

Stephen Court Tel: +353 1 6162000 Fax: Banking +353 1 6162481
18/21 St Stephen's Green SWIFT: AngolE2D Fax: Treasury +353 1 6162467
Dublin 2 Website: www.angloirishbank.com Fax: Personal Deposits +353 1 6162483
Ireland Fax: Personnel +353 1 6162488

CEBS Working Group on own Funds,
Committee of European Banking Supervisors

22nd February 2008

**ANGLO IRISH BANK COMMENTS TO CEBS' DRAFT PROPOSAL FOR A
COMMON EU DEFINITION OF TIER1 HYBRIDS**



Dear CEBS' Committee

Anglo Irish Bank ('Anglo') welcomes the opportunity to comment on the Committee of European Banking Supervisors (CEBS) proposal for a Common EU definition of Tier 1 hybrids. Whilst we understand and support the committee's objectives of harmonizing and simplifying hybrid rules across Europe we do have a number of specific concerns with the proposals as they are currently drafted.

Principles Based:

We believe the CEBS objective of integrating the Sydney Press Release ('SPR') into EU legislation is best realised by introducing a common, agreed set of principle-based guidelines. These principles could then be interpreted by individual European regulators in a way that accommodates the different company law, insolvency law and tax regimes within their own jurisdiction. We believe that differences between individual member states' tax and legal frameworks should be specifically recognised and accommodated within the final proposal, particularly as it is the local regulator that would ultimately be the final arbiter for addressing the challenges created by a failing bank.

As a result of the current prescriptive proposals, we are likely to see more divergence amongst European bank structures rather than convergence in order to address the country-specific tax and corporate challenges directly created by CEBS proposals. We are concerned at how prescriptive the proposals are, and how this approach may prove inflexible, particularly in light of the current challenges facing the banking sector.

Competitive Disadvantage:

The timeframe for the proposed introduction of these changes will put European banks at a competitive disadvantage to their non-European peers and CEBS should be aware of the implications of a lack of coordination with the Basel Committee.



The proposed changes could have an immediate impact on banks access to the hybrid capital market when implemented. The fixed income investor base for Tier 1 hybrid instruments has evolved as a sub-section of the fixed income investor base over the last decade. Features like write-down requirements and conversion provisions will run contrary to the investment restrictions for many dedicated fixed income investors. The proposals specifically set out to amend the relative ranking between common equity and other Tier 1 investors in certain circumstances; however this will encounter significant resistance from fixed income investors, while also failing to meet the aim of encouraging new capital in a stressed situation in our opinion.

The current proposals have been drawn focusing on a period during which issuers have enjoyed attractive issuance conditions. Investors were willing to purchase instruments which provided regulatory compliant features at limited cost – for example complete discretion to defer and non-payment if this is to cause a breach of regulatory ratios. However, in a market where current sentiment is demanding certainty and protection, investors are increasingly discerning about the features they will be willing to accept in hybrid Tier 1 instruments.

It would preferable that the EU would not legislate and re-define capital prior to the completion of Basle's global review on the definition of capital. This would prevent European banks from being obliged to adapt twice to a new regulatory environment within a relatively short timeframe.

Loss Absorbency

Anglo believes that loss absorption is already achieved on a going concern basis by existing hybrid capital instruments in Ireland and structures have been exactly designed to meet regulator requirements. Issuers across Europe have the ability to cancel periodic payments indefinitely and on a non-cumulative basis. Upon

liquidation holders' claims for the principal amount of the hybrid instrument are subordinated to the claims of all depositors. In order to help a bank continue its operations as a going concern, the instrument must enable the bank to meet its obligations, and avoid the situation where its liabilities exceed its assets. In fact, under the Irish Alternative Capital Instruments ("ACI BSD S 1/04") legislation, in order for a hybrid instrument to be recognised as eligible for inclusion in Tier 1 capital, a regulatory confirmation must be obtained that demonstrates the prudential properties and behaviors required in 15 different scenarios ranging from fraud to insolvency.



The proposal with regard to loss absorption states that the hybrid instrument must include a principal write-down feature or a provision to convert into ordinary shares is of particular concern for a number of reasons.

- It is unclear how these features would enhance the loss absorption ability of existing Tier 1 instruments as the issuer has full control over any cash outflows in respect of the hybrid instrument from the date of issuance as outlined above.
- As part of the loss absorption criteria, CEBS states that hybrids must be senior only to ordinary share capital. This subordination ranking indicates that equity holders should not be better placed than investors of hybrid instruments. On this basis, we question the requirement that hybrids contain a provision which allows the issuer to write-down the principal of an instrument when a similar requirement does not apply to equity. If an issuer's capital ratio falls, distributable earnings will be affected and no dividends will be paid to equity holders, but the par value of the equity remains the same. However, if a situation arose where the value of a hybrid instrument was written down without an equivalent write down in the value of issued share capital, this subordination ranking is effectively reversed.
- Conversion into common equity is unlikely to be utilised in practice by issuers. Any features that result in equity being held or delivered to fixed income investors would result in these investors liquidating common shares immediately due to their inability to hold such instruments, which is clearly not desirable in times of stress.

Limits to Inclusion into Tier 1



The Sydney Press Release proposed that “the aggregate issuances of non-common equity Tier 1 instruments with any explicit feature – other than a pure call option – which might lead to the instrument being redeemed is limited – at issuance – to 15% of the consolidated bank’s Tier 1 capital”. The term ‘at issuance’ has been omitted from the CEBS proposals. It is in our view, imperative that this 15% limit be applied in line with the Sydney Press Release. It would prove extremely difficult for institutions to manage this restriction on any basis other than at issuance.

In addition to the difficulties in managing capital base, the application of limits “at any time” as opposed to “at time of issuance” will lead to a double negative impact on Tier 1 when an institution starts to report losses affecting its core Tier 1. Under the proposed limits, hybrids that would be disqualified will still be providing the financial institution with the required payment flexibility and the ability to absorb losses.

Regarding the overall limits to Tier 1, Anglo believes that the proposed 70% or 50% limit will lead to confusion and hinder harmonization. In our opinion one limit should be made standard across the EU, and we would suggest that a 50% limit apply. At present, European Regulators in six countries allow such a limit (49% or 50%). Whilst we accept that this does not represent the majority of countries, we would raise the point that these six countries account for over 70% of all hybrid capital instruments issued in the EU currently.

Furthermore, the proposed two-tier approach will create a cliff effect. In the instance where an institution, which has historically maintained a Tier 1 ratio above minimum requirements, suffers significant losses, reducing its ratio to the minimum level, the stress on the institution will be compounded by the requirement to reduce the level of hybrids in the capital structure. This will only increase the volatility of capital ratios during a stress period and hurt the financial institution even further while, paradoxically, the actual amount of Tier 1 qualifying capital remains unchanged.

Grandfathering

All Irish issuance has met the stringent criteria for loss absorption, permanence and payment flexibility as set out in ACI legislation (BSD S 1/04) issued by the Irish

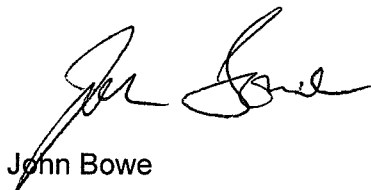
Financial Regulator in 2004. The proposal for write-down and/or conversion features renders all this issuance ineligible under the proposed rules. The grandfathering provisions as proposed, effectively remove the undated nature of Irish issuance. It is our view that the grandfathering provisions should be unqualified, such that all pre-dated instruments that qualified as Tier 1 capital under the rules that are currently in place in that jurisdiction should continue to qualify.



The current proposals make a distinction between instruments with an incentive to redeem and those without, when it states that instruments with a call provision will remain eligible until the next call date, and all remaining instruments will be gradually reduced over a period of 30 years. This effectively encourages institutions to call instruments, as the issuer will be forced to maintain the cost of servicing these instruments with no corresponding contribution to regulatory capital requirements. This in our view undermines the principles of permanence as it may not be appropriate time for the issuer to call. It may not be possible for the issuer to replace the capital with another form of capital of at least the same quality. In the current climate, there is also the possibility that the Regulator may not permit an issuer to call.

Anglo appreciates the opportunity to provide CEBS with comments regarding its proposal to provide guidelines for a common definition of Hybrid instruments. As a regular issuer we know that consistency in the form of the product offered is essential in reducing execution risk, particularly when markets are turbulent. As a result, we consider that CEBS' proposals in respect of permanence; limits and grandfathering (as described above) could be adopted as a first step in harmonisation without creating significant market distortions. A second step should be harmonisation of the proposals in respect of loss absorption and flexibility of payments but this should be done in the context of Basel's recommendations.

Yours sincerely,



John Bowe

Director of Capital Markets