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## The Resolution of Anglo Irish Bank and Irish Nationwide Building Society

by Christophe Galand, Minke Gort<sup>(1)</sup>

### 1. Introduction

Of the banks that have received State aid during the financial crisis, few have received as much aid relative to their risk-weighted assets as Anglo Irish Bank (Anglo) and Irish Nationwide Building Society (INBS). Both institutions failed on a massive scale following their speculative lending during the Irish commercial property boom and the onset of the financial crisis at the end of 2008.

According to the Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules<sup>(2)</sup> (Restructuring Communication), an orderly winding-up should be considered for banks that cannot be restored to long-term viability. The case of Anglo and INBS is one of the few Commission decisions to apply the Restructuring Communication to the resolution of failed institutions.

The choice of an aid instrument, especially during the financial crisis, should be carefully considered with a view to keeping the aid well targeted and to a minimum, in accordance 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<sup>(3)</sup> (Banking Communication).

The response of the Irish authorities to the failing of the banks at the start of the crisis was to guarantee many of the liabilities of the Irish banks, including Anglo and INBS, without knowing the depth of the difficulties these institutions were facing. As a result, private debt was transformed into public debt, which put pressure on the Irish Sovereign. In the end, the cost to the Irish state of the massive recapitalisations necessary to avoid a disorderly failure of Anglo and INBS indirectly forced it to request the European Union and the International Monetary Fund for assistance.

### 2. Beneficiaries

At the beginning of the crisis, around the time of the introduction of the blanket guarantee on

liabilities in Irish banks by the Irish authorities in September 2008, Anglo had a balance sheet of approximately EUR 100 billion, around 50% of Irish GDP. At the time, Anglo was one of the largest Irish banks in terms of balance sheet size. In terms of its business model, Anglo was a ‘monoline’ bank specialising in commercial real estate lending in three core markets: Ireland, the United Kingdom and the United States. Its market share in lending to Irish firms (both property and non-property lending) was around 20% in March 2009. The market share in UK property lending was estimated at 3.3% for that year. Risk management in Anglo was not sufficiently developed and allowed uncontrolled balance sheet growth combined with risky lending practices (such as high loan-to-value lending and interest-only lending), in particular during the years of the Irish property boom. Between 1984 and 2008, the bank’s balance sheet had a compound annual growth rate (CAGR) of approximately 30%. Anglo funded the growth of its commercial property loan book almost entirely by wholesale funding, its market share in the Irish retail savings market in September 2009 being 6%, while in the UK retail saving market, its market share was around 1%.

INBS by the end of 2008 had a balance sheet of around EUR 14 billion, making it the sixth largest Irish domestic bank by balance sheet size. INBS, as a building society, originally focussed on providing retail mortgages and retail savings products to its customers. In the years preceding the financial crisis, INBS aggressively increased its activities in risky commercial property lending, which became its main activity. Its exposure to land and property development loans grew significantly in the period of the Irish property boom, with a CAGR for commercial lending approximately three times higher for the period from 2001-2009 compared to the CAGR for its retail mortgage lending for the same period. INBS’s total loan book at the end of 2008 amounted to EUR 11 billion, divided between around EUR 8 billion in commercial land and property development loans and around EUR 3 billion in retail mortgages. Lending by INBS was funded by EUR 6.7 billion in deposits as at the end of 2008, while the remainder was funded by wholesale funding.

The business models of both institutions proved to be unsustainable and led to unprecedented financial difficulties and losses in the context of the

<sup>(1)</sup> The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

<sup>(2)</sup> OJ C 195 of 19.8.2009, p. 9.

<sup>(3)</sup> OJ C 270 of 25.10.2008, p. 8.

global financial crisis. Both were overly concentrated on commercial property lending, leading to excessive exposure to that sector of the economy which was particularly hard-hit during the financial crisis as commercial property prices decreased peak-to-trough by more than 60% in Ireland. In addition, in both cases lending was partly financed by wholesale funding, a source of funding which dried up as a result of the financial crisis. Since the beginning of the financial crisis, Anglo and INBS have registered heavy losses mainly driven by impairment charges on their respective commercial loan books.

As the difficulties being experienced by Anglo started to surface, the Irish authorities decided to nationalise the institution in January 2009. INBS was de facto nationalised following the first recapitalisation it received in March 2010.

### 3. State measures

The massive failure of both Anglo and INBS led to a bail-out of both institutions by the Irish taxpayer on an equally grand scale. Both institutions benefited from a guarantee on the majority of their liabilities (at least 75%) through the Credit Institutions Financial Support Scheme (CIFS)<sup>(4)</sup> from September 2008 to September 2010. The CIFS scheme was replaced by the Eligible Liabilities Guarantee scheme (ELG),<sup>(5)</sup> which ensured that a considerable amount of the liabilities of Anglo and INBS continued to be guaranteed. Anglo and INBS also benefited from a guarantee on short-term liabilities<sup>(6)</sup>. In addition, Anglo received a guarantee on certain of its off-balance sheet liabilities<sup>(7)</sup>.

<sup>(4)</sup> Commission Decision in Case NN 48/2008, *Ireland - Guarantee Scheme for banks in Ireland*, OJ C 312, 6.12.2008, p. 2.

<sup>(5)</sup> See Commission Decision in Case N 349/2009, *Ireland - Credit Institutions Eligible Liability Guarantee Scheme* (OJ C 72, 20.3.2010, p. 6), subsequently prolonged until 30.6.2010 by Commission Decision in Case N 198/2010, *Ireland - Prolongation of the Eligible Liabilities Guarantee Scheme* (OJ C 191, 15.7.2010, p. 1), extended until 31.12.2010 by Commission Decision in Case N 254/2010, *Ireland - Extension of the ELG scheme until 31 December 2010*, (OJ C 238, 03.9.2010, p. 2), again extended until 30.6.2011 by Commission Decision in Case N 487/2010, *Extension of the ELG scheme until June 2011*, (OJ C 159, 28.5.2011, p.5), subsequently extended until 31.12.2011 by Commission Decision in Case SA.33006, *Prolongation of the ELG scheme until December 2011*, (OJ C 317, 29.10.11, p. 5) and extended until 30.6.12 by Commission Decision in Case SA.33740, *Extension of ELG scheme until June 2012*, not yet published.

<sup>(6)</sup> Commission Decision in Case N 347/2010, *Prolongation of the guarantee for certain short-term liabilities and interbank deposits*, (OJ C 37, 5.2.2011, p. 4).

<sup>(7)</sup> Commission Decision in Case NN 35/2010 (ex N 279/2010), *Ireland - Temporary approval of the third recapitalisation in favour of Anglo Irish Bank*, (OJ C 290, 27.10.2010, p. 4).

The two institutions also received six recapitalisations between them, four to Anglo for a total of EUR 29.3 billion<sup>(8)</sup> and two to INBS for a total of EUR 5.4 billion<sup>(9)</sup>. In addition, both benefitted from an asset relief scheme, which allowed them to transfer a significant part of their commercial land and property development loans in tranches to the National Asset Management Agency (NAMA) at a discount<sup>(10)</sup>. Anglo transferred EUR 35 billion in loans at an average discount above 50%, while INBS transferred EUR 8.9 billion in loans at an average discount of 64%. It has to be noted that the size of the recapitalisations received by both institutions was partly due to the losses resulting from the transfer of the commercial land and property development loans at a loss to NAMA. Finally, both institutions, in order to ensure they could fund their balance sheet, received Emergency Liquidity Assistance (ELA) from the Irish Central Bank, which was partly guaranteed by the Irish State.

Both Anglo and INBS were required to submit restructuring plans following the various rescues. Anglo successfully submitted three restructuring plans (one end 2009 and two in 2010) while INBS submitted one restructuring plan in June 2010. However, following the decision by the Irish authorities to merge Anglo and INBS with a view to working out the respective loan books, the authorities submitted a joint restructuring plan for both institutions at the end of January 2011. The joint restructuring plan sets out how the Irish authorities plan to resolve Anglo and INBS over a period of 10 years. The joint restructuring plan is based on the merger of Anglo and INBS into the Irish Bank Resolution Corporation (IBRC), after the sales of their respective deposit books. IBRC is a licensed financial institution, fully regulated by the Central Bank of Ireland and State owned. IBRC will work-out the legacy commercial property loan book of Anglo over a period of ten years through redemptions and sales and work-out the retail mortgage book of

<sup>(8)</sup> See Commission Decision in Case N 356/2009, *Recapitalisation of Anglo Irish Bank by the Irish State*, (OJ C 235, 30.9.2009, p. 3.), Commission Decision in Case NN 12/2010 and C11/2010 (ex N 667/2009), *Second rescue measure in favour of Anglo Irish Bank*, (OJ C 214, 7.8.2010, p. 3), footnote 7 above for the third recapitalisation and Commission Decision in Case SA.32057 (2010/NN), *Ireland - Temporary approval of the fourth recapitalisation and guarantee in respect of certain liabilities in favour of Anglo Irish Bank*, (OJ C 76, 10.3.2011, p. 4).

<sup>(9)</sup> See Commission Decision in Case NN 11/2010, *Ireland - Rescue measures in favour of INBS*, (OJ C 143, 2.06.2010, p. 23.) and Commission Decision in Case NN 50/2010 (ex N 441/2010), *Ireland - Second emergency recapitalisation in favour of Irish Nationwide Building Society*, (OJ C 60, 25.2.2011, p. 6).

<sup>(10)</sup> Commission Decision in Case N 725/2009, *Ireland - Establishment of a National Asset Management relief scheme for banks in Ireland - NAMA*, (OJ C 94, 14.4.2010, p. 10).

INBS. IBRC is not engaging in any new lending or other new activities. IBRC benefits from a continuation of the guarantees on the remaining deposits, the guarantee on certain off-balance sheet liabilities, the State guarantee on part of the ELA funding it receives and a guarantee on outstanding ELG wholesale funding. No further recapitalisation apart from those already received by Anglo and INBS is foreseen in the base case.

#### 4. Procedural steps

The Commission has taken nine decisions for the two institutions combined. This number does not include the decisions taken by the Commission with regard to the schemes that Anglo and INBS have benefitted from (CIFS, ELG and NAMA). For Anglo, the decisions include: approval of a rescue recapitalisation on 14 January 2009 that was not carried out; the Anglo nationalisation decision on 14 February 2009 (the Commission found there was no State aid involved); the four decisions on the successive rescue recapitalisations of Anglo carried out on 26 June 2009, 31 March 2010, 10 August 2011 and 21 December 2010; and the final decision approving the joint restructuring plan on 29 June 2011. The decision of 31 March 2010 also included an opening of the formal investigation procedure into the first restructuring plan for Anglo, while the decision authorising the fourth recapitalisation also covered the guarantee on short-term deposits and certain off-balance sheet liabilities. In the case of INBS, two decisions were taken regarding its recapitalisation, on 30 March 2010 and 21 December 2010.

The decisions were taken on the basis of Article 107(3)(b) of the Treaty on the Functioning of the European Union.

#### 5. Assessment of the resolution of Anglo and INBS

The final decision adopted by the Commission approving the restructuring of Anglo and INBS was based on the joint restructuring plan submitted by the Irish authorities on 31 January 2011. The Commission assessed this plan on the basis of the Restructuring Communication. However, instead of assessing whether Anglo and INBS would be returned to viability, the Commission in this case had to assess whether the resolution of the two institutions was in line with the Restructuring Communication. In addition, the Commission had to assess whether there had been sufficient burden-sharing and whether there were sufficient measures in place limiting the distortion of competition.

#### 5.1. Orderly resolution of Anglo and INBS

Compared to the assessment of a financial institution's return to viability, the analysis of a bank's resolution is relatively straightforward. The Commission in these cases verifies whether a liquidation, wind-down or resolution is carried out in an orderly manner, taking into account chapter 5 of the Banking Communication with regard to limiting moral hazard, the period required for the resolution, the activities carried out by the institution during the resolution and burden-sharing.

In the case of Anglo and INBS, the Commission concluded that the work-out of the loan books of Anglo and INBS was carried out in an orderly manner, as the loan book will be reduced through the sale of loans and restructuring and redemption of the remainder over a period of ten years. The entity will have all the resources needed to carry out the work-out.

#### 5.2. Own contribution/burden-sharing

In order to avoid moral hazard and to ensure that the aid necessary for a resolution is limited to the minimum, the Commission has to verify whether the own contribution by the institution and burden-sharing with the creditors has been sufficient. The guidance provided by the Restructuring Communication is therefore also relevant for resolution and liquidation cases.

In the case of Anglo and INBS, despite the massive aid already provided to both institutions, the Commission could still conclude that the aid was limited to the minimum on the basis that Anglo and INBS would both cease to operate on the market, and because the aid is strictly limited to financing the economic activities needed to work-out the loan books.

As for burden-sharing, it has to be noted that both the shareholders in Anglo and the members of INBS were totally wiped out and will not benefit from their economic ownership of either institution. The subordinated debt holders in both institutions furthermore contributed to the restructuring through the various liability management exercises conducted by Anglo and INBS.

#### 5.3 Measures limiting the distortion of competition

The Restructuring Communication says that measures limiting the distortion of competition should be proportional to the aid received and the distortion of competition in the relevant markets. Anglo and INBS both received massive amounts of aid; Anglo received 43.9% of aid relative to its risk

weighted assets (RWA) and INBS received 59% of aid relative to its RWA <sup>(1)</sup>. These amounts justify far-reaching measures to limit the distortion of competition.

In the assessment, the fact that both Anglo and INBS were to be resolved over time was taken into account, as this leads to a complete exit from the market by both institutions. In other words, the aid does not allow a competitor to stay on the market; it only serves to finance the orderly exit of both institutions. Furthermore, several commitments were provided by the Irish authorities to ensure that Anglo and INBS (IBRC) will not carry out any economic activities apart from the activities necessary to work-out the loan book. New lending is restricted to a minimum and must lead to an increase in the net present value of the loan concerned, while IBRC will also not be able to collect new deposits and will reduce the deposits it has on its balance sheet over time. The complete exit of Anglo and INBS from the market, combined with the commitments, provided the Commission with sufficient assurance that the distortions of competition would be limited.

## 6. Conclusion

This is one of the few resolutions of banks approved by the Commission. It is important because it shows how the Commission assesses a complete resolution or wind-down of a bank. This case also shows how the principles in both the Banking Communication and the Restructuring Communication interact in terms of the assessment of a wind-down and the assessment of burden-sharing and measures limiting the distortion of competition.

In addition, this case illustrates which kinds of commitments are necessary to ensure that the distortions of competition during the wind-down phase are limited to a minimum.

This case also underlines the fact that Member States must carefully select the aid measure used to rescue one or several financial institutions. To do this, they need to have accurate knowledge of the depth of the difficulties experienced by the institutions they are trying to save before providing any form of State aid. Indeed, in this case, having guaranteed most of the liabilities of Anglo and INBS and having taken the role of sole creditor of Anglo in place of private creditors, the Irish State could not let it fail, even when it turned out that the rescue would be extremely costly.

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<sup>(1)</sup> Only taking into account the recapitalisations and asset relief measure.