

Financial Regulatory Brief

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FINANCIAL REGULATORY GROUP BRIEFING

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Recapitalisation of Allied Irish Bank and Bank of Ireland

This update covers details of the recapitalisation package recently announced by the Irish Government (the “**Government**”) for the State’s two biggest banks, Allied Irish Banks, Plc (“**AIB**”) and Bank of Ireland (“**BOI**”).

Background

On 21 December 2008, the Government announced its intention to recapitalise each of AIB, BOI and Anglo Irish Bank. However, the initial plan to recapitalise all three institutions was revisited following the nationalisation of Anglo Irish Bank on 15 January 2009. After extensive discussions with AIB and BOI over a number of weeks, the Minister for Finance announced details of a recapitalisation package for AIB and BOI on 11 February 2009 (the “**Recapitalisation**”).

AIB and BOI both remain “covered institutions” under the Credit Institutions (Financial Support) Scheme 2008 (the “**Guarantee Scheme**”), so their “covered liabilities” remain guaranteed by the Minister of Finance until 29 September 2010.

Financial aspects of the Recapitalisation

The main financial features of the Recapitalisation are as follows:

- The Government will invest €3.5bn of Core Tier 1 capital in each of AIB and BOI. This investment will be funded from the National Pension Reserve Fund and the necessary legislation to amend the National Pensions Reserve Fund Act 2000 will be introduced in the Irish Parliament shortly.
- In return for its investment, the Government will receive preference shares (the “**New Preference Shares**”) with a fixed dividend of 8% payable in cash or alternatively ordinary shares in lieu of a dividend. The Financial Regulator has confirmed that the New Preference Shares constitute Core Tier 1 capital.
- AIB and BOI have a discretion to pay the fixed dividend in cash or issue ordinary shares in lieu of a dividend. Ordinary shares issued in this way must be issued no later than the date on which the relevant bank subsequently pays a cash dividend on other Core Tier 1 capital. The voting rights associated with such shares may be exercised from the date the dividend became payable.

- AIB and BOI will be able to repurchase the New Preference Shares at par until the fifth anniversary of the issue and at 125% of their face value thereafter.
- The New Preference Shares are transferable by the Government, without voting rights, and rank pari passu with ordinary share capital on liquidation.
- The Minister will have the power to appoint 25% of the directors to both AIB and BOI, and will also control 25% of total ordinary voting rights in respect of change of control and board appointments.
- The prior consent of the Minister is required for capital issuance or redemptions (other than redemption of the New Preference Shares) or other changes in the capital structure of either bank.
- Warrants attached to the New Preference Shares will give an option to the Government to purchase up to 25% of the ordinary share capital of each bank existing on the date of issue of the New Preference Shares, calculated on a post-dilution basis. The strike price of the first 15% of the warrants exercised by the Government will be €0.975 for AIB and €0.52 for BOI. The strike price of the balance of the warrants will be €0.375 for AIB and €0.20 for BOI.
- If either AIB or BOI redeems up to €1.5bn of the New Preference Shares from privately sourced Core Tier 1 capital by 31 December 2009, the warrants will be reduced pro rata to that redemption to an amount representing not less than 15% of the ordinary shares of the bank.
- AIB and BOI will each pay an arrangement fee to the State of €30 million.

AIB and BOI have also accepted that they will reduce remuneration for all senior executives by at least 33%. There will be no salary increases or performance related bonuses for senior executives in relation to 2008 and 2009. In addition, fees for non-executive directors will be reduced by 25%.

The Recapitalisation remains subject to: (a) regulatory approval in a number of jurisdictions; (b) EU state aid approval; and (c) approval of the ordinary shareholders of AIB and BOI respectively.

Additional Features of the Recapitalisation

In addition to the financial features of the Recapitalisation described above, the Government has imposed additional conditions which BOI and AIB will have to comply with. Statutory codes of practice on business lending (the “**Business Lending Code**”) and mortgage arrears (the “**Mortgage Arrears Code**”) were published by the Financial Regulator on 13 February 2009.

The Business Lending Code applies to small and medium enterprises (“SMEs”). SMEs are defined as “enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding €50 million, and/or an annual balance sheet total not exceeding €43 million”. The Code explicitly excludes lending to other financial institutions, syndicated, club, or multi-lender transactions and lending to special purpose vehicles.

The Business Lending Code will require banks to offer customers annual review meetings, to inform customers of the basis for decisions made and to have written procedures for the proper handling of complaints. Where a customer gets into difficulty, the banks will have to seek to agree an approach to resolve problems and provide reasonable time for resolution and appropriate advice. Banks must not impose unreasonable collateral requirements for providing credit and must not impose unreasonable personal guarantee requirements on borrowers.

The Mortgage Arrears Code covers the provision of finance for a borrower’s principal primary residence. The Code provides that where a borrower is in difficulty, the lender will make every reasonable effort to agree an alternative repayment schedule and will not commence legal action for repossession until six months after the arrears first occur. AIB and BOI have agreed not to commence court proceedings for repossession of a principal private residence until after 12 months of arrears appearing, where the customer continues to co-operate reasonably and honestly. In addition, AIB and BOI have assured the Government that in the normal course of events they will make every effort to avoid repossessions.

AIB and BOI have each confirmed the commitment they made in December 2008 to increase lending capacity to small and medium enterprises by 10% and each bank will contribute €15 million to an Enterprise Ireland seed capital fund. A €100 million environmental and clean

energy innovation fund will also be established by each bank.

AIB and BOI have also agreed to participate in a 'clearing group' comprised of business interests and state agencies. This clearing group will identify cases where the flow of credit to viable projects appears to be blocked, and seek to identify solutions. AIB and BOI will fund and cooperate with an independent review of credit availability.

AIB and BOI will each provide 30% additional capacity for lending to first time home buyers in 2009.

Other Issues

As well as the details of the Recapitalisation set out above, the Minister of Finance's announcement contained the following information:

Guarantee of Longer Term Instruments

In conducting its six month review of the Guarantee Scheme, to be completed by mid-April 2009, the Government will examine how the

Guarantee Scheme can be revised in ways which include supporting longer-term bond issuance by the covered institutions. This would be in line with EU trends where the average term of State cover for bond issues extends beyond 2010. Any amendments to the Guarantee Scheme will be subject to EU State aid approval.

Proposals for Dealing with Certain Assets

The Minister for Finance explained that Irish credit institutions are exposed to specific risks in relation to their loan books at a time of falling property prices and difficult economic conditions. The Minister confirmed that, as a matter of priority, he will be looking at proposals for the management and reduction of risks within Irish financial institutions in relation to their property related exposures. Any proposals put forward will have regard to international developments and ongoing work being undertaken by the ECB and the EU Commission.

Full details of the Recapitalisation can be found at the following link to the Department of Finance website:

<http://www.finance.gov.ie/viewdoc.asp?DocID=5669>.

Contact

For further information, please contact:

Cormac Kissane

Tel: +353 1 618 0529

cormac.kissane@arthurcox.com

Robert Cain

Tel: +353 1 618 1146

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

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