EUROPEAN COMMISSION

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Subject: **State aid N 331/2010 - Ireland**

Transfer of the first tranche of assets to NAMA

Sir,

I. PROCEDURE

(1) On 26 February 2010, the European Commission took a no objection decision on the Irish asset relief scheme (hereafter "the NAMA decision"[1]).

(2) On 10 May 2010, a first tranche of impaired assets was transferred from the participating institutions to the National Asset Management Agency (NAMA).

(3) Between March and July, several discussions and exchanges of information took place between the European Commission and the Irish authorities.

(4) On 22 July 2010 the Irish authorities notified the transfer of the first tranche of assets to NAMA.

[1] Commission Decision of 26.02.2010 Establishment of a National Asset Management Agency (NAMA), in case N725/2009 (Ireland), OJ C 94/2010 of 14.04.2010.

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II. DESCRIPTION

1. Introduction

(5) NAMA was established on 22 December 2009 to arrange and supervise the purchase of approximately EUR […][*] billion worth of land, development property and associated commercial loans from five financial institutions in Ireland. The purchase price is paid through the issuance by NAMA of State-guaranteed senior debt securities for 95% of the purchase price and the issuance of (non State-guaranteed) subordinated debt securities for 5%. The issued securities are held by the participating credit institutions pro rata to their share in the assets transferred to NAMA. The State-guaranteed debt securities may then be used by the participating credit institutions as collateral to receive financing from the European Central Bank, helping to improve the liquidity position of these banks.

(6) Assets are transferred by "impaired borrower" exposures across all participating institutions, i.e. (i) Anglo Irish Bank (Anglo), (ii) Allied Irish Banks (AIB), (iii) Bank of Ireland (BOI), (iv) Irish National Building Society (INBS) and (v) Educational Building Society (EBS). For organisational purposes, the Irish authorities have divided the assets in seven tranches of loans, which are gradually transferred to NAMA.

(7) The Irish authorities committed to notify to the Commission each transfer of a tranche of assets to NAMA. The transfer of the first tranche, which includes the ten largest borrower-relationship positions, was initiated on 29 March 2010 and completed on 10 May 2010. As mentioned in the NAMA decision[2], the Commission relies on a commitment from the Irish authorities to claw back any payment in excess of the real economic value of the assets that would become apparent after the review by the Commission of the individual notifications related to the transfer of each tranche of assets.

2. Portfolio description of the first tranche[3]

(8) Two kinds of assets were transferred to NAMA, (i) loans and (ii) a portfolio of associated derivatives.

(9) The total balance of loans transferred (in the first tranche) amounts to EUR 15,284 million[4]. The split by participating institution is the following: (i) Anglo: EUR 9,251 million (60.5 % of total); (ii) AIB: EUR 3,290 million (21.5 % of total); (iii) BOI: EUR 1,930 million (12.6 % of total); (iv) INBS: EUR 669 million (4.4 % of total); (v) EBS: EUR 144 million (0.9 % of total).

[*] Confidential information.
[2] Paragraph 122.
[3] More details are available in Annex.
[4] This corresponds to the loan balance outstanding as of 31 January 2010, using for non euro loans the exchange rate two days prior to the transfer date.

(10) The market value of the total loans amounts to EUR 5,856 million, which corresponds to 38% of the total balance of the loans. The real economic value (REV) of the loans amounts to EUR 7,532 million, which corresponds to 49% of the total balance of the loans.

(11) The market value of the underlying properties amounts to EUR 7,454 million, while the real economic value (REV) of the properties amounts to EUR 8,275 million, suggesting an average uplift of 11.01% above the market value.

(12) In terms of asset class, the split of properties[5] is the following: (i) investment property (52.23%); (ii) land (including development property less than 30% developed) (27.85%); (iii) residential property for resale (14.34%); (iv) hotels (4.17%) and (v) development property (at least 30% completed) (1.42%).

(13) In terms of geography, the split of properties[6] is the following: (i) Ireland (66.33%); (ii) Britain and Channel Islands (30.07%); (iii) US and Canada (0.39%); and (v) Rest of Europe (3.21%).

(14) As well as the loans, a portfolio of derivatives associated with the loans was also transferred to NAMA at a market value[7] of EUR 163 million.

(15) In total, the transfer price of assets (including both loans and derivatives) amounts to EUR 7,696 million. The difference between the transfer price and the market value, i.e. the aid amount, represents EUR 1,676 million, which can be broken-down between participating institutions as follows: (i) Anglo: EUR 870 million; (ii) AIB: EUR 422 million; (iii) BOI: EUR 296 million; (iv) INBS: EUR 70 million; (v) EBS: EUR 18 million.

3. Payment by NAMA for the first tranche

(16) As payment for the assets received by NAMA under the first tranche, NAMA has issued debt instruments (bonds) to the participating institutions.

(17) Total bonds issued by NAMA amounted to EUR 7,696 million, of which EUR 7,311 million (95%) consisted of State-guaranteed bonds and EUR 385 million (5%) consisted of (non State-guaranteed) subordinated bonds.

4. Losses incurred by each participating institution

(18) Total losses[8] that each of the participating institutions made following the transfer of loans to NAMA are as follows: (i) Anglo: EUR 5,094 million; (ii) AIB: EUR 1,385 million; (iii)

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[5] Expressed in % of the market value of the properties.
[6] Expressed in % of the market value of the properties.
[7] See Annex for more details.
[8] Losses are calculated as the difference between the loan balances and the transfer price paid by NAMA. These losses also include losses taken prior to the transfer of assets.

BOI: EUR 668 million; (iv) INBS: EUR 389 million; (v) EBS: EUR 53 million. In total, losses amount to EUR 7,588 million.

5. Certification of the valuation

(19) The valuation process for the loans has been certified by independent experts (Ernst & Young for the Financial Regulator and KPMG for NAMA), and validated by the relevant supervisory authority, the Financial Regulator.

(20) The valuation of the underlying properties has also been certified by loan valuers.

III. THE POSITION OF IRELAND

(21) The Irish authorities acknowledge that the notified transfer of assets under the Irish asset relief scheme may contain elements of State aid.

(22) However, the Irish authorities consider the conditions and criteria of the transfer are in line with the scheme and it is thus compatible with the internal market on the basis of Article 107(3)(b) TFEU as it is necessary in order to remedy a serious disturbance in the Irish economy.

(23) The Irish authorities reiterated all the commitments provided in the context of the NAMA decision.

IV. ASSESSMENT

1. State aid character of the measure

(24) As set out in Article 107(1) TFEU, 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 or the production of certain goods shall, in so far as it affects trade between Member States, is incompatible with the internal market.

(25) As described in the NAMA decision, the asset relief scheme (and, *de facto*, any measure falling under this scheme) does constitute aid to the participating institutions pursuant to Article 107(1) TFEU.

2. Compatibility

Applicability of Article 107(3)(b) TFEU

(26) Article 107 (3)(b) TFEU enables the Commission to declare aid compatible with the internal market if it has the effect "to remedy a serious disturbance in the economy of a Member State". The *Communication from the Commission on application of State aid rules to measures taken in relation to financial institutions in the context of the current global*

financial crises[9] (the Banking Communication) confirms and details the principles of the applicability of Article 107(3)(b) of the TFEU to support measures for banks in the context of the financial crisis.

(27) As described in the NAMA decision, the Commission finds that the asset relief scheme (and, *de facto*, any measure falling under this scheme) is apt to remedy a serious disturbance in the Irish economy.

Framework for evaluating compatibility

(28) As explained in the Banking Communication, 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 under Article 107(3) TFEU. This implies that the measure has to be appropriate, necessary and proportionate.

(29) More specifically, asset relief measures, irrespective of their exact nature, need to be assessed under the Impaired Assets Communication[10] (IAC) which provides guidance as for the methodologies concerning the valuation of the impaired assets, the necessary remuneration of the State for the asset relief provided and the procedural steps that are to be followed, as well as the criteria that will be used to evaluate the State aid given to the banks as a result.

3. Assessment

(30) The IAC sets out criteria for the compatibility of such measures with the internal market. These criteria comprise (i) the appropriate identification of the problem and disclosure, (ii) the appropriateness of the remuneration and burden-sharing, (iii) the alignment of banks' incentives with public policy objectives, (iv) the eligibility of assets, (v) the valuation of eligible assets, (vi) the management of assets subject to relief measures and (vii) the requirement of the assessment of a restructuring plan by the Commission.

(31) With regard to issues pertaining to the valuation methodologies employed in the context of the asset relief scheme, the Commission has drawn on technical assistance provided by an external expert under contract by the Commission and by an expert from the European Central Bank.

Transparency and ex-ante disclosure

(32) The IAC requires that any bank participating in an asset relief scheme should (i) provide full ex-ante transparency and disclosure of impairments on the assets to be covered by the scheme (including the additional impairment and/or losses to be taken as a result of the participation to the scheme) and (ii) follow-up on any application to the scheme by a full review of that bank's activities and balance sheet with a view to assessing the bank's capital adequacy and its prospect for a return to future viability.

[9] OJ C 270, 25.10.2008, p. 8

[10] Commission Communication "On the Treatment of Impaired Assets in the Community Banking Sector OJ C 72, 26.3.2009, p. 1

(33) The Commission views positively that the incurred losses for the participating institutions from the asset transfer were identified in advance of the asset transfer (see paragraph (18)) and that the valuation process for the eligible bank assets was certified by recognised independent experts and validated by the relevant supervisory authority, the Financial Regulator (see paragraph 19). The property valuation outcome per se was certified by each independent loan valuer who provided a certificate to the audit coordinator (see paragraph 20).

(34) As for the full review of the bank's activities and balance sheet, the Commission notes that the Irish authorities have complied with their commitment to submit a restructuring plan for each participating institution.

Burden-sharing and remuneration

(35) The principle of burden-sharing as set out in the IAC requires that banks ought to bear the losses associated with impaired assets to the maximum extent. Therefore, the assets should be transferred at a price that matches or stays below the real economic value. In this respect, the Commission notes that the assets were transferred at a price equal to the real economic value of the assets, i.e. EUR 7,696 million, leading to total losses of EUR 7,588 million for the participating banks, which represents a significant burden-sharing.

(36) The IAC also explains that burden-sharing is achieved through an adequate remuneration of the scheme. In this respect, the Commission recalls that, in compliance with the NAMA decision, the remuneration of the State is embedded in the purchase price as a 170 bp margin is added to the Irish government bond yield for the relevant maturity used to discount the assets' expected long-term cash flows. The Commission notes that (i) a 170 bp margin was indeed used and (ii) the appropriate Irish government bond yield was used. Therefore, the Commission concludes that the remuneration is appropriate.

(37) Consequently, the Commission considers that the measure provides an appropriate framework for an adequate burden-sharing of the costs of the measure between the State and participating institutions.

Alignment of banks' incentives with public policy objectives

(38) The Commission already concluded in the NAMA decision that the scheme included adequate provisions to align participating banks' incentives with public policy interests.

(39) The Commission also notes that the restructuring plans submitted by Ireland for the participating institutions must include the necessary behavioural constraints to align banks' incentives with public policy objectives.

Eligibility of Assets

(40) The Commission already concluded in the NAMA decision that the scope of assets included in the NAMA scheme was in line with the eligibility requirements of the IAC.

Valuation

(41) The Commission already concluded in the NAMA decision that the valuation methodology used to value the assets was in compliance with the requirements of the IAC.

(42) Regarding the assessment of the actual valuations, the Commission's expert confirmed that the real economic value of the first tranche is conservatively estimated and, therefore, that the transfer price is appropriate. More particularly, since the value of loans is highly correlated to the value of the underlying properties and the valuation methodology was previously agreed in the NAMA decision, the expert focused its due diligence on the valuation of the underlying properties. The long-term economic value of properties being the market value of the properties inflated by a certain uplift factor, the expert (i) verified that these factors were within reasonable ranges and consistent with the guidelines previously approved in the NAMA decision, and (ii) performed a consistency check of the market value of the properties. The Commission's expert concluded that the average level of uplift of 11.01% was reasonable and that the market value declines implied in the market value of properties were fairly consistent with the selected benchmark indicators for each origination year of the loans, and showed a systematic and significant conservative bias.

Management of assets

(43) The Commission already concluded in the NAMA decision that the management of assets was in compliance with the requirements of the IAC.

Follow- up (restructuring plan)

(44) The Commission notes that the Irish authorities have complied with their commitment to submit a restructuring plan for all participating institutions.

V. DECISION

The Commission concludes that, in line with the Commission Decision in State aid case N/725/2009, the application of the Irish asset relief scheme in the transfer of the first tranche of assets from certain financial institutions in Ireland to NAMA constitutes State aid within the meaning of Article 107(1) TFEU.

Since the transfer fulfils the requirements of Article 107(3)(b) TFEU in general and the conditions and criteria set forth in the above-mentioned Commission decision in particular, it is compatible with the internal market and the Commission raises no objections.

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

European Commission
Directorate-General for Competition
State Aid Greffe
Rue Joseph II, 70
B-1049 Brussels
Fax No: +32-2-296 12 42

Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-president of the Commission

VI. ANNEX

1. First tranche portfolio statistics

In EUR million	**Total**		**AIB**	**BOI**	**Anglo**	**EBS**	**INBS**
Loans							
Loan Balance retranslated* (Nominal value) (a)	15.284	*100%*	3.290	1.930	9.251	144	669
Loan CMV** (Market value) (b)	5.856	*38%*	1.417	950	3.207	73	210
Loan LEV*** (Real economic value) (c)	7.532	*49%*	1.838	1.246	4.077	91	280
Transfer price (d)	7.532	*49%*	1.838	1.246	4.077	91	280
Average discount (d)/(a) - 1	*-51%*		*-44%*	*-35%*	*-56%*	*-37%*	*-58%*
Aid amount (d) - (b)	1.676	*11%*	422	296	870	18	70
Underlying property CMV**	7.454		1.872	1.264	3.860	95	363
Underlying property LEV***	8.275		2.040	1.415	4.311	103	406
Underlying property average uplift	11,01%		8,96%	11,99%	11,68%	8,10%	11,84%
Derivatives							
Market value of derivatives transferred (e)	163		67	16	80	0	0
Transfer price of derivatives (f)	163		67	16	80	0	0
Aid amount (f) - (e)	0		0	0	0	0	0
Total							
Total transfer price (d) + (f)	7.696		1.906	1.262	4.157	91	280
Total aid amount	1.676		422	296	870	18	70

* Foreign currency balances are translated at exchange rates 2 business days prior to transfer
** Current Market value
*** Long-term Economic Value

2. Split by type of property of the market value of the properties

In EUR million	**Total**	
Investment property	3.893	52,2%
Land (including development property < 30% complete)	2.076	27,9%
Residential property for resale	1.069	14,3%
Hotels	311	4,2%
Development property (> 30% complete)	106	1,4%
Total market value of properties	**7.454**	**100,0%**

3. Split by geography of the market value of the properties

In EUR million	**Total**	
Ireland	4.944	66,3%
Brittain and Channel Islands	2.241	30,1%
US / Canada	29	0,4%
Rest of Europe	239	3,2%
Total	**7.454**	**100,0%**