

Memorandum on the intervention conditions and other matters relevant to seeking a Transfer Order for Newbridge Credit Union (“NCU”) under the Central Bank and Credit Institutions (Resolution) Act 2011 (the “2011 Act”)

To: The Governor
From: Special Resolution Unit (“SRU”) of the Central Bank of Ireland (the “Bank”)
Date: 8 November 2013

A. INTRODUCTION

1. This report (the “**Report**”) is prepared in order to assist you in the performance of your functions under the 2011 Act in respect of the matters discussed herein. To the extent that this Report outlines a policy position or suggests a course of action, this is done for consideration and discussion purposes and does not purport to represent an official policy view or decision of the Bank, whether for the purposes of the 2011 Act or any other purpose, and whether with respect to institutions named in this report or generally.
2. This Report includes information made available to SRU by the Registry of Credit Unions (“**RCU**”). RCU is a division of the Bank and is responsible for the registration, regulation and supervision of credit unions. Credit unions are mutual not for profit organisations whose principal activities are the accepting of shares and deposits from members and the making of loans to members. They are regulated under the Credit Union Act, 1997 (as amended) (the “**CUA**”).
3. The purpose of this Report is to outline the facts which may assist you to determine: 1) whether the conditions for intervention set out in section 9 of the 2011 Act (the “**Intervention Conditions**”) have been fulfilled in relation to NCU; and 2) whether an application for a transfer order transferring NCU’s assets (excluding NCU’s premises) and liabilities to Permanent TSB Public Limited Company (“**PTSB**”) under Part 5 of the 2011 Act should be made. Finally the Report provides an overview of the proposed content of a transfer order, should you decide that an application for such an order should be made.
4. The key views expressed in this Report are that, in the opinion of SRU:

- 4.1 the Intervention Conditions are fulfilled in relation to NCU;
- 4.2 an application for a transfer order in relation to NCU under Part 5 of the 2011 Act is considered to be necessary in all the circumstances to address one or more of the reasons for the intervention conditions being fulfilled;
- 4.3 it is necessary in all the circumstances for the transfer order in relation to NCU to have immediate effect pursuant to section 30(5) of the 2011 Act;
- 4.4 an application for a transfer order transferring NCU's assets (excluding NCU's premises) and liabilities to PTSB with immediate effect under Part 5 of the 2011 Act is the recommended course of action for the Bank in relation to NCU.

B. BACKGROUND

5. As you are aware, a Special Management Order ("**SMO**") was made by the President of the High Court on 13 January 2012 in respect of NCU pursuant to an application by the Bank under Section 58 of the 2011 Act. Under the SMO Luke Charleton of Ernst & Young was appointed as Special Manager to NCU (the "**Special Manager**") with immediate effect.
6. In February 2012, the Special Manager produced two reports in relation to NCU: 1) the "Credit Report"; and 2) the "Viability Report", both of which were dated 10 February 2012 and were prepared pursuant to the SMO (together the "**SM's Reports**").
7. If a Special Manager had not been appointed to NCU, there would have been extremely serious consequences for NCU. If NCU's true financial position (as identified in the SM's Reports) had emerged publically, it would have most likely led to the withdrawal of members' savings, and a potential run on NCU, which would have significantly destabilised NCU's position, ultimately to the detriment of NCU and its members. The appointment of the Special Manager prevented this outcome from materializing and afforded an opportunity to develop resolution options for NCU.
8. The SMO was extended on 9 July 2012 for a further six month period, up to and including 12 January 2013 (the "**First Extension**").

The First Bid Process

9. In a letter dated 19 June 2012, you authorised SRU to undertake the work identified in a letter from Greg Dempsey of 19 June 2012, and any other necessary work, to enable you to consider whether the intervention and other conditions set out in the 2011 Act were met, and whether a transfer order was necessary in all the circumstances. A copy of the letter from Greg Dempsey of 19 June 2012 is enclosed. The work authorised by you included that SRU carry out a competitive bid process that allowed the determination of the market value of the assets and liabilities to be transferred in accordance with Section 28 of the 2011 Act (the “**First Bid Process**”). On the same date, you approved a draft First Bid Process steps plan for NCU, which outlined the criteria to be used by the Bank in identifying potential transferees and assessing any bids received from those potential transferees (the “**First Bid Process Steps Plan**”).
10. The First Bid Process was completed in accordance with the First Bid Process Steps Plan. This initially involved only credit union bidders. The First Bid Process was subsequently extended to include eligible banks. The Bank did not receive any bids from eligible banks. Of the four credit unions approached by SRU under the First Bid Process, only one credit union, [REDACTED] (the “**2012 Bidder**”), submitted a formal bid. The 2012 Bidder’s bid was received by SRU on Friday, 14 September 2012 (the “**2012 Bid**”).
11. Having regard to the function of the Minister for Finance (the “**Minister**”) under Section 46 of the 2011 Act of providing a financial incentive to a person to become a transferee under a transfer order, a copy of the 2012 Bid was provided to officials at the Department of Finance on 17 September 2012. Officials from the Department of Finance met with representatives from the 2012 Bidder on 4 October 2012 to discuss the 2012 Bid.
12. As part of the 2012 Bid, the 2012 Bidder requested a financial incentive to assume NCU’s entire engagement, assets and liabilities amounting to €78,430,000 (the “**2012 Incentive**”). The 2012 Incentive requested by the 2012 Bidder was estimated to represent an excess of total liabilities over total assets of approximately €2.3 million on NCU’s balance sheet as at 31 July 2012¹, plus:
- 12.1 An additional loan loss risk premium of approximately €35 million (over the Special Manager’s latest estimate of the total loan loss provisions for NCU of approximately €56 million as at 31 July 2012). This represented approximately a 62.5% increase over the Special Manager’s 31 July 2012 loan loss estimate for NCU and was a key

¹ Extracted from NCU’s (unaudited) management accounts for month ended 31 July 2012.

element of the 2012 Incentive. The 2012 Bidder had estimated the total stock of loan loss provisions within NCU's loan portfolio at approximately €91 million, compared to the Special Manager's latest estimate of the total loan loss provisions for NCU of approximately €56 million (as at 31 July 2012);

- 12.2 a premises write down of approximately €15 million;
 - 12.3 integration and transaction costs of €7.4 million, which included a potential dividend and interest rebate of €2.9 million for NCU members for the financial year ended 30 September 2012; and
 - 12.4 a replenishment of the 2012 Bidder's post transfer regulatory reserve position by approximately €19 million.
13. Following submission of the 2012 Bid, a further meeting took place on 18 October 2012 between representatives of the 2012 Bidder, the 2012 Bidder's accounting advisers, the Special Manager and his team, and representatives from both the Bank and the Department of Finance. At that meeting, the parties discussed the difference between the Special Manager's view of the level of NCU's bad debt provisions (per the Special Manager's loan loss assessment as at 31 July 2012) and the 2012 Bidder's view of the level of the appropriate level of bad debt provisions (which formed part of the 2012 Incentive), which differed significantly.
 14. In explaining the rationale behind the 2012 Incentive and the significant difference in the appropriate level of bad debt provisions for NCU as between the 2012 Bidder and the Special Manager, the 2012 Bidder indicated that it had adopted a highly conservative approach to its assessment of NCU's loan portfolio. The 2012 Bidder indicated that, given the conservative approach adopted by it in this respect, the Board of the 2012 Bidder would not be prepared to agree to a transfer of NCU at an amount less than the 2012 Incentive. As you are aware, the 2012 Bid was ultimately withdrawn in a letter from the 2012 Bidder to the Central Bank dated 14 December 2012. A copy of that letter is enclosed.
 15. A further application for an extension was made and, on 20 December 2012, the Court granted a further six month extension of the SMO to 12 July 2013 (the "**Second Extension**").
 16. The principal reason for seeking the Second Extension was to enable the Bank to continue to explore all potential solutions for NCU, including a transfer solution. In particular, the

Second Extension enabled the Bank to explore with the Credit Union Restructuring Board (“**ReBo**”) the possibility of a restructuring of NCU under the Credit Union and Co-Operation with Overseas Regulators Act 2012 (the “**2012 Act**”). As well as granting the Second Extension, the Court also ordered that the matter be listed before the Court on 22 April 2013 so that the Bank and the Special Manager could provide update reports to the Court (the “**April Reports**”)

The ReBo process

17. As part of its consideration of different potential resolution options for NCU, the Bank considered that one possible option, once the 2012 Act came into force, was for NCU to be restructured as part of the restructuring of the credit union sector envisaged under the 2012 Act (the “**Restructuring Process**”). The Bank referred to the potential public interest benefit that could arise from NCU’s participation in the Restructuring Process, given its size and location, in its arguments supporting the appointment of a special manager to NCU under the 2011 Act in January 2012, and the subsequent extensions thereof.
18. Engagements took place between you and Mr. Bobby McVeigh, the Chairman of ReBo, in late December 2012 and early January 2013, to see if ReBo could find a solution for NCU by means of a combination with another credit union. An agreement was reached between the Bank and ReBo to the effect that ReBo would facilitate any possible restructuring options regarding NCU under the 2012 Act on the basis of certain terms and conditions, including the provision of certain assistance from the Bank to ReBo, particularly in terms of access to human resources and the provision of information on an expedited basis. Pursuant to this, from January 2013, Mr. Patrick Casey was temporarily seconded to ReBo on a part-time basis to undertake work in relation to NCU. It was envisaged that Mr. Gregory Dempsey would also be temporarily seconded to ReBo for this purpose. Mr. Dempsey, although initially involved in assisting on the work with ReBo, was subsequently involved in another project on behalf of the Bank, and was therefore not in a position assist ReBo with the work.
19. As outlined in the April Report from the Bank dated 12 April 2013 the work undertaken covered the following:
 - 19.1 developing a number of potential restructuring proposals;
 - 19.2 analysing these proposals and other proposals developed by ReBo;

- 19.3 making recommendations regarding which proposals should be selected for further analysis; and
- 19.4 continuing to work with ReBo to bring forward the most favoured proposal for consideration by ReBo.
20. Gregory Dempsey and Patrick Casey met a working sub-committee of the ReBo Board on 16 January 2013, and presented some preliminary high level amalgamations ideas on behalf of the Bank involving NCU and a significant number of other credit unions based, *inter alia*, on geographic proximity and industry affiliation.
21. Mr. Casey was tasked by the ReBo Board to undertake a detailed financial and non-financial review of combinations regarding specific credit unions, to engage with industry representatives and to report back to the ReBo Board thereafter. Following the completion of that work, under which Naas Credit Union Limited ("**Naas CU**") was identified as a possible candidate for a combination with NCU, Mr. Casey updated the ReBo Board on that basis. An engagement process began with Naas CU signing a non-disclosure agreement and, thereafter, Naas CU began examining financial information in relation to NCU facilitated through the Special Manager. Mr. Casey provided updates on a monthly basis to the ReBo Board regarding that on-going engagement. Following that, Mr. McVeigh sent a letter to you on 8 April 2013 by way of update in which Mr. McVeigh informed you that ReBo had completed a detailed financial and non-financial review of potential restructuring candidates that might seek to combine with NCU and that, following that review, ReBo had engaged in early stage discussions with Naas CU regarding a possible combination with NCU.
22. On 29 April 2013, Mr. McVeigh met with you and indicated that having undertaken due diligence on NCU, Naas CU had signed a non-binding term sheet dated 29 April 2013 (the "**Naas Term Sheet**") in relation to a proposed transfer of NCU's assets (excluding NCU's premises) and liabilities to Naas CU in accordance with the terms set out in the Term Sheet (the "**Proposed Naas Transaction**"). A copy of the Term Sheet is enclosed. The Naas Term Sheet contemplated that the Proposed Naas Transaction would take place by way of a transfer of NCU to Naas CU under a transfer order pursuant to Part 5 of the 2011 Act.
23. Mr. McVeigh also indicated at that meeting that ReBo considered that a transfer of NCU to Naas CU should be pursued as a directed transfer under Part 5 of the 2011 Act, rather than through a restructuring process under the 2012 Act.

The Second Bid Process

24. For the purpose of pursuing a directed transfer under Part 5 of the 2011 Act, in May 2013, the Bank carried out a further competitive bid process pursuant to Section 28(3) of the 2011 Act in order to: (a) identify all suitable potential transferees in respect of NCU that may exist; and (b) determine the up-to-date market value of the assets and liabilities of NCU, for the purposes of Section 28 of the 2011 Act (the “**Second Bid Process**”). On 17 May 2013, you approved a bid process steps plan, which outlined the criteria to be used by the Bank in identifying potential transferees and assessing bids received by those potential transferees (the “**Second Bid Process Steps Plan**”). Four credit unions (other than Naas CU) were identified as potential transferees following an analysis covering suitable transferees based upon the criteria set out in the Second Bid Process Steps Plan. Copies of the Second Bid Process Steps Plan, the letter from Greg Dempsey to you dated 17 May 2013, the responding letter from you to Greg Dempsey dated 17 May 2013 and the SRU analysis of potential transferees under the Second Bid Process Steps Plan are enclosed. The four credit unions concerned were approached by telephone by Central Bank officials on 17 May 2013 concerning their interest in participating in the Second Bid Process in relation to NCU. The 2012 Bidder indicated that it would only be prepared to consider engaging in the Second Bid Process concerning NCU on a basis that the 2012 Bidder would receive the cash amount requested under the 2012 Incentive, and not any lesser amount. As the proposal put forward by Naas CU (as set in the Naas Term Sheet) would result in a lower cost to the Resolution Fund, the Central Bank indicated to 2012 Bidder that it would not seek to engage with the 2012 Bidder on the basis of the 2012 Incentive. Notes of the Second Bid Process telephone calls are enclosed.
25. Other than the proposal put forward by Naas CU (as set in the Naas Term Sheet), and the indication by the 2012 Bidder that it would only be prepared to consider engaging in the Second Bid Process on the basis of the 2012 Incentive, no bids were received on foot of the Second Bid Process. In the circumstances, it was determined to pursue the Proposed Naas Transaction.
26. As you are aware, on 7 May 2013, you sent a letter to the Minister (copy enclosed) seeking an indication of whether the Minister was prepared to support the provision of a financial incentive at the level in the Naas Term Sheet. The Minister indicated in a letter dated 25 June 2013 (copy enclosed) that he was prepared to support the provision of a financial incentive at the level (and based on the structure) requested by Naas CU in the Naas Term

Sheet. He noted that the Naas Term Sheet remained subject to contract (including negotiation and agreement of definitive legal documentation), the completion of transaction due diligence (including transferee due diligence), the preparation of a detailed integration plan by Naas CU and consideration by the Registrar of Credit Unions of the regulatory implications of the transfer. The Minister also noted that the Naas Term Sheet was also subject to the High Court's approval of a proposed transfer order under Part V of the 2011 Act.

27. The SMO was further extended by Order of the Court on 5 July 2013 for an additional six month period to 12 January 2014, (the "**Third Extension**") to provide additional time to secure a solution for NCU.
28. Since the date of the Third Extension Order, the Bank, the Minister, the Special Manager and Naas CU continued to liaise with each other with a view to progressing negotiations and all other steps required for the implementation of the Proposed Naas Transaction.
29. Under the Naas Term Sheet (which was based on the NCU balance sheet as at 28 February 2013), Naas CU sought a financial incentive under the 2011 Act comprising circa €48 million in cash upfront at transfer (to cover the NCU balance sheet shortfall at transfer and to replenish the capital ratio of NCU to a 10% reserve ratio) plus a loan guarantee amounting to €21.5 million (net of a 20% first loss to Naas CU), implying a total support requirement of €69 million. The covered amount under the proposed guarantee of €21.5 million was excluded from the total assets in order to ascertain the level of regulatory reserve ratio replenishment for NCU at 10%. The proposed guarantee made provision for a guarantee fee of 0.1625% per annum to be applied against the amount of loans guaranteed on a reducing balance basis, to be paid by Naas CU over the life of the guarantee. The Naas Term Sheet prescribed a profit sharing mechanism to apply post transaction for a 10 year period on NCU's loan portfolio that requires all cash recoveries (net of directed related recovery costs) over the net realisable value of each loan, that was to be split 50%/50% between Naas CU and the Minister.
30. Naas CU indicated that its board of directors would not be in a position to approve the Proposed Naas Transaction until 31 October 2013 following the completion of a full due diligence review on both NCU and Naas CU, the preparation of a combined strategic and business plan, the preparation of a suitability review on Naas CU and the preparation of an integration plan by Naas CU and its advisors concerning NCU.

31. Negotiations between the Bank and Naas CU on the structure and amount of the financial incentive to be paid by the Bank to Naas CU under the Proposed Naas Transaction progressed to 31 October 2013. Simultaneously, Naas CU's accountants prepared a report based on their due diligence undertaken in respect of the NCU merger (the "**Suitability Report**"). The details of the negotiations and the Suitability Report were presented to the Board of Naas CU on the evening of 31 October 2013.

Publicity in relation to the Proposed Naas Transaction

32. On 28 July 2013, an article appeared in The Sunday Business Post revealing details of the Proposed Naas Transaction and other highly commercially sensitive and confidential information concerning NCU (the "**SBP Article**"). We enclose a copy of the SBP Article. The SBP Article resulted in further publications appearing in other national papers and local media in County Kildare. The public controversy generated by these publications led to significantly increased withdrawals of members' savings from NCU. In the interests of NCU members, the Bank had sought to maintain strict secrecy and confidentiality in respect of the Proposed Naas Transaction. The disclosure of the terms of the Proposed Naas Transaction into the public domain has had a material impact on the confidence of the members of NCU, which in turn has resulted in a significant increase in the withdrawal of members' savings since the SBP Article.
33. In an attempt to address the uncertainty among NCU members, as evidenced by the high level of withdrawals following the SBP Article, the Bank issued a public statement on 1 August 2013 confirming certain details with respect to the Proposed Naas Transaction. A copy of the Bank's statement is enclosed. The Bank confirmed the identity of the proposed transferor and that the Minister had indicated that he was prepared to support the Proposed Naas Transaction in principle. The Bank issued an information document for members dated 6 August 2013 and the Registrar of Credit Unions gave a local radio interview in an attempt to address the concerns of NCU members and to stem the level of savings' withdrawals.
34. Since details of the proposed transfer of NCU to Naas CU became public on 28 July 2013, there has been a significant level of opposition among NCU members and in the wider community of Newbridge. On 29 July 2013 a Facebook page was established by a group which opposed the transfer, called Save Newbridge Action Group. A public meeting was held by the Save Newbridge Action Group on 31 July 2013 to discuss the proposed transfer

and to formulate a plan of action to oppose the transfer. On 3 August 2013 a public rally was held by the Save Newbridge Action Group during which a march to NCU took place. On 7 August 2013 a public meeting was organised by the Save Newbridge Action Group to provide an update to attendees in relation to the opposition that was planned by the Save Newbridge Action Group and to discuss details for a protest march by the Save Newbridge Action Group at the Bank on 9 August 2013. A local radio station, KFM, reported that 700 people attended the meeting. On 9 August 2013, the Save Newbridge Action Group held a protest march at the Bank, followed by a protest march at the Special Manager's office. A further public rally was organised by the Save Newbridge Action Group in Newbridge on 31 August 2013. On 23 September 2013, a member of NCU read an open letter to the Minister opposing the transfer to Naas CU on KFM. On 26 September 2013 a meeting took place between members of the Save Newbridge Action Group with Mr. David Begg, General Secretary of ICTU, to talk to him about the campaign against the transfer to Naas CU and ask for his support. After the meeting Mr. Begg offered his services to chair an Alternative Dispute Resolution process should that be accepted by the Minister. On 28 September 2013, the Save Newbridge Action Group held a protest at the opening of the new branch of Naas CU at Monread, Co Kildare. On 30 September 2013 the Save Newbridge Action Group Chairman appeared on Primetime during a brief report on the NCU situation. On 2 October 2013, a public meeting was organised by the Save Newbridge Action Group during which there were contributions from MEP Marian Harkin, TD Jack Wall and a number of Save Newbridge Action Group Committee members. On 8 October 2013, a proposal by the Save Newbridge Action Group was presented to the Minister. On 1 November 2013, a delegation from the Save Newbridge Action Group led by Chairman, Mr. Willie Crowley met with Bank officials to discuss the Save Newbridge Action Group's proposal to restructure NCU. A table quiz has been scheduled by the Save Newbridge Action Group for 8 November 2013 to raise money for the Save Newbridge Action Group's campaign.

35. Another group called Concerned Members of Newbridge Credit Union was also set up to oppose the transfer to Naas CU. This group set up a website called www.whyisthishappening.net. They have published a number of documents on the website including a number of letters and questions which they sent to the Registrar of Credit Unions dated 21 August 2013 and a letter which they sent to the Minister dated 18 August 2013. They have also published documents entitled, an NCU loan book analysis, an NCU savings analysis, an NCU financial analysis and information on the NCU proposed merger with Naas CU.

36. As is evident by the above summary of the activities of the groups that have been set up to oppose the transfer of NCU, there has been strong opposition to a transfer of NCU to Naas CU. This strong opposition was in circumstances where the proposed transferee was another credit union. SRU believe the opposition that would exist to the transfer of NCU to PTSB would be substantially stronger. SRU believe that if details of the transfer to PTSB are revealed to NCU members, and particularly the groups that have been set up to oppose the transfer to NCU, there will be protests in Newbridge and at the Bank. If the Transfer Order does not have immediate effect, SRU believe that NCU would be further destabilised by these protests and there is a very high probability that elevated withdrawals from NCU would result.

Withdrawal of members' savings from NCU

37. The rate and level of withdrawal of members' savings from NCU during the period following the SBP Article is summarised as follows:

37.1 At the close of business on Saturday 27 July 2013 (being the date prior to the publication of the SBP Article), NCU held aggregate members savings of €90.7 million and liquidity resources of €11 million. NCU had a liquidity ratio (representing liquidity resources divided by unattached savings) of 14.9%. In the week following the publication of the aforementioned article, during which the Proposed Naas Transaction was the subject of further public discourse, NCU's members' savings base deteriorated rapidly and, at close of business on Saturday 3 August 2013, NCU held aggregate members savings of €87.9 million, an aggregate reduction of €2.9 million or a 3.2 per cent decline over a period of seven days.

37.2 We have been advised by the Special Manager that, in the ordinary course of business, NCU would expect to receive members' savings withdrawal requests in the order of €3.6 million to €5.4 million per calendar month (based upon the range of monthly members' savings withdrawals since February 2012). However, there have been aggregate members' savings withdrawals of approximately €20 million from NCU in the 14 week period since 27 July 2013, a level of withdrawals that NCU would normally expect over a 3.7 to 5.5 month period. In addition, we have been advised that there has been no increase in the amount of members' savings deposited with NCU in that period which would materially offset the withdrawal in that period.

37.3 Set out in the table below are details of receipts and payments over the 14 week period from 27 July 2013 to 1 November 2013 and net outflows during this period.

Table 1: Savings Received and Shares Withdrawn over the period 27 July 2013 to 1 November 2013

Currency: €	Total 14 Weeks 27 July - 1 November 2013
Savings Received	9,098,475
Members Shares Withdrawn (net of transfers)	(20,017,728)
Net Movement	(10,919,252)

Note: this excludes other cash movements such as salaries and wages and other expenses.

Withdrawal of Naas CU and the Amended Second Bid Process

38. On 1 November 2013, SRU received a phone call from Peter Fulham, the Chairman of Naas CU, and Sean Murray, the General Manager of Naas CU, indicating that the Board of Naas CU had decided to withdraw from the process, indicating that the Proposed Naas Transaction was above their risk appetite, and was not in the best interests of their members, in light of information revealed during due diligence of NCU. In a letter dated 7 November 2013 Naas CU formally confirmed its withdrawal from the process. A copy of the letter is enclosed.
39. Following the withdrawal of Naas CU, the Department of Finance contacted SRU to indicate that PTSB might be interested in taking on the loan book and member shares of NCU. Banks had not been asked to bid in the Second Bid Process on the basis that a credit union solution was preferred arising from credit unions' shared business models, compatible regulatory regimes and shared mutual not-for-profit ethos. As the Second Bid Process ultimately produced no potential credit union transferees, it was proposed that the Second Bid Process be amended to facilitate bids from banks with branches operating within NCU's common bond area, being the next preferred solution. On 1 November 2013, SRU sent a letter to you in which SRU requested you to approve the amendment of the terms of the Second Bid Process to allow for a further bid process to be carried out on an expedited basis in accordance with an amended bid process step plan (the "**Amended Second Bid Process Steps Plan**"), which was attached to the letter. In a letter dated 1 November 2013, you

authorised SRU to undertake this amended bid process (the “**Amended Second Bid Process**”). The referenced correspondence and the Amended Second Bid Process Steps Plan are enclosed.

40. As part of the Amended Second Bid Process, phone calls were made on 1 and 2 November 2013 to senior persons at the four banks with branches in Newbridge, namely PTSB, Allied Irish Banks, p.l.c. (“**AIB**”), the Governor and Company of the Bank of Ireland (“**Bank of Ireland**”) and Ulster Bank Ireland Limited (“**Ulster Bank**”), asking if they would be interested in taking over the assets (excluding the premises) and liabilities of NCU. These banks were contacted because it is considered important that the potential transferee has a branch presence in Newbridge to ensure a continuing physical presence in Newbridge following a transfer. The reason why banks with a presence in Newbridge were contacted is that this is a criteria for banks under the Amended Second Bid Process Steps Plan. A note of the phone calls on 1 and 2 November 2013 with the four banks are enclosed. PTSB confirmed that it would be interested in examining the opportunity, signed a confidentiality agreement on 1 November 2013 and was given access to the NCU data room. AIB indicated an interest on the initial call. AIB signed a non-disclosure agreement on 5 November 2013 and was given access to the NCU data room. However, AIB indicated on 6 November 2013 that it was no longer interested in pursuing the opportunity. Each of Bank of Ireland and Ulster Bank confirmed on 4 November 2013 that it was not interested in the opportunity. Therefore, other than the interest expressed by PTSB, no other bids were received on foot of the Amended Second Bid Process. In these circumstances, it was determined to pursue discussions with PTSB.

C. THE PROPOSED PTSB TRANSACTION

41. Discussions with PTSB progressed over the course of 2 to 7 November 2013 and the terms of a proposed transfer of all assets and liabilities of NCU (excluding the business premises owned by NCU at Moorefield Road, Newbridge, County Kildare, and any liabilities associated with those premises) to PTSB (the “**Proposed PTSB Transaction**”) were commercially agreed and set out in a draft Transfer Order and a draft financial incentives agreement between the Bank and PTSB (the “**FIA**”). The terms of the Proposed TSB Transaction can be summarised as follows:

41.1 All assets and liabilities of NCU (excluding the business premises owned by NCU at Moorefield Road, Newbridge, County Kildare, and any liabilities associated with those premises) will be transferred to PTSB pursuant to a transfer order made under the 2011 Act.

41.2 In consideration for the transfer of those assets and liabilities to PTSB, the Bank, through the Resolution Fund established under the 2011 Act, would provide certain financial incentives to PTSB (the “**PTSB Financial Incentives**”), the principal terms of which are summarised in the following table:

Table 2: Summary of PTSB Financial Incentives

Incentive Structure for PTSB			
€	Cash Financial Incentive Amount plus Restructuring & Integration Costs	Loss Compensation Payments - assuming the maximum loss to Fund	Total Financial Incentive
Upfront cash incentive	23,007,782	0	23,007,782
Restructuring & Integration Costs	4,250,000	0	4,250,000
Transferring Liabilities	2,000,000	0	2,000,000
Loss Compensation Payments	0	24,656,483	24,656,483
Incentive Structure for PTSB	<u>29,257,782</u>	<u>24,656,483</u>	<u>53,914,265</u>

41.3 In addition, to the extent that the value of NCU’s loan book is determined (taking into account any recoveries received by PTSB during the previous six months), at the end of each six month period post-transfer until the tenth anniversary of completion, to be (i) greater than €49,312,966 (being the estimated current value of those loans), PTSB will make a payment equal to 50% of any excess into the Resolution Fund, or (ii) less than the same amount, the Bank will make a payment of half of any deficit from the Fund to PTSB.

42. The NCU assets to transfer to PTSB under the Proposed PTSB Transaction include:

42.1 any and all of NCU’s right, title and interest in and to all causes of action, claims, entitlements and proceedings that relate to any period prior to the time that the

Transfer Order comes into effect (the “**Transfer Time**”) (whether arising from breach of law, regulation, contract, tortious actions or omissions, breach of duty or otherwise howsoever arising and whether actual, contingent or prospective) which NCU is or would at any time in the future (apart from the making of any transfer order) be entitled to take, make or claim against any person, company or body corporate, partnership, limited partnership or any other association or entity (“**Person**”) and all remedies and recourse in respect thereof (“**NCU Claims**”);

- 42.2 any and all of NCU’s right, title and interest in and to all loans made by NCU prior to the Transfer Time, including, without limitation, (A) any right, title and interest of NCU in any security granted to secure any of the Loans (“**Security**”), (B) any right, title and interest of NCU under any guarantee or other surety given in respect of any Loan (“**Surety**”) and (C) any right, title and interest of NCU in and to all NCU Claims relating to the Loans, any Security and / or any Surety;
- 42.3 any and all of NCU’s right, title and interest in and to all fixtures and fittings, plant, machinery, equipment (including, without limitation, all information technology, computer and telecommunications systems and equipment), motor vehicles, tools, furniture, stock and other tangible assets of NCU;
- 42.4 any and all of NCU’s right, title and interest in and to all means patents, trade marks, service marks, registered designs, utility models, design rights, topography rights, copyrights (including copyright in computer programs), database rights, inventions, know-how, confidential information, business or trade names, get-up, domain names, and all other intellectual property and neighbouring rights and rights of a similar or corresponding character (including all associated goodwill), enforceable anywhere in the world (whether or not the same are registered or capable of registration) and all applications for, or for the protection of, any of the foregoing owned, used-by, or licensed-to, NCU;
- 42.5 any and all of NCU’s right, title and interest in and to all securities, shares, investments, bonds (including Irish Government Bonds);
- 42.6 any and all of NCU’s right, title and interest in and to all cash in hand or at bank and all cheques and other securities representing them; and
- 42.7 all other property, rights and assets of NCU of any description.

43. The NCU assets excluded from the transfer to PTSB under the Proposed TSB Transaction are:
- 43.1 all such right, title and interest of NCU in, and NCU Claims in respect of, the premises located at Moorefield Road, Newbridge, County Kildare and all fixtures and fittings, plant and other tangible assets that are attached to the premises.
44. The NCU liabilities to transfer to PTSB under the Proposed TSB Transaction include:
- 44.1 all claims, liabilities (actual, contingent, prospective or otherwise), obligations, debts of and amounts owed by NCU at Transfer Time of any nature, kind or description including, without limitation, (a) all liabilities of NCU relating to all deposit or other accounts held at the Transfer Time with NCU in the name of or on behalf of any person, (b) all amounts owing to employees and trade creditors and (c) all fees owing or accrued to the Special Manager up to and including the Transfer Time.
45. The NCU liabilities excluded from the transfer to PTSB under the Proposed TSB Transaction are:
- 45.1 all such all liabilities of NCU in respect of the Premises and all fixtures and fittings, plant and other tangible assets that are attached to the Premises; and
- 45.2 all causes of action, claims, entitlements and proceedings that relate to any period prior to the Transfer Time (whether arising from breach of law (including tax law), regulation, contract, tortious actions or omissions, breach of duty or otherwise howsoever arising and whether actual, contingent or prospective) which the Applicant or any governmental, regulatory or prosecuting authority in any jurisdiction is or would at any time in the future (apart from the making of any transfer order) be entitled to take, make or claim, against NCU and/or any Person and all remedies recourse in respect thereof ("**Regulatory Actions**"), including, but without limitation to the generality of the foregoing, all Regulatory Actions involving any director, officer, or employee or former director, officer or employee of NCU in respect of any negligence, wrongdoing, default, breach of duty, breach of contract or breach of trust or any other ground whatsoever and all costs, expenses and obligations arising in connection therewith.
46. The Transfer Order will also effect:

46.1 the “Employees” being the rights and obligations of NCU arising from contracts of employment existing at the Transfer Time or from collective agreements; and

46.2 the “Records” being all mandates, terms and conditions, instructions, applications, customer verification documents, directions, files, books, correspondence and other records of NCU in so far as they relate to the assets and liabilities of NCU referred to at certain paragraphs of the draft Transfer, held on whatever medium.

47. In summary the following categories of assets and liabilities would transfer under the PTSB Transaction:

Assets	Liabilities
<ul style="list-style-type: none"> • Loans • NCU Claims • Fixtures and fittings, plant, machinery, equipment • Intellectual property rights • Securities, shares, investments, bonds • Cash in hand or at bank and all cheques and other securities • All other property, rights and assets 	<ul style="list-style-type: none"> • Deposits • Rights and obligations of NCU arising from contracts of employment • Special Manager’s fees • All other claims, liabilities (actual, contingent, prospective or otherwise), obligations, debts of and amounts owed by NCU

48. A copy of the draft Transfer Order and the draft FIA are enclosed. The FIA has not been executed yet. If it is decided to make a proposed transfer order (“PTO”) and apply to the High Court for a Transfer Order in the terms of the PTO, the FIA will be executed by PTSB and the Bank in advance of the application to Court for the Transfer Order. However, the FIA will only take effect if a Transfer Order is made by the Court and upon the Transfer Order becoming effective in accordance with the terms of the 2011 Act.

PTSB's approval of the Proposed Transaction

49. PTSB held a Board Meeting on 6 November 2013 to consider the Proposed PTSB Transaction and the terms of the FIA. The Proposed PTSB Transaction and the FIA were approved by the Board of PTSB at the meeting.

Provision of the PTSB Financial Incentives under section 46(1) of the 2011 Act

50. The Minister has not formally been requested yet to provide the PTSB Financial Incentives under the Proposed PTSB Transaction in accordance with Section 46(1) of the 2011 Act. However, his officials have undertaken discussions with PTSB on the level and structure of the PTSB Financial Incentives. It is envisaged that a formal request for the provision of the PTSB Financial Incentives pursuant to section 46(1) of the 2011 Act will be made at the same time as the consultation with the Minister under section 9(1)(c) of the 2011 Act in respect of the Proposed PTSB Transaction.
51. Separately, it is proposed that the Minister would provide you with a letter whereby, in relation to the provision of the PTSB Financial Incentives, he directs you to make the relevant payments under section 46(4) of the 2011 Act and where he confirms that he understands that the amount of the financial incentive owing under the FIA is to be ring-fenced in the Resolution Fund. This letter has been agreed with the Department of Finance and a draft of this letter is enclosed.

Consideration of the Proposed PTSB Transaction by the Banking Supervision – Covered Banks Division of the Bank (the “BSD”)

52. BSD has given regulatory consideration to the Proposed PTSB Transaction and its view is that the impact of the Proposed PTSB Transaction on PTSB's liquidity and solvency is expected to be minimal, as the assets and liabilities being transferred are not material relative to the size of PTSB's overall balance sheet. The Proposed PTSB Transaction is not expected to destabilise PTSB's financial position.

The Fees of the Special Manager

53. All fees due and owing or accrued to the Special Manager will transfer to PTSB as part of the PTSB Transaction. It is envisaged that PTSB will discharge those fees shortly after a Transfer Order takes effect.

54. It is also envisaged that terms will be agreed with the Special Manager to ensure that he shall remain in office after the Transfer Time pending the appointment of a liquidator to wind-up NCU. However, as at the date of this Report, final agreement has not been reached with the Special Manager with respect to his continuing role post-transfer.

Appointment of a Liquidator to NCU following a Transfer Order having effect

55. It should be noted that, in the event a transfer order is made, it will still be necessary to appoint a liquidator to NCU in order to deal with the assets and liabilities not being transferred under the terms of the Proposed PTSB Transaction. These are the business premises owned by NCU at Moorefield Road, and any liabilities associated with those premises, and the liability that will, with effect from the Transfer Time, be due and owing from NCU to the Fund of an amount equal to the total financial incentive payments made from the Fund to PTSB under the FIA. It should also be noted that, in that liquidation scenario, the Fund will be by far the largest creditor in the liquidation of NCU. However, the appointment of a liquidator to NCU in these circumstances (i.e. following the making of a transfer order) is an entirely different scenario to (in a situation where no transfer order is made) appointing a liquidator over all of NCU's current assets and liabilities.

Meetings with Representatives of the NCU Board

56. Representatives of SRU met with representatives of the NCU Board on Tuesday 22 October 2013 to provide them with an update in relation to the Proposed Naas Transaction. During the meeting SRU asked the representatives of the NCU Board to consider whether the NCU Board would consent to the Proposed Naas Transaction. They agreed to discuss this with the NCU Board and to revert to the Bank through their legal advisors.
57. Following the withdrawal of Naas CU on 1 November 2013, SRU focused on trying to identify another solution for NCU. On 6 November 2013, the Bank's legal advisors contacted the NCU Board's legal advisors to arrange a meeting for the purpose of providing an update to the NCU Board on the developments since the meeting on 22 October 2013, including the serious liquidity position of NCU, Naas CU's withdrawal from the process and the Proposed PTSB Transaction. The legal advisors of the NCU Board confirmed that the earliest that representatives of the Board could meet was on 8 November 2013. A meeting between representatives of SRU and representatives of the NCU Board has been arranged for 8 November 2013.

D. OTHER PROPOSALS CONSIDERED

58. A number of proposals for dealing with the situation in NCU have been received by SRU over the past two years. These include options put forward by directors of NCU in affidavits submitted to the Court in response to the application for the SMO and for extension applications, as well as a proposal submitted by the Newbridge Credit Union Action Group and the Concerned Members of NCU. These proposals are summarised below, and the rationale given by the Bank for rejecting each one is also set out. SRU remains of the opinion that none of the below listed proposals represents a viable alternative to the Proposed PTSB Transaction.

A Merger with another Credit Union

59. In affidavits responding to the First Extension, Mr. Ben Donnelly and Mr. Kevin Johnston suggested that NCU could be merged with a similarly sized credit union, or with a credit union with an industrial common bond rather than a geographic one. They also suggested a merger of NCU with several credit unions to form a large credit union, or putting NCU at the centre of a hub-and-spoke system of interlinked credit unions. In an affidavit responding to the Third Extension, Mr. Donnelly suggested the combination of NCU with a smaller credit union.

60. SRU has spent a large amount of time pursuing a solution involving a merger with another suitable credit union. This has involved extensive engagement with ReBo to secure a transfer to another suitable credit union. Ultimately, however, no other suitable credit union was willing to engage in such a merger. In addition, in relation to a merger with a smaller credit union, the Bank has significant concerns in relation to the financial stability of such an entity post-transfer. Another potential concern considered in such a merger related to governance and deficiencies in systems and controls in NCU that would need to be rectified in a merger. While a credit union merger solution was the SRU's preferred option, ultimately no viable merger was available.

Appoint a director under the CUA

61. In an affidavit responding to the First Extension, Mr. Johnston suggested that the Bank might use its powers under the CUA to appoint a director to the Board of NCU.

62. SRU rejected this proposal in the replying affidavit of Mr. Gregory Dempsey in which he noted that the appointment of a director would be wholly inadequate to address the serious liquidity and governance issues which had arisen in relation to NCU.

Introduce a New Deposit Product to Attract and Retain Deposits

63. In an affidavit responding to the First Extension, Mr. Johnston suggested that the Bank might allow the creation of a new deposit product to which member shares would transfer, and which would repay a relatively lower return than their current shares.
64. SRU rejected this approach in the replying affidavit of Mr. Dempsey, noting that some special interest rate for depositors would not address the capital deficit of NCU. He noted that the Bank could not wait for six years for NCU to reach its regulatory requirements in such circumstances. Given the subsequent deterioration in the position of NCU, the likelihood of such an option providing a solution for NCU is even more remote.

Support NCU on a Contingency Basis Exempting it From Legal Requirements

65. In his affidavit in response to the Second Extension, Mr. Donnelly suggested that for a limited number of years, the Bank could allow NCU to be supported on a contingency basis rather than through a capital injection.
66. In a replying affidavit, Mr. Dempsey outlined the SRU's position, noting that the suggestion that the Bank could exempt NCU from complying with its legal requirements to allow it to trade out of its difficulties was simply ignoring the legal requirements that a credit union must maintain a certain level of reserves.

Conversion of the SM Process to an Administration Process

67. In an affidavit responding to the Third Extension, Mr. Donnelly suggested that the special management process could be converted into a fixed cost administration to facilitate NCU to trade out of its difficulties over time.
68. In response, Mr. Patrick Casey swore an affidavit on behalf of SRU in which he noted that this was not an appropriate action, on the grounds that administration would not address the concerns in relation to the regulatory reserve deficit. In addition, there is no means available in legislation to recapitalise NCU on a standalone basis.

A Member Campaign to Raise Funds

69. In his affidavit responding to the Third Extension, Mr. Donnelly suggested that a member fundraising campaign might be sufficient to reduce the deficit in NCU.
70. SRU responded that this was not a viable option on the basis that credit unions are constrained generally in their capital raising ability. The time required to raise sufficient funds is not available, particularly given the level of balance sheet deficit and deficit in the required regulatory reserve.

Newbridge Credit Union Action Group Proposal

71. In a proposal submitted to the Minister and the Bank, the Newbridge Credit Union Action Group put forward a proposal that they sought to be considered by the Bank as an alternative to the transfer to Naas CU. This plan envisaged the conversion of some member shares into debentures owed to NCU which would pay a coupon, but which would be non-recoupable, and which would rank pari passu with equity in the event of a liquidation. This plan envisaged taking three months to see if sufficient debenture holders would come forward to allow the regulatory deficit hole of NCU to be filled. At that point, the plan involved the transfer of all NCU assets and liabilities to a new credit union set up for those purposes, which would be recapitalised using the Resolution Fund.
72. The following specific issues with the Newbridge Credit Union Action Group proposal were identified:
- 72.1 It was stated that it *“would be a challenge for the Proposers of Newco to convince existing members of NBCU or potential members that there is considerable merit in subscribing on a voluntary basis to a debenture.”* The Newbridge Credit Union Action Group states that it has pledges of €1 million secured, however no details or terms and conditions relating to these pledges were included in the proposal. It should be further noted that the amount of €1 million is significantly short of the required minimum amount to restore the reserve position of NCU.
- 72.2 The proposal does not set out the business case outlining the impact of the proposed debenture, associated interest and repayment costs and the ability of NCU to generate a surplus sufficient to support the reserve base of NCU and the payment of a dividend to members.

73. In summary, the Bank has concerns on the potential impact of the proposal on members' savings including any request to members to convert their savings to support a new structure, which has a high degree of risk.

Concerned Members of NCU

74. The Concerned Members of NCU (the "Group") are four individual members of NCU who submitted a document entitled 'A proposed solution for Newbridge Credit Union and the wider Credit Union structure' to the Department of Finance on 8 October 2013. This document was then forwarded to SRU and RCU.
75. The key issue raised in this proposal was that a separate legal institution be created to carve out bad and underperforming loans from NCU. The Group proposed that an assessment should be made at what threshold loans should be carved out of NCU that could match savings to allow NCU to carry on in its present location. The Group also proposed that this institution could be used to manage the recovery of doubtful debt of not only NCU but of non-traditional type lending across the credit union sector in its entirety.
76. The Bank holds a number of concerns in relation to this proposal including that the Group's proposal did not outline the structure of the 'run-off institution'. In addition, the legislative basis for the capitalisation of this entity, via support from ReBo, was not clearly defined by the Group's proposal. The Proposal appeared to suggest that a new Board would be appointed to 'run the day to day business of this institution'. However no details were provided on how they would comply with the new governance requirements of the CUA.

Set up a new credit union in Newbridge to which a transfer of NCU could be made

77. SRU have considered whether a new credit union could be set up in Newbridge to act as a transferee for a transfer of NCU under the 2011 Act. While it may be possible for this to be done, and it could be a method of effectively providing a financial incentive to NCU, SRU believe that this would not be a viable resolution option. It would lead to similar concerns as were identified in relation to the merger of NCU with a smaller credit union. SRU would have serious concerns as to the financial stability of such an entity post transfer. SRU would also be seriously concerned that such a transfer would not bring about sufficient changes in the governance deficiencies and deficiencies in systems and controls in NCU. SRU does not believe that this is a viable resolution option for NCU a new entity would not have a proven

track record. In addition, setting up a new credit union would take at least a number of months.

Conclusion on other proposals considered

78. In conclusion, none of the other proposals provided a satisfactory solution for NCU or addressed the capital deficit. In addition, the other proposals did not adequately protect members' savings.

E. ANALYSIS OF THE INTERVENTION CONDITIONS

79. Section 21(1)(a) of the 2011 Act requires the Bank to decide that the Intervention Conditions set out in section 9 of the 2011 Act are fulfilled prior to the making of a PTO. Set out below is a summary of the reasons why SRU believes that conditions A, B, C and D are fulfilled.

CONDITION A

80. *Condition A is that the Bank has serious concerns relating to the financial stability of the authorised credit institution concerned and:*

(a) Directs that credit institution to take particular action to address the Bank's concerns and the Bank is satisfied that:

(i) The credit institution has failed to comply fully with the direction under this paragraph, or

(ii) The credit institution is incapable of taking the necessary action to so comply within the period specified by the Bank in that direction,

or

(b) Is satisfied that, having regard to the urgency of the situation or for any other reason, its serious concerns cannot be adequately addressed by such a direction.

Serious concerns relating to the financial stability of NCU

81. SRU has serious concerns relating to the financial stability of NCU. As at 30 September 2013, based on its management accounts, NCU had an excess of total liabilities over total assets of

approximately €8 million. As such, NCU had a regulatory reserve ratio at that date of -10.9%. Accordingly, NCU remains in breach of the requirement to maintain a regulatory reserve ratio of 10% pursuant to the Credit Union Act 1997 (Section 85) Rules 2009 (S.I. No. 344 of 2009) (the “**2009 Rules**”). In addition, NCU is balance sheet insolvent. In addition to the deficiency NCU has in relation to its reserves, NCU’s liquidity buffer is currently depleted with a liquidity ratio (representing liquid resources divided by unattached savings) of 8.68 per cent as at 30 September 2013. SRU considers that if the current level of withdrawals of members' savings from NCU continues (representing an average daily net cash outflow of €76,000 since 28 July 2013), it would be recommending to the Bank that it petition to have NCU liquidated by 10 November 2013.

82.

[REDACTED]
[REDACTED]
[REDACTED] While the Deposit Guarantee Scheme (the “**DGS**”) protects those with eligible deposits up to €100,000, those with ineligible deposits or other unsecured creditors would not necessarily recover in a liquidation scenario. In light of the liquidity issues in NCU, members who were not covered by DGS would suffer losses in the event of a liquidation. [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED] SRU's view in this regard is supported by a letter which was received from the Special Manager on 7 November 2013 which states that if the resolution process involving PTSB does not reach a satisfactory conclusion the Special Manager has indicated that he would be obliged to formally request that the protection afforded to NCU under the 2011 Act be withdrawn, that the High Court be asked to terminate the Special Manager’s tenure and that the Bank petition for the winding up of NCU.

83.

This position assumes that details of Naas CU’s withdrawal from the transfer process and the Proposed PTSB Transaction do not become public in advance of a Transfer Order taking effect. SRU is of the view that if these details become public in advance of a Transfer Order

taking effect, there is likely to be a significant increase in the withdrawal of deposits and liquidation at an earlier point would be very likely to be required.

84. Based on the average level of withdrawals since the heightened level of withdrawals commenced on 28 July 2013 (i.e. an average daily net cash outflow of €76,000), it is currently estimated that NCU will reach the Liquidation Trigger Point by • November 2013, but this estimate is subject to change depending on the rate and level of withdrawals in the future.
85. Arising from both NCU’s reserve position and also its liquidity position as outlined above, SRU is of the opinion that the Bank should have serious concerns as to NCU’s financial stability.

Direction under Section 9(2)(a) of the 2011 Act

86. SRU from the outset has not recommended that the Bank issue a direction to NCU pursuant to the 2011 Act, as SRU is of the view that the difficulties inherent in NCU’s ability to correct the deficit in its regulatory reserve requirement (pursuant to the 2009 Rules), means that NCU would not be capable of taking the necessary action sufficiently promptly to address the serious situation that has arisen in this regard. NCU is severely restricted in its ability to raise capital for two key reasons:

86.1 NCU is not a member of the Irish League of Credit Unions (“ILCU”) and therefore it does not have a legal entitlement to financial assistance from ILCU’s Savings Protection Scheme; and

86.2 Credit unions are, by their very nature, limited in their ability to raise capital by private sector means. This is illustrated by the following table:

Table 3: Actions available to NCU to raise capital

Action	Comment
Issue new capital	Credit unions do not have access to equity capital or alternative capital instruments in the same manner as other credit institutions such as banks.
Restore capital through retained	The SM’s Reports project that NCU could generate sufficient revenue to cover costs and a dividend in future years. However, the SM’s Reports

earnings	indicated that NCU will take approximately six years to replenish its capital to a level which meets minimum regulatory reserve requirements (as set out in the 2009 Rules) through normal trading and without obtaining further capital.
Repay member shares	By reducing the size of the balance sheet, the ratio of reserves to assets increases. It is considered by SRU that this measure is not capable of rebuilding NCU's reserve position to an acceptable level within the required timeframe, given NCU's financial position with an excess of total liabilities over total assets.

The urgency of the situation or other reasons

87. In the opinion of SRU, the current level of media attention being given to NCU, together with the continuing postponement of NCU's AGM and the non-payment of a dividend to members, has led to a further loss of public confidence and large levels of savings withdrawals from NCU members. NCU is balance sheet insolvent, its liquidity buffer has been severely depleted and there remains a risk of a continued heightened level of savings withdrawals that would further affect NCU's liquidity position. As noted above, if the current level of withdrawals of members' savings from NCU continues (representing an average daily net cash outflow of €76,000 (excluding normal trading expenses) since 28 July 2013), SRU would be recommending that the Bank make an application to Court to have NCU liquidated by • November 2013.
88. However, as noted above, SRU is of the view that if details of Naas CU's withdrawal from the transfer become public, the situation will deteriorate further and liquidation at an earlier point is likely to be required.
89. In addition, there is no prospect of a direction being able to remedy the situation because there is no capacity to address the Bank's concerns relating to financial stability.
90. Given the reasons set out above, it is the opinion of SRU that the Bank should be satisfied under Section 9(2)(b) of the 2011 Act that, having regard to the urgency of the situation and other reasons, the serious concerns that the Bank retains regarding the financial stability of NCU cannot be adequately addressed by a direction under Section 9(2)(a).

91. Accordingly, SRU is of the opinion that the Bank should be satisfied that Intervention Condition A is fulfilled.

CONDITION B

92. *Condition B is that the Bank believes there is a present or imminent serious threat to the financial stability of the authorised credit institution concerned or the financial system in the State.*
93. Condition B, like the first clause of Condition A, focuses on the financial stability of NCU. However, a higher threshold must be met for Condition B to be fulfilled. The Bank must be satisfied that there is a present or imminent serious threat to NCU's financial stability, rather than simply having serious concerns about NCU's financial stability.
94. As you are aware you did not consider at the time when the Bank applied for the original SMO on 13 January 2012 that condition B, as set out at section 9 of the 2011 Act, had been fulfilled in relation to NCU. SRU was of the view when applying for the three SMO extensions thereafter, that there had not been any change of circumstances since the original SMO application which would result in you concluding that condition B was fulfilled. However, there has been a material change in circumstances since then.

Change in circumstances

95. The publication of the SBP Article and subsequent publicity concerning the Proposed Naas Transaction has led to a highly elevated and an unsustainable level of savings withdrawals from NCU by members. These savings withdrawals have seriously threatened the financial position and stability of NCU. NCU's liquidity buffer is severely depleted and SRU considers that if the current level of withdrawals of members' savings from NCU continues (representing an average daily net cash outflow of €76,000 (excluding normal trading expenses) since 28 July 2013), SRU would be recommending that the Bank make an application to Court to have NCU liquidated by • November 2013. However, should it become public that Naas CU has withdrawn from the process, the situation is likely to deteriorate more rapidly and liquidation may be required at an earlier point.
96. SRU's view in this regard is supported by a letter which was received from the Special Manager dated 7 November 2013 which states that if the proposed transfer does not proceed he will formally request that the protection afforded to NCU under the 2011 Act be

withdrawn, that the High Court be asked to terminate the Special Manager's tenure and that the Bank petition for the winding up of NCU. A copy of this letter is enclosed.

97. Accordingly, SRU is of the opinion that the Bank should be satisfied that there is a present or imminent serious threat to the financial stability of NCU.

CONDITION C

98. *Condition C is that the Bank is satisfied that the authorised credit institution concerned has failed or is likely to fail to meet a regulatory requirement or a condition of its licence or authorisation.*

Current Breaches of the CUA by NCU

99. NCU was, at the date of the original SMO application on 13 January 2012, and is currently in breach of:

99.1 the requirement to hold minimum regulatory reserves pursuant to the 2009 Rules. These Rules require NCU to maintain a regulatory reserve ratio of 10% (as defined in the 2009 Rules), effective from 30 September 2010². As explained above, the management accounts of NCU as at 31 October 2013 indicate that the regulatory reserve ratio was -8% and the capital deficit to regulatory requirements is approximately €13.25 million. Accordingly, as mentioned above, NCU remains in breach of this requirement; and

99.2 the prohibition in Sections 35(2)(c) and 35(3) of the CUA on issuing a loan greater than 1.5% of its total assets. Section 35(2)(c) of the CUA provides that a credit union shall not make a loan to a member in the circumstances set out in Section 35(3) of the CUA. The circumstances set out in Section 35(3) are those where, were a loan to

2

Credit Union Act 1997 (Section 85) Rules 2009, Statutory Instrument Number 344 of 2009. Where a credit union did not have adequate reserves to meet the Regulatory Ratio by 30 September 2009, the Central Bank's document "Regulatory Reserve Ratio for Credit Unions" dated August 2009 provides for transitional arrangements that provide that "credit unions must achieve the regulatory reserve ratio within the shortest timeframe possible" but in any event by 30 September 2013. NCU's regulatory reserve ratio at 30 September 2009 was 9.94% and at 30 September 2010 was 11.8%. Accordingly, from the 30 September 2010 (when NCU had built the regulatory reserve ratio to 10%), the transitional arrangements no longer applied to NCU (i.e. the requirement from that date is to comply with the minimum regulatory reserve ratio of 10% on an on-going basis).

be made to a member, the amount of the member's outstanding liability (including a contingent liability) to a credit union, whether as borrower, guarantor or otherwise, would exceed whichever is the greater of: (a) €39,000; and (b) 1.5% of the total assets of the credit union. As reported by NCU at 31 December 2009, the credit union was in breach of this requirement, having reported a loan of €3.2 million which exceeded 1.5% of total assets at that date. As at the date of the last Prudential Return for NCU, dated 30 September 2013, a balance of €2.8 million was still outstanding on this loan, which exceeded 1.5% of NCU's total assets of approximately €75.3 million as of that date. The Special Manager has confirmed that, as at the date of this Memorandum, the outstanding balance (including interest) on this loan is €2.8 million, and as a result, NCU remains in breach of section 35(3) of the CUA.

Previous breaches

100. In addition to the current breaches of the CUA by NCU summarised above, RCU considers that NCU has also previously breached a number of regulatory requirements, as follows:

100.1 Section 27(4) of the CUA

Section 27(4) of the CUA requires that a member of a credit union shall: (a) not have a deposit exceeding €100,000; and (b) shall not have a claim or interest in shares in a credit union exceeding an amount which, when aggregated with the amount held by the member on deposit with the credit union, exceeds either €200,000 or 1% of the total assets of the credit union, whichever is the greater. NCU was in breach of this requirement in June 2008.³

100.2 Section 35(2)(a) and (b) of the CUA

Section 35(2)(a) and (b) of the CUA requires that the proportion of a credit union's total loans that have maturities in excess of five years and in excess of 10 years must not exceed certain limits. As reported by NCU in the Prudential Return at 30 June 2008, the credit union was in breach of this requirement with the total amount outstanding in respect of all loans exceeding five years at 51.6% of total gross loans (the maximum permitted under the Act was 20%) and with the total amount

³ Please refer to NCU's 30 June 2008 Prudential Returns at Appendix B14.

outstanding in respect of all loans exceeding ten years at 18.5% of total gross loans (the maximum permitted under the Act was 10%).⁴

100.3 *Section 32(3) of the CUA*

Section 32 of the CUA outlines certain restrictions on withdrawals of shares and deposits. Grant Thornton indicated in its management letter of 30 September 2009, received by the Bank on 12 May 2010, that during the course of its audit for the financial year ended 30 September 2009, it noted breaches of Section 32(3)(b) of the CUA based on samples.⁵

101. SRU is therefore of the view that the Bank should be satisfied that Condition C is fulfilled.

CONDITION D

102. *Condition D is that, having regard to the purposes of the 2011 Act, any guidelines issued by the Bank under section 107 of the 2011 Act and such of the matters set out in section 9(6) of the 2011 Act as appear to the Bank to be relevant in the circumstances, the immediate winding-up of the authorised credit institution concerned is not in the public interest.*

103. The 2011 Act sets out its purposes at Section 4, which read as follows:

“4. The purposes of this Act are -

(a) to provide an effective and efficient resolution regime for authorised credit institutions that are failing or are likely to fail,

(b) to provide for a resolution regime for such credit institutions that is effective in protecting the Exchequer, the stability of the financial system and the economy,

(c) to provide for the taking of measures to maintain public confidence in the financial system in the State, including to protect the interests of depositors in such authorised credit institutions, and depositors generally,

(d) to secure, to the extent possible in the circumstances, the continuity of banking services generally and in particular in relation to authorised credit institutions that are failing or are likely to fail,

⁴ Please refer to NCU's 30 June 2008 Prudential Returns at Appendix B14.

⁵ Please refer to Grant Thornton's management letter for the financial year ended 30 September 2009 at Appendix C4.

(e) to facilitate the orderly winding-up of an authorised credit institution that is insolvent,

(f) to provide a mechanism to prevent the financial instability, or threat to the financial stability, of an authorised credit institution contributing to financial instability of any other authorised credit institution, the financial system or the economy, and to avoid creating a risk of such financial instability,

(g) to facilitate the re-organisation of, or the preservation or restoration of the financial position of, an authorised credit institution that is failing or is likely to fail, and

(h) to provide the Bank with the necessary powers for the purposes set out in paragraphs (a) to (g) and to provide a framework within which the Bank can exercise those powers consistently with its legal obligations, including the legal obligations arising pursuant to the Treaty on European Union and the Treaty on the Functioning of the European Union.”

104. As at the date of this Report, no guidelines have been issued by the Bank under section 107 of the 2011 Act.
105. Set out below is a consideration of whether an immediate winding-up of NCU is in the public interest. In this regard it will be necessary to consider the purposes of the 2011 Act and, in particular, the purposes set out at Sections 4 (c), (f) and (g). In addition, it is necessary to consider those matters set out in Section 9(6) of the 2011 Act that appear to be relevant in the circumstances. As there is an overlap between the matters set out in Section 9(6) and the purposes of the 2011 Act, set out below is a consideration of the relevant Section 9(6) matters, which includes as appropriate information and analysis which is relevant to the purposes generally of the 2011 Act.

Section 9(6)(a): Whether the authorised credit institution concerned is of systemic importance to the economy of the State

106. NCU is not, in itself, considered to be of systemic importance to the economy of the State. However, NCU is part of a discrete sub-section of the financial services industry in Ireland and credit unions are linked in the public’s perception, with the result that a problem in one credit union could cause confidence and contagion issues across the credit union sector as a

whole. For the reasons set out in the following section, contagion in the credit union sector could, in turn, contribute to instability in the banking system.

Section 9(6)(b): Whether the failure of that credit institution would be likely to contribute to instability of the banking system or serious damage to the financial system in, or the economy of, the State

107. SRU considers that there remains a real risk that the failure of NCU (should this be precipitated) could lead to contagion in the credit union sector, which could contribute to instability in the banking sector as, notwithstanding the fact that this would be the failure only of a single credit union, it could give rise to instability in respect of the general banking sector through a lack of understanding in the market as to the causes of that failure.
108. As at 30 September 2013, based on data provided by individual credit unions to RCU within their prudential returns, there is a total of €7.1 billion deposited by credit unions with banks. The majority of these deposits are in domestic Irish banks. Withdrawals of members' savings from credit unions will have a virtually one-for-one impact on deposits in Irish banks, as credit unions redeem their deposits with banks to fund the savings withdrawals. There is no certainty that members, having withdrawn their savings from credit unions, would deposit those monies with Irish banks – indeed it is likely that some would be placed with subsidiaries or branches of foreign-owned credit institutions.
109. The withdrawal of €7.1 billion in deposits with Irish banks by the credit union sector as a result of a failure of NCU would not of itself contribute to the instability of the banking system. However, such withdrawals combined with the failure of an Irish credit institution at the present time, could, SRU believes, damage both the public and market's perception generally of the Irish banking and financial services system, and its on-going restructuring. NCU's failure, principally as a result of significant loan loss impairment levels, could call into question the level of loan losses across the Irish banking system and the requirement for further external equity capital support. On that basis, NCU's failure could contribute to instability within the banking system and seriously damage the financial system, the economy and the State.

Section 9(6)(c): The importance of ensuring that the depositors of that credit institution will continue to have prompt access to their deposits (whether in that credit institution or elsewhere)

110. In a liquidation scenario, all eligible deposits (in the form of members' savings) would be covered under the DGS up to €100,000 per person. Any members' savings not covered by the DGS would only be entitled to be repaid by a liquidator through the liquidation process if the liquidator was able to realise sufficient resources in NCU to repay all ineligible savings from a DGS perspective. As at 7 October 2013, NCU had 15 members with savings in excess of €100,000, with a combined total of €2.6 million in savings. DGS would cover only €100,000 for each of these 15 accounts, totalling €1.5 million, so the balance of €1.1 million would not be covered by the DGS. Such ineligible savings would only be entitled to be repaid from the liquidation process if the liquidator was able to realise sufficient resources in NCU to repay all such ineligible savings. According to the Special Manager, a liquidation practitioner, it would take a minimum of three months for a liquidator to make an interim payment of this amount, if there were sufficient funds to make such a payment, which is unlikely to be the case.
111. As at 7 October 2013, the Special Manager has estimated that there are 211 members with savings that are ineligible for the purposes of the DGS in his assessment by virtue of the type of account holder, with a combined total of approximately €960,000 in savings. Examples of these type of accounts are charities that are established as companies limited by guarantee or schools that are incorporated as companies limited by guarantee. Such ineligible savings would only be entitled to be repaid from the liquidation process if the liquidator was able to realise sufficient resources in NCU to repay all such ineligible savings. According to the Special Manager, a liquidation practitioner, it could take a significant amount of time for a liquidator to make an interim payment of this amount, if there were sufficient funds to make such a payment, which is unlikely to be the case.
112. DGS would make a compensation payment to duly verified eligible depositors by means of a crossed cheque (i.e., a cheque that could only be lodged, not cashed) posted to members' addresses within 20 days.⁶ There are a number of possible adverse consequences associated with this course of action. The 20-day period during which deposits could not be accessed would be likely to cause inconvenience to many members, and may result in hardship in some cases. For members who do not have access to an alternative bank account, lodging cheques in order to access their cash would be practically difficult. There is also a risk of

⁶ Legally, the 2011 Act (Section 88) gives the Bank powers to transfer insured deposits to another credit institution in the event of liquidation, instead of repaying them immediately. However, in this situation there is no agreed transferee to accept such a transfer of deposits.

delays in reimbursement if, for example, NCU had incomplete records or incorrect addresses for some members.

Section 9(6)(d): The importance of maintaining public confidence in the financial system in the State

113. The stability of the financial sector is heavily dependent on confidence and SRU believes that the liquidation of NCU at this time has the potential to undermine public confidence in the credit union sector and such damage to the credit union sector is liable to undermine public confidence in the financial system generally, which is not in the public interest.
114. There exists a general, public expectation that the State would intervene rather than let credit unions fail. Significantly, the Minister for Finance announced on 6 October 2011 that between €500 million and €1 billion of State funds would be made available to support the sector.⁷ This money was provided from funding originally designated for the recapitalisation of banks, under Ireland's November 2010 agreement with the European Union, the European Central Bank and International Monetary Fund. This is consistent with the general policy approach towards domestic banks of State intervention to achieve an orderly resolution rather than a disorderly failure. In terms of support for the credit union sector which underpins that perception, the Minister has provided €250 million to the Credit Institutions Resolution Fund for resolution and €250 million to the Credit Union Fund for the restructuring of the credit union sector.
115. Most savings in NCU would be refunded through the DGS in the context of a liquidation. In contrast, members with savings in excess of €100,000 would not be covered under the DGS for those sums in excess of €100,000 and members who are ineligible for DGS by virtue of the identity of the account holder (e.g. charities established as companies limited by guarantee) would not be covered/insured for any of their savings. Both groups would only be entitled to be repaid if there were sufficient funds available from the liquidation process. An inability to fully repay these deposit holders could have an adverse effect on public confidence in the credit union sector.
116. In addition, it is likely that some media attention would focus on any delay and inconvenience suffered by insured member savers, and on any losses incurred by uninsured member savers. These factors might have serious negative effects on the credit union

⁷ Please refer to transcript of Seanad Éireann Debates for 6 October, 2011 at Appendix F4, and "Government set to inject up to €1bn into credit unions", 7 October, 2011, *The Irish Times* at Appendix G3.

sector, and they could be sufficient to encourage withdrawals across the system, regardless of the presence of the DGS guarantee.

117. In this context, SRU considers that the liquidation of NCU would be likely to cause alarm to the members of NCU, and, given the size of NCU, this could unsettle members at other credit unions, leading to contagion in the sector. Such contagion could lead to other credit unions becoming cash-flow insolvent in a short period of time. Indeed, in some media reports, credit unions have been described, wrongly, as being branches of a single entity rather than as discrete legal entities, leading to a perception in some quarters that a problem in one is a problem in all credit unions. Accordingly, it is important to demonstrate that the Bank is prepared to take steps to bolster public confidence in the credit union sector.
118. Internationally, the failure of a credit union could be reported as a failure of an Irish credit institution. As the specific status of a credit union might not be appreciated, this could lead to further concern in international financial markets about the Irish financial system, at a time when confidence in this sector remains weak.
119. The potential impact of the failure of an Irish credit institution on Ireland's relationship with its official creditors as well as with the wholesale funding providers to Irish banks and to bond market purchasers of Irish Government debt, would also need to be considered.
120. Domestically, it is also possible that a contagion dynamic in the credit union sector could be catalysed by the liquidation of NCU; the potential damage of such instability would be significant, though the cost to the Exchequer and effects on the economy would be more modest than in the case of instability in the retail banking sector.
121. This risk is heightened by NCU's high public profile: while no longer the case, it is perceived as one of the largest community credit unions in the country, and is closely watched by players in the industry. In addition, there has been a significant increased level of media attention in NCU since details of the proposed transfer with Naas CU became public. Any financial difficulties or loss of confidence in NCU would be likely to attract more media attention than that of a typical credit union. In particular, a failure of NCU might raise concerns for smaller credit unions.
122. Furthermore, a failure of NCU following the appointment of a Special Manager for nearly a two year period might exacerbate the potential instability and undermine confidence in

future intervention measures by the Bank, including through the appointment of a Special Manager.

Section 9(6)(e): The importance of maintaining continuity of banking services to NCU's customers

123. It is not possible to identify the proportion of members of NCU who retain existing banking relationships with other credit institutions. However, within Ireland, 20% of Irish households do not have a bank current account, for various reasons.⁸ Transferring members' shares and borrowings to another credit institution ensures these individuals continue to have access to financial services.
124. NCU offers its members a selection of banking services: lending, savings, foreign exchange and various insurance products. In the event of liquidation, NCU would close and these services would cease.
125. The cessation of member saving services by NCU would create cash-flow difficulties for members. In the first instance, many members use their accounts as current accounts, making regular withdrawals to pay for groceries and other living expenses. The closure of their only savings account may cause these members particular inconvenience, and may result in some of them choosing to remain outside the banking sector.
126. It is likely that at least some members do not have bank accounts outside NCU. According to a publication by the Economic and Social Research Institute in 2011:

"In 2008 it was found that 20% of Irish households did not have a bank current account. The level of banking exclusion in Ireland was almost three times higher than the average for the EU15. The proportion without a bank current account rose to 40% among those with low education qualifications, 38% in households in the bottom income quintile, 50% among local authority tenants and 27% among those aged over 55 years.

While the levels of personal credit grew during the economic boom, in 2008 31% of households were found not have access to credit (credit cards, loans, overdraft

⁸ Central Statistics Office (2008) "Survey on Income and Living Conditions", cited in Economic and Social Research Institute (2011) "Financial Exclusion and Over-indebtedness in Irish Households" (Appendix F2).

facilities). Taking out those who said they did not need to borrow, 10% of households were defined as credit excluded.”⁹

127. While it is likely that some members will find it difficult to secure credit from other institutions on comparable terms and conditions as they have enjoyed with NCU, having no access to an account with a financial institution, as may be the scenario where NCU was liquidated, would constrain the credit available for these individuals further.

Section 4(b) of the 2011 Act: Minimising cost to the Exchequer

128. Section 4(b) of the 2011 Act provides for the following purpose of the 2011 Act: *“to provide for a resolution regime for such credit institutions for such credit institutions that is effective in protecting the Exchequer, the stability of the financial system and the economy”*. Having regard to this purpose in considering whether an immediate winding up of NCU is in the public interest, SRU has undertaken an analysis of the potential costs of the PTSB Transaction and a liquidation of NCU, which is summarised below:

Cost of transfer to PTSB

- 128.1 Under the FIA (which is in final form but has not been signed), it is conditionally agreed that the Bank will provide PTSB with financial incentives under section 46 of the 2011 Act on the following basis:

Incentive Structure for PTSB			
€	Cash Financial Incentive Amount plus Restructuring & Integration Costs	Loss Compensation Payments - assuming the maximum loss to Fund	Total Financial Incentive
Upfront cash incentive	23,007,782	0	23,007,782
Restructuring & Integration Costs	4,250,000	0	4,250,000
Transferring Liabilities	2,000,000	0	2,000,000
Loss Compensation Payments	0	24,656,483	24,656,483
Incentive Structure for PTSB	29,257,782	24,656,483	53,914,265

⁹ Economic and Social Research Institute (2011), “Press Release: Financial Exclusion and Over-indebtedness in Irish Households”, at Appendix F1.

Cost of liquidation

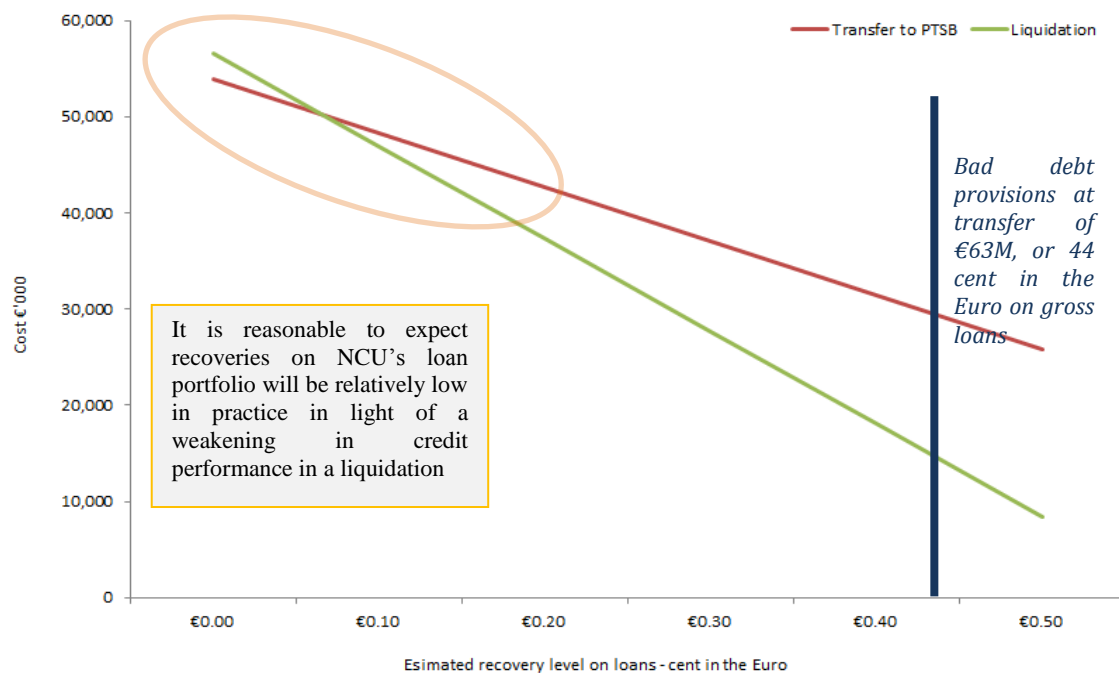
128.2 We have sought to assess the cost of liquidation based upon the following key assumptions:

- (a) tangible fixed assets can be realised at a value of €3.9 million, based upon indicative terms recently offered by a third party for NCU's existing premises, less assumed transaction related costs of €0.3 million, implying net proceeds of €3.6 million;
- (b) all other assets, excluding member loans, are recovered on a Euro for Euro basis;
- (c) liquidation costs are assumed to total €2 million and a liquidation contingency totals €1 million; and
- (d) the cost of laying off staff is assumed to cost €1 million.

128.3 There is no comparable precedent to benchmark against regarding the expected recovery on NCU's loan book in the context of a liquidation. In the absence of such a precedent, and based on using the above assumptions, we have equated the cost of liquidation to the cost of transfer, in order to derive a rate of recovery from the loan book – on a cent in the Euro basis – for comparison purposes.

128.4 The following chart outlines the costs of transfer (based on the agreed financial incentives under the FIA) and liquidation, based on varying levels of loan recovery.

Chart: Costs of liquidation versus cost of transfer to PTSB



Source: NCU Management Accounts 31 October 2013

128.5 At higher loan recovery levels, all other things being equal, the cost of transfer substantially exceeds the quantifiable cost of liquidation given the FIA includes a profit sharing mechanism to the Fund – where there is no such sharing mechanism under a liquidation. At lower loan recovery levels however, the cost of liquidation and transfer are more aligned, with transfer less expensive at a recovery rates of less than 10 cent in the Euro. With the exception of the low loan recovery levels noted, the analysis suggested that liquidation is theoretically cheaper than transfer.

Impact of liquidation on loan recoveries

128.6 It is difficult to quantify precisely the impact of a liquidation event as part of a desktop analysis. It is reasonable to assume that in practice a liquidation of the NCU portfolio will achieve a relatively low level of loan recovery overall. This reflects the impact of a number of key factors on recoveries:

- (a) reduced repayments would likely result from a liquidation given a bias of borrowers towards other lenders that continue to operate on a going concern basis - borrowers would see such lenders as worthy of developing a longer term banking relationship, thereby prioritising repayment to them;

- (b) the specific profile and product mix within NCU's loan portfolio, with a higher average loan size than the wider credit union sector and a significant unsecured lending bias, points towards a challenging credit performance from the loan portfolio given continuing weakness in the domestic economic environment over the short to medium term;
- (c) post-liquidation, a liquidator would be unlikely to extend credit to borrowers, which may have a negative impact on the capacity of some borrowers to meet their ongoing loan repayment obligations, as well as the knock on impact on borrower repayment priorities towards other lenders; and
- (d) under potential sale of the loan book, a third party buyer would seek to price the purchase on a heavily discounted basis reflecting a perceived risk of diminished repayments from borrowers – the third party would demand a higher rate of return on any such investment reflecting the perceived increased risk, thereby lowering the overall valuation of the book under any net present value assessment of cash flows.

128.7 We believe, factoring in the above issues, that the likely outcome in a transfer on a going concern basis, is that the loan recovery level will far exceed a comparable recovery on liquidation.

Indirect impact of liquidation

128.8 It is important to also bear in mind that the above analysis do not take into account any possible wider contagion effects from the liquidation of a credit union.

128.9 Naas CU, as a neighbouring credit union to NCU, previously expressed concerns to the Central Bank that a liquidation of NCU would have significant knock on impacts both locally within the credit union sector in County Kildare, and across the wider sector nationally. If that occurred and credit unions were impacted in that way, there might be very substantial resolution costs for the State which could far outweigh any perceived saving in costs under a liquidation. Members of credit unions could start to question the financial stability of their credit union and the sector generally, affecting public confidence in the sector. If that occurred and the credit union was

impacted in that way, the Exchequer would bear a much greater cost in terms of resolution under the 2011 Act.

128.10 We do not believe liquidation in practice would be cheaper than transfer. Nonetheless, SRU considers that any possible saving that might be achieved through the liquidation route would be far outweighed by the unquantifiable but very real costs that would arise as a result of the matters identified in the context of SRU's consideration of the issues set out in Section 9(6) of the 2011 Act above.

129. On the basis of the above, SRU is of the opinion that an immediate winding up of NCU would not be in the public interest having regard to the purposes of the 2011 Act and, in particular, the purpose set out in section 4(b) of the 2011 Act.

Other purposes of the 2011 Act

130. SRU has considered all the purposes of the 2011 Act as set out in Section 4 thereof and, in the particular context of NCU, SRU considers the purposes set out at (b),(c) and (f) of Section 4 to be the most relevant. Having regard to the information and analysis set out above in relation to Section 9(6) of the 2011 Act and the issues identified therein which are relevant to the purposes set out at Section 4 of the 2011 Act, SRU believes that the immediate winding up of NCU is not in the public interest. In particular, this is so having regard to the particular purpose set out in the 2011 Act of maintaining public confidence in the financial system in the State, including the protection of members' savings in credit unions. It is also so in the context of the 2011 Act's objective of preventing the financial instability (or threats to the financial stability) of an authorised credit institution contributing to financial instability of any other authorised credit institution, the financial system, and the economy as a whole, and the objective of avoiding creating a risk of such financial instability.

Conclusion on Condition D

131. Accordingly, SRU believes that, having regard to the purposes of the 2011 Act and the matters set out in section 9(6) of the 2011 Act, the immediate winding up of NCU is not in the public interest and that, on this basis, the Bank should be satisfied that Condition D is fulfilled.

Consultation with the Minister

132. The final intervention condition specified in the 2011 Act is that the Bank has consulted the Minister.
133. Although discussions have taken place with SRU, the Department of Finance and PTSB in relation to the Proposed PTSB Transaction and the structure and level of the financial incentives that would be provided to PTSB under the Proposed PTSB Transaction pursuant to section 46 of the 2011 Act, to date, this formal consultation has not yet taken place.

Conclusion on the Intervention Conditions

134. On the basis of the evidence set out above, SRU is of the opinion that the Bank should decide that Intervention Conditions A, B, C and D have been met in relation to NCU. Therefore, all of the necessary Intervention Conditions have been met, subject to consultation with the Minister by the Bank.

E. THE NECESSITY TEST

135. Section 21(1)(b) of the 2011 Act provides that the Bank may make a PTO if it decides that having regard to any adverse consequences that may arise as a result of the transfer order, in relation to the interests generally of the creditors of the transferor or, where the transferor is a subsidiary or holding company, in relation to the interests generally of the creditors of the transferor or the authorised credit institution concerned, a transfer order is necessary in all the circumstances to address one or more of the reasons for those intervention conditions.

The interests of creditors will not be adversely affected by the transfer

136. SRU is of the view that the interests of NCU creditors will not be adversely affected by the Proposed PTSB Transaction. Even if there any unanticipated material effects on creditors the proposed transfer is the only way to address the reasons for the Intervention Conditions. All assets and liabilities of NCU (including all deposits and loans), except for the premises, will be transferring to PTSB, thus no creditors will be adversely affected.
137. The terms of loans held by members of NCU will not change a result of the transfer to PTSB.
138. Following the proposed transfer taking effect all members accounts will become deposit accounts with PTSB and we understand that PTSB intends to write to each of the members

in due course to offer them an interest rate on those deposits in place of a dividend, which is the current entitlement of the members.

Intervention conditions A, B and C

139. Intervention conditions A, B and C relate to the financial position of NCU, and specifically the regulatory reserve deficit. A standalone recapitalisation of NCU is not possible under current legislation. As NCU is unable to restore its financial position on a standalone basis, the provision of an incentive under a transfer order is the only way that the financial position of NCU can be restored.
140. The remaining legislative options for dealing with NCU have each been considered by SRU and have each been discounted as an option to restore the financial position of NCU for the reasons provided below.

140.1 *Appointment of an Administrator under Section 137 of the CUA*

SRU believes that an Administrator would occupy a similar role to the Special Manager and the Administrator would have no mechanism to restore the financial position of NCU. At the time of the SMO application in January 2012 SRU considered it preferable to seek the appointment of the Special Manager under the 2011 Act, rather than the appointment of an Administrator under s.137 of the CUA.

140.2 *Credit Institutions (Stabilisation) Act 2010 (“CISA”)*

CISA no longer applies to credit unions.¹⁰ Consequently resolution action under CISA would not be an option in the context of NCU.

140.3 *Issue a direction under s.87 of the CUA*

It would be open to RCU to issue a direction to NCU to restore its capital position under Section 87. However, as outlined above, the Bank does not consider such an issuance appropriate in the circumstances, as the Bank considers that NCU is incapable of taking the necessary action to comply within the period that would be specified by the Bank in such a direction.

140.4 *ReBo to provide funds under the 2012 Act*

¹⁰ See part 5 of Schedule 2 to the 2011 Act, which amended the definition of “relevant institution” in CISA.

ReBo can only arrange and seek financial support from the Minister in connection with voluntary credit union transfers. As there is no suitable credit union transferee willing to enter into a transfer with NCU, this is not an option.

141. Therefore under intervention conditions A, B and C a transfer order is necessary as the only circumstance where the capital deficit can be remedied.

Intervention condition D

142. Intervention Condition D relates to the reasons why an immediate wind up of NCU is not in the public interest. For the reasons set out above, we are of the view that Condition D is fulfilled and we are of the opinion that a transfer order is necessary in all the circumstances to address the reasons why an immediate wind up of NCU is not in the public interest.

143. Continuation of services to members, which is among the purposes specified in section 4(d) of the 2011 Act, is also an important consideration. A transfer to PTSB of NCU's business would ensure that NCU members could continue to obtain the normal suite of financial services from a premises in Newbridge, which would remain open as a branch of PTSB.

144. Under a transfer all members will maintain 100% of their savings. The entirety of members' savings may not be similarly protected in a liquidation.

Recommendation

145. On the basis of the above, SRU is of the opinion that, having regard to any adverse consequences that may arise as a result of the transfer order, in relation to the interests generally of the creditors of the transferor, a transfer order is necessary in all the circumstances to address one or more of the reasons for the Intervention Conditions.

G. IMMEDIATE EFFECT

146. Section 30(5) of the 2011 Act provides that the Court shall order that a transfer order has immediate effect if the Court is satisfied that it is necessary, in all the circumstances, for the order to have that effect.

147. SRU believes that it is necessary in all the circumstances for the Transfer Order to have immediate effect. If the Transfer Order did not have immediate effect, this would be highly

likely to result in the requirement to make a petition for the liquidation of NCU within a matter of days and to completely frustrate the proposed transfer and to render resolution by way of a transfer wholly ineffective. This view is based on a number of factors which are set out below.

NCU's liquidity position

148. As previously stated, the liquidity position of NCU has seriously deteriorated since July 2013, when details of the Proposed Naas Transaction were disclosed into the public domain.
149. In order to tightly monitor the level of withdrawals from NCU and to ensure that the Bank is in a position to respond quickly to a run on NCU, the Bank has placed NCU on an hourly liquidity watch since 30 July 2013. NCU's liquidity position is sent to RCU by the Special Manager and circulated within the Bank on an hourly basis. A daily email is circulated to you and senior management in the Bank and the Department of Finance to update them on the liquidity position of NCU. The level of attention that has been given to the NCU liquidity position within the Bank and the Department of Finance demonstrates the seriousness with which the liquidity position of NCU is viewed.
150. From 27 July 2013, until 1 November 2013, there was a total of €20.2 million in shares withdrawn from NCU. This represents a 12% decrease in the shares of NCU. See the below table which illustrates the total level of withdrawals from NCU on a weekly basis since 29 July 2013.

Table 5: total level of withdrawals from NCU on a weekly basis since 29 July 2013

Week	Members' Shares Withdrawn (€)
27 July – 02 August	3,219,655
03 August – 09 August	2,029,228
10 August – 16 August	1,482,341
17 August – 23 August	1,290,105
24 August – 30 August	1,177,022
31 August – 06 September	986,294
07 September – 13 September	1,081,285
14 September – 20 September	1,062,727
21 September – 27 September	1,233,969
28 September – 04 October	2,017,001

05 October – 11 October	1,118,817
12 October – 18 October	795,075
19 October – 25 October	1,007,305
25 October – 01 November	757,574

151. As you will note, the level of withdrawals during the 14 week period have not been constant. While the average weekly rate of withdrawals during that period was €1,446,000, the level of withdrawals range from a high of € 3,287,000 to a low of €813,000 per week. The weeks where there was a heightened level of withdrawals coincided with the times when there was an increase in publicity in relation to the Proposed Naas Transaction. We have identified 3 different periods when the level of withdrawals was particularly high. The appointment of the Special Manager in January 2012 resulted in the level of unattached savings (i.e. savings by members not attached to borrowings) decreasing by 19% over a subsequent two week period. On 27 July 2013 media coverage of the proposed combination of Naas CU and NCU led to a decrease in the level of unattached savings by 5% over a subsequent two week period. From 27 July 2013 to 6 November 2013 there was significant activity by the Save Newbridge Action Group and local and national media coverage which resulted in the withdrawal of 14% of unattached savings. The movement in savings during those period is set out in the table below:

Table 6: Movements in savings during certain periods

	Appointment of SM		Media Coverage of Directed Transfer		Protest Groups Activity	
Unattached Shares €'000	13/01/12	123,261	27/07/13	73,808	27/07/13	73,808
	27/01/02	100,385	10/08/13	69,896	06/11/13	63,614
	% change	-19%	% change	-5%	% change	-14%

152. Based on the above trends, SRU believes that if there is an increase in publicity in relation to NCU, there is likely to be an attendant increase in withdrawals on the basis of past experience. If that publicity was in relation to the Proposed PTSB Transaction, there is very likely to be a large increase in withdrawals from NCU. This is because members have been informed that a transfer with Naas CU was proposed and significant concern is likely to arise when it becomes known that Naas CU has withdrawn from the process and that a

transaction with a bank is proposed in its place. Notwithstanding that NCU has not paid a dividend for three years, many members have chosen to maintain their savings in NCU as a credit union and members are likely to be concerned therefore that their deposits are being transferred to a bank. It appears also that one of the main reasons for the previous withdrawals from NCU was because of a lack of certainty on a resolution for NCU and SRU believes that this uncertainty is likely to be exacerbated if details of the Proposed PTSB Transaction are disclosed in advance of the Transfer Order having effect and in circumstances where there may be a challenge to the Transfer Order.

153. One of the reasons that SRU believes that it is necessary in all the circumstances that the Transfer Order has immediate effect is therefore because the level of withdrawals from NCU would be likely to become seriously elevated when news of the Proposed PTSB Transaction is made public. If it is made public that the Bank has applied for the Transfer Order but it is not effective immediately, the elevated level of withdrawals, together with the liquidity position of NCU, are very likely to force the Bank to instruct the Special Manager to close the doors of NCU and an application being made to the Court to appoint a provisional liquidator. Closing the doors of NCU is likely to have the very serious effects outlined in paragraphs 160-162 below. Although there may not be any challenge filed during that period, it is very likely that if the Transfer Order does not have immediate effect the elevated level of withdrawals during that period would necessitate a liquidation of NCU. In such circumstances, the Proposed PTSB Transaction would not take effect.
154. While we have addressed the elevated level of withdrawals from NCU and the resultant liquidity difficulties, it is worth focusing on the liquidity difficulties in further detail. The liquidity of NCU currently stands at €8.5 million plus €0.8 million held at the Bank. As stated above, the Bank, with the assistance of the Special Manager, has identified a level of liquidity at which the Bank would make an application to liquidate NCU, which is described as the Liquidation Trigger Point. Details of how the Liquidation Trigger Point is calculated are set out below.

Liquidity - estimated trigger point and available headroom	
[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]
Estimated trigger point	5,858,107
Total funds currently available	7,315,917
Minimum reserve requirement held at CBI	806,422
Total resources still available	8,122,339
Headroom	2,264,233

155. The Liquidation Trigger Point currently stands at €5,858,107. There is a €2,264,233 difference between the current liquidity level of NCU and the Liquidation Trigger Point. Based on the average daily level of withdrawals from NCU since 28 July 2013 (i.e. €76,000), there would be 29 days until the Liquidation Trigger Point was reached. Based on the average withdrawals from the week of 27 July to 2 August 2013 (i.e. €536,609 per day), when the publicity in relation to the Proposed Naas Transaction was at its height, there would be 4 days until the Liquidation Trigger Point was reached. SRU's concern is that if news of the Proposed PTSB Transaction was made public, the level of withdrawals would be at least at a similar level to the level of withdrawals when details of the Proposed Naas Transaction first became public. We would expect, however, that the level of withdrawals would be higher than when details of the Proposed Naas Transaction became public as concern would arise over Naas CU's withdrawal from the process, the fact that the Proposed PTSB Transaction is a transfer to a bank and whether there might be a challenge to the transfer order. It is clear that NCU would not be in a position to sustain such a level of withdrawals without reaching the Liquidation Trigger Point. At that point, the Bank would have no option but to apply to the Court to liquidate NCU. Based on the above analysis, SRU believe that if the Transfer Order is not granted with immediate effect, the Liquidation Trigger Point will be reached before the Transfer Order will become effective, which will lead to a situation where an application will need to be made to the Court to liquidate NCU.
156. The Special Manager has indicated that when the Liquidation Trigger Point is reached, he will issue a letter to the Bank stating that NCU is no longer in a position to continue to trade.

157. SRU believes that it is necessary in all the circumstances that the Transfer Order has immediate effect so that the Transfer Order becomes effective and the transfer takes place before the Liquidation Trigger Point is reached. If Court does not order that the Transfer Order has immediate effect and if the Liquidation Trigger Point is reached between the date of the initial Court hearing in relation to the Transfer Order and the date when the Transfer Order takes effect (whenever that may be), the Bank will have no option but to seek the appointment of a liquidator to NCU under the 2011 Act and the Proposed Transaction would not then take place. Based on the level of liquidity in NCU and the estimated number of days until the Liquidation Trigger Point is reached, SRU believes that it is of fundamental importance that the Bank seek an order from the Court that the Transfer Order has immediate effect pursuant to section 30(5) of the 2011 Act.
158. SRU is also concerned that if the Transfer Order does not have immediate effect, there is a serious risk that the level of withdrawals from NCU could increase between the date of the initial application for a Transfer Order and the Transfer Order taking effect. If this occurred, the Liquidation Trigger Point could be reached sooner than the estimate set out above. The publicity surrounding an application to the Court for a Transfer Order on the terms sought is likely to increase deposit withdrawals.

Option of directing NCU to cease business

159. SRU have considered whether it would be a viable option to direct NCU to cease business if the Transfer Order was not granted with immediate effect and there was a seriously elevated level of withdrawals from NCU which was likely to result in the Liquidation Trigger Point being reached. SRU believe that this would not be a viable option for financial stability reasons. Throughout the financial crisis in Ireland, no credit institution closed its doors as a result of elevated levels of withdrawals. If NCU closed its doors, it could lead to widespread concerns not just in relation to NCU, but in relation to the credit union sector as a whole. This is because, given the widespread publicity in relation to NCU, this could undermine confidence in the Bank's resolution tools and therefore, lead to contagion. Members of other credit unions are likely to be concerned that their credit unions' doors may also be closed. In addition, the public may not differentiate between such a direction being issued in relation to a credit union and that of other financial institutions. There is a concern therefore that this could have a contagion effect and could have an adverse impact on all deposit-taking institutions in Ireland.

160. The effect of directing NCU to cease business would also be very likely to have a detrimental effect on PTSB should the transfer order take effect as it is likely that once the deposits have been transferred to PTSB, following a period in which such members could not access such deposits, a large number of members would be likely to seek to withdraw their deposits. The Bank would be concerned that PTSB would seek to withdraw from the transfer in such a situation.
161. The Bank also needs to be conscious of the circumstances in which a “compensation event” under the European Communities (Deposit Guarantee Scheme) Regulations 1995 could be claimed to have occurred exposing the DGS to claims and making a liquidation necessary. It is extremely important to avoid claims against the DGS even if unjustified. Even the making of claims against the DGS might itself lead to instability in the context of the financial crisis, thereby rendering a pay-out under the Deposit Guarantee Scheme and a liquidation necessary.

Possible withdrawal of PTSB from PTSB Transaction

162. If the Transfer Order does not take immediate effect, the Bank would be concerned that PTSB would seek to withdraw from the transfer. This is because, as noted above, there is likely to be a significantly increased level of withdrawals if the Transfer Order does not have immediate effect. In these circumstances, PTSB may no longer wish to proceed with the Transfer Order and it would be necessary therefore for the Bank to seek to liquidate NCU.

Position of members and creditors on liquidation

163. In all the circumstances, members of NCU would be in a better situation under a Transfer Order to PTSB when compared with a liquidation. There are circa €2 million of shares in NCU that would not be covered by the DGS in the event of a liquidation. These members will not lose out financially if the Proposed PTSB Transaction takes place, which may not be the case in the event of a liquidation. In addition, no dividend has been declared by NCU in three years and there is no prospect of a dividend being declared in the future. By contrast, following a transfer to PTSB, former members of NCU would be eligible for interest payments in respect of deposit accounts in accordance with PTSB’s applicable terms and conditions.
164. In addition, some members would lose access to basic banking services if their accounts were not transferred to another financial institution. In particular, we understand that a

proportion of members of NCU do not retain existing banking relationships with other credit institutions and particular difficulties may arise for them in terms of accessing their monies following a liquidation. Transferring members' shares to another credit institution ensures such individuals continue to have access to financial services.

165. In addition, the cessation of member saving services by NCU would be likely to create cash-flow difficulties for members. While eligible depositors would be repaid under the DGS within 20 days, hardship is likely to arise for depositors during the period in which they cannot access their deposits. For members who do not have access to an alternative bank account, lodging cheques in order to access their cash would be practically difficult.
166. Other creditors of NCU would be made whole under an effective transfer to PTSB which would be unlikely to be the case under a liquidation.
167. Given that liquidation is not an appropriate response to the situation in NCU for all of the above listed reasons and the reasons set out in the Bank's analysis of Condition D of the intervention conditions, it is absolutely crucial that the transfer order has immediate effect, and SRU considers this necessary in all of the circumstances as outlined above.

H. NEXT STEPS

168. The Bank, in consultation with the Department of Finance, has discussed the PTSB Financial Incentives with PTSB and has come to a provisional agreement. The FIA is in a final draft form but is not signed. It would not be executed until after you have formally consulted with the Minister under the terms of the 2011 Act and requested that the Minister provide the PTSB Financial Incentives pursuant to Section 46 of the 2011 Act and the Minister has provided the enclosed letter in relation to his agreement that the PTSB Financial Incentives be provided.
169. If, having considered this Memorandum, the consultation with the Minister and any submissions from the NCU directors and NCU, you reach a decision that the Intervention Conditions have been fulfilled in respect of NCU and that a transfer order is necessary in all the circumstances, and the Minister agrees to provide the PTSB Financial Incentives, the next step under the 2011 Act would be to make a PTO in respect of the PTSB Proposed Transaction and apply to the High Court for a transfer order under Part 5 of the 2011 Act.

Enclosures:

1. *Letter from Greg Dempsey dated 19 June 2012*
2. *Letter from [REDACTED] to SRU dated 14 December 2012*
3. *Naas Term Sheet dated 29 April 2013*
4. *Letter from Greg Dempsey dated 17 May 2013, Second Bid Process Steps Plan and Letter to Greg Dempsey dated 17 May 2013*
5. *SRU analysis of potential transferees under the Second Bid Process Steps Plan May 2013*
6. *Note of the Second Bid Process telephone calls on 17 May 2013*
7. *Letter to the Minister dated 7 May 2013*
8. *Letter from the Minister dated 25 June 2013*
9. *Sunday Business Post Article dated 28 July 2013*
10. *Public Statement in respect of NCU issued by the Bank on 1 August 2013*
11. *Letter from Naas CU dated 7 November 2013*
12. *Letter to SRU dated 1 November 2013 and the Amended Second Bid Process Steps Plan*
13. *Note of telephone calls on 1 and 2 November 2013 with PTSB, AIB, Bank of Ireland and Ulster Bank*
14. *Draft Transfer Order*
15. *Draft FIA*
16. *Draft Letter from the Minister*
17. *Letter from the Special Manager dated 7 November 2013*