

## Financial Regulatory Brief

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FINANCIAL REGULATORY GROUP BRIEFING

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## ■ CREDIT INSTITUTIONS (FINANCIAL SUPPORT) SCHEME 2008

### Background

On 17 October 2008, the Credit Institutions (Financial Support) Scheme 2008 (the “Scheme”) was formally approved by both Houses of the Oireachtas (the Irish Parliament). On 20 October 2008, the Scheme was then made by the Minister for Finance, Brian Lenihan (see SI No. 411 of 2008).

The Scheme gives formal effect to the bank guarantee announced by the Irish government on 30 September 2008, and was made by the Minister for Finance pursuant to powers given to him by the Credit Institutions (Financial Support) Act 2008 (the “Act”), which was passed on 3 October 2008.

On 13 October 2008, the Scheme was approved by the European Commission as being compatible with EC Treaty state aid rules.

### Scope

#### Institutions covered by the Scheme

In order to join the Scheme, credit institutions and named subsidiaries are required to execute a “guarantee acceptance deed” and must then be designated in an order by the Minister for Finance. On joining the Scheme, an institution then becomes a “covered institution”.

When the guarantee was announced on 30 September 2008, it was expressed to be for the benefit of six institutions: AIB, Bank of Ireland, Anglo Irish Bank, Irish Life and Permanent, EBS Building Society and Irish Nationwide. The Minister for Finance subsequently announced on 9 October 2008 that he intended to extend the availability of the guarantee to certain banking subsidiaries in Ireland with a significant and broad-based footprint in the domestic economy, namely: Ulster Bank, First Active, Halifax Bank of Scotland, IIB Bank (now KBC Bank) and Postbank.

Once an institution has executed a guarantee acceptance deed and the Minister for Finance has then made the necessary order, its name will appear on the website of the Department of Finance: <http://www.finance.gov.ie>

The first wave of covered institutions was named on 24 October 2008:

- Allied Irish Banks, p.l.c. and its subsidiaries AIB Mortgage Bank, AIB Bank (CI) Limited, AIB Group (UK) p.l.c. and Allied Irish Banks North America Inc.;
- Anglo Irish Bank Corporation p.l.c. and its subsidiary Anglo Irish Bank Corporation (International) p.l.c.;
- The Governor and Company of the Bank of Ireland and its subsidiaries Bank of Ireland Mortgage Bank, ICS Building Society and Bank of Ireland (I.O.M.) Limited;
- EBS Building Society;
- Irish Life and Permanent p.l.c. and its subsidiary Irish Permanent (IOM) Limited; and
- Irish Nationwide Building Society and its subsidiary Irish Nationwide (I.O.M.) Limited.

On 5 November 2008 Postbank Ireland Limited was also named as a covered institution.

Ulster Bank, First Active, Halifax Bank of Scotland and KBC Bank have each announced that they do not intend to join the Scheme.

The Department of Finance has clarified that branches of covered institutions will automatically benefit from the guarantee. In contrast, subsidiaries will only be able to benefit from the guarantee if they become covered institutions, i.e. if they execute a guarantee acceptance deed and are then designated by the Minister.

### **Liabilities covered by the Scheme**

The liabilities covered by the Scheme (“covered liabilities”) are:

- all retail and corporate deposits (to the extent not covered by existing deposit protection schemes in Ireland or any other jurisdiction);
- interbank deposits;
- senior unsecured debt;
- covered bonds (including asset covered securities); and
- dated subordinated debt (Lower Tier 2) (subject to certain restrictions),

excluding any intra-group borrowing and any debt due to the European Central Bank arising from Eurosystem monetary operations.

The Scheme operates over and above the existing deposit guarantee scheme for Irish banks and building societies, which was extended on 20 September 2008 to cover €100,000 per depositor per institution.

The Financial Regulator has deemed that, under the standardised approach, covered liabilities will qualify for zero risk-weighting for regulatory capital purposes whilst the guarantee is in effect.

### **Nature of the guarantee**

The Minister will stand as guarantor of covered liabilities of a covered institution for the period 30 September 2008 to 29 September 2010 inclusive.

No call can be made under the guarantee after 29 September 2010.

The guarantee does not affect any other rights or claims of creditors.

The guarantee is unconditional, irrevocable and ensures timely payment of the covered liabilities of the covered institutions. In the event of any default of a covered institution in respect of a covered liability, the Minister for Finance will pay to the relevant creditor, on demand, an amount equal to the unpaid covered liabilities.

Should an institution be removed from the guarantee scheme, all of its fixed term covered liabilities outstanding at that time will continue to have the full benefit of the

guarantee to 29 September 2010 or their maturity, whichever is the earlier. All covered liabilities, including on-demand deposits, will be protected by notice of at least 90 days prior to any covered institution being removed from the guarantee scheme.

### Restrictions on commercial conduct

Under the Scheme, the Financial Regulator, in consultation with the Minister for Finance, will impose conditions that regulate the commercial conduct and competitive behaviour of covered institutions.

For example, covered institutions will be required to:

- appropriately manage their balance sheets in a manner consistent with the purposes of the Act;
- put in place improved structures to ensure long-term funding stability;
- take steps to restructure their executive management responsibilities and strengthen their management capacity and corporate governance arrangements;
- improve their liquidity, solvency and capital ratios in circumstances where this is required; and/or
- take measures to minimise any risk of recourse to the guarantee.

There will also be restrictions on the level of permitted growth in each covered institution's balance sheet, limitations on the declaration of dividends and restrictions on share buy-backs and redemptions.

The Scheme contains specific requirements in relation to board representation and executive management remuneration. For example, covered institutions will be obliged, at the direction of the Minister for Finance and in order to promote the public interest, to appoint at least one but no more than two non-executive directors to their boards from a panel approved by the Minister. An independent committee will also be established by the Minister to oversee all remuneration plans in respect of senior

executives of the covered institutions. Each covered institution will be required to prepare a plan to structure the remuneration packages of directors and executives so as to take account of the objectives of the Act. For the period of the guarantee, bonuses paid by covered institutions will have to be measurably linked to reductions in guarantee charges, a reduction in excessive risk taking and the encouragement of the long-term sustainability of the covered institution in question.

### Charge to be imposed on the covered institutions

Under the Scheme, the covered institutions must pay a quarterly charge to the Irish government for benefit of the guarantee. The estimated aggregate cost of the guarantee over the next two years is expected to be around €1 billion. The aggregate amount of the charge is based on the increased debt servicing costs that Ireland will bear as a result of providing the guarantee.

The individual charge that each covered institution will pay is expected to be based, in part, on its long-term credit rating and, as such, its risk profile.

Covered institutions will be prohibited from passing the costs of the guarantee to their customers in an unwarranted fashion.

Finally, by joining the Scheme, a covered institution will agree to indemnify the Minister in respect of any payments made, or costs incurred, by the Minister under the guarantee provided to the institution. However, covered institutions will not be required to cross-indemnify any covered institutions outside their own group.

### Further details

Copies of the relevant legislation (including the scheme document itself), a market notice in relation to the guarantee scheme and a list of covered institutions can all be found on the website of the Department of Finance: <http://www.finance.gov.ie>.

## Contact

For further information, please contact:

**Cormac Kissane**

Tel: +353 1 618 0529

[cormac.kissane@arthurcox.com](mailto:cormac.kissane@arthurcox.com)

**Robert Cain**

Tel: +353 1 618 1146

[robert.cain@arthurcox.com](mailto:robert.cain@arthurcox.com)

### DUBLIN

Earlsfort Centre  
Earlsfort Terrace  
Dublin 2  
Ireland

T: +353 1 618 0000

F: +353 1 618 0618

[mail@arthurcox.com](mailto:mail@arthurcox.com)

[www.arthurcox.com](http://www.arthurcox.com)

### BELFAST

Capital House  
3 Upper Queen Street  
Belfast BT1 6PU  
Northern Ireland

T: +44 28 9023 0007

F: +44 28 9023 3464

### LONDON

12 Gough Square  
London EC4A 3DW  
England

T: +44 20 7832 0200

F: +44 20 7832 0201

### NEW YORK

300 Park Avenue  
17th Floor  
New York NY 10022  
USA

T: +1 212 705 4288

F: +1 212 572 6499