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State Aid NN 48/2008 Ireland: Guarantee scheme for banks in Ireland

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Brussels, 13.10.2008
C(2008)6059

**Subject: State aid NN 48/2008 - Ireland
Guarantee scheme for banks in Ireland**

Sir,

I. PROCEDURE

1. On the 30th September 2008, the Irish Minister for Finance announced a government decision to guarantee all deposits and debts of six Irish banks and their subsidiaries located abroad.
2. The same day, the Commission sent a letter to the Irish authorities asking further information about this measure, followed on the 1st October by a list of questions concerning the precise features of the guarantee.
3. The Irish authorities replied to the Commission on the 2nd October. On the 3rd October they formally notified the scheme. Further information on the precise features of the guarantee was sent to the Commission between the 8th and 12th October.
4. The Commission also received observations by third parties (dated 7th October), and European citizens (dated respectively 30th September & 1st October).

II. DESCRIPTION

1. The Government declarations of 30 September and 9 October 2008

5. On 30 September 2008, the Irish Minister for Finance Brian Lenihan announced a government decision to put in place with immediate effect a guarantee arrangement to safeguard all deposits (retail, commercial, institutional and interbank), covered bonds, senior debt and dated subordinated debt (lower tier II), with the following banks: Allied Irish Bank, Bank of Ireland, Anglo Irish Bank, Irish Life and Permanent, Irish Nationwide Building Society and the Educational Building Society and such specific subsidiaries as may be approved by Government following consultation with the Central Bank and the Financial Regulator. The guarantee covers all existing and new such

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facilities issued from midnight 29 September 2008 onwards, and expires at midnight on 28 September 2010. It is being provided at a charge to the institutions concerned and will be subject to specific terms and conditions so that the taxpayers' interest can be protected.

6. The Minister noted that this decision was taken following advice from the Governor of the Central Bank and the Financial Regulator about the impact of the recent international market turmoil on the Irish Banking system with a view to removing any uncertainty on the part of counterparties and customers of the six credit institutions and to maintaining financial stability for the benefit of depositors and businesses and is in the best interests of the Irish economy.
7. On 9 October 2008, the Minister confirmed the Government's intention that the Guarantee scheme for banks previously announced would be available to certain banking subsidiaries in Ireland with a significant and broad based footprint in the domestic economy. In particular, the Minister said that Ulster Bank, First Active, Halifax Bank of Scotland, IIB Bank and Postbank would be eligible for the scheme.

2. The Credit Institutions (Financial Support) Act, 2008

8. The Credit Institutions (Financial Support) Act, 2008 ("the Act") provides a legislative framework to underpin the guarantee arrangement for depositors and lenders to Irish financial institutions which was announced by the Government earlier. It empowered the Minister for Finance ("the Minister") to provide financial support to credit institutions where that is necessary in order to maintain the stability of the financial system in Ireland. It also provides a framework for the future to address financial stability. The Act was signed into law & came into force on 2nd October, 2008.
9. The principal features of the Act are listed below.
 - The Minister is empowered to provide financial support to credit institutions and their subsidiaries in respect of their borrowings, liabilities and obligations.
 - Financial support is defined to include loans, guarantees, exchanges of assets and any other kind of financial support or accommodation.
 - The financial support may be provided by the Minister on such terms and conditions which he or she thinks fit and the Act expressly provides that this may include conditions regulating the commercial conduct of the credit institution or subsidiary as well as the competitive behaviour of that credit institution or subsidiary.
 - The Act provides that all financial support provided must, so far as possible, be recouped from the credit institution to which it was provided.
10. In exercising this power to provide financial support, the Minister will have regard to whether:
 - there is a serious threat to the credit institutions in the State generally, or whether there would be such a threat if he did not provide the financial support;
 - the provision of the financial support is necessary, in the public interest, for maintaining the stability of the financial system in the State;
 - the provision of the financial support is necessary to remedy a serious disturbance in the economy of the State.

11. The Minister will take into account:
 - the extent and nature of the obligations undertaken and which may need to be undertaken by the State in relation to financial support; and,
 - the resources available to the Minister in respect of financial support.
12. According to the Act, financial support may not be granted for a period longer than two years from 30 September 2008 and any financial support provided during that period under the Act will not continue beyond 29 September 2010.
13. The Act obliges the Minister to review, from time to time, the necessity for the financial support provided and, if the financial support is no longer necessary, the Minister is obliged to withdraw it.
14. During the two year period ending on 29 September, 2010, secondary legislation (regulations) may be made to do anything necessary to bring the Act into operation.

3. The Credit Institutions (Financial Support) Scheme 2008

15. The Credit Institutions (Financial Support) Scheme 2008 ("the Scheme")-sets out an enabling framework which equips the Minister to take such action as is necessary to achieve the goals of the Act at the present time, consistent with the broader interests of the economy. The principal feature of the Scheme is the provision of a guarantee to covered institutions.

Eligibility

16. The institutions covered under the Scheme are those systemically important credit institutions which the Minister specifies by Order as requiring financial support. The Minister may consult with the Governor prior to making any such order (see §3 of the Scheme). The Irish authorities clarified to the Commission that the scheme may apply to foreign subsidiaries as well as to branches of systemic significance, in particular branches with a significant customer "main street" retail presence, taking into account that the absence of a distinct legal personality would require to enter into an individual agreement under the legislation with an overseas banks to address the specific issues that would arise in seeking to guarantee deposits in a branch operating in Ireland.

Material scope

17. According to §10 of the Scheme, the covered liabilities are 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:
 - All retail and corporate deposits (to the extent not covered by existing deposit protection schemes in the State or any other jurisdiction);
 - Interbank deposits;
 - Senior unsecured debt;
 - Asset covered securities; and
 - 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.

Temporal scope

18. Subject to the terms and conditions of this Scheme and the relevant Guarantee Acceptance Deed, the Minister stands as guarantor of the covered liabilities of a covered institution for the period from 30 September 2008 to 29 September 2010 inclusive. No call may be made under the guarantee after 29 September 2010 (see §9 of the Scheme).
19. The Minister may review and vary the terms and conditions of this Scheme from time to time, at no later than six-month intervals, to ensure that it is achieving the purposes of the Act. At such a review, the Minister will consider, *inter alia*, the continued requirement for the provision of financial support under the Scheme. The results of any such review will be provided to the Commission (see §8 of the Scheme).

Financial conditions

20. A covered institution joins this Scheme by executing a Guarantee Acceptance Deed in the form to be specified by the Minister. The Minister may also require that a parent or any other company within the covered institution's group execute such Guarantee Acceptance Deed. By entering into a Guarantee Acceptance Deed, a covered institution and in certain circumstances a group company party to a Guarantee Acceptance Deed, agree to:
 - Pay the quarterly *charge* as detailed in the Scheme;
 - *Indemnify the Minister in respect of any payments of covered liabilities* made by the Minister following a claim made under the guarantee or any other liabilities incurred by the Minister in that regard; and
 - *Indemnify the Minister in respect of any costs, claims, losses or liabilities* incurred by the Minister in connection with the provision of the financial support to the covered institution or a subsidiary;

together, in all cases, with interest accrued to the date of payment at a rate to be specified in the Guarantee Acceptance Deed (see §7 of the Scheme).

(a) The Charge (i.e. up-front fee)

21. The main principle is that the Minister estimates the aggregate cost that the State will bear as a consequence of the guarantee Scheme and each covered institution will pay its share in accordance with its risk profile. In case the actual cost for the State is higher, the charge will be adapted accordingly (§19 of the Scheme).
22. Each covered institution will pay the charge quarterly. The charge will be calculated by reference to the composition of the covered institution's average month-end covered liabilities during the quarter (see §16 & 17 of the Scheme). In particular, the charge will be calculated separately each quarter for each covered institution having regard to, *inter alia*:
 - the realistic assessment of the risk it is assessed to represent on the basis of all the relevant factors (including the credit quality of the covered institution, the covered liabilities, and the duration of the guarantee);
 - the steps the covered institution has taken to reduce that risk consistent with the objectives of the Scheme;

- the fact that the charge imposed seeks to make this Scheme self-financing, so far as possible having regard to the circumstances of the covered institution and the purposes of this Scheme,
- the need to ensure that the covered institutions are not unduly advantaged by the guarantee;
- the likely risk of default;
- the administrative costs of this Scheme; and
- the provision of an adequate return for taxpayers.

(b) Claw-back clause

23. In line with §7 of the Scheme, , the cost of all financial support provided to a covered institution is recouped from it or its assets and that covered institution reimburses the Minister for all costs, expenses and liabilities incurred by the Minister in connection with the Scheme . Where the guarantee is activated and a payment is made but the financial support cannot be recouped in full from the credit institution to which it was provided, the principle is that it would be recouped in full from the covered institutions by the State over time, in a manner consistent with their long-term viability and sustainability (§2.6 of the Scheme).

Conditions relating to the commercial conduct of covered banks

24. The Scheme includes the power to direct the commercial conduct and competitive behaviour of Covered Institutions to minimise any potential competitive distortion that might otherwise arise and requires regular and detailed reporting by Covered Institutions. In particular, the Regulatory Authority in consultation with the Minister will monitor and review the expansion of the activities of covered institutions benefiting from the guarantee in order to ensure that their aggregate growth in balance sheet volume is not excessive and does not in any event exceed :
- the annual rate of growth of Irish nominal GDP in the preceding year, or
 - the average annual historical growth in the balance sheets of Irish credit institutions during the period 1987-2007, or
 - the average growth rate of the balance sheet volumes in the credit institution sector in the EU in the preceding six months,

whichever is the higher. In case of any breach of this obligation, the Regulatory Authority will adopt, within four weeks, appropriate measures to restore the situation and inform the European Commission thereof (see §36 of the Scheme).

25. More generally, in order to be covered by the guarantee, credit institutions must comply with all directions given and requirements made by the Minister or the Regulatory Authority (§6 of the Scheme). Covered institutions are expected to conduct their affairs in a manner that progressively reduces the risk to the Exchequer under the Guarantee (§37 of the Scheme). In particular, they are required to:
- Appropriately manage their balance sheet in a manner consistent with the purposes of the Act and the need to avoid significant distortion of financial flows;

- Put in place improved structures to ensure long-term stability of funding;
- Take steps to restructure their executive management responsibilities and strengthen their management capacity and corporate governance;
- Improve liquidity, solvency and capital ratios in circumstances where this is required; and/or
- Take measures to minimise any risk of recourse to the guarantee,

as directed by the Governor and the Regulatory Authority, after consultation with the Minister.

26. In addition, covered institutions may have to comply with any targets on assets and liabilities set by the Regulatory Authority, after consultation with the Minister. These targets may include, but are not limited to: loan/deposit ratio, wholesale funding/total liabilities, deposit growth and maximum loans-to-value on new loans; all of which will be limited to agreed values on new residential mortgages and all other new lending activity. Covered institutions will also be required to limit their exposures to sectors, customers or connected customers where in the opinion of the Regulatory Authority, after consultation with the Minister, it is in the public interest, as well as to establish such funding structures as the Regulatory Authority, in consultation with the Minister, considers appropriate (§36-41 of the Scheme).
27. The scheme also foresees controls on and oversight of the remuneration of directors and executives of the Covered Institutions in receipt of financial support.
28. Finally, in line with §11 of the Scheme, the Minister will impose more specific restrictions to covered institutions in respect of subordinated debt (Lower Tier 2), so as to prevent the unwarranted expansion of capital and lending activity (see below).

Follow-up by adjustment measures

29. According to §53 of the Scheme, in the event of a default of a covered institution, relevant creditors will make a claim against the Minister, he will pay them and pursuant to the Guarantee Acceptance Deed, he will be entitled to repayment of such amounts from the covered institution.
30. In such circumstances, the covered institution will have to comply with any direction of the Minister concerning its business and corporate structures and in particular, it will have to draw up a restructuring plan within six months that will be notified to the Commission. This applies also where covered institutions' solvency ratio falls below the minimum regulatory standards on a material basis.

Transparency & Enforcement

31. The Scheme provides for additional oversight and scrutiny of the covered institutions while they are in receipt of financial support from the State, including the appointment of public interest representatives to the boards of directors of those institutions in receipt of financial support. It foresees regular and detailed reporting to the Minister, via the Regulatory Authority, to ensure protection of the taxpayer and the realisation of the objectives of the Scheme (§24-35 of the Scheme). If in the opinion of the Minister a covered institution is in breach of its obligations in a manner which is material in the context of the provision of the guarantee, the Minister may increase the charge, impose additional conditions, or revoke the guarantee.

III. POSITION OF IRELAND

32. The Irish authorities note that the emergency legislation has been introduced in circumstances of unique and unprecedented financial threat to the stability of the Irish financial system and consequently to the entire Irish economy.
33. They stress that the expert advice received by the Government on the evening of the 29th September from the Governor of the Central Bank and the Financial Regulator was that during trading hours that day there were [...] (*) outflows from the financial institutions the subject of the guarantee, which were they to continue on the 30th could do irreversible damage to the financial system. [...] These difficulties were compounded by the rejection that evening, by the US Congress of the US Government's TARP initiative.
34. The [...] advice received by the Government from the Governor of the Central Bank of Ireland and the Irish Financial Regulator was that in the absence of such immediate and decisive action the [...] situation pertaining in the Irish market on 29th September would have led to a systemic banking crisis in Ireland. The Government was further advised that unless it undertook to provide a guarantee to the named Irish institutions prior to the opening of the financial markets the following morning irreversible damage could be done to the Irish economy.
35. In relation to the Credit Institutions (Financial Support) Act, 2008, the Irish authorities do not believe that its terms and application involve unlawful State Aid within the meaning of Article 87(1) of the EC Treaty. Without prejudice to this view, if the measures were taken to constitute State Aid within the meaning of Article 87(1), the Irish authorities believe that the measures are compatible with the Common Market on the basis of Article 87(3)(b) of the EC Treaty as the measures are necessary to remedy a serious disturbance in the Irish economy.

1. Compliance of the guarantee with the MEIP

36. The Irish authorities recall that in general, a measure will not constitute State Aid if it is provided on commercial terms in accordance with the market economy investor principle ("MEIP"). In their view (**), the scheme complies with this principle for the following reasons:
 - Under the scheme, the State will charge for the provision of any guarantees that would be provided under the Act and would recoup monies in such fees as a result. The charges that will apply are currently being considered and further details will be provided as soon as they are available.
 - The Minister may attach such terms and conditions to any guarantee provided to a credit institution as the Minister believes is appropriate in order to safeguard against the scheme being misused by credit institutions. The terms and conditions are currently being considered and further details will be provided as soon as they are available.
 - The Minister may also review and withdraw any individual guarantee granted to a credit institution, for example, should the circumstances of the institution change or if the guarantee creates a commercial distortion which outweighs the benefit of the guarantee.
 - The Scheme may run for two years, i.e. until 29th September, 2010. No financial support under the scheme may continue beyond that date. In addition, as noted above, the Act allows for the possibility of review at any stage and provides for an obligation on the Minister to withdraw financial support that is no longer considered necessary in

(*) The parts of the text in brackets refer to sensitive information that have been left out.

(**) Note: as per the notification made on 3rd October 2008.

accordance with the criteria set out in paragraph 7 above. Therefore, it is intended that where the market circumstances no longer warrant the continuation of financial support, this will be withdrawn. As a result, while the scheme may last for two years, in the event that market circumstances change such that there is no longer a risk of systemic failure of the Irish financial system, the Act allows that any financial support provided under the scheme may be withdrawn.

37. In these circumstances, the Irish authorities believe that the scheme does not constitute State Aid as the scheme involves the provision of guarantees on commercial terms in accordance with the MEIP.

2. Compatibility of the Act under Article 87(3)(b)

38. If the Act were considered to constitute State Aid within the meaning of Article 87(1), the Irish authorities consider that the Act is compatible with the Common Market on the basis of Article 87(3)(b) of the EC Treaty as any financial support envisaged under the Act is necessary to remedy a serious disturbance in the Irish economy.

39. Indeed, in considering the legislation which the Government adopted on 2nd October, 2008, the Government was advised by both the Governor and the Irish Financial Regulator that there was an imminent risk of a systemic failure in the Irish banking system if the measures contained in the Act were not adopted at that time as a matter of urgency. By way of illustration, on 29th September, 2008, the ISEQ Index of the Irish Stock Exchange dropped by 13% primarily due to fears over the stability of Irish banks, with bank shares suffering the greatest falls [...]. Whilst the share price of banks does not directly affect a bank's liquidity, it does so indirectly as depositors quickly lose confidence in a bank with a plummeting share price. In these circumstances, the Governor, exercising his statutory duty, advised the Government that there was an imminent risk of systemic failure in the Irish banking system which would have had very serious consequences for the Irish economy as a whole. In particular:

- the Governor, having consulted with the banks and reviewed their financial position, advised the Government that there was an imminent risk of the failure of [...] Irish banks if the liquidity problem could not be immediately addressed;
- [...];
- the Governor advised that the Irish economy would suffer irreversible damage [...]; and,
- the Financial Regulator advised the Government in the same terms.

40. A combination of these considerations, in addition to the relatively small scale of the balance sheet of the Central Bank, significantly increased the risk of systemic failure in the Irish financial system should liquidity continue to flow out of the system. Moreover, the Irish authorities note that the Government had previously given, in the context of increasing the Deposit Guarantee Scheme limit to €100,000, the strongest possible soft 'guarantee' short of a legal guarantee - in line with what other Member States have stated. This, however, did not lead to any easing in the severe pressures on Irish financial institutions that led to the imminent risk of systemic failure experienced earlier this week.

41. It was in these circumstances that the Irish Government decided to adopt legislation which would enable the Minister to provide the guarantee provided for under the Act in order to stem the flow of liquidity from the credit institutions in question. As such, the Irish authorities believe that the decision was both necessary and proportionate in order to remedy the serious disturbance which was occurring in the economy. In doing so, the

Government decided to apply the scheme to those credit institutions in the Irish financial system which presented the greatest risk to the system from a systemic perspective. These were identified as AIB Bank, Bank of Ireland, Irish Nationwide Building Society, EBS, Anglo-Irish Bank and Irish Life and Permanent. [...] However, the Act allows for the possibility that other credit institutions might be included in the scheme and as announced by the Government on 9 October 2008, foreign credit institutions in Ireland with a significant and broad based footprint in the domestic economy are eligible under the scheme.

IV. ASSESSMENT

42. The Commission observes that the measure at issue is a guarantee scheme in favour of certain banks announced by the government on the 30th September 2008, as complemented on the 9th October 2008. The legislative Act adopted on the 2nd October 2008 provided a general framework for this guarantee and the Scheme defined more precisely its conditions. The present decision concerns this guarantee scheme, as provided for in the Act & specified in the Scheme.

1. State aid character of the guarantee

43. As set out in Article 87(1) EC, 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 common market.

Imputability

44. The guarantee was first announced on 30 September 2008, by the Irish Minister for Finance as a government decision. It was then enshrined in the Credit Institutions (Financial Support) Act, 2008 adopted by the Irish Parliament & specified in the Credit Institutions (Financial Support) Scheme 2008 drawn up by the Minister and laid before the Parliament for approval. Thus, the guarantee is clearly imputable to the State.

State resources

45. The provision of the guarantee implies that the risk associated with the guarantee is carried by the State. Such risk-carrying by the State should normally be remunerated by an appropriate premium. If the State forgoes all or part of such a premium, there is both a benefit for the undertaking and a drain on the resources of the State. Also, any monies to be paid out under the scheme if the guarantee was activated would be paid out of the State's Central Fund. Thus, the guarantee clearly involves State resources¹.

Selective advantage to economic activities

46. As acknowledged by the Irish authorities, the guarantee was intended to support certain economic operators (banks), in the context of the current financial crisis, with the view first to boosting confidence to the banking system and avoiding bank runs and secondly to allowing them to have access to the interbank lending market and obtain liquidity.
47. The measure applies to the six Irish banks specified by the Government's announcement of 30th September and is open to five banking subsidiaries in Ireland with a significant and broad based footprint in the domestic economy, as clarified by the Minister on the 9th October. According to the Scheme, foreign branches having a systemic significance

¹ See the Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees, OJ C 155, 20.6.2008, p. 10–22.

would also have access to the guarantee. In the light of the changes announced on 9 October, the Commission accepts that the rules of the Scheme are not discriminatory in themselves, and emphasises the importance of observing the fundamental rules of the Treaty in the exercise of the powers used for its implementation. However, the measure is clearly selective as it only concerns the banking sector. In addition, it may not apply to smaller institutions which don't play an important role for the maintenance of the stability of the banking system.

48. The Commission is not convinced by the arguments of the Irish authorities that the guarantee involves no aid because it would be provided on commercial terms in accordance with the market economy investor principle ("MEIP"). In this respect, the Commission first notes the very large scope of the guarantee, which covers all existing deposits, covered bonds, senior debt and dated subordinated debt and any new such facilities issued from on 30 September 2008, up to 29 September 2010 inclusive (See §9 of the Scheme). It is unlikely that any private operator would engage to such a guarantee without, at least imposing a cap. As the Irish authorities also acknowledge such guarantees don't exist in the market. Also, the Commission is convinced that in the current circumstances of financial crisis, no private investor would have granted such a significant guarantee which, given its large scope, could only be bearable by the State. In fact, for the guarantee to be credible and achieve its intended effect which is to reassure the market and restore the banks' access to liquidity, it had to be given by the State².
49. The possibility for the Minister to impose conditions on the granting of the guarantee, including to safeguard against the scheme being misused by credit institutions and withdraw any individual guarantee, don't change the fact that no market operator would have granted such a guarantee in particular in the current economic context.
50. Moreover, even if the Commission accepted the argument that such guarantee could be provided by the market, the Irish authorities have not provided any element to show that the fee imposed in exchange to the guarantee is market conform. [...] the Irish authorities have opted for a methodology to define the fee that is based on the additional funding cost for the State due to the guarantee and not on the price that the banks would have had to pay for the guarantee in the open market. By thus determining the level of the fee, the guarantee allows the banks to obtain the liquidity at advantageous conditions, which could over the time become close to that of the Irish State.
51. The Commission therefore considers that the guarantee confers a selective advantage to the banks concerned.

Effect on competition & trade

52. This economic advantage granted to the beneficiaries of the guarantee strengthens their position compared to that of their competitors in Ireland and other Member States and must therefore be regarded as distorting competition and affecting trade between Member States. In addition, the measure is liable to affect the flows of funds between banks competing within and between Member States.
53. The measure therefore constitutes State aid within the meaning of Article 87(1) of the EC Treaty.

2. Compatibility

Application of Article 87(3)(b) EC

² Cf. Commission Decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published

54. Ireland intends to provide operating aid under a scheme which is granted to assist banks that have problems accessing liquidity.
55. 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, given the present circumstances in the financial market, the Commission considers that it may be acceptable to examine this measure directly under the Treaty rules and in particular under Article 87(3)(b) EC³.
56. Article 87 (3) b) EC enables the Commission to declare aid compatible with the Common Market if it has the effect "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 needs to be applied restrictively and must tackle a disturbance in the entire economy of a Member State⁴.
57. The Commission considers that the present scheme concerns the entire Irish banking industry. In fact, the Commission does not dispute the analysis of the Irish authorities that even fundamentally sound banks are having trouble getting access to liquidity, a difficulty which shall be overcome by the scheme. The Commission also considers that this shortage of liquidity will not only result in difficulties for the banking sector but due to its pivot role in providing funds to other sectors is having a systemic effect for other industry sectors and thus the entire Irish economy. The Commission agrees with the Irish assessment that, in view of the current exceptional situation, the present scheme contributes to overcome the inaccessibility for liquidity to Irish banks. Hence it finds that the scheme is apt to remedy a serious disturbance in the Irish economy.

Conditions for compatibility under Article 87 (3) (b)

58. 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, in order for such aid to be compatible, any aid or aid scheme must comply with general criteria for compatibility under Article 87 (3) EC, viewed in the light of the general objectives of the Treaty and in particular Article 4(2), which imply compliance with the following conditions⁵:
 - a. *Appropriateness*: The aid has to be well targeted to its objective, i.e. in this case to remedy a serious disturbance in the entire economy. This would not be the case if the disturbance would also disappear in the absence of the measure or 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 were sufficient to remedy a serious disturbance in the entire economy, the measures in

³ Cf. Commission Decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published

⁴ 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*, not yet published, points 166. See Commission Decision of 5 December 2007 in case NN 70/2007, *Northern Rock*, ABL C 43 of 16.2.2008, p. 1, Commission Decision of 30 April 2008 in case NN 25/2008, *Rescue aid to WestLB*, ABL C 189 of 26.7.2008, p. 3, Commission Decision of 4 June 2008 in Case C9/2008 *SachsenLB*, not yet published.

⁵ Cf. Commission Decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published

question would not be necessary. This is confirmed by settled case law of the Court of Justice⁶.

- c. *Proportionality*: The distortions of competition must be properly balanced against the positive effects of the measures. Hence the distortions must be limited to the minimum necessary to reach the objectives. This follows from Article 3 (1) g EC and Article 4 (1) and (2) EC, which provide that the Community shall ensure the proper functioning of an internal market with free competition. Therefore, Article 87 (1) EC prohibits all selective public measures that are capable of distorting trade between Member States. Any derogation under Article 87 (3) b) EC which authorises State aid must ensure that such aid must be limited to that necessary to achieve its stated objective, limiting to a minimum consequential distortions of competition.

Assessment of the conditions for compatibility under Article 87 (3) (b)

59. *First, as regards appropriateness*, the objective of the schemes is to restore confidence in the banking system. The Commission acknowledges that in the current context there is an international market-failure where even fundamentally sound banks have difficulties to get access to liquidity. Banks have lost confidence in lending money to each other given that the risk of failure is too high. This risk is avoided by the present guarantee mechanism. The scheme should allow for a revival of the interbanking lending. In addition, by fully guaranteeing deposits, the measure at issue is able to restore depositors' trust in the banking system and avoid bank runs. Thus, the Commission considers that the guarantee is an appropriate measure to remedy a serious disturbance of the Irish economy⁷.
60. *Second, the Commission must examine whether the guarantee is limited to the minimum necessary* in scope and time, having regard to the current exceptional circumstances.
61. As regards the scope of the guarantee, in the context of the current crisis, the Commission acknowledges that it may be necessary to reassure depositors with financial institutions that they will not suffer losses, so as to limit the possibility of bank runs. Therefore, the inclusion under the guarantee of retail deposits (and debt held by retail clients) seems appropriate.
62. The Commission also agrees with the Irish authorities that the drying-up of interbank lending due to an erosion of confidence between financial institutions may also justify guaranteeing wholesale deposits and even short- and medium-term debt instruments, to the extent such liabilities are not already adequately protected by existing investor arrangements or other means.
63. However, in the present case, the guarantee goes further and covers also dated subordinated debt (lower tier 2 capital). The coverage of such debt allowing expansion of capital and thus of lending activity, requires specific restrictions to avoid undue competition distortions vis-à-vis non covered banks.
64. In the current exceptional circumstances, the Commission notes that the inclusion of subordinated debt into the guarantee may be necessary to ensure revolving of existing subordinated debt, which in the context of the current wide spread crisis is difficult to

⁶ 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 [...]."

⁷ Cf. Commission Decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published

ensure also for fundamentally sound banks. The Commission notes that the Irish authorities have committed to impose specific restrictions to banks enjoying from the guarantee as far as dated subordinated debt is concerned. According to §11 of the Scheme, where new subordinated debt is covered by the guarantee, the bank benefiting from such a financing must also maintain at least the solvency ratio initially obtained when this financing takes place during the whole duration of the guarantee period⁸. This safeguard mitigates the concerns that the inclusion of subordinated debt in the guarantee could raise in terms of use of the guarantee by the beneficiaries to unduly expand their activities to the detriment of competitors. The Irish authorities also committed to transmit to the Commission every six months the details of the restrictions imposed by the Minister.

65. As regards the time, the Commission acknowledges that two years are the minimum necessary for such scheme to safeguard financial stability by contributing to facilitate the resumption of interbank lending. Six months might be sufficient in an individual case where a follow up is envisaged (such as rescue aid), but not were the measure is aiming at establishing financial stability in the whole Irish banking sector⁹.
66. The Commission also notes positively the commitment made by the Irish authorities to review the scheme every six months, in order in particular to assessing the continued requirement to maintain the guarantee and to communicate the results of such review to the Commission (see §8 of the Scheme).
67. *Third, as regards proportionality, the distortions of competition seem minimised by various safeguards.*
68. Indeed, the aid amount is minimised through the private banks contribution in the guarantee mechanism as follows:
 - The covered institutions are required to pay as in return to the guarantee a charge (*i.e. an up-front fee*), which will compensate the State for the additional funding costs it bears as a consequence of the guarantee. The principle is that the Minister estimates an aggregate additional funding cost linked with the provision of the guarantee and each covered institution pays its share in accordance with its risk profile, as detailed in the guarantee charging methodology. According to §19 of the Scheme, in case the actual cost for the State is higher, the charge is adapted accordingly.
 - The covered institutions are required to *indemnify the Minister in respect of any payments of covered liabilities* made by the Minister following a claim made under the guarantee or any other liabilities incurred by the Minister in that regard.
 - Where the guarantee is activated and a payment is made but the financial support cannot be recouped in full from the credit institution to which it was provided, the principle is that *it will be recouped in full from the covered institutions by the State, over time*, in a manner consistent with their long-term viability and sustainability.
69. Given that the covered institutions will ultimately reimburse the State for the additional funding costs it incurs as a consequence of the guarantee, and that any payments that the State may make under the guarantee will ultimately be recouped in full either by the individual bank which benefited from it or, if this is not possible, by the covered institutions overall (see §2 of the Scheme), the Commission considers that the

⁸ This includes renewal & revolving of subordinated debt.

⁹ Cf. Commission Decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published

beneficiaries contribute, as much as possible, to the costs of the measure and any distortions are limited to the minimum.

70. In addition, the scheme comprises several behavioural conditions which help to ensure that the participating banks do not expand their activities under the scheme and thus do not receive more support than necessary for re-establishing their long term viability. According to §36 of the Scheme, the Regulatory Authority in consultation with the Minister may regulate the commercial conduct of covered institutions and impose conditions having regard to capital ratios, market share and balance sheet growth, in order to minimise any potential competitive distortion that may otherwise arise and to avoid any abuse of the guarantee.
71. The Commission also positively views that the Regulatory Authority in consultation with the Minister will monitor and review the expansion of the activities of covered institutions benefiting from the guarantee in order to ensure that their aggregate growth in balance sheet volume is not excessive and does not in any event exceed :
- the annual rate of growth of Irish nominal GDP in the preceding year, or
 - the average annual historical growth in the balance sheets of Irish credit institutions during the period 1987-2007, or
 - the average growth rate of the balance sheet volumes in the credit institution sector in the EU in the preceding six months,

whichever is the higher. In case of any breach of this obligation, the Regulatory Authority will adopt, within four weeks, appropriate measures to restore the situation and inform the European Commission thereof.

72. Moreover, the behavioural commitments are also aiming at fostering long term viability of the covered institutions, so that at the end of the scheme, they will be able to obtain loans on their own financial credibility again¹⁰. For example, covered institutions may be required to put in place improved structures to ensure long-term stability of funding, improve liquidity, solvency and capital ratios and they may have to comply with targets on assets and liabilities to be set by the Regulatory Authority, such as loan/deposit ratio, wholesale funding/total liabilities etc.
73. Finally, in the event that a specific covered institution calls on the guarantee, or where covered institutions' solvency ratio falls below the minimum regulatory standards on a material basis the covered institution will have to comply with any direction of the Minister concerning its business and corporate structures and in particular, it will have to draw up a restructuring plan within six months that will be notified to the Commission.
74. Overall, as regards coherence with other principles of the rescue and restructuring guidelines, the Commission notes that many of the overriding principles such as active fostering of viability, aid being limited to the minimum and safeguards which aim to prevent or minimise distortions of competition are included in the scheme. Moreover, Ireland committed to report on the functioning of the scheme on a bi-annual basis.

V. DECISION

75. The Commission has accordingly decided not to raise objections against the scheme, since it fulfils the conditions to be considered compatible with the EC Treaty.

¹⁰ A similar principle is imposed by point 37 of the rescue and restructuring guidelines.

Yours faithfully,

For the Commission

Neelie Kroes
Member of the Commission