EUROPEAN COMMISSION

Brussels, 3.9.2012
C(2012) 6090 final

Subject: **State aid SA.35209 (2012/N) - Ireland**

Prolongation of the Credit Union Resolution Scheme until 31 December 2012

Sir,

I. PROCEDURE

(1) On 20 December 2011, the European Commission approved the Credit Union Resolution Scheme[1] (hereinafter the "CUR scheme") until 30 June 2012 (hereinafter "the original decision").

(2) On 2 August 2012, the Irish authorities notified the prolongation of the CUR scheme until 31 December 2012.

II. DESCRIPTION

The Credit Union sector and its difficulties

(3) The CU sector and its difficulties were described in detail in recitals 3 to 9 of the original decision. For the purposes of this prolongation decision, some elements have been provided below.

Credit Unions ("CUs") are member-owned, not-for-profit entities whose business primarily relates to savings and loans. Credit unions cannot do business with the general public due to charter limitations; instead they serve a membership that is

[1] Commission Decision of 20.12.2011 in State Aid N 33170/2011 "*Restructuring scheme for Credit Unions – Ireland*", OJ C 82, 21.03.2012, p. 2.

Mr. Eamon Gilmore T.D.
Minister for Foreign Affairs,
Department of Foreign Affairs
80, St. Stephen's Green,
Dublin 2,
IRELAND

characterised by a "common bond". The common bond is based on a pre-existing social connection (such as belonging to a particular community, industrial or geographical group). Each credit union is governed by its members, who are economically equivalent to ordinary depositors. Credit unions play an important role in the Irish financial sector as they are traditionally seen as providing access to financial services to the financially excluded or the less well-off members of the community.

(4) As at 31 March 2012, there were 401 CUs with around EUR 13.8 billion of total assets in Ireland, with savings amounting to around EUR 11.9 billion and membership to circa 2.9 million[2]. As at 31 March 2012, there were 29 CUs with assets greater than EUR 100 million (representing total assets of around EUR 4.5 billion, or 32.7% of total CU assets), with 208 CUs holding assets of less than EUR 20 million (representing total assets of around EUR 2.1 billion, 15.1% of total CU assets). The smallest credit union has assets of around EUR [0 – 2 million][*], with the largest holding assets of around EUR [200 – 400 million].

(5) As part of its extensive analysis of the CU sector, the Central Bank of Ireland (hereinafter "the CBI") has carried out a Prudential Capital Assessment Review ("PCAR") in 2011, which was a review of the capital needs of the Irish financial sector and which was conducted as part of the Financial Support Programme for Ireland. The results indicated a cumulative capital deficit of between EUR […] million and EUR […] million for the credit union sector[3.] The key driver of the figures is the loan loss forecast for the period between 2011 and end 2013.

(6) Most CUs have experienced difficulties related to increasing loan losses due to the adverse economic climate in Ireland since the beginning of the financial crisis combined with problems related to governance, management and know-how.

Objective and description of the scheme

(7) The objective of the CUR scheme and a description of it were set out in detail in recitals 10 to 28 of the original decision. For the purposes of this prolongation decision, some elements have been provided below. The scheme has so far not been used by the Irish authorities.

The objective

(8) The main objective of the scheme is aimed at providing a resolution regime for CUs that are failing or likely to fail, and that is effective in protecting the Exchequer and stability of the financial system and the economy. To that end, the CBI has been provided with the necessary powers of resolution to meet those objectives.

The scheme

[2] As at 31 December 2011. Source: Report of the Commission on Credit Unions of March 2012, paragraph 2.4.3, page 13.

[*] Confidential information, where possible figures have been replaced with ranges in [brackets].

[3] Base versus stress scenarios (assuming a regulatory capital ratio of 10% of total assets).

(9) The scheme has not changed since the original decision. Of the tools available to the CBI to resolve a CU (i.e. transfer order, modified liquidation process, the appointment of special managers or the establishment of a bridge bank), the Irish authorities have sought an approval for the prolongation of the use of the transfer order as a resolution mechanism. Where such an order is used, once the CBI determines a CU is likely to fail in accordance with the criteria established by the Central Bank and Credit Institutions (Resolution) Act 2011, the CBI can order that all the assets and liabilities of the failing CU will be transferred to another credit institution, i.e. there will be no rump.

(10) The consideration paid by the buyer of the assets and liabilities of a failed CU will be established in all cases via a competitive process run by the CBI in order to establish the market price. The CBI will determine which institutions will be invited to bid, with the bidders expected to be mainly […]. When selecting a preferred bidder, the CBI will take into account, amongst others, its ability to complete the transaction and its viability post-transfer.

(11) It is likely that the buyer will need a financial incentive from the State in order to take on the failing credit union. The incentive can take various forms, including a direct grant or a guarantee.

(12) The State provides the initial money to fund the resolution, either through a contribution to the Resolution Fund or to the buyer directly, but intends to levy the financial sector to recoup its costs over time. At the end of 2011, the Minister for Finance provided EUR 250 million to the Credit Institution Resolution Fund with the view to meeting then-anticipated credit union resolution costs. The maximum amount of funding provided by the State will be EUR 500 million.

III. THE POSITION OF IRELAND

(13) The Irish authorities have notified the prolongation measure as compatible State aid pursuant to Article 107(3)(b) of the Treaty on the Functioning of the European Union (TFEU). In line with the previous decision, the Irish authorities accept that the scheme contains State aid elements.

(14) In the view of the Irish authorities, the scheme is compatible with Article 107(3)(b) TFEU as an aid measure intended "to remedy a serious disturbance in the economy of a Member State".

(15) Firstly the Irish authorities consider that the scheme is appropriate because funding is only provided where the CBI finds that the CU in question has failed or is likely to fail, where financial stability of the CU or the wider system is concerned and where it is not in the public interest to wind-up the CU. The CUR scheme therefore targets the CUs most in need of resolution. In addition, the CUR scheme will only be used if other voluntary resolution actions are not feasible.

(16) Secondly the Irish authorities consider that the scheme is necessary because otherwise it would not be possible to successfully transfer the assets and liabilities in a way that ensures the on-going viability of the transferees.

(17) Thirdly the Irish authorities consider that the scheme is proportionate because the impact on competition is limited due to the fact that the assets and liabilities are transferred following a competitive process open to a number of potential credible buyers. That process will in particular serve to limit the distortion of competition and the amount of State aid involved in the transfer.

(18) The Irish authorities furthermore have committed to the following:

a. To re-notify the scheme to the Commission in case a partial transfer of assets and liabilities is envisaged under the CUR scheme;

b. To re-notify the scheme in case any of the other resolution tools available to the CBI will be activated that give rise to State aid (i.e. the bridge bank);

c. To report to the Commission on a six-monthly basis on the operation of the scheme;

IV. ASSESSMENT

1. Existence of State aid

(19) 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, be incompatible with the internal market, save as otherwise provided.

(20) For the reasons indicated in the original decision the Commission considers that the CUR scheme constitutes State aid. The notified prolongation of the scheme does not affect that finding. The CUR scheme remains State aid within the meaning of Article 107(1) TFEU.

2. Compatibility

Legal base

(21) The Commission finds that the circumstances which allowed it to approve the CUR scheme on the basis of Article 107(3)(b) TFEU in the original decision still apply.

(22) The Commission observes that financial markets have not yet returned to normal functioning and the aid scheme envisaged can be considered necessary to preserve the confidence of depositors in CUs and the financial system as a whole to avoid a serious disturbance in the Irish economy. That assessment is confirmed by the role of the CBI in the scheme, whereby the CBI is only mandated to intervene when it has serious concerns about the CU's financial stability or is satisfied that there is a present or imminent serious threat to the financial stability of the CU concerned and where the immediate winding-up of the CU is not in the public interest, having regard to the importance of maintaining public confidence in the financial system of Ireland. The necessity to preserve financial stability in the Irish

financial sector was also confirmed in the Commission's decision on the extension of the Irish Eligible Liabilities Guarantee scheme until 31 December 2012[4].

(23) For those reasons, the conditions that have been established by the Banking Communication[5] and the Commission's subsequent decisional practice and Communications continue to apply.

Prolongation of the CUR scheme

(24) In recitals 52 to 67 of the original decision, the Commission analysed whether the CUR scheme fulfilled the conditions for compatibility of the scheme with the internal market. Given that the CUR scheme has not changed since the initial approval in the original decision and there have been no relevant changes in the situation in which it will be implemented, the Commission's assessment likewise remains unchanged.

Appropriateness

(25) The CUR scheme is appropriate as it ensures that financial stability is maintained by resolving the CUs that have failed or likely to fail in a sufficiently short time-frame to reassure depositors by a full transfer of assets and liabilities. The Commission finds that controlled resolution in that case is more likely to safeguard financial stability than an uncontrolled liquidation.

(26) In addition, only the CUs that need to be resolved because of their financial position are targeted by the scheme. In that context the Commission notes that before the CUR scheme is used, all other possible voluntary avenues for resolution need to be exhausted. The decision by the CBI to resolve a CU is based on objective criteria as is its assessment of the viability of the buyer.

(27) As in the original decision, the Commission acknowledges that the sale process, which can take different forms, has to be carried out rapidly (thus limiting the amount of potential bidders) and is likely to involve […]. Provided that a competitive process is organised, those limitations do not change the Commission's assessment that the sale process will be equivalent to an open tender.

Necessity

(28) The CUR scheme is necessary to resolve CUs that have failed or are likely to fail. In order to avoid financial stability concerns related to a failed CU, CBI intervention is necessary to ensure that those CUs are resolved in an orderly fashion. As observed in recital 26, intervention by the CBI is based on objective criteria and will only be a measure of last resort.

(29) In order to ensure that all the assets and liabilities of an affected CU are transferred, an incentive for the buyer might be required. In that context the

[4] Commission decision in case SA.34746 (2012/N), *Prolongation of the ELG Scheme until 31 December 2012,* not yet published.

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

Commission notes that the nature and size of the incentive are determined by the competitive tender run by the CBI. As a result, the aid provided to assist the sale will be kept to the minimum as the sale process will establish a market price for the assets and liabilities. In addition, the impact on the tax payer is minimised in so far as public funds will be recoupable and the Resolution Fund will be financed over the longer term by all licensed banks and registered credit unions in Ireland. Any losses encountered by the Resolution Fund would eventually be covered by the whole banking sector.

Limiting competition distortions to the minimum

(30) The Commission considers that the distortions of competition caused by the aid to assist the complete transfer of assets and liabilities of troubled CUs are limited to the minimum.

(31) Firstly, the competitive tender will ensure that the competitors of the CU whose assets and liabilities are being sold will have an opportunity to acquire it. The aid required to complete the transaction in addition will be the outcome of the sale process and reflected in the overall consideration that the troubled CU will receive. The affected CU will furthermore exit the market, even though its assets and liabilities will be transferred to another CU.

(32) In that respect, the Commission considers that the distortions of competition due to the continued market presence of the resolved credit unions are very limited. Credit unions in general are very small, with only 29 having assets greater than EUR 100 million and 208 holding assets of less than EUR 20 million. Credit unions offer only limited banking services, i.e. they do not offer current accounts.

(33) Finally the impact on competition is limited by the existence of the common bond, whereby a credit union may only deal with members covered by its membership criteria, such as geographic or professional ties, which is unlikely to provide a basis for competing against other financial institutions (since only people who meet the common bond criteria can become members).

V. DECISION

The Commission finds that the notified measure is compatible with the internal market under Article 107(3)(b) of the Treaty on the Functioning of the European Union, until 31 December 2012. The Commission has accordingly decided not to raise objections.

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http://ec.europa.eu/competition/elojade/isef/index.cfm

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

European Commission
Directorate-General for Competition
State Aid Greffe
J-70 3/225
B-1049 Brussels
Fax No: +32-2-296 12 42

Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President