions since September 2008 has adversely impacted the grading of the Bank's loan book across all sectors and locations with a significant increase in the amount of loans classified as impaired or past due but not impaired. Impaired loans have increased from € 0.9 billion as at September 2008 to € 10.7 billion as at 31 March 2009. By location Ireland accounts for € 8.6 billion (80%), UK € 1.8 billion (17%) and US € 0.3 billion (3%). Development exposure, both residential and commercial, represents half of the total

driven by an impairment provision of € 4.9 billion for the six months to end March, 2009. This deterioration can be seen in the table below which contains information on the Core Tier 1 capital and total capital of the Bank.[5]

	Regulatory Ratio	Sept 2008[6]	March 2009[7]	September 2009 (estimates)
Core Tier 1	4%	5.9%	1.4%	[…]
Total Capital	8%	12%	8.2%	[…]

(10) Funding markets have remained extremely challenging for the Bank throughout the period. The composition of the Bank's funding profile has deteriorated since September 2008 with a significant decline in balances from non-retail customers and market counterparts resulting in an increased reliance on funding support from central banks. Customer funding balances account for 43% of total funding at 31 March 2009, down from 58% at 30 September 2008. Market funding, including borrowing from central banks, accounts for 57% of total funding, up from 42% at 30 September 2008. Reliance on borrowings from central banks has increased significantly during the period from € 7.6 billion at 30 September 2008 to € 23.5 billion at 31 March 2009.

(11) Shareholder funds in the Bank were only € 99 million based on the Bank's accounts to 31 March, 2009. They have decreased from € 4.1 billion at 30 September 2008.

(12) The Bank's recent asset quality review […] concluded that impairment losses were likely to reach € 7.5 billion. As at 31 March 2009, total impairment provisions on the balance sheet amounted to € 4.9 billion. The review also estimated that in a range of further stress scenarios, additional impairment of between € 1.5 billion and € 3.5 billion could arise.

(13) Given the level of impairment realised by Anglo Irish Bank in recent months, the Bank's Interim Report shows that the Bank would have been in breach of a number of the capital adequacy requirements imposed by the Financial Regulator unless the Bank was granted derogations from the requirements.

2. The events triggering the Measure

(14) The decision by the Irish Government to make the State Investment was taken in consideration of the deterioration in the Bank's financial position which came to light in the context of the publication on 29 May 2009 of the Bank's Interim Report. In light

---

impaired loan balance with 30% of the total land and development portfolio impaired. The amount of loans classified as past due but not impaired has increased to € 12.9 billion from €1.6 billion in September 2008, reflecting the impact on business cash flows caused by the general economic downturn. Lower quality but not past due or impaired cases at 31 March 2009 totalled € 5.3 billion. They have increased from € 2.5 billion at 30 September 2008, affected by the same factors giving rise to the increase in impaired and past due loans.

5 The figures for September 2009 are estimates provided by the Bank and do not take the State Investment into account.

6 Source: Annual Report for the year ended 31st September, 2008.

7 Source: Interim Report

of the size and activities of the Bank in the Irish economy and its specialised lending in the property development and commercial property areas, these developments in the Bank's financial position are also regarded by the Irish authorities to create a significant risk of systemic disturbance to the financial system in Ireland. The measure at issue therefore aims to address the risk of systemic disturbance to the Irish economy.

(15) The extent of the problems in Anglo's financial position has resulted in the Bank's solvency ratio falling below the minimum regulatory standards applicable to it […], despite a number of measures envisaged for the Bank.

(16) 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 13 October, 2008.[8] The liabilities covered under the Guarantee Scheme were those liabilities existing at close of business on 29 September, 2008 or at any time thereafter, up to and including 29 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. Despite its coverage under the Guarantee Scheme, the impact of the global financial crisis on the Bank as well as difficulties that arose with regard to its corporate governance, led the Irish Government to announce on 21 December, 2008, its intention to make a capital injection of €1.5 billion into Anglo. The Commission issued State aid approval for the proposed recapitalisation on 14 January, 2009.[9]

(17) However, on 15 January, 2009, the Irish Government announced its decision to take Anglo into public ownership. The change of ownership occurred on 21 January, 2009 pursuant to the Anglo Irish Bank Act. The decision to nationalise the Bank was taken in circumstances where the Bank's funding position, notwithstanding the recapitalisation announcement of 21 December, 2008, had weakened while recent corporate governance developments at the Bank had caused serious reputational damage to it at a time when overall market sentiment towards it was highly negative. The objective of the change of ownership was, therefore, to stabilise the Bank's financial position. On 16 February, 2009, the Commission concluded that the change of ownership of Anglo as such did not involve State aid to the bank.[10] Following the nationalisation, the Government did not proceed with the proposed capital injection of €1.5 billion.

(18) However, the liquidity position of the Bank has continued to deteriorate even after the change of ownership. For the period from 16 January, 2009 to 20 May, 2009, the Bank has seen an outflow of […], mainly from corporate/non-retail funding.

---

8 See Commission decision of 13 October 2008 in Case NN48/2008 'Guarantee Scheme for Banks in Ireland'.

9 See Commission decision of 14 January 2009 in case N9/2009, 'Recapitalisation of Anglo Irish Bank by the Irish State', not yet published.

10 See Commission decision of 16 February 2009 in case N61/2009, 'Change of Ownership of Anglo Irish Bank', not yet published.

(19) In light of this liquidity gap, the Irish Central Bank has provided […] to the Bank. As of 20 May, 2009, the funds provided […] amounted to […]. This is additional to […] funding Anglo is currently receiving based on liquidity arrangements with the ECB. […].

3. The decision to intervene

(20) In view of the outcome of the Interim Report concerning the great impairment provisions, which in the Irish authorities' view could undermine market confidence in the Irish financial sector as a whole and impact negatively on the funding position of other institutions in Ireland, the deterioration of the Bank's capital position as well as the fragile liquidity situation of the Bank which pose a threat to the stability of the Irish financial system, the Irish authorities, following consultations with their financial advisers, the Central Bank and the Financial Regulator, project that the Bank will require a capital injection of […] € 4 billion in order to ensure that the Bank continues to operate above the minimum capital adequacy ratio of 8%.

(21) On the basis of the proposed capital injection, the Financial Regulator agreed on 28 May 2009 to grant temporary derogations in respect of certain capital adequacy requirements. The derogations are granted until 31 July, 2009 or such shorter period if the Bank's capital ratios are restored to a level adequate to enable it to comply with its existing capital ratio requirements prior to the granting of the derogations. The derogations relate to the following:

(i) reduction in the minimum total capital ratio from 9.5% to 8%;
(ii) removal of the limit that total Tier 1 capital must comprise at a minimum 51% of core Tier 1 capital;
(iii) removal of the limit that Tier 2 capital cannot exceed total Tier 1 capital;
(iv) removal of the limit on Core Tier 1 capital to 4%;
(v) removal of the Financial Regulator's limit on Tier 1 capital of 4.75%;
(vi) amendment of the requirements in relation to the risk weighting applied to speculative commercial real estate so that the applicable risk weighting is 100%.

(22) In these circumstances, the Irish authorities consider the proposed State investment as a matter of absolute urgency in order to preserve the financial stability of Anglo Irish Bank, to safeguard the Irish financial system and to remedy a serious disturbance in the Irish economy caused by the impact of the ongoing global financial crisis on the financial position of the Bank.

4. The Measure

(23) The Measure at issue is a € 4 billion capital injection into Anglo in the form of ordinary shares. The State Investment will boost Anglo Irish Bank's Core Tier 1 capital ratio from 1.4%[11] to 5.9%[12] and its total capital from 8.2%[13] to 12.4%[14]. The capital injection amounts to around 5% of the Bank's Risk Weighted Assets ('RWA').

---

[11] Source: Interim Report. Basis:
Current CT1: €1,089m
Current RWA: €80,175m
==> Current CT1 ratio of 1.4%

(24) The State Investment will be in the form of ordinary shares of € 0.16 nominal value each which will be acquired by the Minister. The Financial Regulator has confirmed that the Ordinary Shares will be treated as Core Tier 1 Capital for regulatory capital purposes.

(25) The proposed capital injection will be in the form of ordinary shares in order to preserve an adequate level of Core Tier 1 Capital even after further impairment. Since the Bank has been in 100% State ownership since 21 January, 2009, the Minister will not acquire any additional voting rights or other rights as a result of this acquisition of Ordinary Shares over and above the rights already acquired by the Minister under the Anglo Irish Bank Act. The ordinary shares will rank pari passu with existing ordinary shares held by the Minister.

(26) The Bank will continue to be subject to the behavioural conditions imposed under paragraphs 24 to 50 of the CIFS Guarantee Scheme.

Liability Management Exercise

(27) Anglo Irish Bank is in a position to generate further capital of its own by engaging in a liability management exercise under which the Bank would buy back subordinated loans issued in previous years by it (the "Liability Management Exercise"). This exercise will crystallise losses, relative to the par value of the debt concerned, in the hands of the bondholders, while generating a profit and additional Core Tier 1 for the Bank. According to the Irish authorities, there is currently €4.3 billion outstanding debt trading at between 12 cent and 55 cent for each euro issued.

(28) The Irish authorities, following consultation with their financial advisers, project that, of the €4 billion, Anglo Irish Bank requires approximately €1 billion of capital for the abovementioned Exercise. It is estimated that this would increase the Bank's Core Tier 1 capital by approximately […], which would be available to set off against future losses, if required. Therefore, Anglo will use € 1 billion out of the € 4 billion injected by the State in order to buy back instruments (Tier 1, Upper Tier 2, Lower Tier 2 instruments) issued in previous years. Since the current market price of these outstanding instruments is lower than the price at which they were previously issued, the Bank will make a profit by buying back these instruments at a reduced price. The Bank will be able to record the difference between the two prices as profit, thus increasing the Bank's Core Tier 1 capital and decreasing the debt.

(29) The financial advisers to the Irish authorities estimate that if the Bank was to offer the current market price or slightly above the current market price for that debt, approximately […] of the current holders of the debt would take up the offer.

(30) The Irish authorities plan to carry out the Liability Management Exercise as soon as the State Investment is made. The pricing for this exercise will be set in a way to

---

[12] Based on latest available end-April position.

[13] Source: Interim Report. Basis:
Current total capital: €6,577m
Current RWA: €80,175m
==> Current total capital ratio of 8.2%

[14] Based on latest available end-April position.

maximise the increase in Core Tier 1 capital and to minimise any premium to bondholders. The exercise is designed to ensure that the offer price will refer to the historic trend pricing for the bonds and not take into account more recent uplifts in price thereby minimising any gain to bondholders while maximising the Core Tier 1 of the Bank.

(31) With regard to the pricing of the Bank bonds, this can vary substantially between market participants. Therefore, the Bank will, in consultation with its investment bank advisers, determine a consensus price for each security based on each individual investment bank's own quoted levels and the index quote where applicable. This price will be confirmed and agreed with the Department whose advisers will carry out a parallel exercise.

(32) The premium added to the market price in order to incentivise the holders of these instruments to sell them is calculated balancing market precedents (including premiums paid by, inter alia, Allied Irish Banks and Bank of Ireland in recent similar exercises), the minimum acceptable price at which investors will participate (i.e. the maximum loss they are able to crystallise) and the price required to encourage participation so as to optimise core capital generated through the exercise. Where bonds have been subject to market speculation, there will be a downward adjustment to the premium.

(33) Based on experience, and the estimates carried out by the Department's advisers, the premium should not be higher than […] on the market price of the bonds immediately pre-announcement of the exercise. The premium is at the lower end of the recent benchmark issues in the market. The actual offer will be subject to agreement with the Department, which will take independent advice from its advisors.

(34) According to the Irish authorities, the terms of the instruments targeted by Anglo Irish Bank under the Liability Management Exercise dictate that coupons may be paid, subject to the Bank having distributable reserves. The terms of these instruments also provide that Anglo Irish Bank would be precluded from undertaking a Liability Management Exercise in a context where it had not made the coupon payment on its Tier 1 instruments. Subsequent to the completion of this exercise the Irish Authorities will provide that coupon payments on Anglo Irish Bank's outstanding Tier 1 instruments are not paid.

5. The issues raised by the complainants

(35) The Commission received approximately 60 complaints emanating from individual citizens. The issues raised were the same in most of the complaints, some of which were forwarded by different individuals as part of a chain of e-mails. The main issues raised can be summarised as follows: (i) Anglo is not a systemically important institution and should, therefore, not be rescued; (ii) Anglo presented serious failures in its corporate governance before the nationalisation; (iii) the Bank was involved in fraudulent activities and had political connections to the ruling party in Ireland.

III. POSITION OF IRELAND

(36) The Irish authorities accept that the notified measures contain State aid elements. The Irish Government 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.

(37) The Irish Government notes that the 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.

(38) The Irish authorities acknowledge that Anglo Irish is a distressed bank and its insolvency could lead to a serious disruption of the Irish financial system. In these circumstances, the State Investment is required as a matter of absolute urgency to preserve the financial stability of the Bank and to safeguard the Irish financial system as a whole due to the bank's systemic relevance. This is confirmed by the letter of 27 May 2009 of the Central Bank and the Financial Services Authority of Ireland.

(39) The Irish authorities have provided the following commitments:

(a) the Bank will refrain from advertisement or promotion invoking the recapitalisation measure as an advantage in competitive terms; and

(b) they will notify to the Commission a restructuring plan for Anglo by, at the latest, the end of November 2009.

The restructuring plan

(40) The adoption of a restructuring plan is consistent with paragraph 28 of the CIFS Scheme and paragraph 30 of the Commission's approval of the CIFS Scheme[15]. In particular, the Minister will require a restructuring plan to be produced if a participating institution's solvency ratio falls below the minimum regulatory standards applicable to it on a material basis. Anglo Irish Bank does not have sufficient capital to meet the solvency requirements under the CIFS Scheme and this triggers a need for a fundamental restructuring.

(41) In the immediate term, the Bank continues to be covered by the Guarantee under the CIFS Scheme in order to ensure that it can continue to operate pending the approval and implementation of the proposed recapitalisation and the transfer of its impaired assets to the recently established National Assets Management Agency ("NAMA")[16].

---

15 See Commission decision of 13 October 2008 in Case NN48/2008 'Guarantee Scheme for Banks in Ireland.

16 NAMA (National Asset Management Agency) is an independent commercial entity under the aegis to the Treasury management Agency (http://www.nama.ie/). The Government decision to set up NAMA was announced on 7th April 2009 with a view to addressing in a comprehensive way the problem of impaired or potential impaired assets in the Irish banking system. Assets will be transferred from banks to NAMA to strengthen their balance sheets and ensure that uncertainty over bad debts is reduced. This will facilitate a sustained flow of credit on a commercial basis to individuals, households and businesses in the real economy. Because it is clear that the principal uncertainties in relation to the asset quality in the Irish banking system lie in the banks' land and development loans and the largest aggregate associated exposures in the banks, it is these categories of loans that will be transferred to the Agency. These assets pose the main systemic risk to the banking sector in Ireland and the most significant obstacle to the recovery and restoration of lending by the Irish banking system

The purpose of the recapitalisation is, therefore, to rescue the Bank from its current distressed state.

(42) Anglo Irish Bank is finalising a Business Plan which will examine all options for the future of the bank. This restructuring plan will look at all options and meet the EU rules in this regard. Any restructuring plan which envisages viability will take into account the need to remunerate the capital being injected in line with state aid rules. An initial deleveraging is to be achieved through participation in the National Asset Management Agency (NAMA) proposal and through the selling of assets, if possible.

(43) The restructuring plan will be consistent with the principles laid down in EC Guidelines on State aid for rescuing and restructuring firms in difficulty and the Banking Communication. Any restructuring plan will focus on selective core business areas and include a significant reduction in the Bank's balance sheet and Risk Weighted Assets. The restructuring plan will address, inter alia, the following issues:

- presentation and analysis of the Bank's strategy and business model to consider its long-term viability in a reasonable timeframe so that it might continue to meet the credit needs of the economy thereby underpinning economic recovery;
- minimisation of State aid, including ensuring the contribution of the Bank to any restructuring costs that arise;
- minimisation of competition distortions as a consequence of the State investment;
- management changes;
- commercial conduct restrictions in relation, inter alia, to the following: (i) reduction in the size of the Bank's balance sheet and (ii) restrictions on new lending pending the restructuring of the Bank. Anglo Irish Bank has agreed to stabilising and deleveraging its balance sheet. Therefore, for a period of at least 12 months, the Bank will not provide new lending except to existing customers for current projects.
- commitment that the Bank will refrain from advertisement or promotion invoking the recapitalisation measure as an advantage in competitive terms;
- the Bank will continue to be subject to the behavioural conditions imposed under paragraphs 24 to 50 of the CIFS Guarantee Scheme.

(44) The Irish authorities provided their comments on the complaints submitted to the Commission by Irish citizens regarding the proposed recapitalisation. The Irish authorities' response to the main issues raised in these complaints are as follows:

(i) With regard to the Bank's systemic importance, the Irish authorities provided the Commission with the interim report for the six months up to 31 March 2009 showing, inter alia, the most relevant accounting information which demonstrates the importance of the Bank in terms of, inter alia, balance sheet and number of customers. The Central Bank and the Financial Regulator endorsed the view that Anglo is a systemically important institution and that the proposed measure is necessary in order to preserve the stability of the financial system; (ii) With regard to the Bank's corporate governance failures before it was taken into public ownership, the Irish authorities stated that certain corporate governance failures are now the subject of ongoing investigations at national level by the Financial Regulator and the Office of the Director of Corporate Enforcement and the police. The Irish Government has been clear that breaches of regulatory or legal requirements in relation to any of the corporate governance matters currently under investigation at Anglo will be dealt with in accordance with the law; (iii) In relation to the allegations of political corruption and in view of the fact that no evidence has been provided to support such allegations, the Irish authorities consider that it would be inappropriate for them to comment. They have, however, stated that, should such evidence exist, it should be reported to the competent national authorities.

IV. ASSESSMENT

1. Existence of State Aid

(45) 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.

(46) Given that Anglo Irish Bank is active in the financial sector, which is open to intense international competition, any advantage from State resources to Anglo would have the potential to affect intra-Community trade and to distort competition. Since the Irish Government injects € 4 billion to the Bank, it is also clear that the measure is imputable to the Irish State and that State resources are involved.

(47) It must also be examined whether the measure leads to a selective advantage to Anglo Irish for it to constitute a State aid. The State capital injection gives an economic advantage to the Bank. The advantage is selective since it only benefits the Bank.

(48) In particular, the proposed recapitalisation would not have been provided by a market economy investor. The Commission recalls that a market economy investor expects a reasonable return on his investment. However, if a firm is in difficulty or acts in an industry experiencing particular difficulties it is normally not justified to assume a reasonable return. For the proposed recapitalisation this is confirmed by the fact that the State is only investing because no market economy operator was willing to invest on similar terms[17]. As stated by the Irish authorities, the willingness to avoid a further deterioration in Anglo's financial position, which would represent a threat to the stability of the financial system as a whole, has determined the State intervention, rather than the possible return for the State as an investor.

(49) 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

[17] See Commission decision in case N 507/2008 – UK "Financial Support Measures to the Banking Industry in the UK", point n. 39.

(50) 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[18].

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

(51) 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")[19], 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[20]:

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.[21]

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

18 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.

19 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.

20 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.

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

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.

(52) The fourth chapter of the Communication on the financial crisis[22], as well as the Communication on recapitalisations[23], 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

(53) The Anglo Irish Interim Report for the six months to 31 March 2009 showed a severe deterioration in the capital position of the Bank as huge impairment provisions against capital are required to cover the losses on its loan book. Without the proposed capital injection, the estimates provided by the Bank and stated in the Interim Report indicate a Core Tier 1 of […] in September 2009 and a total capital of […] in September 2009 (as indicated in para 9). The Bank is covered under the State Guarantee Scheme adopted under the CIFS Act which envisages that if a bank's solvency ratio falls below the minimum regulatory standards, this would trigger a need for a fundamental restructuring. On 28 May 2009, the Financial Regulator agreed to grant the Bank the requested derogations as described above (para 21) on a temporary basis and in exceptional circumstances on the basis of the Government commitment to make the proposed capital injection. In view of the above, the Commission considers that the Bank is distressed and in serious difficulties with a failure to meet the equity and solvency ratio requirements necessitating the issuing of derogations by the Financial Regulator.

(54) The Irish authorities have stated that without a capital injection of € 4 billion there would be a failure of the Bank with consequent severe adverse impacts on other banks and the wider financial system in Ireland. This position has been confirmed by the Central Bank and the Financial Services Authorities of Ireland. According to the Central Bank, it is essential that Anglo, as a systemically important bank, the stability of which is essential to the maintenance of financial stability in the banking sector in Ireland, participates in the government recapitalisation programme. The intention of the Irish authorities is that, following the capital injection, there will be a transfer of approximately […] of land and development loans and connected exposures to NAMA.

(55) The Commission shares the view of the Irish authorities that the proposed recapitalisation is necessary in order to preserve the stability of the banking sector in Ireland. The Commission notes that the size and the activity of the Bank in the Irish economy and its specialised lending in the property development and commercial property areas which register a dramatic deterioration, as indicated in the Interim

---

[22] 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.

[23] 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

Report, would create a risk of systemic failure/disturbance to the Irish financial system. Moreover, the Commission takes note of the fact that the proposed capital injection is a rescue measure which is essential to bring forward the restructuring plan triggered by the Guarantee Scheme and the transfer of € […] of impaired assets to NAMA.

(56) Based on the above and contrary to what certain complainants have argued in this respect, the Commission notes that the Irish authorities have provided extensive information that demonstrates that the Bank is of systemic importance. The Commission also wishes to note that no elements have been brought forward by the complainants that would allow the Commission to change its assessment in this respect. Based on the above, the Commission is therefore satisfied that Anglo is of systemic importance for the maintenance of the stability of the Irish financial system and has no reason to continue the investigation of the complaints in this respect.

(57) Therefore, the Commission considers that a public sector capital intervention in Anglo Irish Bank 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

(58) 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.

(59) As regards the **amount** of the recapitalisation, the Commission takes into account the letter of the Financial Regulator and the Minister of Finance supporting Anglo's application for temporary derogations from the capital adequacy requirements and committing to provide € 4 billion of Core Tier 1 capital. The recapitalisation amounts to approximately 5% of the Bank's Risk Weighted Assets which is above the 2% ceiling indicated for fundamentally sound banks in the Communication on bank recapitalisation.[24] The State Investment will boost Anglo Irish Bank's Core Tier 1 capital ratio from 1.4% to 5.9% and its total capital from 8.2% to 12.4%. This is adequate to ensure that the Bank continues to operate above the minimum capital adequacy ratio since, as stated in the Interim Report, the level of the impairment, the deterioration of the capital position and […] is likely to further undermine market confidence and to cause further outflow of funds from the Bank.

(60) Taking the above into account, the Commission finds that the recapitalisation measure serves the purpose of keeping the Bank afloat until an in-depth restructuring plan is drawn up and hence the competition distortion appears to be limited.

(61) The Irish authorities do not envisage an expected return for ordinary shares which, in their view, is in line with the aim of the proposed recapitalisation i.e. to avoid that the insolvency of a distressed bank of systemic relevance would lead to a serious disruption of the Irish financial system.

24 See 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.

(62) In this respect, the Commission wishes to note that, by definition, the remuneration for ordinary shares is the dividend which it is not possible to define ex ante, since it can vary on the basis of the bank's performance. Should Anglo be able to generate profit, the potential dividend would be retained thus reinforcing/rebuilding the State owned bank's capital while decreasing the Bank's debt obligations. However, if the Bank is not generating value, no residual claim for remuneration can exist (by dividends or capital gains). Based on the projection of the Interim Report, the Commission considers it unlikely, at this stage, that the Bank will generate enough profit to distribute since, as stated by the Financial Regulator, the sole aim of the proposed measure is to fulfil the minimum regulatory capital requirement which, in the absence of the capital injection, is estimated to sharply deteriorate in September 2009 at […] Core Tier 1 and […] total capital. The fact that the beneficiary does not currently appear to be able to pay any remuneration for the ordinary shares is in line with the Commission's assessment of the distressed state of the Bank which could not reasonably allow it to envisage, at this stage, any profit and consequently any dividend payment i.e. remuneration for the ordinary shares.

(63) The State capital injection aims solely at maintaining the financial stability with the measure being temporary pending the participation of the Bank in the NAMA impaired asset relief proposal and the drawing up and implementation of an in-depth restructuring plan. The Bank continues to be covered by the Guarantee under the CIFS Scheme in order to ensure that it can continue to operate until the recapitalisation takes place. Accordingly, both the State capital injection and the continued cover under the CIFS Scheme have to be considered as temporary measures in view of the in-depth restructuring which the Irish authorities have committed to carry out.

(64) Therefore, since, at this stage, it does not seem justified to assume a reasonable return for the Bank[25] and considering that the purpose of the recapitalisation is solely to rescue Anglo in its current distressed situation and to allow it to transfer its impaired assets to NAMA and to carry out an in-depth restructuring operation where all solutions, liquidation included, will be considered, the Commission finds the Irish proposal not to envisage an expected return for ordinary shares acceptable. The Commission considers that not to foresee, at this stage, any remuneration for the ordinary shares strikes, in the particular circumstances of this case, the appropriate balance, as indicated in paragraph 11 of the Recapitalisation Communication, between the competition concerns and, inter alia, the objectives of restoring financial stability because the measure is treated solely as a temporary urgent relief on the assumption and condition that in the longer term the costs of public intervention in Anglo's favour will be reflected in the in-depth restructuring plan which must be submitted. The restructuring plan will examine all options for the future of the Bank, liquidation included[26] and meet the EU rules in this regard.

(65) The fact that the Irish authorities consider that the capital injected in the Bank is not likely to be remunerated at all, is indicative of the high level of distress of Anglo Irish. As a consequence, the necessary restructuring and the compensatory measures will

---

[25] See Commission decision N 507/2008 – UK "Financial Support Measures to the Banking Industry in the UK", point n. 39.

[26] See Commission Communication of 13 October 2008 on 'The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, OJ C270/8 of 25.10.2008, chapter 5.

have to be proportionate to the level of distress of the Bank. In this context, the Commission notes that paragraph 15 of the Recapitalisation Communication allows an exception to the general requirement of remuneration for recapitalisations only in the short term, and only on the assumption and condition that the costs of public intervention and the competitive impact of the state intervention be reflected in the compensatory measures within the restructuring phase. The assessment is without prejudice to the position the Commission may take with regard to this measure in the context of the analysis of the restructuring plan that the Irish authorities committed to present by, at the latest, the end of November 2009. The Commission anticipates that the costs of public intervention in favour of the Bank will be reflected in the restructuring plan which will need to take account of the competitive impact of the support given by making commensurate provisions for compensatory measures. [27]

(66) The Commission's approach in this case is also in line with point 44 of the Recapitalisation Communication which states that 'notwithstanding the need to ensure financial stability, the use of State capital for these banks can only be accepted on the condition of either a bank's winding up or a thorough and far-reaching restructuring, including a change in management and corporate governance where appropriate'. In this context, the Commission wishes to note the far-reaching restructuring that will take place in Anglo as previously described which will examine all options for the future of the Bank (see above, position of Ireland).The Commission also wishes to note the changes that have already occurred in the Bank's management, namely changes in its board of directors where four of the directors are now nominated by the Minister (two of which are representative of the public interest) as well as with regard to the remuneration arrangements (reduction in base salary, bonus and pension level for chief executives and ordinary board members). Moreover, it is envisaged that immediate further management changes at the Bank will take place.

(67) The Commission notes positively that the Bank will increase its Core Tier 1 capital by engaging in a Liability Management Exercise under which Anglo would buy back subordinated loans issued in previous years by the Bank. Any premium over the market price is minimised to that necessary only to ensure a participation rate sufficient to make the Liability Management Exercise worthwhile. The pricing for this exercise will be set in a way to maximise the increase in Core Tier 1 capital and to minimise any premium to bondholders. The exercise is designed to ensure that the offer price will refer to the historic trend pricing for the bonds and not take into account more recent uplifts in price thereby minimising any gain to bondholders while maximising the Core Tier 1 of the Bank. Accordingly, to the extent that this exercise will generate additional capital for the bank, it does not raise any State aid concerns.

(68) The Commission also notes that the instruments that will be used to make the State investment are ordinary shares. As stated by the Irish authorities, the injection of ordinary share capital aims at protecting the Bank's core Tier 1 capital. Since the State already owns 100% of the Bank's share capital, no issue arises regarding dilution of existing shareholders. Ordinary shares are the highest form of capital since they can be registered without any quantitative limitations as Core Tier 1 capital which is the best in terms of loss absorption.

[27] See e.g. Commission decision of 11 May 2009 in case N 189/2009 – Latvia "Modification to the public support measures to JSC Parex Banka, point 34; Commission decision of 29 May 2009 in case N264/2009, -Germany, Rescue Aid (recapitalisation and risk shield) to HSH Nordbank AG, point 45-47.

(69) The Commission notes positively that the Bank has also made specific progress in relation to the main elements under the CIFS Scheme, namely: (i) board of directors (four directors nominated by the Minister); (ii) remuneration arrangements (reduction in base salary, bonus and pension level for chief executives and ordinary board members); (iii) dividends; (iv) funding (prevention from undertaking any funding programme without the prior consultation with the Financial Regulator); (v) corporate social responsibility (e.g. promotion of financial inclusion, development of financial inclusion); (vi) advertising (prevention from promoting itself on the basis of the CIFS); (vii) public disclosure (prevention from any disclosure as regards its assets without the prior consultation with the Financial Regulator).

(70) As the ordinary shares will represent pure ordinary equity, no mandatory dividend will be payable. Dividends will be payable at the discretion of the Board, but only subject to distributive reserves. Furthermore, the Commission notes positively that, subsequent to the completion of the Liability Management Exercise, no coupon payments will be made on Anglo Irish Bank's outstanding Tier 1 instruments.

(71) On the basis of the above, the Commission considers that the terms and conditions of the State investment, together with the terms and conditions already imposed on Anglo under the CIFS Guarantee Scheme, contain adequate safeguards against possible abuses and distortions of competition.

(72) Under the terms of CIFS Guarantee Scheme the Irish authorities committed to file individual restructuring plan for banks that default on their liabilities and which causes the guarantee to be called upon. The Irish authorities commit that the Bank will submit by, at the latest, end of November 2009 to the Commission a new business plan which will be based on an in-depth restructuring of the Bank. As stated by the Irish authorities, the in-depth restructuring plan for the Bank will follow the principles laid down in the Rescue and Restructuring Guidelines and will, inter alia, focus on selective core business areas and include a significant reduction of the balance sheet and RWAs. Furthermore, the State will ensure that to avoid disproportional distortions of competition (i) the state measure is not used for marketing purposes as a commercial advantage, (ii) the balance sheet growth is restricted, (iii) no aggressive expansion will be conducted. Therefore, the restructuring plan will be aimed at (a) if possible restoring long-term viability; (b) ensuring that aid has been reduced to the minimum necessary and that burden is shared appropriately, and (c) avoiding undue distortions of competition.

(73) The Commission considers that the submission of a restructuring for the Bank by the end of November 2009 at the latest and all the related behavioural commitments constitute appropriate safeguards in order to secure the proportionality of the aid and to limit possible distortions of competition. This assessment is without prejudice to that which the Commission will reach following the analysis of the restructuring plan if these measures are maintained in it.

(74) Finally, in relation to the allegations regarding the serious failures in Anglo's corporate governance as well as the potential fraud and its alleged relations to the Irish Government, the Commission notes that, regardless of the merits of such claims, the investigation of these issues lies within the competence of the national authorities. It is therefore outside the Commission's competence to investigate these issues under the

state aid rules of the Treaty. Based on the above, the Commission finds that these further grounds for the complaints also have to be rejected.

3. Conclusion

(75) 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

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

(77) 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.

(78) The Commission takes note of Ireland's commitment to notify a restructuring plan to the Commission by, at the latest, end of November 2009.

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.

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