



TUARASCÁIL ón gComhchoiste Fiosrúcháin i dtaobh na Géarchéime Baincéireachta

An tAcht um Thithe an Oireachtais
(Fiosrúcháin, Pribhléidí agus Nósanna Imeachta), 2013

REPORT of the Joint Committee of Inquiry into the Banking Crisis

Houses of the Oireachtas
(Inquiries, Privileges and Procedures) Act, 2013

Volume 1: Report
Volume 2: Inquiry Framework
Volume 3: Evidence

Dept. of Finance
DOF: Core Book 18

January 2016

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THEME: C3

Appropriateness and effectiveness of the Department of Finance actions during crisis

LINE OF INQUIRY: C3a

Appraisal of conditions prior to increasing the Deposit Guarantee Scheme

What is your assessment of the Irish Financial situation?

- There have been dramatic events in international financial markets over the past fortnight as illustrated by recent stock market volatility; and the unprecedented developments on Wall Street over the last week
- Swift actions by international central banks, including the ECB, to provide major injections of liquidity and the US authorities' plan to rid US banks of troubled assets and shore up US financial institutions has helped stabilise markets internationally
- The US financial institutions in the headlines are investment banks operating largely in wholesale markets and are very different to Irish retail banks
- Irish financial institutions have no material exposure to the sub-prime securities which have created major losses for large investment banks
- The Governor of the Central Bank and the Financial Regulator have stressed repeatedly that Irish financial institutions are well capitalised and liquid with good quality assets.
- They have proved resilient in dealing with challenging market conditions
- Their access to liquidity from the European Central Bank on account of Ireland's membership of the euro zone is a major benefit and had proved a real strength in helping the Irish financial system to weather difficult financial conditions over the last year
- Depositors in Irish financial institutions can be confident that their deposits are safe and secure.

Should Irish Depositors be concerned?

- The Financial Regulator has made clear that our banks have ready access to cash from the European Central Bank, that there are no difficulties in ensuring that our banks have adequate funds for depositors and that depositors can be confident that their deposits are safe and secure.
- The Minister for Finance has said that the Government will take whatever steps are necessary to ensure the stability of Ireland's banking system.
- The message that I am giving this morning couldn't be clearer:- the Government puts the highest priority on ensuring the stability of our financial system and the safety and security of savings in all our financial institutions.

Financial Regulator's decision on short selling?

- I welcome the move by the Financial Regulator to prevent short selling.
- It is essential to act in tandem with our international partners, namely the US and British authorities, so as to ensure that our financial market is not subject to destabilising financial speculation
- Short-sellers have sought to gain from undermining confidence in our financial institutions

Will the Government be increasing the level of the Deposit Protection Scheme?

- The Government has agreed to increase the existing statutory limit for the deposit guarantee scheme for banks and building societies to €100,000 per depositor.
- The Government has also decided that 100% of each individual's deposit will be covered up to that limit.
- It has also been decided that this guarantee level will apply to credit union savers.
- The decision will require legislation, which will be backdated to today.

- Given recent comments by Fine Gael and Labour I am sure they will be fully supportive of this decision.

Why is the decision occurring now?

- In line with normal arrangements for such decisions, it was made public outside of normal financial institution opening hours. This will allow people to digest and fully understand the importance of this decision in terms of providing a further reassurance to depositors who may have been concerned by developments in financial markets and Wall Street earlier this week.
- The Government has always kept the Deposit Protection Scheme under review, participating in the EU review of the Deposit Guarantee Directive. Ill informed and misleading speculation about the stability of the banks and the guarantee scheme has caused concern to savers. This decision is being taken to stress that savers can be confident that their savings are safeguarded and guaranteed.
- It is always quite difficult to choose the right time for this decision to ensure that the reasons for it are fully understood. In light of recent developments and the uncertainty in the financial world, I believe the Government has acted at the appropriate time.
- The key point is that the Government wants to protect the whole financial sector, and secure its stability. The Regulator has confirmed that deposits in Irish banks are safe.

Has this decision been taken in reaction to public panic?

- No, this decision has been made in light of the ongoing review of the deposit protection scheme. Obviously, the recent turbulence has highlighted the need to bring consideration of this specific issue to an end and take the decision on what is the appropriate level of guarantee to emphasise the Government's commitment to looking after the interests of savers.
- Indeed the Government has been impressed at the informed calm which the vast majority of customers have kept over the past fortnight.

- The key point is that the Government wants to protect the whole financial sector, and secure its stability. The Regulator has confirmed that deposits in Irish banks are safe.

Are the Irish Banks in difficulty?

- The US financial institutions that have been the headlines today are wholesale investment banks and are very different to the retail banks in Ireland.
- Irish banks have no material exposure to sub-prime securities
- As the Governor of the Central Bank has stressed, they are well capitalised and liquid with good quality assets.
- Their strong performance over recent years has provided them with strong buffers to deal with the current market environment.
- Ireland's membership of the eurozone and its access to ECB liquidity is a real strength
- They have proved resilient and are weathering well current difficult financial market conditions.
- Irish banks are continuing to go about their normal business in the challenging environment in which they find themselves and are working through the issues that they face.

Will you comment on the rumours of takeovers?

- I do not want to comment on any particular institution in the current climate as that would be unhelpful.

BANKING – DEPOSIT GUARANTEE SCHEMES

The Council held a policy debate on the functioning of deposit guarantee schemes and their role in ensuring financial stability, in particular with regard to the banking industry.

The Commission is expected to present a report on the subject in September, providing the basis for a more targeted policy debate later in the year.

Deposit guarantee schemes help prevent panic reactions by depositors in the event of a bank experiencing difficulties or loss of public trust. The Financial Stability Forum, an international forum of central banks, supervisory authorities, national ministries and international financial institutions, has recommended a review of deposit guarantee arrangements in the light of the recent difficulties in the banking sector. At EU level, the key policy question is whether there is a case for developing common principles and/or strengthening the regulatory framework.

Directive 94/189/EEC requires member states to ensure the existence of one or more deposit guarantee schemes that can reimburse depositors at least up to EUR 20 000 within three months if a bank is unable to pay back deposits. The cost of financing the scheme must be borne by the banks themselves, though the directive doesn't harmonise methods of financing.

The directive provides discretion to the member states in implementing the rules, so the schemes differ significantly across the EU. The main differences concern the share-out of roles between public authorities and the private sector, triggers for pay-outs, the types of deposits covered, the level of protection offered to customers and the financing of the schemes.



**COUNCIL OF
THE EUROPEAN UNION**



10014/08 (Presse 152)

PROVISIONAL VERSION

PRESS RELEASE

2872nd Council meeting

Economic and Financial Affairs

Luxembourg, 3 June 2008

President **Andrej BAJUK**
Minister for Finance of Slovenia

P R E S S

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10014/08 (Presse 152)

1
EN

Government Increases Deposit Guarantee Limit to €100,000 per depositor

20.08.08

The Government has decided to increase the statutory limit for the deposit guarantee scheme for banks and building societies from €20,000 to €100,000 per depositor per institution. The cover will apply to 100% of each individual's deposit. This guarantee level will also apply to credit union savers.

Announcing the decision, the Minister for Finance, Brian Lenihan TD, said "I want it to be known that the Government is confident about the strength and resilience of the Irish financial system. The Government is committed to the stability of our financial system, so that money placed with an Irish credit institution would not be at risk. As I said yesterday, the Irish Government wants to protect the whole financial system, secure its stability and ensure that all deposits in Irish financial institutions are safe."

The Minister added "the Central Bank and Financial Regulator have stressed the soundness and stability of the Irish financial system. This measure provides additional reassurance to depositors in Ireland that their savings are safe. The new guarantee level is now among the highest in the EU."

The Minister also commented that notwithstanding the uncertainty caused by the turbulence in international financial markets over the last week, it is encouraging that the banks have retained the confidence of their customers.

This measure has been under consideration for some time, and the Minister believes that this is the appropriate time to make the announcement.

Ends

Notes for Editors

Legal basis to the Deposit Protection Scheme

The legal basis for the Deposit Protection Scheme in Ireland is the European Communities (Deposit Guarantee Schemes) Regulations, 1995. These Regulations implemented the European Union Directive on Deposit Guarantee Schemes (94/19/EC). The Irish regulations were amended in 1999 to provide for a maximum compensation of €20,000.

Legislation

Legislation will be introduced shortly by the Minister to implement the new guarantee level but this new level will have affect from today following the Government's decision.

EU Guarantee Levels

The single largest number of EU Member States currently have guarantee thresholds of €20,000 – Austria, Belgium, Cyprus, Germany, Greece, Ireland, Luxembourg, Malta, Slovakia, Spain. Other States have thresholds variously in excess of this – e.g. Finland and Portugal €25,000, Netherlands €38,000, Denmark €40,300, UK €48,500 euro equivalent of £35,000) and Italy €103,000.

EU Review

Ireland is participating in the ongoing review of the EU Deposit Guarantee Schemes Directive. This review includes consideration of the minimum level of the EU guarantee but also focus on wider policy areas such as co-insurance requirements (under which depositors bore 10% of losses which is being abolished for the Irish scheme) improving

the speed of payouts, better depositor information, the case for gross rather than net compensation (as at present) and cross-border interoperability of schemes. It is expected that the conclusions of this review will be reached by end-year. In the context of the conclusions of the EU review, any further changes required in the Irish Deposit Guarantee Scheme will be progressed to ensure that savers in Ireland benefit from safeguards in line with EU best practice.

Funding of the Deposit Guarantee Scheme

The level of contribution required from each credit institution is 0.2% of eligible deposits held at all branches of the credit institution in the EEA, including deposits on current accounts and share accounts with a building society, but excluding interbank deposits and deposits represented by negotiable certificates of deposit. A minimum contribution of €25,400 is required. Each contribution is maintained in a Deposit Protection Account at the CBFSAI. As of 2007, the total amount held in Deposit Protection Accounts was €526 million.

Appropriate mechanisms will also be put in place, in consultation with the financial institutions to increase the level of funds in the Deposit Protection Accounts over time but in the interim, the existing system provides for the availability of additional funds from the CBFSAI if required.

Coverage of the Deposit Protection Scheme

The Deposit Protection Scheme currently covers:

- current accounts;
- demand deposit accounts;
- term deposit accounts; and
- share accounts with building societies (other than shares which fall within the definition of own funds)

held with banks, building societies and other types of deposit-taking institutions (other than credit unions) regulated by the Financial Regulator. It is now being extended to include share and deposit accounts in credit unions.

EU Branches

Deposits with credit institutions authorised in another European Economic Area (EEA) country and operating in Ireland on a branch basis are covered under that country's system.

Credit Unions

The Irish League of Credit Unions (ILCU) has since 1989, operated on an all-island basis a savings protection scheme (SPS) for credit unions. The SPS has, to date, operated by providing financial support to credit unions that get into difficulty and it has never been necessary to make savings protection payments to individual credit union members. Under the SPS regime no credit union has become insolvent and no member of a credit union has experienced any loss of shares or deposits. The Registrar of Credit Unions in the Financial Regulator is working closely with ILCU to approve a reform to SPS. It is expected that these discussions would conclude shortly.

It is intended that the guarantee that has now been announced for credit institution savers would act as a backstop to an approved SPS scheme for credit unions.

Operation of the DGS

The Deposit Protection Scheme in Ireland is administered by the Central Bank and Financial Services Authority of Ireland (CBFSAI).

Other compensation schemes

The Minister will be requesting the views of consumer interests, industry and other stakeholders regarding the implications of the announcement for investor compensation levels and the case for introducing an insurance guarantee scheme for the life sector.

Further Information

Further information on the Deposit Protection Scheme in Ireland can be found at the Financial Regulators consumer information website www.itsyourmoney.ie .

Any further queries should be addressed to the Department of Finance Press Office at 01-6767571 or Eoin Dorgan.

Breslin, Colm

From: Howard, Paddy T
Sent: 20 September 2007 16:59
To: Conlon, John; Meenan, Brian
Cc: Breslin, Colm; Carrigan, Aidan; Beausang, William; Cardiff, Kevin; Nolan, Kevin
Subject: Press office material re deposit guarantee

Attachments: Press office material.doc



Press office
material.doc (32 ...)

John

Material herewith

Paddy

How has the Irish Deposit Protection Scheme developed since 1995?

Before the Deposit Guarantee Directive came into force in 1995, Ireland had no statutory deposit protection scheme. The Directive provided for a minimum level of protection of €20,000 or 90% of the loss, whichever is the lesser. It also provided a derogation until 1999 that allowed Member States with either no scheme or a scheme that paid less than this time to adapt. Hence, the level of protection in Ireland in 1995 was set at €15,000 – the minimum permitted by the derogation. This was increased in 1999, as required by the Directive, to the present figure of €20,000.

Has there been any recent review of the minimum required by the Deposit Guarantee Directive?

It should be first remembered that what really protects the interest of depositors is sound regulation and solvent banks. Hence, a generous Deposit Protection scheme is not necessarily an indicator of financial stability.

That said, in 2006 the European Commission carried out a major review of the Deposit Guarantee Directive, which included the minimum level of protection. The Commission concluded that there is currently no case for changing the current minimum guarantee level of €20,000.

Is Ireland out of step with EU other countries by not increasing its level of protection in line with inflation (or some other measure)?

According to a survey carried out by the European Commission as part of its review, taking protection levels as at 2004, Ireland was not alone in setting the level of protection at the minimum required by the Directive, nor had most other Member States increased their coverage in the period under study.

The study found that the most protection offered by a scheme in the EU was €103,291 by Italy. France's scheme covers €60,980 (unchanged since 1995), the UK's €44,961, Denmark's €40,329. At that time no other scheme paid out more than €30,000. 3 schemes paid out less than €15,000 under a derogation given to some new Member States. According to the Commission's survey 11 Member States, including Ireland, had their schemes guaranteeing the minimum value of €20,000. (Note: it is understood that the Dutch have recently increased their scheme from the minimum).

Should there be a statutory scheme for Credit Unions?

There is already a savings protection and stabilisation scheme run by ILCU, which has a substantial fund and has served the movement well. The question of a statutory scheme was raised in the Seanad late last year. The Minister made clear his preference for an enhanced, independent scheme based on existing arrangements. It is understood that discussions in this regard between the Registrar of Credit Unions and ILCU are at an advanced stage.



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Government of Ireland - Department of Finance

Government Increases Deposit Guarantee Limit to €100,000 per depositor

20th September 2008

The Government has decided to increase the statutory limit for the deposit guarantee scheme for banks and building societies from €20,000 to €100,000 per depositor per institution. The cover will apply to 100% of each individual's deposit. This guarantee level will also apply to credit union savers.

Announcing the decision, the Minister for Finance, Brian Lenihan TD, said "I want it to be known that the Government is confident about the strength and resilience of the Irish financial system. The Government is committed to the stability of our financial system, so that money placed with an Irish credit institution would not be at risk. As I said yesterday, the Irish Government wants to protect the whole financial system, secure its stability and ensure that all deposits in Irish financial institutions are safe."

The Minister added "the Central Bank and Financial Regulator have stressed the soundness and stability of the Irish financial system. This measure provides additional reassurance to depositors in Ireland that their savings are safe. The new guarantee level is now among the highest in the EU."

The Minister also commented that notwithstanding the uncertainty caused by the turbulence in international financial markets over the last week, it is encouraging that the banks have retained the confidence of their customers.

This measure has been under consideration for some time, and the Minister believes that this is the appropriate time to make the announcement.

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The legal basis for the Deposit Protection Scheme in Ireland is the European Communities (Deposit Guarantee Schemes) Regulations, 1995. These Regulations implemented the European Union Directive on Deposit Guarantee Schemes (94/19/EC). The Irish regulations were amended in 1999 to provide for a maximum compensation of €20,000.

Legislation

Legislation will be introduced shortly by the Minister to implement the new guarantee level but this new level will have affect from today following the Government's decision.

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The single largest number of EU Member States currently have guarantee thresholds of €20,000 - Austria, Belgium, Cyprus, Germany, Greece, Ireland, Luxembourg, Malta, Slovakia, Spain. Other States have thresholds variously in excess of this - e.g. Finland and Portugal €25,000, Netherlands €38,000, Denmark €40,300, UK €48,500 euro equivalent of £35,000) and Italy €103,000.

EU Review

Ireland is participating in the ongoing review of the EU Deposit Guarantee Schemes Directive. This review includes consideration of the minimum level of the EU guarantee but also focus on wider policy areas such as co-insurance requirements (under which depositors bore 10% of losses which is being abolished for the Irish scheme) improving the speed of payouts, better depositor information, the case for gross rather than net compensation (as at present) and cross-border interoperability of schemes. It is expected that the conclusions of this review will be reached by end-year. In the context of the conclusions of the EU review, any further changes required in the Irish Deposit Guarantee Scheme will be progressed to ensure that savers in Ireland benefit from safeguards in line with EU best practice.

Funding of the Deposit Guarantee Scheme

The level of contribution required from each credit institution is 0.2% of eligible deposits held at all branches of the credit institution in the EEA, including deposits on current accounts and share accounts with a building society, but excluding interbank deposits and deposits represented by negotiable certificates of deposit. A minimum contribution of €25,400 is required. Each contribution is maintained in a Deposit Protection Account at the CBFSAI. As of 2007, the total amount held in Deposit Protection Accounts was €526 million.

Appropriate, mechanisms will also be put in place, in consultation with the financial institutions to increase the level of funds in the Deposit Protection Accounts over time but in the interim, the existing system provides for the availability of additional funds from the CBFSAI if required.

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It is intended that the guarantee that has now been announced for credit institution savers would act as a backstop to an approved SPS scheme for credit unions.

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Other compensation schemes

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Further Information

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**Summary of rescue/emergency measures and deposit guarantee schemes
in certain EU States as at 14th October 2008**

1. Background

On 7th October Ecofin agreed to support systemic financial institutions and committed to taking all necessary measures to enhance the soundness and stability of the banking system and to protect the deposits of individual savers. Specifically Ecofin agreed that all Member States would, for an initial period of at least one year, provide deposit guarantee protection for individuals for an amount of at least €50 000, acknowledging that many Member States were determined to raise their minimum to €100 000.

In the declaration issued after the Summit of Euro Area countries on 12th October 2008 it was agreed that a coordinated approach would be adopted aimed at:

- ensuring appropriate liquidity conditions for financial institutions;
- facilitating the funding of banks, which is currently constrained;
- providing financial institutions with additional capital resources so as to continue to ensure the proper financing of the economy;
- allowing for an efficient recapitalisation of distressed banks;
- ensuring sufficient flexibility in the implementation of accounting rules given current exceptional market circumstances;
- enhancing cooperation procedures among European countries.

A number of States have taken/announced measures in the wake of the Ecofin conclusions and Summit declaration. This note summarises the position in Belgium, France, Germany, Hungary, Italy, Netherlands, Spain and UK. At the appendix is a document produced by the EU Commission which provides an overview of the national rescue measures and deposit guarantee schemes arrangements.

2. BELGIUM

Deposit Guarantee: The maximum amount protected under the deposit guarantee scheme will be raised from € 20,000 to € 100,000. The scope of the scheme will also be expanded to catch insurance companies for certain life insurance products; insurers will be allowed to join the scheme on a voluntary basis and against payment of remuneration.

Recapitalisation: In coordination with the governments of Luxemburg, France and The Netherlands, substantial amounts of new capital have been injected into Fortis Group and Dexia. Furthermore, Fortis Banc Belgium and Fortis Insurance Belgium have been sold to the Belgian government with a view to a 75% on-sale to BNP Paribas. The Dutch banking and insurance entities of the Fortis Group have been sold to the Dutch government.

Debt guarantee: The Belgian government has offered to guarantee the wholesale funding of Belgian credit institutions. The guarantee is available to Belgian credit institutions that so wish, subject to a satisfactory assessment of their solvency by the Belgian government and regulator, and against payment of an arm's length remuneration to be determined.

35/e/BK/01

The guarantee will extend to any form of wholesale funding, i.e. funding obtained from other credit institutions or from institutional investors, provided that the transaction is entered into or rolled over between 8 October 2008 and 31 October 2009, and that its maturity is not beyond 31 October 2011. The funding may take the form of interbank deposits, central bank loans, deposits by institutional customers, CDs, MTNs, etc.

2. FRANCE

Guarantee Fund: € 360 billion in support of the banking system approved by French Parliament 15th October.

Deposit guarantee: If necessary, the French State is committed to extending the existing deposit guarantee fund (currently set at € 70,000 per deposit), if and when necessary.

Recapitalisation: € 40 billion will be applied to the existing French government-backed financing vehicle called "SPPE" to offer regulatory capital to banks in case of need. The objective is to allow French banks to be as competitive as possible and meet the current 9 per cent. insolvency ratio of UK counterparts. It is expected this package will enter into force by end of this week.

Debt Guarantee: The French State will apply up to € 320 billion (which includes the existing € 55 billion guarantee awarded to the refinancing of Dexia Bank) to facilitate refinancing of banks on the medium term inter-bank and capital markets.

A dedicated entity will be created under the supervision of the French Treasury and will be backed by eligible assets monitored by the Bank of France. Any issue by such entity will benefit from a French State guarantee. The scheme is meant to last up to five years. It is anticipated that such entity may also be open, to a limited extent, to banks. Any institution requesting the involvement of the scheme will need to meet a number of criteria: its regulatory capital will need to be sufficient, it will need to commit to a code of conduct (which provides, inter alia, for a ban on "golden parachutes") and has to be involved in the financing of local authorities, SME and individuals.

3. GERMANY

Guarantee fund: Guarantees of up to € 400 billion for interbank receivables. Banks will have to pay a fee for those guarantees.

Deposit guarantee: The three banking systems (Sparkassen (saving banks and Landesbanken), Volksbanken (co-operative banks) and private banks have their own protection systems each. The current package does not supplement those systems. Chancellor Merkel, however, in connection with the market turmoil "guaranteed" all deposits of, basically, private customers.

Recapitalisation: Creation of a fund of € 70 billion (can be increased by another € 10 billion) to be used for the recapitalisation of banks where needed. As consideration for the recapitalisation the German State will receive equity or quasi equity stakes in

banks. Further conditions may be imposed on the banks, e.g. bank's business policy including limits on management compensation.

Debt Guarantee: No further guarantees.

Other measures: The recapitalisation fund can, at a later stage, also be used to buy so-called bad assets from banks. This shall only be possible if the other measures turn out to be insufficient. Insolvency law is to be amended to exclude mere balance sheet insolvency where business continuation is most likely ("überwiegend wahrscheinlich"). The rescue package is meant to be temporary only and to expire by the end of 2009.

4. HUNGARY

Guarantee Fund: Creation of a guarantee fund is not envisaged in Hungary.

Deposit guarantee: The Hungarian parliament has passed a bill to increase deposit guarantee levels to HUF 13 million (approximately € 50,000) from the current HUF 6 million (approximately € 23,000) in the national deposit guarantee scheme.

Debt Guarantee: The Hungarian government has offered a guarantee on OTP Bank's interbank lending. Citing its stable capital and liquidity conditions OTP Bank has refused the guarantee.

Other measures: The Hungarian government has (i) amended accounting rules relating to banks and brokerages to facilitate handling of repo deals for accounting purposes, which may provide additional liquidity; and (ii) lifted investment obligation on pension funds to invest into shares, which may allow further investment into government bonds and greater liquidity on that market. The Hungarian government and central bank, the National Bank of Hungary ("NBH"), have proposed a 12-point structural reform package aimed at boosting investors' confidence. Most of the measures are aimed at the government and not the financial sector. The NBH has announced that it will conduct its two-way FX swap tenders - providing € and Forint liquidity - under a competitive bidding scheme. Effectively, this means that NBH will act as a market-maker on the FX swap market. rate levels are not exactly attractive.

5. ITALY

Guarantee fund: Issued decrees do not contain provisions on this subject. The Italian Minister of Economy stated that the Italian government will cover all the necessary costs if and when such costs arise.

Deposit guarantee: Bank deposits to be guaranteed by the Italian government, such guarantee being additional to the one already provided by the inter-bank guarantee fund - which already covers deposits up to € 103,000 (USD 140,000, GBP 81,000) - thus giving state backing to what was previously a private guarantee by banks.

Recapitalisation: Possible underwriting by the Italian government of the recapitalisation of banks or by it becoming a direct shareholder. (Such temporary intervention, if needed, will take place on a case-by-case basis and only after the relevant bank has failed in attracting fresh capital from the market. In addition, the

government will not invest in ordinary shares of distressed banks, but rather in privileged shares with no voting rights attached.)

Debt guarantee: State guarantee on liabilities newly undertaken by banks on or before 31 December 2009 for the duration of up to five years. Such guarantee shall be given at market conditions, following the Bank of Italy's evaluation of a bank's capital adequacy and solvency.

Other measures: Compulsory administration for banks whose financial position may undermine the overall stability of the financial system. The Ministry of Economy and Finance may swap government securities in exchange for ineligible collateral, thus allowing banks to post such government securities as collateral in order to obtain financing from the European Central Bank.

It has also been announced that the Bank of Italy will adopt further measures to make it easier for banks and companies in general to post collateral in order to obtain financing.

6. NETHERLANDS

Guarantee fund: The Dutch government has also extended a € 20 billion guarantee fund to financial institutions and insurers, on terms yet to be finalised.

Deposit Guarantee: The Dutch government has increased the maximum guaranteed amount under the Deposit Guarantee System to € 100,000 per person per financial institution (the Landsbanki Icesave accounts held in The Netherlands also benefit from this (increased) guarantee system although the first EUR 20,000 is guaranteed by Iceland, and in this context the Dutch government has agreed to extend a loan to Iceland to provide funding for this). The Guarantee under the system is available for natural persons (with very few exceptions) and small businesses.

Any payments made under the Deposit Guarantee System will be made by the Dutch Central Bank but will eventually be for the account of the banks participating in the system. However, some banks have already publicly indicated that they will not participate in any increase of the maximum guaranteed amount under the system (i.e. any amount over the original maximum amount of € 38,000 per person per financial institution) given the unilateral character of the measure taken by the Dutch Minister of Finance.

Recapitalisation: € 20 billion has been made available by the Dutch government to financial institutions and insurance companies (including foreign institutions with seat in The Netherlands) until 20 January 2009 in the form of participation, preference shares or by other means agreed. In addition additional monies will continue to be made available by the Dutch Central Bank to financial institutions against sufficient security.

Debt Guarantee: € 200 billion available in the form of a Dutch State guarantee in respect of senior unsecured loans to financial institutions by other financial institutions and institutional investors without security. Guarantees under this scheme can be requested until 31 December 2009 for a period no longer than 36 months. This guarantee is available to financial institutions with their principal place of business in The Netherlands and to subsidiaries of foreign banks with substantial operations in The Netherlands



7. SPAIN

Guarantee fund: € 100 billion has been made available for government guarantees of future issues of debt instruments and inter-bank deposits.

Deposit Guarantee: Deposit guarantee funds and investor protection schemes have been updated, providing protection of up to a maximum of € 100,000 (or equivalent in another currency) per depositor or investor (whether an individual or a legal entity) in each participating credit entity or investment firm.

Recapitalisation: By way of exception, and until 31 December 2009, the Ministry of Economy and Finance is to be authorised to acquire shares (including preferred shares and quotas) issued by credit entities resident in Spain if so required. Shares acquired in this way by the State will not be subject to the limits set out by the law as regards assessment of own resources. According to the Royal Decree-Law on Urgent Measures within the Financial Economical Framework, it is not clear whether subordinated bonds may also be acquired. This is to be clarified in the regulations developing the law.

Debt Guarantee: A maximum amount of € 100 billion will be made available for the granting of guarantees. The Spanish Government will be entitled to grant guarantees in order to secure issuances of debt instruments (i.e. commercial paper or bonds) traded in Spanish official secondary markets carried out by credit entities and inter-bank deposits in favour of Spanish resident in Spain or Spanish subsidiaries of foreign credit entities as far as they perform a significant activity in Spain. State guarantees may extend to other banking instruments such as interbank deposits

This measure will be in place until 31 December 2008. The maximum expiry date of the guaranteed transactions will not exceed five years. Entities willing to obtain governmental guarantees will need to comply with certain requirements that will be set out by the Ministry of Economy and Finance.

Other measures: The Spanish Government will establish the Financial Assets Acquisition Fund to invest in high quality investment assets issued by credit entities or securitisation funds (which are backed by loans granted to individuals, companies and non-financial entities) as a liquidity-increasing measure.

The Fund's initial endowment will amount to 30 billion €, which may be increased to 50 billion € if required. Initially, its endowment amounts to 10 billion € which may be increased up to 30 billion € in 2008 and it will be financed with public debt.

All returns of any nature accrued by the account of the Financial Assets Acquisition Fund and all financial assets in which the Financial Assets Acquisition Fund has invested may be incorporated to the resources of the Financial Assets Acquisition Fund, unless its Supervisory Council decides to distribute them to the Public Treasury. Assets will be acquired through competitive public auctions and limitations will be put in place in order to ensure that a large number of entities may obtain liquidity rather than concentrating access to liquidity on a few.

8. UK

Guarantee Fund: £400 billion has been made available for the various measures described below.

Deposit Guarantee: As of 7 October 2008, the level of savings for bank deposits guaranteed by the Financial Services Compensation Scheme was increased to £50,000.

Recapitalisation: On 13 October 2008, the UK government announced capital investments to the Royal Bank of Scotland (RBS) and, upon successful merger, to HBOS and Lloyds TSB totalling £37 billion.

Each institution has committed to raise their total Tier 1 capital and have a Tier 1 capital ratio in excess of 9 per cent. In return, each institution is to maintain lending to small business owners and homeowners at 2007 levels, support schemes to help struggling mortgage holders and allow government input in relation to remuneration schemes, board appointments and dividend policy.

Debt Guarantee: UK-incorporated banks (including subsidiaries of foreign institutions) that have a substantial business in the UK and UK building societies are eligible to participate in the UK government's 2008 Credit Guarantee Scheme. The guarantee is only available to one entity per banking group.

The UK government announced that it will guarantee specified bank and building society debt instruments issued during a six month period from the date of the notice (13 October 2008). Eligible instruments are certificates of deposit (CDs), commercial paper and senior unsecured bonds and notes, but only those denominated in €, Sterling or US dollars.

Moreover, there is a cut-off, in that the term of the guaranteed instruments must not exceed three years. (There is scope to extend the maturity of certain guaranteed instruments, through "rollover", provided though that the overall maturity date will not extend past 13 April 2012, unless extended by the UK Treasury.)

A fee (of 50 basis points plus 100 per cent. of the relevant institution's median five-year Credit Default Swap (CDS) spreads in the year to 7 October 2008) is payable to the UK Treasury for the guarantee. There may also be an incremental fee payable for non-Sterling issues.

Other measures: Unlimited U.S. dollar funds provided to financial institutions by the Bank of England conducting tenders of US dollar funding at 7-day, 28-day and 84-day maturities at fixed interest rates for full allotment against appropriate collateral. The Bank of England has amended its swap line with the US Federal Reserve so that there is no fixed limit to the amount of dollar liquidity for financial institutions.

The UK government's new Banking Bill was introduced into Parliament and received its first reading on 7 October 2008. The second reading was due to be on 14 October 2008.



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Note - ...

16 January 2008

Oifig an Aire Airgeadis
Memorandum for the Information of Government
Financial Markets Developments

1. Matter-Issue for Information

The Tánaiste is submitting this Memorandum in accordance with his commitment to keep the Government informed of ongoing developments in the financial markets and their possible impact on Ireland. The Memorandum is based on the assessment of the Central Bank and Financial Services Authority of Ireland (CBFSAI) made to the recent meeting of the Domestic Standing Group on Financial Stability on 11 January.

2. Background

Through December, massive and co-ordinated intervention by major central banks provided liquidity to money markets, enabling banks to meet year end (2007) financing needs. There is a general sense of relief that the year end point has been passed; credit market conditions appear to have improved, but remain difficult. Markets are expected to remain disrupted for some time to come as banks and others hoard funds until the extent and impact of the sub-prime loan issues become clear and to re-build their capital position in some instances as a bulwark against further market turmoil. There are reports that financial institutions have already incurred losses of €60 Billion; with estimates of eventual losses ranging from €100bn to €275bn. Losses of this magnitude have implications for even the largest institutions, with reports of major international banks seeking additional balance sheet investment from Middle and Far Eastern investors. The macroeconomic climate is also a concern, as poor levels of economic growth globally – in particular the risk of a US recession - could impact further on the financial markets.

3. Interbank market and other funding markets

Interest rates in the interbank market have receded to their best levels since the financial market turbulence began. However, this is still significantly (circa 35 basis points) above what previously would have been considered normal levels and improvement has been concentrated at the short end of the maturity profile. The US commercial paper market has improved, allowing banks (including Irish banks) to access liquidity from this source. The asset-backed commercial paper market increased in January for the first time since the market turbulence began. However, maturities for funding remain short with long-term markets, such as asset covered securities and securitisation, effectively remaining closed at present.

4. Irish Impacts

Liquidity i.e. ability to finance day-to-day operations

The improvements in the markets have meant that Irish institutions have continued to access their required liquidity. They are meeting their financial ratios but the maturity of their funding continues to shorten exacerbating funding pressures over time. The significant rollover of funding required by Irish banks early in 2008 are a priority for the banks and in this context, in addition to other contingency measures they are active in sourcing funding from new markets, such as Japanese and other Asian markets in order to build new funding streams for the future.

Market situation of major Irish retail banks

The Irish banks have reported that they feel that Ireland's "name" is getting a more positive response in the market; for example, Fitch's (rating agency) have recently improved Ireland's rating. However, negative sentiment about Ireland remains on account of concerns regarding the property market and the share prices of the banks have continued to fall.

Impact on commercial and retail services

Currently there is a high level of competition for corporate deposits in the Irish banking market. This could cause difficulties for smaller banks which may not be able to compete with larger institutions in this market. Indications from the banks is that they anticipate that 2008 will be a relatively flat year for lending, reflecting increasing evidence that the credit difficulties are impacting the real economy. This is supported by the latest Euro area banking survey which indicated that lending has tightened significantly since the financial turbulence began.

5. Northern Rock developments

The UK Government has continued to attempt to arrange a private sector sale of Northern Rock, while the amount borrowed by Northern Rock from the Bank of England has continued to increase (currently estimated to be around £26bn). The Treasury has also extended its guarantee of deposits in Northern Rock to include all wholesale deposits. The two possible private sector interests have found it difficult to raise the funds for their purchase in the current market environment, and the Treasury has signed up a provisional executive chairman for Northern Rock, should it be nationalised. Nationalisation of Northern Rock would now appear a much more likely outcome.

6. Contingency Planning

The Domestic Standing Group on Financial Stability is continuing its work to strengthen financial stability planning arrangements in Ireland, in line with EU requirements. In this context a financial stability simulation exercise, involving the Department and the CBFSAI took place in December 2007. The DSG is also continuing to examine the lessons for Ireland from developments in Northern Rock in the UK including in relation to the powers available to the CBFSAI and the Minister for Finance to respond to any such situation arising in Ireland and any legal impediments to solutions to crisis situations, as well reviewing Deposit Guarantee arrangements in Ireland.

7. Conclusion

It is important to emphasize that the Irish banking system is strong, liquid and well capitalised. Notwithstanding the current turbulence, the Irish banks are accessing their required liquidity, although their share prices have been significantly reduced. The next two hurdles that the global financial system, including Ireland, face, are the rollover of significant long term funding arrangement early in the year and the publication of audited accounts in due course. Both of these events may cause difficulties for banks, particularly if the audited accounts reveal further significant subprime losses by some of the large investment banks that erode financial market confidence. **In addition there are fears in the market that a recession in the US could have significant impact on financial markets globally.** The Financial Regulator and the DSG continues to monitor the situation closely.

45
Manley, Michael

From: Beausang, William
Sent: 23 June 2008 14:48
To: Manley, Michael
Subject: Could you finalise and circulate this version please

Attachments: revised Note for Minister flwg DSG19 june 08.doc

MI

Could you review / proof read and make any final changes thanks



revised Note for
Minister flwg...

- Quick down request
- copied you to a letter which CASPAE to monitor

1. Mr Beausang
2. Runai Aire

**Subject: Note for the information of the Minister for Government meeting
Financial market developments**

Key Points

- The ECB, Bank of England and Federal Reserve have signalled a greater focus on inflationary concerns and the likelihood of interest rate increases.
- Significant change in sentiment in financial markets has stalled the nascent recovery in the share prices of financials as markets factor in anticipated increases in interest rates and further sub-prime losses.
- Estimates of the ultimate losses from US sub-prime crises are now starting to exceed \$1 Trillion and are expected to extend well into 2009.
- Losses disclosed to date total circa \$380 Billion; markets believe there are major losses still to be absorbed and financial stocks remain in deep disfavour by investors.
- Irish financials have seen a 25% approx. fall in their share prices since mid March (Bear Stearns) and are viewed as significantly exposed to further decline in property values (residential and commercial) as latent credit difficulties begin to emerge.
- Bank of Ireland successfully issued a €1.2 Billion bond, but at a significant premium (112 basis points) to normal market rates reflects negative investor sentiment concerning the Irish market.
- There is further evidence that adverse financial market developments are impacting on the real economy through higher interest rates and restrictions on the availability of credit.

A more detailed note, based on discussion at the meeting of the domestic Standing Group of 19 June is attached.

Michael Manley
23 June, 2008

Note for the information of the Minister for Government meeting
Financial market developments

Background

There has been a significant change in sentiment in financial markets since early June, driven by statements from the ECB, Bank of England and Federal Reserve that increasingly identify inflation as a policy concern to which the Central Banks will if necessary respond with interest rate increases. Additionally market expectations are that further losses on sub-prime loans will be more than double the \$380 billion already disclosed leading to pressures on bank earnings and the likelihood of banks needing to raise capital to restore their balance sheets.

Financial Sector

Market volatility has significantly increased as markets seek to anticipate how these factors will impact, resulting in large changes in share prices on a daily basis, but with a persistent downward trend overall.

Ireland

Irish bank shares have fallen significantly in the last month (AIB -22%; BoI - 25%; Anglo -27%; IL&P -24%). The recent issue of a research note to investors by Keefe, Bruyette Woods Ltd (KBW) stating Bank of Ireland and Anglo Irish Bank have lower tier 1 capital, a measure of financial strength, than most European banks lead to a 6% fall in BoI share value on Wednesday 18 June. The bank suffered heavily in the sell-off of financial stocks and by the close of business, its shares were down 6 per cent as it shed 42 cent to €6.56.

Irish banks are considered highly exposed to property (residential and commercial) with BoI cited as having 70% of its lending tied to 'bricks and mortar'. International investors believe that a latent credit problem is yet to emerge in the Irish market. It is unlikely there will be any significant recovery in share prices until property values start to recover; equally, any further falls in property prices are likely to put additional stress on the share prices of Irish financials.

A number of banks remain on negative ratings watch by Ratings Agencies indicating they may be may be downgraded. A key issue in any downgrading would be the extent of ratings change; a significant downgrading would increase the costs of funding for an institution, put share prices under further pressure and may lead to certain larger depositors transferring funds out of the institution.

International

Financial shares internationally have declined significantly with US and UK Financial share price indices down by 16% and 20% respectively (mid-May to mid-June) and significant individual falls by major banks, e.g. Royal Bank of Scotland (UK) and UBS (Swiss) both down 25% (Confirm). These banks are generally being impacted by the sub-prime crisis and changed expectations in relation to international growth.

Financial Markets

While debt securities markets remain virtually closed, there has been record activity in bond markets reflecting pent-up demand, with \$303 Billion raised in May, mostly by financial institutions with the highest ratings. Bank of Ireland successfully issued a €1.2 billion bond, but at a significant premium of 112 basis points reflecting negative investor sentiment regarding the Irish market. In money markets, an anticipated increase of 25 basis points by the ECB has already been priced in and a further similar increase is expected, though there is no consensus as to whether this will take place late this year or early 2009. The price of 3-month money remains high, at 4.961% it is now higher than the peak end-year rate for 2007, as against the ECB benchmark rate of 4%.

There is no evidence of increased reliance by Irish banks on ECB funding which remains around 7%, with an estimate 2½% held by domestic banks.

Impact on Real Economy

The increased cost of money has started to feed through in increases in interest rates charged to borrowers with increases announced by EBS and BoI in May, IL&P 1st June and AIB on 12th June. With pressure on banks to seek to at least maintain earnings, further increases in funding costs are likely to be quickly passed on to borrowers. Banks have also continued to tightly ration lending, seeking to protect larger, long standing and more important borrowers and provide for anticipated credit demands. The CBFSAI expects that this continuing tightening in credit availability and cost will likely increase bad debts. The issue of anticipated increase bad debts has already featured in brokers notes/briefing and has received some media comment.

Overall, lending is unlikely to grow by more than mid single figures this year and lending that does take place will be targeted by banks at the maintenance of their existing customers. According to the Financial Regulator, there is particular concern regarding residential and commercial property investment outside the main urban centres as well as significant strains affecting property developers, particularly mid-tier operations that are not asset rich and do not have access to significant liquidity.

Conclusion

Internationally, significant change in sentiment in financial markets due to anticipated increase in interest rates and further large sub-prime losses have led to a stalling in the nascent recovery in the share prices of financials. Money markets remain tight and are pricing in further interest rate increases, though there has been increased activity in bond markets where financials have raised significant funding on payment of higher interest rates.

Internationally the financial sector is out of favour. While the Irish financial sector should not expect to be immune to this, the widespread perception that Irish banks are very heavily dependent on property lending has exacerbated the position. As property prices continue to fall, the position of Irish banks is vulnerable to further deterioration.

Secret – for preparation for Government meeting

Report of Domestic Standing Group Meeting – 8 July 2008

Attendees

Tony Grimes, Central Bank

Brian Halpin, Central Bank

Con Horan, Financial Regulator

Kevin Cardiff, Department of Finance

William Beausang, Department of Finance

Recent share price declines

The CBFSAI was staying in close touch with the Irish banks; the sharp decline in Irish bank shares had not had any significant effect on their deposit base to date.

International developments

The CBFSAI believed that the decline in bank share prices internationally was helping to highlight the international market situation ahead of the domestic environment.

Liquidity

[REDACTED] Oireachtas-P have both recently topped-up with liquidity in order to ensure that it remained strong against all eventualities.

Corporate Deposits

It was considered inevitable that weaker share prices would in time be reflected in some withdrawals of, in particular, corporate deposits.

Bank of Ireland trading statement

Bank of Ireland's interim management statement (8 July) was considered 'downbeat' but reflected concerns regarding the impact on profitability of the bank's exposure to the UK commercial property market

Long-term investors

There were some indications that recent falls in share prices reflected share sales by long-term investor indicating that if the current unfavourable market environment persisted there was an increased risk of a general loss of confidence in the Irish banks. International investors believed that the sharp slow-down in the Irish economy and property market would give rise to significant loan losses for the Irish banks, a collapse in profitability and the need to raise significant capital and that they would be disadvantaged in doing so on account of the delay in going to the market for additional capital, in contrast to the steps taken by some UK banks. This type of assessment does not correspond with that of the Irish banks. The FR reported a detailed line-by-line examination of its loan book by one of the major Irish banks which highlighted that even allowing for 'worst-case' loan losses, profitability would remain strong measured against objective market benchmarks.

38
Lonergan, Ciara

From: Cassidy Mark [mark.cassidy@centralbank.ie]
Sent: 09 July 2008 18:13
To: Lonergan, Ciara
Subject: RE: special resolution regime

Ciara

Many thanks. This should address the issue comprehensively.

Mark

-----Original Message-----

From: Lonergan, Ciara [mailto:Ciara.Lonergan@finance.gov.ie]
Sent: 09 July 2008 18:04
To: Cassidy Mark
Cc: Beausang, William; Nolan, Kevin
Subject: RE: special resolution regime

Mark

Please see suggested amended speaking points

- 1) There are a number of considerations relevant to that issue, which as I understand it remains a proposal subject to ongoing consultation in the UK.
- 2) First of all there are a range of institutional and legislative arrangements in place in Ireland to ensure that we have an effective and robust supervisory framework and a sound and resilient financial system [...This includes the detailed and comprehensive template of EU financial services law and our integrated Central Bank and Financial Regulator within the single unitary organisation which has received high marks from authoritative international assessments...]
 - (2) In terms of dealing with the current uncertain financial environment, Irish banks also have full access to the funding facilities of the ECB, which accepts a much broader range of collateral than many other CBs [...the Eurosystem's operational framework has worked very successfully over the last year in ensuring that liquidity was available to market participants...]
 - (3) In accordance with EU requirement, a Domestic Standing Group on Financial Stability (DSG) operates in Ireland comprised of high level officials of the Department of Finance, the Central Bank and the Financial Regulator. [...This has of course been active in sharing information and assessments since the onset of the current market dislocation. One of its main purposes is to facilitate full and timely information exchange, co-operation and co-ordination, contributing to the maintenance of financial stability and a solid and sound financial system in Ireland as well as ensuring that we continue to play our part in terms of our responsibilities at EU level...]
 - (4) At EU level a very significant initiative arising from the October 2007 Ecofin Roadmap is the signing by all Member States of a Memorandum of Understanding (MoU) on co-operation between the Financial Supervisory Authorities, Central Banks and Finance Ministries of the European Union on cross-border financial stability. [...The MoU sets out practical arrangements aimed at strengthening co-operation between authorities throughout Europe for the maintenance of financial stability, prevent, and if necessary, manage potential systemic problems...]
 - (5) I am satisfied that on the basis of these type of arrangements that we are in a position in Ireland to properly assess and evaluate all relevant issues and considerations that might be expected to arise, and to respond appropriately.

I have nothing more to say on that subject.

-----Original Message-----

From: Cassidy Mark [mailto:mark.cassidy@centralbank.ie]
Sent: 09 July 2008 13:30
To: O'Gorman, Ciara
Subject: special resolution regime

Hi Ciara

Following our telephone conversation, the following are the points (in very rough form) the Governor would like to make if asked about a Special Resolution Regime.

- (1) There are a range of institutional arrangements in place to ensure an adequate supervisory framework
- (2) Irish banks also have full access to the funding facilities of the ECB, which accepts a much broader range of collateral than many other CBs
- (3) Domestically, there is also a Domestic Standing Group, involving the Department of Fin, CB and Fin Reg which considers issues related to crisis management
- (4) All relevant issues are considered within that group
- (5) Other than that I have nothing more to say on that subject.

Sorry for the short notice.

Kind regards

Mark

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Tá dianchosc ar chraobhscaoileadh, ar dháileadh nó ar chóipeáil neamhúdaraithe ar bith, díreach nó indíreach, an ríomhphoist seo nó aon iatán a ghabhann leis. Má tá an ríomhphost seo faighte agat trí dhearmad, cuir an seoltóir ar an eolas agus scríos an t-ábhar ó do chóras le do thoil.

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Lonergan, Ciara

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Note of Meeting, 18 September 2008

14

Minister
NTMA Michael Somers, John Corrigan, B McDonagh
D/Finance Kevin Cardiff*, David Doyle
CBFSAI John Hurley, Tony Grimes, Brian Halpin
FR Jim Farrell, Patrick Neary*

*for part

John Hurley gave a report – liquidity under great strain – potentially serious crisis considerations (a) what can we do now? (b) specific bodies to focus on in next few days?

Re (a)

- Said Minister's reassuring statements had helped
- Needs to be something quickly on deposit guarantees and a further reassuring statement on the financial sector
- An 'all deposits' guarantee may be counterproductive. CB/FR not suggesting that now.
- Proposal
 - DGS to increase to 100k
 - Additional statement from Minister
 - Liquidity provision structures to provide immediate liquidity may be required (with letter of comfort from Minister) – a €10 billion emergency fund should be available for a pressure scenario.

Re (b)

- AIB & BofI – liquidity tight but ok for now
- EBS & ILP – liquidity tight but have ECB access
- INBS & Anglo – very immediate problems – Anglo is the bigger problem – Corporate financiers are to be in there and report back immediately. Re Nationwide: residual cash allow it to be nursed for a while – if Anglo does not stabilise, could create knock on difficulties.

Re Anglo, John Hurley said options if trouble continues include (a) nationalising (b) support it but take equity share as a price for that – then work it out over a period of time – State should give itself potential for upside.

His conclusion (a) put liquidity facility in place asap and (b) look at how to deal with broader issues over next week or so.

Jim Farrell stressed DGS should also apply to credit unions.

John Hurley suggested an Anglo/INBS merger would be problematical as Anglo not strong enough.

Michael Somers outlined the Exchequer funding position; noted that a CU was seeking a facility to deposit with NTMA; raising large amounts of money takes time.

Minister asked that Kevin Cardiff, Pat Neary and Brian Halpin draft a statement re DGS immediately.



THEME: C3

Appropriateness and effectiveness of the Department of Finance actions during crisis

LINE OF INQUIRY: C3b

Appropriateness of the bank guarantee decision

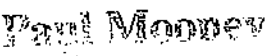
30 October 2008

Mr. Jean-Claude Trichet
President
European Central Bank
Kaiserstrasse 29
D-60311 Frankfurt am Main
Germany

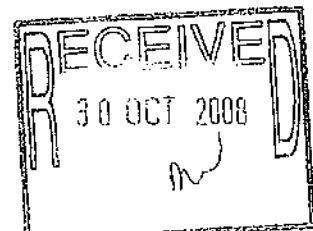
Dear Mr. Trichet,

I wish to acknowledge receipt of your letter and enclosure of 16 October 2008 which will be brought to the Taoiseach's attention as soon as possible.

Yours sincerely,


Paul Mooney
Taoiseach's Private Office

Mr. Dermot McCarthy
For information





EUROPEAN CENTRAL BANK
EUROSYSTEM

Jean-Claude TRICHET
President

An Taoiseach, Mr. Brian Cowen, T.D.
Department of the Taoiseach,
Government Buildings,
Upper Merrion Street,
Dublin 2,
Ireland.

16 October 2008

L/JCT/08/1657

Dear Taoiseach,

RE: Credit Institutions (Financial Support) Scheme 2008

The ECB was recently consulted on the draft Credit Institutions (Financial Support) Scheme 2008, which was published on the website of the Department of Finance this morning. I understand that the draft scheme is still subject to the approval of the Oireachtas.

Under paragraph 10 of the Schedule to the draft scheme, the liabilities covered under the Minister for Finance's guarantee of certain liabilities of systemically important credit institutions designated by the Minister under the scheme include interbank deposits and senior unsecured debt. I am writing to request that the Irish Government arrange that interbank deposits with a maturity of up to three months be excluded from the liabilities covered under the draft scheme. In this respect, I would like to draw your attention to the ECB opinion on the draft scheme¹, which was adopted yesterday by the ECB Governing Council. In its opinion the ECB attached great importance to the declaration made by the euro area Heads of State on 12 October 2008², according to which Member States have to act in a coordinated manner to avoid that significant differences in national implementation could have a counter-productive effect, creating distortions in banking markets. The euro area Heads of State also acknowledged the need to work in cooperation with the ECB so as to ensure consistency with the management of liquidity by the Eurosystem and compatibility with the operational framework of the Eurosystem. Against this background, the ECB opinion notes that uncoordinated decisions to guarantee interbank deposits in some Member States should be avoided as they may involve a fragmentation of the euro area money market.

¹ See paragraph 3.7 of ECB Opinion CON/2008/48 of 15 October 2008 at the request of the Irish Minister for Finance on a draft Credit Institutions (Financial Support) Scheme 2008, available at: <http://www.ecb.europa.eu/ecb/legal/opinions/html/index.en.html>

² 'Declaration on a concerted European action plan of the euro area countries', available on the website of the French Presidency at www.ue2008.fr.

The extension of the guarantee to cover interbank deposits, as is the case under the draft scheme, could entail a substantial distortion in the various national segments of the euro area money market by potentially increasing short-term debt issuance activity across Member States and therefore impairing the implementation of the single monetary policy, which is a competence of the Eurosystem under Article 105(2) of the Treaty.

The ECB opinion also highlights the statement in the declaration that the euro area Governments would make available a Government guarantee of new medium term (up to 5 years) bank senior debt issuance, whereas the scheme proposes to cover senior unsecured debt and asset covered securities, and dated subordinated debt (Lower Tier 2), without limitation as to maturity.

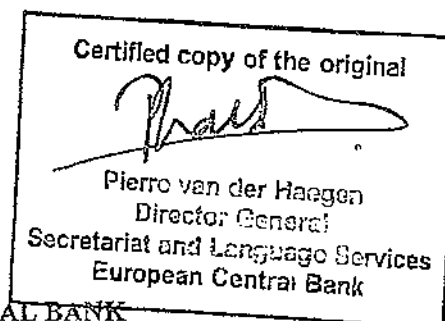
I am writing to underline the importance that the ECB attaches to the exclusion of interbank deposits with a maturity of up to three months from the liabilities covered by the draft scheme. I would wish that the Irish Government would maintain such an exclusion until this matter has been fully coordinated throughout the euro area Member States, in order to avoid distortions in the implementation of the euro area single monetary policy.

Yours truly,

A handwritten signature in black ink, appearing to read 'John Hurley', written over a set of three horizontal lines. The signature is slanted upwards to the right.

cc. Mr. Brian Lenihan, T.D.,
Department of Finance,
Upper Merrion Street,
Dublin 2,
Ireland.

Mr. John Hurley,
Governor,
Central Bank and Financial Services Authority of Ireland,
Dame Street,
Dublin 2,
Ireland.



OPINION OF THE EUROPEAN CENTRAL BANK

of 15 October 2008

at the request of the Irish Minister for Finance
on a draft Credit Institutions (Financial Support) Scheme 2008
(CON/2008/48)

Introduction and legal basis

On 10 October 2008 the European Central Bank (ECB) received a request from the Irish Minister for Finance (hereinafter the 'Minister') for an opinion on a draft Credit Institutions (Financial Support) Scheme 2008 (hereinafter the 'draft scheme') to be adopted by the Minister by means of a statutory instrument under the provisions of the Credit Institutions (Financial Support) Act 2008 (hereinafter the 'Act'). On 13 October 2008 the ECB was informally provided by the Irish Department of Finance with an updated version of the draft scheme (hereinafter the 'updated draft scheme')¹. The scheme implements the more general rules contained in the recently adopted Act, on which the ECB has been consulted and issued its Opinion CON/2008/44 on 3 October 2008². In accordance with the Act, the Minister may not adopt the scheme until a resolution approving it has been passed by each House of the *Oireachtas* (National Parliament)³. The Minister requested the ECB's opinion on the scheme as a matter of urgency, prior to its submission to the *Oireachtas*.

The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty, in conjunction with the third and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions⁴, as the scheme relates to a national central bank, the Central Bank and Financial Services Authority of Ireland (hereinafter the 'Central Bank'), and contains rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

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- 1 The draft scheme and the updated draft scheme are only referred to specifically in this opinion where a distinction needs to be made between them. Otherwise the legislative provisions to be adopted are referred to as the 'scheme'.
 - 2 See ECB Opinion of 3 October 2008 at the request of the Irish Minister for Finance on a draft Credit Institutions (Financial Support) Bill 2008 (CON/2008/44).
 - 3 See Section 6(5) of the Act.
 - 4 OJ L 189, 3.7.1998, p. 42.

concerted European action plan of the euro area countries⁹, in which they confirmed their commitment to act together in a decisive and comprehensive way in order to restore confidence and proper functioning of the financial system, aiming at restoring appropriate and efficient financing conditions for the economy. They agreed on common principles to be followed by the EU and euro area governments, central banks and supervisors to avoid national measures adversely affecting the functioning of the single market and the other Member States. Against this background, the ECB highlights that all the initiatives put in place by national governments to restore the confidence in financial markets should be aimed at implementing such common principles, in the spirit of close cooperation with other Member States and EU institutions.

- 2.2 The ECB underlines that the recommendations expressed in this opinion in relation to the scheme should be taken together with the recommendations expressed by the ECB in relation to the draft Act in its Opinion CON/2008/44¹⁰. The ECB wishes to draw the consulting authority's attention to the recent ECB opinions issued at the request of other Member States, whereby the ECB has commented on legislative proposals sharing some of the features of the scheme¹¹. It is the ECB's intention to facilitate coordination of the various national efforts addressing the current financial situation, inter alia through timely adoption and publication of ECB opinions on such draft national legislation.

3. Scope of the financial support provided

3.1 *Selection of covered credit institutions*

Under the scheme on which the ECB was originally consulted, the institutions covered are those credit institutions and subsidiaries which the Minister, following a recommendation from the Governor of the Central Bank, specifies by order under the Act as requiring financial support¹². A credit institution joins the scheme by executing a guarantee acceptance deed in the form to be specified by the Minister and, if required by the Minister, its parent or any other group company also executing such a guarantee acceptance deed¹³. A subsidiary of any parent credit institution which is not regulated by the Regulatory Authority may qualify as a 'covered institution', but in the case of a covered institution which is a subsidiary of any non-Irish parent credit institution, the only liabilities covered would be those which relate to the subsidiary's own business¹⁴.

- 3.2 In the context of the above provisions, the ECB notes that on 30 September 2008 the Irish Government announced that it had decided to put in place a two-year guarantee arrangement to

⁹ See the declaration of 12 October 2008, available on the website of the French Presidency at www.ue2008.fr.

¹⁰ See in particular paragraphs 2.3 and 3.2 of Opinion CON/2008/44, as reiterated in paragraphs 3.4 and 3.7 of this opinion.

¹¹ See, e.g. ECB Opinion CON/2008/46 of 8 October 2008 at the request of the Belgian Ministry of Finance on a preliminary draft law on measures promoting financial stability and in particular establishing a State guarantee for the provision of credit in the context of financial stability. All ECB opinions are available on the ECB website at www.ecb.europa.eu/ecb/legal/opinions/html/index.en.html.

¹² See paragraph 3 of the Schedule to the scheme.

¹³ See paragraph 5 of the Schedule to the updated draft scheme.

¹⁴ See paragraph 12 of the Schedule to the updated draft scheme.

balance sheet growth²¹. In this regard, the ECB underlines the importance of establishing appropriate safeguards such as for example limits to marketing of financial products or limits to expansion of activities on the basis of the state guarantees²².

3.5 The ECB understands that the Commission has confirmed the compatibility of the guarantee arrangement proposed by the Irish Government with Community State aid rules²³. The ECB reiterates the importance of ensuring that the further regulatory practice under the proposed arrangements will be conducted in full compliance with the relevant Community law provisions, in particular as regards competition and State aid rules, as well as EU financial services legislation and the single market principles²⁴.

3.6 *Types of liabilities covered by the guarantee*

Under the scheme 'covered liabilities' are defined as those liabilities of covered institutions existing on 30 September 2008 or at any time thereafter up to and including 29 September 2010 in respect of: (i) all retail and corporate deposits (to the extent not covered by existing deposit protection schemes in Ireland or any other jurisdiction); (ii) interbank deposits; (iii) senior unsecured debt; (iv) covered bonds; and (v) dated subordinated debt (Lower Tier 2)²⁵. In the case of a covered institution which is a subsidiary of any non-Irish parent credit institution, the only covered liabilities would be those which relate to the subsidiary's own business and in respect of which there is no recourse to any other entity (and would not include liabilities which, in the absence of the guarantee, would normally be those of other members of the covered institution's group)²⁶.

3.7 As a further comment as regards the scope of coverage of the State guarantee, the ECB notes that, in line with the declaration made by the euro area Heads of State mentioned before, Member States have to act in coordinated manner to avoid that significant differences in national implementation could have a counter-productive effect, creating distortions in global banking markets. The euro area Heads of State also acknowledged the need to work in cooperation with the ECB so as to ensure consistency with the management of liquidity by the Eurosystem and compatibility with the operational framework of the Eurosystem. Against this background, the ECB notes that uncoordinated decisions to guarantee interbank deposits in some Member States should be avoided as they may involve a fragmentation of the euro area money market. The extension of the guarantee

²¹ See the Explanatory Memorandum Relating to a Scheme Dated X day of October 2008, pp. 2-4.

²² See in particular the safeguards introduced by paragraph 36 of the updated draft scheme.

²³ See the Commission press release IP/08/1497 of 13 October 2008. The non-confidential version of the Commission's decision will be made available under Case NN 48/2008. The Commission took account, in particular of the provision of the updated draft scheme stating that the Minister may review and vary the scheme at no later than six-month intervals, and the results of such review will be provided to the Commission (see paragraph 8 of the Schedule to the updated draft scheme). See also 'Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis' of 13 October 2008, available at the Commission's website at www.ec.europa.eu.

²⁴ Cf. paragraph 2.3 of ECB Opinion CON/2008/44.

²⁵ See paragraph 10 of the Schedule to the scheme.

²⁶ See paragraph 12 of the Schedule to the updated draft scheme.

Such central bank lending to a solvent credit institution on the basis of a State guarantee is, in principle, possible, provided that the Central Bank's compliance with the monetary financing prohibition under Article 101 of the Treaty is ensured. Specific criteria for such compliance must be respected as noted by the ECB in a recent opinion issued with respect to another EU jurisdiction which has legislated in response to the current market turmoil³⁴. In this opinion, the ECB underlines its earlier recommendation that nothing in the legal framework governing the provision of financial support by the Irish authorities should prejudice the Central Bank's compliance with the prohibition on monetary financing under Article 101 of the Treaty³⁵.

- 3.10 Finally, as regards the payment of the claims in respect of covered liabilities, the ECB highlights that in general the existing funding mechanism of the deposit-guarantee scheme should be used to the extent possible. In this respect, in fact, the ECB notes that the scheme covers all retail and corporate deposits to the extent they are not covered by existing protection schemes in the State or any other jurisdiction³⁶. However, the ECB notes that the relationship between the scheme and the existing deposit guarantee scheme as regards the treatment of claims and the reimbursement of deposits should be further clarified.

4. Allocation of supervisory powers related to provision of financial support

- 4.1 The scheme confers extensive powers on the Minister, the Governor of the Central Bank and the Regulatory Authority, which are divided as follows.

- (i) The Minister has the power to: (i) impose specific obligations on covered institutions which are subsidiaries of non-Irish parent credit institutions to ensure that the scheme is not used for the benefit of any entity other than the relevant covered institution³⁷; (ii) in consultation with the relevant overseas regulator (subject to the requirements of the Treaty and the ESCB Statute), require certain obligations of the scheme to apply to the parent of a covered institution or any member of its group³⁸; (iii) receive confirmations from covered institutions regarding compliance with relevant regulatory standards³⁹ and (through covered institutions' auditors) with the conditions of the scheme⁴⁰; (iv) direct, following consultation with the

³⁴ See paragraph 4.3 of ECB Opinion CON/2008/46. This opinion specified the following criteria under which a central bank may engage in lending to a solvent credit institution on basis of a collateral in the form of a State guarantee: (i) the central bank needs to independently exercise full discretion regarding the decision whether to extend emergency liquidity assistance; (ii) it should be ensured that the credit provided by the central bank is as short term as possible; (iii) there must be systemic stability aspects at stake; (iv) there must be no doubts as to the legal validity and enforceability of the State guarantee under applicable national law; and (v) there must be no doubts as to the economic adequacy of the State guarantee, which should cover both principal and interest on the loans, thus fully preserving the financial independence of the central bank.

³⁵ See paragraph 3.2(iii) of ECB Opinion CON/2008/44.

³⁶ See paragraph 10, first bullet point of the Schedule to the draft scheme (paragraph 10.1 of the Schedule to the updated draft scheme).

³⁷ See paragraph 11 of the Schedule to the draft scheme (paragraph 12 of the Schedule to the updated draft scheme).

³⁸ See paragraph 50 of the Schedule to the scheme.

³⁹ For example, the Irish Bankers' Federation Code of Practice on Mortgage Arrears and the Regulatory Authority's Consumer Protection Code (see paragraph 24 of the Schedule to the draft scheme (paragraph 26 of the Schedule to the updated draft scheme)).

⁴⁰ See paragraph 25 of the Schedule to the draft scheme (paragraph 27 of the Schedule to the updated draft scheme).

responsibilities⁵², as well as with respect to the exercise of certain more specific powers of the Minister under the scheme⁵³. The Governor monitors, together with the Regulatory Authority's Chief Executive, the operation of the scheme and reports regularly to the Minister thereon⁵⁴.

- (iii) The Regulatory Authority, apart from the abovementioned functions performed jointly with the Governor: (i) receives (on behalf of the Minister) from the covered institutions reports, addressing their key supervisory parameters⁵⁵ and submits to the Minister reports on the compliance by covered institutions with the terms and conditions of the scheme⁵⁶; (ii) after consultation with the Minister, may require a covered institution to establish appropriate funding structures⁵⁷; (iii) if so directed by the Minister, may require any report or other information to be provided by a covered institution to be audited by an independent auditor⁵⁸; (iv) is consulted by the covered institutions towards developing a code of practice for effective risk management, in furtherance of the purposes of the Act⁵⁹; (v) may, following consultation with the Minister, require changes in the composition of a covered institution's board in order to achieve an appropriate balance between executive and non-executive directors⁶⁰; and (vi) may, after consultation with the Minister, require changes in the specific elements of the commercial conduct of the covered institution⁶¹.

- 4.2 On the one hand, the ECB welcomes those provisions of the draft scheme that allow the Governor to be involved in the exercise of the Minister's powers under the Act and the scheme for purposes of maintaining the stability of the Irish financial system. Moreover, the ECB welcomes the express safeguards introduced under the draft scheme as regards the role of the Governor, in particular the clarifications that: (i) nothing in the scheme shall prejudice the independence of the Governor⁶²; (ii) the Governor's authority to disclose information concerning a covered institution or its subsidiaries to the Minister and the Regulatory Authority is subject to the confidentiality

⁵² See paragraph 51 of the Schedule to the scheme.

⁵³ See consultation powers given to the Governor under paragraphs 13, 26, 36, 39 and 41 of the Schedule to the draft scheme (the Schedule to the updated draft scheme provides for such consultation powers in four cases, referred to in paragraphs 13, 28, 38 and 42).

⁵⁴ See paragraph 52 of the Schedule to the scheme.

⁵⁵ See paragraph 22 of the Schedule to the draft scheme (paragraph 24 of the Schedule to the updated draft scheme). The parameters in question include, inter alia, liquidity requirements, capital ratios, asset quality, risk exposures and funding costs.

⁵⁶ See paragraph 23 of the Schedule to the draft scheme (paragraph 25 of the Schedule to the updated draft scheme).

⁵⁷ See paragraph 40 of the Schedule to the updated draft scheme.

⁵⁸ See paragraphs 25 and 27 of the Schedule to the draft scheme (paragraphs 27 and 29 of the Schedule to the updated draft scheme).

⁵⁹ See paragraphs 29 of the Schedule to the draft scheme (paragraph 31 of the Schedule to the updated draft scheme).

⁶⁰ See paragraph 33 of the Schedule to the scheme.

⁶¹ See paragraphs 38, 40, 43 and 44 of the Schedule to the draft scheme (paragraphs 36, 39, 41 and 44 of the Schedule to the updated draft scheme). The elements of commercial conduct to be regulated by the Regulatory Authority under these provisions include: (i) targets on loan/deposit ratios, wholesale funding/total liabilities, deposit growth and maximum loans-to-value on new loans; (ii) limitations on exposures to any sector, customer or connected customers; (iii) liquidity, solvency and capital ratios; (iv) restrictions in relation to market share and balance sheet growth introduced to minimise any potential competitive distortion that may otherwise arise; (v) directions for the covered institution to cease passing on the costs of the guarantee to its customers in an unwarranted manner.

⁶² See paragraph 51 of the Schedule to the scheme.

draft scheme could be ensured⁷¹. The ECB recommends that a more coherent delineation of the powers of the respective supervisory authorities is introduced.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 15 October 2008.



The Vice-President of the ECB

Lucas D. PAPADEMOS

⁷¹ For example, paragraph 42 of the updated draft scheme provides that the power to limit the payment of dividends by the covered institution is to be exercised by the Minister after consulting the Governor and the Regulatory Authority, while the similar power under paragraph 43 of the updated draft scheme to prohibit the covered institution from engaging in buy-backs or redemptions of its ordinary shares is to be exercised by the Regulatory Authority after consulting the Minister.

Bullet Points for cabinet 28 Sep. 08

Banking crisis globally – US, UK (Bradford and Bingley), Europe (Fortis, Dexia in trouble)

Generalised shortage of liquidity – liquidity being gradually withdrawn from banks all over – Ireland not an exception

Situation exceptionally difficult for some banks, but all affected

Seeking to avoid State intervention – markets may be assisted by US rescue package

But must prepare for worse outcomes – interventions may include:

Buy time by providing short term liquidity, but must nurse our own liquidity

Legislate to guarantee/take control of more troubled institution(s). If this arises it will be emergency legislation, and may have knock on implications for other institutions

Pressure banks to consolidate (may not happen quickly enough)

Any intervention by us will require putting the credibility of Ireland behind institutions – this will probably raise our own funding costs and may seriously strain our ability to raise funds in the market

Governor of Central Bank in touch with ECB

Minister from DDoyle

Above summarises position on financial markets.

As of 9 A.M today the Governor has NOT heard from TRICHET.

X 28/9

Statement by An Taoiseach,

Mr. Brian Cowen, TD,

Dáil Éireann,

30th September, 2008.

In recent months, the international financial system has been affected by unprecedented turmoil and dislocation.

Credit markets, which are central to meeting the medium-term funding needs of the financial system, have effectively closed. Inter-bank lending rates have increased very significantly thereby escalating the cost of finance to financial institutions.

Recent developments in the US have created major structural issues for the global financial system. Ireland as a small, highly open economy with a significant financial sector closely integrated in the international financial system cannot be immune from these developments.

It is clear that we are witnessing extraordinary volatile times and the exact extent of the impact of this volatility has yet to fully emerge. It is the job of Government to pursue the establishment of the right context for economic recovery and to deal with whatever new issues come our way with determination and purpose.

Maintenance of the overall stability of the Irish financial system is a central priority of Government. The Government has, therefore, been very active in supporting public confidence in the safety of their deposits and supporting the stability of the financial system overall.

Throughout the current period of turmoil, the Government has stressed its commitment to the stability of the Irish financial system and, in particular, to ensuring that money placed with an Irish credit institution would not be placed at risk.

The Government announced on 20th September 2008 our decision to increase the deposit guarantee for savers five-fold from €20,000 to €100,000. This was a clear demonstration of the swift and decisive action Government is prepared to take to help maintain confidence in Ireland's financial institutions.

The Government's view was that agreement on the extensive and far-reaching plans announced recently by the US authorities would help to stabilise financial markets and rebuild confidence in the international financial system. However, Government has noted yesterday's vote in the US Congress and we are conscious of its impact and the potential for further volatility and uncertainty.

As the Minister for Finance has confirmed for the House, the Government has now decided to guarantee the retail, wholesale, dated term debt, secured borrowings and interbank deposits of the six domestic credit institutions namely, Allied Irish Banks, Bank of

Ireland, Anglo-Irish, Irish Life and Permanent, Irish Nationwide and the EBS.

The Government has taken this decision following advice from the Governor of the Central Bank and the Financial Regulator about the impact of the recent international market turmoil on the Irish Banking system.

The guarantee is being provided at a charge to the institutions concerned and will be subject to specific terms and conditions so that the taxpayers' interest can be protected.

The guarantee will cover all existing aforementioned facilities with these institutions and any new such facilities issued from midnight on 29 September 2008, and will expire at midnight on 28 September 2010.

I also wish to confirm to the House that the Financial Regulator has advised that all the financial institutions in Ireland will continue to be subject to normal ongoing regulatory requirements.

The decision taken by Government is designed to remove any uncertainty on the part of counterparties and customers of the six credit institutions. The Government's objective action is to maintain financial stability for the benefit of depositors and businesses. This decision is in the best interests of the Irish economy.

This initiative has been taken to counteract a serious disturbance in the economy caused by the recent turmoil in the international financial markets. It is a concrete determination of the Government's intention to protect the soundness and stability of the Irish Financial system. In taking this action the Government is acting first and foremost in the interest of the stability of the Irish economy and the long term interest of the taxpayer.

A secure and stable financial sector is in the best interests of the Irish people. The measure announced this morning is designed to protect the Irish economy and all who work in it. If we do not have a stable banking system, we do not have an economy. This is not about protecting the banks: it is about protecting the economy. This Government makes no apology for that.

In regard to the Guarantee arrangements, I want to point out to the House that normal practice is that the guarantee would extend to wholly owned subsidiaries within the Irish bank's group, but this is subject to confirmation of status of the relevant entity to the Government by the bank and the Financial Regulator.

This guarantee is intended to secure the funding of these institutions. Equity investors and those holding junior debt will take first charge on the risk of any losses in these institutions over time under the guarantee provided by the State is not intended to insulate them from the risks that they have taken on.

It is important also to stress that the risk of any potential financial exposure is significantly mitigated by a very substantial buffer made up of the equity and near-equity (high yielding subordinated debt). There is, therefore, a significant buffer before there is any question of credit impairments impacting on the Exchequer on foot of the guarantee.

The guarantee provided by the State relates to the liability side of the institutions' balance sheets - some €400bn or so in deposits - retail, corporate and wholesale - and their senior and dated subordinated debt. These liabilities are supported by €500bn in assets. Put simply, the amount that is being guaranteed is significantly less than the assets of the financial institutions concerned.

Owing to the importance from the point of view of market sensitivity of putting definitive figures into the public domain, the Minister for Finance has asked the Central Bank and Financial Services Authority of Ireland to confirm detailed figures.

It should also be stated that the asset quality in our financial institutions is good with a strong concentration in residential mortgages with a relatively low loan-to-value ratio (LTV) on average. While Ireland along with all developed economies has experienced a sharp decline in its property market there is very significant capacity within the institutions to absorb any losses.

Concerns have been raised about the exposure of Irish taxpayers and I want to address further some of those points. Firstly, I would stress that this guarantee was not given lightly. It was informed by the strong advice of the Central Bank and Financial Regulator that on account of unprecedented disruption in international financial markets the system-wide State guarantee was required:

- To ensure that Irish financial institutions has access to the normal liquidity and funding to effectively operate their day-to-day business
- and,
- To provide confidence to depositors and wholesale lenders that they should continue to transact their business as usual with the institutions concerned.

The interests of taxpayers will be very firmly safeguarded from any risk of loss form the very substantial warranty that the State is now providing. Legislation which is to be brought forward to underpin this guarantee:

- will provide for specific terms and conditions, including fees, in relation to a guarantee provided
- and,
- will provide a very useful mechanism, alongside existing regulatory powers, to ensure that the Irish financial institutions are managed and operated in a manner which it fully consistent with their long-term sustainability

The intensified scrutiny of financial institutions which has been put in place since the onset of the current turmoil will be maintained and strengthened further to ensure that high regulatory standards are achieved in Ireland and that the quality of corporate governance in these institutions is a bulwark against any risk of loss for the State.

As far as the question of 'moral hazard' is concerned, it will be a priority for the Government to ensure that the highest regulatory standards and standards of corporate governance apply in all of the institutions concerned including in relation to lending practices to safeguard the interests of taxpayers against any risk of financial loss.

The point also needs to be made that this guarantee will not be a free ride. Legislation which is being brought forward to underpin this guarantee will provide for specific terms and conditions, including fees, in relation to a guarantee provided.

This intervention is about enabling Irish banks to meet their liquidity needs in the current very difficult international financial circumstances to allow them to work through these difficulties and realise the value in their loan books.

This guarantee will be paid for and the taxpayer who ultimately underwrites this support will be paid for the support provided. The terms will ensure that the taxpayer gets value for money.

The Government's objective for the guarantee is to stabilise the Irish financial system as much as possible against the backdrop of the very uncertain and volatile international environment at present so that individuals and businesses can transact their normal financial business in a normal way.

The essential point is that the measure helps secure the stability of the Irish banking system. As is clear from the impact of the international credit crunch on the Irish economy, the financial system overall plays a central role in the economy and in the day-to-day lives of ordinary people.

The Government's announcement makes clear that the guarantee will be provided at a charge to the institutions concerned and will be subject to specific terms and conditions so that the taxpayers' interest can be safeguarded.

The Minister of Finance will be drawing on the advice of the Central Bank and NTMA to put a fee mechanism in place to remunerate the guarantee taking into account such factors as the possibility of increased funding costs for the Exchequer, the economic value for the institutions and need to support the investor confidence in the Irish financial system overall.

In current highly abnormal market conditions I don't think it is useful to speculate on what might be described as commercial rate for the

guarantee. It is important to be clear that it is only the State that could provide such a warranty; no market mechanism would provide it.

The State in its approach to costing the guarantee will wish to take all relevant factors into account including ensuring that, in the medium-term, the Irish economy supports a strong and viable banking system, the benefit and value it creates for the financial sector and above all else that the Exchequer suffers no financial loss from having provided it. Above all else, we have taken this decision to ensure that the best interests of the Irish economy and the Irish people are served.

Announcement in relation to Covered Institutions

30.11.08

On 28th November 2008, Mr. Brian Lenihan T.D., Minister for Finance, stated:

“Today, I have asked the Institutions covered by the Government’s guarantee Scheme to consider the contribution that they can make to the economy through appropriate credit initiatives in relation to small and medium sized businesses and otherwise, and to come back to me on this matter within the next ten days.”

This request has been made during meetings with each of the covered institutions covered by the Government’s guarantee Scheme. These meetings followed on from the submission by the Central Bank and Financial Regulator to the Minister for Finance of a report on the financial position of the major financial institutions participating in the Government’s guarantee Scheme. The Minister has met with the Governor and the Financial Regulator to discuss the report which presents an analysis of the institutions having regard to their loan books. The content of the report is confidential and commercially sensitive and the details cannot be disclosed.

The report confirmed that the capital position of each of the institutions reviewed is in excess of regulatory requirements as at 30 September 2008. The report also concludes that even in certain stress scenarios the capital levels in the financial institutions will remain within regulatory requirements in the period to 2011.

The Minister noted that the Government’s guarantee Scheme has been successful in safeguarding the stability of the Irish banking sector and in restoring its liquidity position. The Minister has been engaging with the financial institutions in respect of their obligations under the Scheme. However, the Minister is aware that international capital market expectations in relation to capital levels in the banking sector have altered.

In the meetings, the Minister’s focus has been to secure a stable and active banking sector which serves the needs of the Irish economy. The Minister said that these discussions have been productive and informative.

The Minister said that he welcomes the views of a number of institutions that they are open to raising additional capital, with a view to being better able to fulfil their full role in the economy, while ensuring that they remain strong and stable institutions with capital levels well above the normal regulatory minima.

The Minister noted that for certain institutions the need for additional capital may be very modest, whereas for others the need may be greater. He noted in that regard that certain institutions are already in discussions with potential investors, and he encouraged the institutions concerned to progress these discussions.

The Minister indicated that in certain circumstances it would be appropriate for the State, through the National Pensions Reserve Fund or otherwise, to consider supplementing private investment with State participation, where in doing so the aim of securing the financial system can be better met. In that regard, the Minister is open to evaluating proposals from potential investors which would add value to the security and stability of the financial system and its ability to contribute in a positive way to economic development.

The State will consider any such involvement in credit institutions active in Ireland on the basis of objective and non-discriminatory criteria, in accordance with the principles set out in the Guarantee scheme. The appropriateness of the State involvement will be assessed on a case by case basis in view of the overarching objective to preserve financial stability, in line with best practice in the EU and elsewhere and consistent with EU state aid rules.

The Minister indicated that it is a matter for the Board of each institution concerned to develop further their own plans for raising capital where appropriate. The relevant institutions have agreed that they will work closely with potential investors and the Government to develop matters further by the end of the year.

The Minister is finalising the arrangements for the appointment of directors to the relevant institutions. An announcement in this regard will be made early next week.

For the sake of clarity, the Minister noted that he has made no proposals in relation to consolidation of financial institutions.

25/WB/03

Anglo Irish Bank Corporation plc

Stoney Court
St Stephens Green
Dublin 2
Ireland
Tel: 353 1 6162001
Fax: 353 1 6785640

David K. Drumm
Group Chief Executive



Strictly Private & Confidential for the attention of the addressee only.

Mr. Patrick Neary
Chief Executive
Financial Regulator
PO Box 9138
College Green
Dublin 2

13 September 2008

Irish Nationwide Building Society

Dear Pat

I refer to our meeting today in relation to the above.

The difficulties currently being faced by the Society in funding itself are likely to worsen. The capital markets are firmly closed to it and it is highly vulnerable to ratings downgrades and negative news flow which in time will erode depositor confidence.

I believe however that the issue is not confined to Irish Nationwide but is in fact a threat to the international perception of the health of the Irish banking sector generally. Therefore it is in the best interests of the country that the matter be dealt with speedily and comprehensively.

I strongly believe that the best solution to this issue is for the Minister to state publicly that no regulated Irish financial institution will be allowed to fail. I fully understand the resistance of the larger players to this measure, as systemic support is already implied in their case.

I want to stress to you again that any solution not involving Anglo Irish Bank will lead to problems in terms of negative perceptions toward our bank. Indeed consideration should be given to the possible negative implications for the other smaller Irish financial institutions.



It is for this reason that I have proposed the solution we discussed and which at your request I have attached in writing.

I look forward to discussing this with you as soon as you have had a chance to consider it.

Yours sincerely

A handwritten signature in black ink, appearing to read 'D. Drumm', written over a horizontal line.

David Drumm
Group Chief Executive

Proposal for Anglo Irish Bank to acquire Irish Nationwide Building Society



A. Financial Structure:

Anglo would acquire a 100% interest in INBS for a consideration equal to the net assets of the Society as ultimately realised.

Consideration for the acquisition would be in the form of Anglo shares, to be paid on final realisation of the net assets. To avoid a 'run' on member deposits in the meantime, a condition would be inserted that a member will only qualify for ultimate payment of their equity interests if they have maintained a (to be determined) minimum balance with the Society for a period of not less than 12 months post acquisition.

Anglo's interest would be held through a wholly owned subsidiary company which is a bankruptcy remote SPV, which is not consolidated into the Anglo Group for the purposes of calculating regulatory capital.

Likewise, the member's equity interest in the Society (the 'General Reserves') will not be consolidated into Anglo's shareholder equity.

B. Minister for Finance role

The Minister would provide support on three levels:

1. To publicly undertake to make up any deficit in net assets after the loan book has been realised and all liabilities (other than members equity) repaid. That is to say, any losses incurred in realising the loan assets will first be absorbed by member's equity (plus any profits accumulating) and then if any loss remains, by the Minister (see illustration attached).

The Minister could consider putting a (say) two year time limit on this on the basis that any deficit (per audited accounts) could be paid into the SPV by the minister at the end of the period at his option.

2. To provide a funding and liquidity backstop to the SPV to provide cover for any loss of funding. This will be explicit and made public.
3. To provide funding and liquidity 'comfort' to Anglo to cover the risk of any secondary 'contagion' effects. This presumably would be provided by allowing Anglo to use commercial loans as collateral for a backstop liquidity facility. This would not be made public.

Page 1 of 3



Proposal for Anglo Irish Bank to acquire Irish Nationwide Building Society
(Continued from previous page).

C. Anglo's Role

1. To intensively manage the loan book in order to achieve maximum recovery and ultimately to turn all assets into cash, pay all liabilities and return any net surplus to the members in the form of Anglo shares. The Minister's interest could be further protected by a board appointment to the SPV.
2. To effect synergies between the businesses where possible. In this regard Anglo would intend to re-brand the branch network and invest in and thereby enhance the existing retail franchise.
3. Anglo's 'fit' in terms of its relevant skill base and customer relationships bring added value in terms of maximising the outcome for all stakeholders.

Page 2 of 3



NOTE

The previous page of this record suggests that there is a further page to this document. However, the file does not appear to contain this additional page.

2/10/10

Briefing for Cabinet Meeting, Sunday 28 September 2008

The Economy

- The economic data which have become available in recent weeks have been very weak. The latest CSO data show that the economy contracted in the first two quarters of this year and was therefore in recession. While the analysis of these data hasn't been completed yet, GDP activity is now expected to contract by around 1½% for this year.
- Combined with external developments over the past week or so - especially in relation to the international financial market difficulties and the continued deterioration in the outlook for many of our trading partners - it is difficult to see where growth will arise for next year. It is unlikely on the external front (through an improvement in exports) and it is almost certain that domestic demand will contract next year (given that housing completions are set to decline further).
- Therefore, while the situation is currently being assessed, it is increasingly likely there will be no growth - and possibly another contraction in activity - next year. Today's memo assumes zero GDP growth for 2009, but the risks to this are very much to the downside.
- The Department of Finance will continue to assess the situation over the coming week or so, bearing in mind that other commentators such as the ESRI and Central Bank will publish revised forecasts shortly. In addition, the IMF will also publish forecasts for growth in our main export markets. At this stage, the indications are that the forecasts from other commentators for Irish growth for next year will be negative.

The Public Finances

- In the Memo to Government of 17 September, it was indicated that a tax shortfall of the order of €6½ billion was likely in 2008. September is a key month for tax revenue and while we do not have full month data yet, early indications suggest that the poor performance in tax receipts witnessed over the summer months is continuing. The end-year call will be finalised in the light of the September outturn and the Department of Finance will publish an updated view on expected tax position on Thursday (2 October) with the publication of the end-quarter Exchequer Returns.
- If this tax shortfall is increased then this will automatically feed into the 2009 base, making the starting position worse.
- Given the weakness in tax receipts this year, particularly in the second-half of the year, it is likely that there will be some further contraction in tax receipts in 2009 on an unchanged policy basis.
- On this basis, tax receipts of the order of €41½ billion, representing around 26% of GNP would be achieved. If that materialised, then this would mean that revenue levels would be somewhere around the 2005/2006 levels.

27/09/08

Briefing for Cabinet Meeting, Sunday 28 September 2008

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18

Nov 2008

Briefing material on banking issues for meeting with EIB Vice President, Plutarchos Sakellaris

Bank Guarantee Scheme

The overarching objective of the guarantee announced by the Government on 30th September 2008 is to remedy the serious disturbance that might otherwise have unfolded for the economy. The guarantee has been successful in stabilising the position of the banking system in Ireland during an unprecedented period in international financial markets. In the immediate wake of its introduction, the level of deposits received by the covered institutions largely reversed the liquidity losses in previous weeks.

The scheme helps the banks access additional liquidity which will allow them to continue to lend in a sustainable manner, supporting the appropriate availability of credit and favouring business activity in the wider economy of the State, especially trading activities. Participation in the euro has enabled Irish financial institutions to avail of the liquidity facilities offered by the ECB and this has been of great assistance not only to domestically-focused credit institutions but also to the banks based in the International Financial Services Centre (IFSC).

Corporate Governance

The state support provided to the banking sector under the guarantee of course needs to be balanced with measures to safeguard the public interest. Thus the guarantee has been made available at a significant charge and the covered institutions are subject to terms and conditions designed to promote behaviour that will progressively reduce the risk of the guarantee ever being called upon while supporting the institutions in undertaking the change required to adjust to the new commercial and regulatory realities of international finance.

Under the Guarantee Scheme approved by both Houses of Parliament, the covered institutions are required to undertake a fundamental review of their corporate governance with appropriate steps to strengthen boards and management, the adoption of a positive attitude to customer needs and steps to ensure their capital base is sufficiently strong to meet the challenging economic and financial environment in which the financial system is now operating. The banks are constrained from inappropriate expansion of their balance sheets and it has been made clear to them that anti-competitive behaviour, exploiting the guarantee, will not be acceptable.

Capital Position of Banks

The Irish scheme is firmly aligned with the main themes of the euro group plan, which contains an option to provide additional capital resources where appropriate to the banks. The position of the Irish government in relation to the capital position of institution is that each must take appropriate steps to ensure their levels of capital are aligned with their needs. The Department of Finance, the Central Bank and the Financial Regulator are in ongoing contact with the covered institutions on their business plans, their capital position and liquidity.

Joint Committee of Inquiry into the Banking Crisis

Chronology of the Banking Crisis

prepared by

FTI Consulting Limited

Chronology of the Banking Crisis - revision

Thursday, 29 January 2015

Chronology of the Banking Crisis

1992

- February: Maastricht Treaty establishes the completion of the EMU as a formal objective
- Basel accord on capital adequacy for banks is implemented in the EU.
- November: General Election – Fianna Fáil/Labour
- Unemployment rate averages 15.2%
- Real GDP grows at 2.5%
- Housing completions = 22,464

1993

- (Second) Social partnership agreement – Programme for Economic and Social Progress 1991-1993. This was the second social partnership agreement and provided for annual pay rises of 4% in 1991, 3% in 1992 and 3.75% in 1993.¹
- Unemployment rate averages 15.5%
- Real GDP grows at 2.9%
- Housing completions = 21,391

1994

- December: General Election - Fine Gael/Labour/Democratic Left
 - Check programme for government for relevant policies
- December 1994: John Bruton (FG) becomes Taoiseach.
- December 1994: Ruairi Quinn (Lab) appointed Minister for Finance.
- Tom Mulcahy appointed CEO of AIB Group
- Unemployment rate averages 14%
- Real GDP grows at 6.5%
- Housing completions = 26,863

¹ The first programme – Programme for National Recovery, 1988-1990, set annual pay awards of 2.5% over the three years, with tax cuts of IR£225 million and a commitment to build a fair, inclusive society with better public services. The sources of the information contained in this briefing paper on the social partnership agreements during the period include the article in *The Irish Times* (5 August 2008) '20 years of social partnership agreements, 1987-2007'. In covering the social partnership agreements during the period, we insert them in the respective end-years and note that they generally included allowances in respect of tax and conditions etc. as well as pay rises, which are summarised here.

1995

- Unemployment rate averages 12.1%
- Real GDP grows at 8%
- Housing completions = 30,575

1996

- (Third) Social partnership agreement – Programme for Competitiveness and Work 1994-1996. This deal saw an 8% total pay rise over the three years, though the staging was very different for the public and private sectors.
- Unemployment rate averages 11.5%
- Real GDP grows at 9.1%
- Housing completions = 33,725

1997

- June: General Election – Fianna Fáil/PD
- June 1997: Bertie Aherne (FF) becomes Taoiseach.
- June 1997: Charlie McCreevy (FF) appointed Minister for Finance.
- September 1997: Paddy Mullarky appointed Secretary General of the Dept. of Finance.
- Section 23 tax incentive scheme introduced.
- Unemployment rate averages 10.3%
- Real GDP grows at 10.8%
- House prices rise by 13%.
- Housing completions = 38,842

1998

- Capital gains tax cut from 40% to 20%
- Special tax incentives for property development introduced and extended in further budgets.
- First Bacon report on housing sector published.
- Government implements Bacon's recommendation on removing tax deductibility of interest on borrowings for residential property against rental income.
- Unemployment rate averages 7.4%
- Real GDP grows at 8.5%
- House prices rise by 23%.
- Housing completions = 42,349

1999

- Euro introduced
- Second Bacon report on housing sector published.
- September 1999: Romano Prodi appointed President of the European Commission

- Unemployment rate averages 5.5%
- Real GDP grows at 10.2%
- House prices rise by 23%.
- Housing completions = 46,512

2000

- Dot-com bubble bursts
- Third Bacon report on housing sector published.
- Planning and Development Act introduces local authority development levies
- Public Service Benchmarking Authority set up
- Social partnership agreement – Partnership 2000, 1997-2000. This national pay agreement provided for wage increases of 7.25% over its lifetime.
- Central Bank of Ireland annual report carries warnings about house prices and credit.
- Unemployment rate averages 4.3%
- Real GDP grows at 9.5%
- House prices rise by 21%.
- Housing completions = 49,812
- January 2000: Dermot McCarthy appointed Secretary to the Government; (also closely associated with Social Partnership as Chair of the Plenary sessions).
- March 2000: John Hurley appointed Secretary General of the Dept. of Finance.
- May 2000: Horst Kohler appointed Managing Director of the IMF.

2001

- May: SSIA accounts become available to open
- June: Nice Treaty rejected in Irish referendum
- July 2001: Dermot McCarthy appointed Secretary General at the Dept. of the Taoiseach and retaining his role as Secretary to the Government.
- Maeve Donovan appointed Managing Director of the Irish Times.
- Unemployment rate averages 3.9%
- Real GDP grows at 5.3%
- House prices rise by 14%.
- Housing completions = 52,602
- Central Bank 2000 annual report (published in 2001) warns about credit and the property market. *“The total level of credit extended to the construction and real estate sectors of the economy has risen significantly as a percentage of GDP over recent years. There are, therefore, significant dangers the Bank’s concern in this matter originates from the fact that boom-bust cycles in credit growth seem to precede many, if not most, of the episodes of systemic collapse that have occurred throughout the world over the last few decades. The worry is that Ireland, currently experiencing a boom in private-sector credit growth, may not be an exception to this well-established pattern.”*

- Budget 2002 restores tax deductibility of interest for property investors and extends “Section 23” tax incentives. (Bowling to sustained criticism from the property industry and tenant bodies, Minister McCreevy has acknowledged that “the presence of investors is required to secure the future supply of housing to meet accommodation needs.” <http://www.independent.ie/irish-news/property-uturn-to-cut-home-prices-and-rents-26064057.html>)

2002

- 2002: Euro notes and coins introduced
- John Hurley replaces Maurice O’Connell as Governor of the Central Bank.
- Central Bank annual report again warns about credit growth - *“a cyclical increase in the debt/disposable income or debt/cash flow ratios is occurring on top of a very strong trend or structural increase in these ratios over the last number of years. It is, therefore, a worrisome development and one that the Bank is monitoring carefully.”* The report welcomes evidence of a moderation in house price increases but notes prices are picking up again and says these *“have largely been attributed to the recent budgetary tax changes, which have encouraged property investors to re-enter the market.”*
- March 2002: Tom Cosgrave appointed Secretary General of the Dept. of Finance
- May: General Election – Fianna Fáil/PD
- October: Nice Treaty approved in second referendum
- Geraldine Kennedy succeeds Conor Brady as Editor of the Irish Times.
- Rabobank purchases the Agricultural Credit Corporation
 - Confirm this as Rabo’s entry to Irish market
- AIB Rusnak losses.
- Social partnership agreement – Programme for Prosperity and Fairness, 2000-2002. This national pay agreement included wage increases of 5.5% in the first two years and 4% in the third – double the rate of the previous deal.
- Unemployment rate averages 4.4%
- Real GDP grows at 5.8%
- House prices rise by 6%.
- Housing completions = 57,695

2003

- May: Irish Financial Services Regulatory Authority established. Liam O’Reilly is appointed Chief Executive.
- November 2003: Jean-Claude Trichet appointed President of the ECB
- Central Bank annual report discussion of financial stability issues concludes with the following: *“The last Financial Stability Report concluded that the Irish banking system was in a sufficiently healthy position to weather a significant adverse shock and that*

domestic pressures in the credit and housing market had moderated. While there has been no major deterioration in domestic sources of financial instability in Ireland in the intervening period, the re-emergence of rapid personal-sector credit growth and house price inflation in recent months could, if it persists, pose risks to the health of the financial sector. Furthermore, the risks posed by recent international developments have also increased. Although the environment facing the Irish banking system is now less benign than in recent years, primarily due to the difficult global environment, there is no significant cause for concern regarding financial stability in Ireland.”

- Summer: First benchmarking payments made
- Unemployment rate averages 4.6%
- Real GDP grows at 3%
- House prices rise by 14%.
- Housing completions = 68,819

2004

- May: Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia join the EU. Ireland is one of a small number of countries to put no restrictions in place for workers from these countries.
- June: Basel 2 Accord is published.
- June 2004: Rodrigo Rato appointed Managing Director of the IMF
- Central Bank publishes first stand-alone Financial Stability Report. It states *“The risk of an unanticipated and sudden fall in residential property prices, accompanied by an increase in the default rate among mortgage holders, is the risk that poses the greatest threat to the health of the banking system. Nevertheless, the shock absorption capacity of the banking system is currently adequate and the system could absorb a modest fall in house prices even if it were to coincide with a modest increase in defaults.”*
- September 2004: Brian Cowen appointed Minister for Finance.
- November 2004: José Manuel Barroso appointed President of the European Commission
- Joaquin Almunia appointed European Commissioner for Economic and Monetary Affairs.
- Unemployment rate averages 4.5%
- Real GDP grows at 4.6%
- House prices rise by 12%.
- Housing completions = 76,954
- January: Credit to households up 26% relative to a year earlier. Credit to nonfinancial corporates up 20%.

2005

- March: Danske takes control of National Irish Bank
 - Confirm this as Danske’s entry to Irish market
- July 2005: Eugene Sheehy appointed CEO of AIB Group

- Final benchmarking payments made
- Some commentators raise concerns about the likelihood of a considerable fall in house prices.
- Gerry O'Regan takes over from Vinnie Doyle as Editor of the Irish Independent Group
- Central Bank Financial Stability report expresses concerns about credit growth. However, it also notes *"The more indebted is the private sector, the more susceptible it is to risk of default if any shocks hit the economy which impact negatively on employment and/or incomes. In mitigation of this, it should be noted that, in the international context, many credit booms have faded without posing significant difficulties for the banking system or the wider economy"* and *"There appears to be no substantial short- to medium-term risks to financial stability arising from the corporate sector."*
- Social partnership agreement – Sustaining Progress, 2003-2005. This deal provided for cumulative rises of 13% over its three-year term.
- Unemployment rate averages 4.4%
- Real GDP grows at 5.7%
- House prices rise by 8%.
- Housing completions = 80,957
- January: Credit to households up 29% relative to a year earlier. Credit to nonfinancial corporates also up 29%.
- December: Patrick Neary appointed Chief Executive of the Financial Regulator.

2006

- May: SSIA accounts begin to mature
- July 2006: David Doyle appointed Secretary General of the Dept. of Finance.
- Central Bank Financial Stability Report notes *"Notwithstanding the strength of the banking system, a correction in house prices, if it were to be combined with a significant increase in arrears among mortgage holders, could pose significant difficulties for the health of the banking system."* However it also states: *"The central expectation, based on an assessment of the risks facing borrowers, the financial position of the banking sector as well as recent stress testing of the system, is that the banking system is reasonably well placed to withstand the impact of any likely adverse developments in the short to medium term."*
- Capital Requirements Directive translates Basel 2 accord into European legislation to be adopted by banks in the EU over the next two years.
- Unemployment rate averages 4.5%
- Real GDP grows at 5.5%
- House prices rise by 14%.
- Housing completions = 93,419
- January: Credit to households up 30% relative to a year earlier. Credit to nonfinancial corporates up 32%.

2007

- January: Bulgaria and Romania join the EU
- April: *Futureshock* documentary explains scenario of how a property crash could put Ireland into a deep recession.
- May 2007: Brian Lenihan (FF) appointed Minister for Finance.
- Central Bank Financial Stability report notes *“this year has been a turning point in some key respects because there has been an improvement in several of the risks identified in earlier financial stability reports. In particular, the upward momentum in residential property prices has abated, thus reducing the vulnerability posed by the previous substantial increases in house prices”* and *“The central expectation, based on an assessment of the risks facing both the household and non-financial corporate sectors, the health of the banking sector and the results of recent in-house stress testing is that, notwithstanding the international financial market turbulence, the Irish banking system continues to be well placed to withstand adverse economic and sectoral developments in the short to medium term.”*
- May: General Election – Fianna Fáil/Greens/PD
- August: First signs of global financial crisis.
- August/September: Northern Rock.
- September: Morgan Kelly publishes ‘Banking on very shaky foundations’, detailing scale of commercial property lending by Irish banks.
- November 2007: Dominique Strauss-Kahn appointed Managing Director of the IMF
- Social partnership agreement – Towards 2016, 2006-2007. This deal provided for a 10% pay rise over a 27-month period, *inter alia*.
- Unemployment rate averages 4.7%
- Real GDP grows at 4.9%
- House prices rise by 8.5% on average over the year.
- Late 2007: Irish house prices begin to fall.
- Housing completions = 78,027
- January: Credit to households up 26% relative to a year earlier. Credit to nonfinancial corporates up 35%.

2008

- March 2008: Bear Stearns.
- March 2008: ‘Anglo St. Patrick’s Day Massacre’.
- May: Brian Cowen becomes Taoiseach
- June: Lisbon treaty rejected
- July 2008: Lenihan says construction sector has “come to a shuddering halt”.
- September 2008: Lehman brothers.
- September 2008: Government guarantees liabilities of Irish banks.
- Late 2008: Government employs consultants PWC to “go deep into the banks”.
- PWC subsequently report that all the banks, including Anglo, are solvent even in stress scenarios.

- December 2008: Plans to provide State capital of €2 billion each to Bank of Ireland and AIB and €1.5 billion to Anglo.
- Unemployment rate averages 6.4%
- Real GDP contracts by 2.6%
- House prices fall by 6%
- Housing completions = 51,724
- January: Credit to households up 16% relative to a year earlier. Credit to nonfinancial corporates up 23%.

2009

- January 2009: Government nationalises Anglo.
- February 2009: Plans to provide €3.5 billion each to AIB and Bank of Ireland.
- Spring 2009: NAMA proposal.
- April 2009: Minister for Finance announces a Government decision to establish NAMA on a statutory basis
- May 2009: Anglo announces it has lost all of its €4 billion capital and says there's another €4 billion loss to come.
- 2009: Increasing reliance on ECB borrowings, including first provision of Emergency Liquidity Assistance (ELA) to Anglo.
- September: Patrick Honohan appointed Governor of the Central Bank.
- October: Lisbon treaty approved in second referendum
- November 2009: Colm Doherty appointed CEO of AIB Group
- December 2009: NAMA formally established on 21 December. Frank Daly appointed Chairperson and Brendan McDonagh as CEO.
- Gavin O'Reilly succeeds Tony O'Reilly as CEO of INM
- December: Basel 3 accord agreed.
- Unemployment rate averages 12%
- Real GDP contracts by 6.4%
- House prices fall by 18%
- Housing completions = 26,420
- January: Credit to households up 8% relative to a year earlier. Credit to nonfinancial corporates up 9%.

2010

- NAMA bill takes six months to pass and EU-overseen loan acquisition process from privately-owned banks occurs in tranches through late 2010.
- Olli Rahn appointed European Commissioner for Economic and Monetary Affairs
- January 2010: Kevin Cardiff appointed Secretary General to the Dept. of Finance.
- March 2010: First loan transfers from participating institutions to NAMA.
- May 2010: Greek Bailout agreement for €110 billion
- September 2010:

- Government announces cost of Anglo alone will be over €30 billion, about €7,000 per head.
- Non-resident deposit flight begins. Other banks run out of ECB-eligible collateral and sovereign-backed ELA is supplied to all the banks.
- Original blanket guarantee expires and large amounts of bondholder debt with maturity dates to coincide with the end of the guarantee are paid off by banks using funds borrowed from ECB.
- September 2010: ECB officials begin to brief about their concerns about “addict banks” <http://www.ft.com/intl/cms/s/0/580109dc-bf43-11df-a789-00144feab49a.html>
- October: Financial Regulator re-unified with Central Bank
- October 2010: David Hodgkinson assumes role as interim Executive Chairman at AIB
- November 2010:
 - ECB communication re Ireland entering an EU-IMF programme.
 - Further round of stress tests and recapitalisation in 2011. All banks apart from Bank of Ireland are fully nationalised.
 - Final costs run to at least 40 percent of GDP.
- Liam Kavanagh appointed Managing Director of the Irish Times
- Unemployment rate averages 13.8%
- Real GDP contracts by 0.3%
- House prices fall by 13%
- Housing completions = 14,602
- January: Credit to households down 1.6% relative to a year earlier. Credit to nonfinancial corporates down 3%.

2011

- February: General Election brings in Fine Gael\Labour government.
- March 2011: Enda Kenny (FG) becomes Taoiseach.
- March 2011: Michael Noonan (FG) appointed Minister for Finance.
- Spring 2011: PCAR (Prudential Capital Assessment Review) published.
- May 2011: Portuguese Bailout agreement for €78 billion.
- July 2011: Christine Lagarde appointed Managing Director of the IMF
- August 2011: Martin Fraser appointed Secretary General at the Dept. of the Taoiseach and Secretary to the Government.
- Summer 2011: Banks are re-capitalised and deposits stabilise.
- INBS merged with Anglo to form Irish Bank Resolution Corporation (IBRC).
- July: European Commission releases Capital Requirements Directive 4 to translate Basel 3 into European law.
- October 2011: Final loan acquisitions by NAMA, bringing the total amount of acquired loans to €74 billion (at par value); NAMA reported to have acquired these loan assets at a discount of X% to their par value.
- November 2011: David Duffy appointed CEO of AIB.
- November 2011: Mario Draghi appointed President of the ECB.

- Kevin O’Sullivan succeeds Geraldine Kennedy as Editor of the Irish Times.
- Unemployment rate averages 14.6%
- Real GDP grows by 2.8%
- House prices fall by 13%
- Housing completions = 10,480
- January: Credit to households down 4.3% relative to a year earlier. Credit to nonfinancial corporates down 2.5%.

2012

- Unemployment rate averages 14.7%
- Real GDP contracts by 0.3%
- House prices fall by 13%
- Housing completions = 8,488
- January: Credit to households down 3.9% relative to a year earlier. Credit to nonfinancial corporates down 2.2%.
- March 2012: John Mulcahy (former Chairman of Jones Lang Lasalle in Ireland and Head of Asset Management at NAMA) appointed to the Board of NAMA
- March 2012: John Moran appointed Secretary General of the Dept. of Finance.
- June 2012: Cypriot requests bailout from the European Financial Stability Facility
- Vincent Crowley appointed CEO of INM
- Stephen Rae appointed Group Editor of INM titles

2013

- 7 February: Special Liquidation of IBRC Ltd
- July: Capital Requirements Directive IV comes into force. Requirements of Basel 3 agreement to be phased in gradually up to the end of the decade.
- Unemployment rate averages 13.1%
- Real GDP grows by 0.2%
- House prices stabilise. Rise by 1% on average over the year.
- Housing completions = 8,301
- January: Credit to households down 4% relative to a year earlier. Credit to nonfinancial corporates down 3.8%.

Compendium of Possible General Supplementary Questions

1. The Guarantee Scheme
2. Meetings with Governor and Banks
3. The position of Irish Banks
4. Regulation of Financial Services in Ireland
5. The International Situation

1. The Guarantee Scheme

What are the institutions covered by the Scheme?

AIB, Bank of Ireland, AngloIrish, Irish Life and Permanent, EBS, Irish Nationwide, and certain subsidiaries. An order for Postbank was made on 5th November.

What are the total liabilities covered?

The estimate is €440 billion.

Why did we not put a cross-indemnity into the guarantee acceptance deed of each institution?

It is important to state that the scheme has not changed, and the implementation arrangements are fully consistent with the scheme.

A cross-indemnity is a particular legal instrument that requires one institution to make immediate payment on the default of another institution, however big that other institutions default would be – instead of putting an onus on the whole sector to make payments over time and on a sustainable basis, these cross-indemnities could theoretically require each institution to make payment in respect of the whole rest of the sector immediately – this is not the principle stated in the Scheme.

Instead of that, the Government, and the Oireachtas, have clearly stated the principle that, if such an issue arose, then arrangements would be made to collect from the sector on a basis consistent with their long-term viability and sustainability. If we, as Government were to insist on a cross-indemnity approach, this would have the opposite effect of making each institution appear to investors to be more risky, rather than less.

Why did certain eligible institutions not go into the scheme?

Ulster Bank, First Active, Halifax/Bank of Scotland Ireland and KBC Ireland (which has just changed its name from IIB Bank) chose not to join the scheme. They have their own reasons for this, including the terms of the scheme, and the fact that their parent institutions have been in a position to benefit from various supports in their home countries. As deputies will be aware, the UK government has taken significant steps to support the UK

banking system and this obviously has a positive impact on those British banks operating through subsidiaries in Ireland. Of course, Ulster Bank, First Active, Halifax, KBC are all fully covered by the standard Deposit Guarantee which provides full cover up to €100,000. The Deputy will note that although these banks have chosen not to join the scheme, there has been acknowledgement that the scheme has been successful in bringing stability to the Irish market.

Was an actuarial or other analysis carried out to establish the open market cost of the guarantee which the Government provided?

The truth is that there is no open market price for this kind of scheme. Various approaches are possible, based on theoretical assumptions but the approach adopted was to look at the likely cost to the Government in terms of debt service.

What liquidity flowed back into the institutions following the guarantee?

The guarantee was very successful in stabilising the situation, and liquidity losses in the previous months have been recouped. Generally speaking however, interbank markets globally have not recovered their previous strength, though the actions of governments and central banks have added to stability.

When will the Minister for Finance put in place the various personnel required to manage the guarantee scheme, including public interest directors, the committee on remuneration, the new Financial regulator staff etc.

- Directors and committee on remuneration – The Minister for Finance will announce a panel of competent individuals from which directors will be selected in due course
- Financial regulator staff – recruitment and selection processes are ongoing
- Department of Finance – new internal arrangements with additional staff having been allocated (entirely within existing resources)

2. Meetings with Governor and banks

What meetings has the Minister had with the Governor and the banks and what has been discussed?

I have regular contact with the Governor of the Central Bank, the Financial Regulator and representatives of the financial sector. In addition through ongoing dialogue at official level I am kept closely in touch with developments.

What measures has the Minister taken to enhance communication with the Regulator and the Central Bank?

The Credit Institutions (Financial Support) Scheme 2008 applies comprehensive information and monitoring provisions to the credit institutions covered by the scheme and provides for enhanced coordination and close working between the Central Bank, the Regulatory Authority and my Department so as to ensure the realisation of the Scheme's objectives. This enhanced cooperation facilitates appropriate detailed information exchange, liaison with Governor and the Chief Executive of the Regulatory Authority as well as consultation on specific prudential aspects of the terms and conditions to ensure a consistent approach across all of the relevant public bodies by reference to the objectives of the Scheme.

3. Position of Irish Banks

What is the level of asset impairment within the banks at present?

It is a matter for each institution and its auditors to publish results at the appropriate periods – the banks will be releasing accounts and information over the coming months. The Financial Regulator clearly takes a direct interest in this issue, with a view to ensuring financial stability. I understand that the Regulator has engaged in an exercise to review the loan books and business plans of the guaranteed institutions.

What actions did the CBFSAI/Financial Regulator take to address the growing exposure of Irish banks to property exposures?

The Financial Regulator has always adopted a conservative approach by requiring banks to hold more capital against higher risk property lending. Prior to the current market turbulence, as far back as May 2006, the Financial Regulator amended the risk weighting of new Irish residential mortgages so that mortgages that exceeded 80 per cent of the value of the property attract a risk weighting of 100 per cent for the portion of the mortgage in excess of 80 per cent, resulting in credit institutions setting aside additional capital in respect of these loans.

In addition at end 2006 in implementing the Capital Requirements directive the Financial Regulator took measures to increase capital requirements for certain categories of property related lending with higher risk weights, and therefore capital charges, for speculative commercial real estate and for higher LTV lending secured on residential property and for exposures secured by properties that are not or will not be occupied by the borrower; this includes residential investment properties and some second homes. The Financial Regulator also revised its prudential stress testing guidance in October 2007.

Is the exposure of Irish banks to the property sector making them vulnerable in the current market turmoil?

Clearly, the extent of exposures to the property sector varies between credit institutions so it is not straightforward to make an assessment which applies in a uniform way for the financial system as a whole.

It is important to stress that Irish credit institutions do not have significant exposures to the subprime market, either directly or indirectly, and also have relatively low exposures to hedge funds and private equity risks. However, Irish banks are not insulated from current conditions in interbank markets and raising funding in these conditions is more challenging, as it is for all banks internationally.

The Central Bank and the Financial Regulator have been monitoring the domestic situation very closely and are keeping me closely advised of developments. The Credit Guarantee scheme provides a framework for the authorities to oversee the assessment of strategic options by the covered institutions, the application of strict terms and conditions, and for the provision of detailed information. In this context, the Financial Regulator commissioned PwC to conduct a review of loan portfolios of the covered credit institutions.

If a question is asked on the dependence of Irish banks on ECB liquidity:

Access to ECB liquidity is a real strength of the Irish financial system. In circumstances where wholesale inter-bank markets are effectively closed, the injections of liquidity by the ECB have a key role to play in maintaining financial stability in the euro zone as a whole. In the figures quoted for Ireland, it is very important to make the distinction between liquidity drawn down by the domestic Irish banks and that accessed by international IFSC banks.

If a question is asked about the position of customers, families, small firms:

The extended international credit crunch which we have experienced has brought home to all of us the pivotal role of the financial system in the economy and in the day-to-day lives of ordinary people. An important aim of the Scheme of Guarantees we have introduced is to ensure that we have a banking system that as a whole works effectively, efficiently and competitively in facilitating all the day-to-day ordinary economic transactions of commercial, business, family and social life. The scheme therefore includes the application of strict terms and conditions on covered institutions to ensure that the public interest, which includes the general consumer and small business sector, is paramount. By putting guarantees in

place we have removed a major obstacle to financial institutions continuing to play their proper role in facilitating enterprises and individuals with credit.

If a question is asked about “bailing out the banks”

As I have said a number of times this guarantee is not a bailout – the banks are required to pay for it, and there are significant conditions imposed upon their commercial conduct, in addition to the cash charge each institution will pay. In examining the charge for the guarantee, there were a number of considerations. Our intention in framing the charge that would be made for the guarantees under the Scheme was to protect the taxpayers’ interest, while not imposing such charges as would add to the problems we are seeking to solve. At the same time, it was our intention that financial markets would continue to function normally and that no unfair competitive advantage would be given to the covered institutions.

On the other hand it would not be appropriate to set the cost of the guarantee so high that the payment of the charge prevented the institution from continuing to do business. I feel that the current cost of €1 billion over two years, recouping the extra cost to the State of borrowing, is the appropriate level for the charge, particularly when taken with the additional conditions imposed on covered institutions under the Scheme.

4. Regulation of Financial Services in Ireland

Does the Financial Regulator have adequate powers given the current turmoil in financial markets?

We have through the Central Bank and Financial Services Authority of Ireland integrated within a single institutional structure both the supervision of individual financial firms by the Financial Regulator and the monitoring of overall financial stability, which is the independent responsibility of the Governor of the Central Bank. This approach facilitates the sharing of information and ensures close co-operation between both bodies.

The provisions of the credit guarantee scheme further underpin the regulatory system in Ireland. Significant conditions imposed upon the commercial conduct of the banks, and the scheme provides a framework for the authorities to oversee the assessment of strategic options by the covered institutions, the application of strict terms and conditions, and for the provision of detailed information.

5. International financial situation

What developments are taking place internationally?

The Deputy will be aware that different countries have taken various approaches to addressing the recent financial market turmoil. At their meeting on 7th October 2008 EU Finance Ministers agreed common principles to guide the actions of Member States aimed at preserving confidence and stability in financial markets. The Finance Ministers welcomed the EU Commission's continued commitment to act quickly and apply flexibility in state aid decisions within the framework of the single market and state aid regime. The Commission has issued guidance for Member States on how decisions within this framework can be rapidly assessed.

Proposals have also been brought forward by the Presidency of the EU, the EU Commission, the OECD and the IMF among others and my officials in consultation with the Central Bank and the Regulatory Authority continue to monitor issues at an international level. In addition a summit of world leaders was held on the 15th of November.

How was Ireland represented at the G20 Summit on November 15th?

Ireland's representation at the planned summit was through its membership of the EU which is a member of the G20. It is important therefore to ensure that EU Members States not members of the G20 in their own right have sufficient opportunity to input to and shape the EU's preparations for the summits.

Why are Irish debt costs rising relative to other states?

The Deputy will be aware that markets are in an unusual mood worldwide and I am not going to try to describe every potential factor. However, in order to keep debt costs to a minimum in the future it is clear that the steps already taken by the Government to control public expenditure at a very difficult time are essential. Failure to show real progress in this regard would lead to higher debt issuance and lowered market confidence, with real implications for our cost of borrowing. Obviously, the guarantee scheme is also playing a part, but this is offset by the positive contribution that it has made to overall stability in our economy.

October 1 2008

Mr David Doyle
Secretary General
Department of Finance
Government Buildings
Upper Merrion St
Dublin 2

Dear David,

Further to our recent discussions in relation to the Financial Support to be provided by the Minister for Finance to the Irish Credit Institutions we would like to set out some thoughts for consideration by Government on how the commercial terms for such an arrangement might be determined.

1. Size of premium

We strongly believe that the quantum of premium should reflect the actual risk to the State and in particular the probability of claim and the expected loss to the State in such an eventuality.

An unreasonably high premium would threaten the viability of even the strongest institutions. Therefore it is vital that the quantum of the premium to be paid would not be such as to cause concern in the equity or debt markets thereby potentially destabilising the entire banking system that the Financial Support sought to strengthen. It would also make it extremely difficult for the major banks to strengthen their capital positions and emerge in two years time as strong institutions without Financial Support from The Minister. Clearly, depending on the quantum it may put an obligation on the quoted institutions to provide guidance to the markets by way of a profit warning and earnings/dividend guidance.

We believe that liabilities already covered by the deposit guarantee scheme should be excluded in calculation of the premium.

2. Allocation of Premium

We agree fundamentally with the premise that the commercial terms of the support will be determined on a risk differentiated basis.

In this regard we would draw your attention to the FDIC Deposit Guarantee Scheme in the United States of America. This scheme provides a basis for establishing rates and differentiated pricing for insurance based on an assessment of the counterparty risk. We acknowledge that a full FDIC type scheme would not be appropriate as the Financial Support in Ireland arises from a short term liquidity issue largely created by dislocated international money markets whereas the FDIC is a perpetual scheme aimed at protecting depositors from insolvency.

We would propose that the Irish Institutions be divided into risk categories with significant price differentiation between each category.

In our view Government action was required as a consequence of individual banks actual liquidity positions and more importantly market perception of these individual positions. Accordingly we believe that these determinants should count heavily in the differentiation process.

We believe the criteria should include consideration of;

1. Rating agencies ratings and outlook prior to granting of Financial Support.
2. CDS rates (Senior and Subordinated) in the markets based on the average for 30 days prior to 29 September 2008.
3. Sophistication of risk systems as determined by whether the institution is standardised or FIRB under Basle II.
4. Recognition of a Credit Institution involvement in the clearing, cash and international payments systems and the liabilities arising there from.
5. Recognition of a Credit Institution's liabilities arising from support of the domestic mortgage market.

We welcome the opportunity to discuss these proposals with you tomorrow

Yours sincerely

Eugene Sheehy/Brian Goggin

Framework for crisis resolution

- Key Principles:-
 - Earliest possible identification and communication to Department of possible threats to financial stability
 - Need to maximise options for early intervention to pre-empt requirement for ELA (by which time banks' financial position is unlikely to be retrievable)
 - Swift resolution presented as *fait-accompli* critical¹
 - Open-ended State guarantees exposing the Exchequer to the significant fiscal risk are not regarded as part of the toolkit for successful crisis management and resolution
 - There are circumstances where such guarantees may be unavoidable to maintain confidence in the overall financial system

¹CB/FR to have, on a continuous basis, all information for ongoing assessment of sustainability of financial institutions

Draft of

BILL

entitled

Credit Institutions (Financial Support) Bill 2008

Credit Institutions (Financial Support) Bill 2008

ARRANGEMENT OF SECTIONS

1. Interpretation.
2. Functions performed in the public interest.
3. Relevant date.
4. Expenses of Minister.
5. Regulations — general implementation of this Act.
6. Provision of financial support for credit institutions.
7. Modification of application of certain provisions of Competition Act 2002.
8. Consequential amendment of other Acts.
9. Short title.

Acts referred to

Central Bank Act 1997	1997, No. 8
Central Bank and Financial Services Authority of Ireland Act 2003	2003, No. 12
Companies Act 1963	1963, No. 33
Companies Acts	
Competition Act 2002	2002, No. 14
Finance Act 1970	1970, No. 14
National Treasury Management Agency Act 1990	1990, No. 18

Credit Institutions (Financial Support) Bill 2008

BILL

entitled

An Act to provide, in the public interest, for maintaining the stability of the financial system in the State and for that purpose to provide for financial support by the Minister for Finance in respect of certain credit institutions, to amend the Competition Act 2002 and other enactments, and to provide for connected matters.

BE IT ENACTED BY THE OIREACHTAS AS FOLLOWS:

Interpretation.

1. In this Act—

“Central Bank” means the Central Bank and Financial Services Authority of Ireland;

“credit institution” has the meaning it has in the Central Bank Act 1997;

“financial support” includes a loan, a guarantee, an exchange of assets and any other kind of financial accommodation or support;

“Governor” has the meaning it has in section 2 (inserted by section 3 of the Central Bank and Financial Services Authority of Ireland Act 2003) of the Central Bank Act 1942;

“Minister” means Minister for Finance;

“Regulatory Authority” has the meaning it has in section 2 (inserted by section 3 of the Central Bank and Financial Services Authority of Ireland Act 2003) of the Central Bank Act 1942;

“subsidiary”, in relation to a credit institution, has the meaning it has in section 155 of the Companies Act 1963.

Functions performed in the public interest.

2. (1) The Minister has, in the public interest, the functions provided for under this Act because, after consulting the Governor and the Regulatory Authority, the Minister is of the opinion that—

- (a) there is a serious threat to the stability of credit institutions in the State generally, or would be such a threat if those functions were not performed, and
- (b) the performance of those functions is necessary, in the public interest, for maintaining the stability of the financial system in the State, and
- (c) the performance of those functions is necessary to remedy a serious disturbance in the economy of the State.

(2) The Minister may continue to consult with the Governor and the Regulatory Authority in the continuing exercise of the Minister's functions under this Act.

(3) Nothing in this Act prevents the performance by the Central Bank or the Regulatory Authority of its functions in relation to any credit institution.

Relevant date.

3. In this Act “relevant date” means 30 September 2008.

Expenses of Minister.

4. To the extent that the Minister incurs any expenditure not met in accordance with *section 6*, the expenditure shall be paid out of the Central Fund or the growing produce thereof.

Regulations—general implementation of this Act.

5. (1) The Minister may, in respect of any difficulty that arises in the operation of this Act during the period of 2 years beginning on the relevant date, make regulations to do anything that appears necessary or expedient for bringing this Act into operation.

(2) Regulations made under this section may contain such incidental, supplementary and consequential provisions as appear to the Minister to be necessary or expedient for the purposes of the regulations.

(3) Where the Minister proposes to make regulations under this section—

- (a) he or she shall, before doing so, consult with any other Minister of the Government that the Minister considers appropriate having regard to the functions of that other Minister of the Government in relation to the proposed regulations,
- (b) he or she shall cause a draft of the proposed regulations to be laid before each House of the Oireachtas, and
- (c) he or she shall not make the regulations unless and until a resolution approving of the draft has been passed by each such House.

Provision of financial support for credit institutions.

6. (1) As and from the relevant date, the Minister may provide financial support in respect of the borrowings, liabilities and obligations of any credit institution or subsidiary which the Minister may specify by order having regard to the matters set out in *section 2*, the extent and nature of the obligations (including the degree of control over possible abuse of the financial support) undertaken and which might be undertaken in the future and the resources available to him or her in that behalf.

(2) In *subsection (1)* a reference to borrowings, liabilities and obligations includes borrowings, liabilities and obligations to the Central Bank or any person.

(3) Financial support shall not be provided under this section for any period beyond 29 September 2010, and any financial support provided under this section shall not continue beyond that date.

(4) Financial support may be provided under this section in a form and manner determined by the Minister and on such commercial or other terms and conditions as the Minister thinks fit, or generally in accordance with a scheme that the Minister may make. Such provision of financial support may be effected by individual agreement, a scheme or otherwise. Without prejudice to the Minister's discretion as to such conditions, all financial support provided shall so far as possible ultimately be recouped from the credit institution or subsidiary to which the support was provided.

(5) A scheme under *subsection (4)* shall be laid before each House of the Oireachtas as soon as may be after it is made and, if a resolution annulling the scheme is passed by either such House within the next 21 days on which that House has sat after the scheme is laid before it, the scheme shall be annulled accordingly but without prejudice to the validity of anything previously done under the scheme.

(6) Without prejudice to *subsection (4)*, the conditions under which the Minister provides financial support under this section may include conditions regulating the commercial conduct of the credit institution or subsidiary to which the support is provided, and in particular may include conditions to regulate the competitive behaviour of that credit institution or a subsidiary.

(7) The Minister may, as a condition of providing financial support to a credit institution or subsidiary under this section, require the credit institution or subsidiary to fulfil the requirements for the time being imposed by the Central Bank or equivalent authority (including those in relation to the conduct of its business and its competitive behaviour) and to continue to do so.

(8) A condition referred to in this section—

- (a) may, where financial support is provided to a credit institution under this section, regulate the commercial conduct of a subsidiary (whether or not financial support is being provided to the subsidiary), and
 - (b) may, where financial support is provided under this section to a subsidiary of a credit institution, regulate the commercial conduct of the supported credit institution or another subsidiary (whether or not financial support is being provided to the credit institution).
- (9) The Minister may subscribe for, take an allotment of or purchase shares and any other securities in a credit institution or subsidiary to which financial support is provided under this section on such terms as the Minister sees fit.
- (10) The Minister may withdraw or revoke financial support provided to a credit institution under this section in accordance with the terms or conditions of the financial support as the Minister thinks fit.
- (11) For the purposes of this section, the Minister may, whenever and so often as he or she thinks fit, create and issue securities—
 - (a) bearing interest at such rate as he or she thinks fit, or no interest,
 - (b) for such cash or non-cash deferred consideration as he or she thinks fit, and
 - (c) subject to such terms and conditions as to repayment, repurchase, cancellation and redemption or any other matter as he or she thinks fit.
- (12) All money to be paid out or non-cash assets to be given by the Minister under this section may be paid out of the Central Fund or the growing produce thereof.
- (13) Money paid by a credit institution to the Minister, or any non-cash consideration received by the Minister from such an institution, is to be paid into, or disposed of for the benefit of, the Exchequer in connection with the performance of his or her functions under this section or for any other purpose in such manner as the Minister thinks fit.
- (14) Where financial support has been provided under this section to a credit institution, the Minister—
 - (a) shall from time to time review the necessity for the financial support, and

- (b) if he or she is satisfied, having regard to the considerations set out in *section 2*, that the financial support is no longer necessary, shall withdraw the financial support.

(15) As soon as practicable after the end of 2009 and each year thereafter, the Minister shall lay a report before each House of the Oireachtas for the purpose of informing the members of each House on the situation with regard to any financial support provided under this section. The report shall give particulars of—

- (b) the aggregate amount of payment and the amount (if any) repaid to the Minister on foot of the payment, and
- (c) the aggregate amount of money that was outstanding at the end of that year on foot of such financial support.

(16) The publication of the reports required by *subsection (15)* shall be taken as satisfying any obligation of the Minister under Regulation 3 of the European Communities (Financial Transparency) Regulations 2004 (S. I. No. 693 of 2004).

(17) A reference in section 99(2) of the Companies Act 1963 to a charge shall be taken not to include any charge created by a credit institution in favour of the Minister or any agent of the Minister (including the National Treasury Management Agency) or the Central Bank. Section 99 of that Act shall not apply to any such charge.

(18) Notwithstanding any provision in any credit institution's memorandum or articles of association that provides for the keeping of a register of charges created by that credit institution, a charge of a kind referred to in *subsection (17)* shall not be entered in that register.

(19) In *subsection (18)* “articles of association” shall, in the case of a body corporate that is not a company within the meaning of the Companies Acts, be taken to include any other instrument constituting or defining its constitution, including bye-laws.

Modification of application, etc., of certain provisions of Competition Act 2002.

7. (1) This section applies to a merger or acquisition (within the meaning of section 16 of the Act of 2002) that involves a credit institution or subsidiary where the Minister—

- (a) after such consultation with the Central Bank and the Regulatory Authority as the Minister considers necessary, is of the opinion that—
 - (i) the proposed merger or acquisition is necessary to maintain the stability of the financial system in the State, and
 - (ii) there would be a serious threat to the stability of that system if the merger or acquisition did not proceed, and
- (b) certifies in writing to the parties to the merger or acquisition, the Competition Authority and the Governor that he or she is of that opinion.

(2) Notwithstanding anything in the Act of 2002, a notification of a merger or acquisition to which this section applies shall be given to the Minister and not to the Competition Authority.

(3) A determination, that a merger or acquisition to which this section applies may be put into effect, is referred to in this section as an approval.

(4) A merger or acquisition to which this section applies and which has been notified to the Minister shall not be put into effect unless and until the Minister has made a determination in relation to the merger or acquisition under this section.

(5) Where the Minister is of the opinion that in order to consider a merger or acquisition to which this section applies he or she requires further information, he or she may by notice require any one or more of the undertakings concerned to supply, within a specified period, specified information. An undertaking shall comply with such a direction.

(6) On receipt of a notification under *subsection (2)*, the Minister—

- (a) shall consult urgently with the Minister for Enterprise, Trade and Employment, the Governor, the Central Bank and the Competition Authority,
- (b) shall publish the notification in any way the Minister thinks fit, and

(c) shall invite the making, in accordance with procedures provided for in the regulations, of submissions on the notification.

(7) The Governor and the Competition Authority shall provide any advice, information and assistance that the Minister reasonably requires for the purposes of making a decision on a notification under *subsection (2)*.

(8) The Minister may appoint a suitably qualified person as a competition advisor for the purposes of assisting with the consideration of a notification under *subsection (2)*.

(9) Any person affected by a proposed merger or acquisition to which this section applies may make a submission to the Minister in relation to the proposed merger or acquisition:

(10) The Minister shall make a decision whether to approve a merger or acquisition to which this section applies as soon as reasonably practicable after he or she receives the notification under *subsection (2)* for its approval.

(11) The Minister shall approve a merger or acquisition to which this section applies if, in the Minister's opinion, the result of the merger or acquisition will not be to substantially lessen competition in markets for goods or services in the State and, accordingly, that the merger or acquisition may be put into effect.

(12) The Minister may approve a merger or acquisition to which this section applies even if he or she forms the opinion that the result of the merger or acquisition will be to substantially lessen competition in markets for goods or services in the State but that the merger or acquisition is necessary having regard to any or all of the following:

- (a) maintenance of the stability of the financial system in the State;
- (b) the need to avoid a serious threat to the stability of credit institutions;
- (c) the need to remedy a serious disturbance in the economy of the State.

(13) The Minister, after considering a notification under *subsection (2)*, may—

- (a) approve the merger or acquisition with or without conditions, or
- (b) refuse to approve the merger or acquisition.

(14) In determining any conditions to be imposed in relation to a merger or acquisition, the Minister shall have regard to the effect of the merger or acquisition in the market for goods or services in the State, the maintenance of the stability of the financial system in the State, the need to avoid any serious stress in the stability of credit institutions and the need to remedy a serious disturbance in the economy of the State. In particular the Minister may impose such conditions as he considers appropriate to facilitate competition in the markets for those goods and services having regard to the matters.

(15) Sections 4(8) and 5(3) of the Act of 2002 shall apply to a merger or acquisition to which this section applies and, accordingly, for that purpose references in those provisions to Part 3 of the Act of 2002 shall be read as references to this section.

(16) Part 3 of the Act of 2002 applies in relation to a merger or acquisition to which this section applies with—

- (a) the modifications specified in *subsection (17)*,
- (b) any other necessary modifications, and
- (c) any adaptations of that Part's provisions made by regulations under *section 5*.

(17) The modifications mentioned in *subsection (16)(a)* are—

- (a) references to the Competition Authority in sections 16, 18, 20 and 26 shall be read as references to the Minister;
- (b) sections 17, 19 21, 22, 23, 24, 25 and 27 shall be disregarded;
- (c) so much of section 20 provision for the matters contained in which are made by this section shall be disregarded;
- (d) the following definition shall be substituted for the definition of “determination” in section 26:
 - “ ‘determination’ means an approval of the Minister for Finance under *section 7* of the *Credit Institutions (Financial Support) Act 2008*”.

(18) References in the Act of 2002 to Council Regulation (EEC) No. 4064/89 on the control of concentrations between undertakings should be read as references to Council Regulation (EC) No. 139/2004 on the control of concentrations between undertakings.

(19) The Minister may make regulations to determine the procedures to be followed in making submissions under this section, including, without limit to the generality of the foregoing—

- (a) the form and type of submissions to be made to the Minister,
- (a) the appointment of representatives of persons having substantially the same interests,
- (d) the means by which confidential information is to be protected from public disclosure.

(20) In this section “Act of 2002” means the Competition Act 2002.

Consequential amendments of other Acts.

8. (1) The First Schedule to the National Treasury Management Agency Act 1990 is amended by—

- (a) the deletion of “and” before paragraph (m); and
- (b) the addition after paragraph (r) of:

“and

“(s) subsections (1) to (11) of section 6 of the *Credit Institutions (Financial Support) Act 2008*”.

(2) Section 54 of the Finance Act 1970 is amended by inserting after subsection (7B) (inserted by the National Development Finance Agency Act 2002):

“(7C) The Minister for Finance may engage in such transactions of a normal banking nature with any person—

- (a) in connection with the performance of his or her functions under section 6 of the *Credit Institutions (Financial Support) Act 2008*, and
- (b) for the purpose of the better management of any indebtedness incurred by the Minister under that section,

and may for the purpose of those transactions issue such funds from the Exchequer as the Minister for Finance considers appropriate. The expenses and other costs incurred by the Minister for Finance in connection with or arising out of those transactions shall be charged on the Central Fund or the growing produce thereof.”.

(3) The First Schedule to the National Treasury Management Agency Act 1990 is amended by inserting the following after paragraph (gggg) (inserted by the National Development Finance Agency Act 2002):

“(ggggg) section 54(7C) (inserted by the *Credit Institutions (Financial Support) Act 2008*) in so far as that section relates to the engagement in certain transactions of a normal banking nature) of the Finance Act 1970.”.

(4) Section 138 of the Finance Act 1993 is amended by inserting, after subparagraph (iv) of subsection (1)(b):

“(v) any securities or financial instrument determined by the Minister as permissible on such terms and conditions as the Minister may determine.”.

Short title.

9. This Act may be cited as the Credit Institutions (Financial Support) Act 2008.

HIGHLY CONFIDENTIALHead re Guarantees in respect of credit institutions in distressNote

The text following is on the basis of a general power to give guarantees in respect of distressed credit institutions. 'Credit Institution' for purposes of this head to be as defined in Regulation 3(1) of the European Communities (Deposit Guarantee Scheme) Regulations 1995 (SI 168 of 1995) except that it is to include credit unions as defined in section 2 of the Credit Union Act, 1997.

Head

Provide as follows:

(a) Power of Minister

Provide that the Minister for Finance may guarantee in such form and manner and on such terms and conditions as he sees fit, any or all of the following -

- (i) the borrowings and liabilities of a credit institution to the CBFSAI or any person
- (ii) deposits in a credit institution

(b) Circumstances where power is exercisable

Provide that the Minister may exercise the power at (a) above only in circumstances where it appears to him that it is necessary for any of the following purposes:

- (i) maintaining the stability of the financial system in Ireland or a credit institution where the Minister considers that there would be a serious threat to its stability if the power was not exercised;
- (ii) protecting the public interest by safeguarding depositors' funds in a credit institution where the Minister considers that such deposit funds would be under serious threat if the power was not exercised;

(c) Provide that a Guarantee under this Section will have effect from the date announced by the Minister as the date from which it will have effect, but not before the date of the announcement, regardless of whether that announcement is made before the passing of this Act.

(d) Provide that the Minister may withdraw or revoke a guarantee as he sees fit.

(e) Provide that all moneys to be payed out by the Minister on foot of a guarantee provided by him under this section will be paid from the Central Fund or the growing produce thereof.

(f) Provide that moneys paid by the Minister under a guarantee under this head are repayable to the Minister, with interest, as and when such moneys are available to Xfi. Moneys paid by Xfi to the Minister are to be paid into or disposed of for the benefit of the Exchequer in such manner as the Minister thinks fit.

(g) Provide that the Minister will have a continuing obligation to use all reasonable means to recover amounts paid out under guarantees provided under this head.

(h) Provide that in the event that moneys paid out under a guarantee under this section are not recovered, the amount outstanding will be repaid to the Central Fund from moneys voted by the Oireachtas. [Note: This is designed to ensure sound accounting principles and provide transparency.]

(i) Provide that the Minister is required to lay a statement before each House of the Oireachtas every year to fully inform members on the situation with any guarantees made under this Head. The Minister's report to give particulars of each guarantee; where payments have been made by the Minister, the amount of payment and the amount (if any) repaid to the Minister on foot of the payment; and the amount of money covered by a guarantee that was outstanding at the end of that year.

Explanatory Note:

The nature, duration etc of a guarantee are important factors in the context of EU State Aid rules. It is envisaged that these factors would be encompassed in "... *such terms and conditions* ..." at (a) above. The criteria laid down in the EU Rescue and Restructuring Guidelines can be summarised as:

- the beneficiary has to be a firm in difficulty and may not have received rescue or restructuring aid during the past 10 years,
- the aid should normally consist of liquidity support and should be restricted to the minimum necessary to keep the firm in business for the rescue period,
- the aid must be granted in the form of loans or loan guarantees,
- the aid must be limited to a period of maximum 6 months,
- if the Member State communicates to the Commission within these 6 months a restructuring plan or liquidation plan, then the rescue aid can normally continue for the time needed by the Commission to examine this plan.

It should be noted that in moving to the restructuring phase the Commission have emphasised that aid must be the minimum necessary and there must be appropriate compensatory measures.

The provision at (d) is required as otherwise it would be necessary for the Minister to arrange a Vote in the Department's Estimate for the purpose or more likely a Supplementary Estimate which would be dependent on the Dáil being in session and would be subject to a possible vote thus not providing sufficient certainty as to the outcome of the process. The text is modelled on section 9(5) of the Bretton Woods (Amendment) Act 1999.

Subparagraph (f) is based on section 9(6) and (9) of the Bretton Woods (Amendment) Act 1999.

Subparagraph (g) is based on section 9(7) of the Bretton Woods (Amendment) Act 1999.

Subparagraph (h) is based on section 9(8) of the Bretton Woods (Amendment) Act 1999.

Subparagraph (i) is modelled on section 9(10) of the Bretton Woods (Amendment) Act 1999.

HIGHLY CONFIDENTIAL

Outline Heads of a Bill to provide for the Irish Authorities (Minister for Finance) to take action in relation to an Irish credit institution by taking it into public ownership

Purpose

The purpose of the Bill is to give the Minister for Finance power to transfer into public ownership a particular distressed credit institution¹ authorised to operate in Ireland (the institution is referred to as 'Xfi' in these heads).

The Bill may also need to provide for necessary or consequential provisions as follows, but should in any event provide a specific power for the Minister for Finance

- to directly appoint and remove directors of Xfi so that he can ensure a level of control and influence over the operations of the company, consistent with the directors' statutory and fiduciary duties to the company;
- Enabling the Minister to remove and appoint directors including the Chairman, Chief Executive and other key executives as the Minister sees fit, and make other modifications of the rules for holding of meetings of the company without being constrained by the provisions of company law or memorandum and articles of association regarding the holding of meetings of shareholders.
- Extinguishing of the existing share options
- Providing for the any amendment necessary in consequence of the impact of transfer of ownership on rights or obligations of lenders, bondholders, swap counterparties or suppliers which would be triggered by the act of bringing the financial institution into temporary public ownership. (Apparent from UK NR legislation that a range of contractual arrangements that NR had previously entered into were impacted by the transfer of ownership and required provision in the legislation to address these issues/ensure these were not triggered – may have to be dealt with on a specific case by case basis)
- Resolution of pension issues.

¹ 'Credit institution' as defined in regulation 1 of the European Communities (Deposit Guarantee Scheme) Regulations 1995 [SI 168 of 1995] i.e. "... an undertaking other than a credit union or friendly society whose business it is to receive deposits or other repayable funds from the public and to grant credit on its own account". This definition encompasses both banks and building societies. The definition should be amended for the purposes of these Heads to include credit unions as defined in section 2 of the Credit Union Act, 1997.

Head 1 - Circumstances in which powers under the Bill would be exercisable by the Minister for Finance

Provide that the Minister for Finance may exercise powers under the Bill in relation to Xfi only where it appears to him to be necessary for any or all of the following purposes:

- maintaining the stability of the financial system in Ireland or a credit institution where the Minister considers that there would be a serious threat to its stability if the power were not exercised;
- protecting the public interest in circumstances where financial assistance or a guarantee has been provided by the Minister to Xfi for the purpose of maintaining the stability of the financial system in Ireland².
- where the Minister has been notified by the Central Bank and Financial Services Authority of Ireland that it intends to use its powers under Section 3(2)(b) of the Companies Act 1990 to petition the Court to appoint an examiner, or under Section 48(1) of the Central Bank Act, 1989 to petition the Court to have the holder of a licence wound up. Provide that the CBFSAI must give advance notice to the Minister for Finance of any decision to petition the Court

"Financial assistance" for the purposes of this Head would include any case where another person has provided financial assistance to Xfi and the Minister assumed a liability in respect of that assistance .

"guarantee" for the purpose of this Head would include

(i) Any case where the Minister for Finance has announced that the Minister for Finance would if necessary put in place depositor guarantee arrangements in relation to Xfi, and

(ii) A guarantee under section x of ANOTHER Act 200X (See separate Head 'Guarantees in respect of credit institutions in distress')

² Advice from the AG's Office is that it would not seem necessary at present to provide a definition of financial stability which is self evident from the ordinary meaning of the word.

Head 2: Transfer of securities

Provide that by virtue of this head the securities [shares] in Xfi are transferred to the Minister for Finance and that the securities shares are transferred

- free of any trusts, liabilities and encumbrances
- together with all the rights, benefits and privileges which relate to the shares transferred.

Provide the securities [shares] may be transferred to a nominee of the Minister, a company wholly owned by Minister for Finance or any other body public or private.

Provide that the transfer of securities will be effective notwithstanding;

- the absence of any consent otherwise required
- Any restriction otherwise applicable to the transfer

Provide that any shares 'lent' or otherwise assigned, e.g. to a hedge fund, will on the transfer, transfer to the Minister or other public/private body.

Provide that Xfi shall take all necessary steps to ensure that the Minister is registered as the holder of the shares and that he is to have all rights and advantages of a member of the company pending registration (i.e. even while not yet registered).

Securities [shares] for the purposes of this head may need to be defined widely having regard to the credit institution concerned but would be likely to include;

- shares and stock,
- debentures, including debenture stock,
- loan stock, bonds, certificates of deposit and other instruments creating or acknowledging indebtedness;
- warrants or other instruments entitling the holder to acquire such securities.

Head 3: Extinguishing of subscription rights

Provide in relation to Xfi, for the extinguishing of

- share options or other rights held by persons to subscribe for, or otherwise acquire, securities of Xfi, or any of its subsidiaries.
- rights to shares arising from or in connection with a person's employment or office or provision of services with or to Xfi or one of its subsidiary or connected entities

Note

This power is thought likely to be necessary to deal with a case where persons have an enforceable right to be issued with or otherwise acquire shares or other securities of Xfi or any of its subsidiaries. This power may be necessary depending on the financial institution involved as the existence of, and exercise of, such rights might frustrate the purposes of a transfer to the Minister or his nominee.

Compensation for securities transferred

Note

1. The UK Banking (Special Provisions) Act 2008 provides that the Treasury will develop a compensation scheme up to three months after the transfer of securities. i.e. (Sn5) "...the Treasury must...make a scheme determining the amount of any compensation payable by the Treasury to persons who held the securities immediately before they were so transferred [and for subscription] rights extinguished...". Broadly similar provisions are provided in relation to transfer of property (Sn 7) supplemented by Sn 9, which sets out areas to be covered in compensation schemes – manner and procedure of assessment, appointment of independent assessor, appeals, expenses, etc. Generally under Sn 5 the UK authorities have 3 months within which to make a scheme of compensation in relation to the transfer of securities³.

This approach has the advantage that there may be issues specific to a particular institution that need examination/analysis before a specific compensation provision can be drafted. However the Oireachtas may be less willing to approve a transfer of assets without knowing the terms on which people will be compensated. There may also be constitutional issues.

2. The approach in Head 4 which follows is to provide for payment of compensation to persons who held securities in Xfi immediately before they were transferred based on a valuation of the securities on the date falling before the day on which this Bill is passed. Advisory Counsel has advised of the importance of making express provision for compensation in the Bill to balance the interference with property rights stating " Heads providing for compensation must be included in the draft heads of the Bill ...".

An extensive provision is set out in the draft Head following, but it may be that a short provision stating the intention to make a compensation scheme and the principles for determining compensation would suffice.

³ Notwithstanding the provision to enable the separation by up to three months, the Northern Rock Plc Transfer Order was made on 21 February 2008 and the NR Plc Compensation Scheme Order on 12 March, 2008.

Head 4: Compensation for securities transferred

Provide that the Minister for Finance will by Order made under this Bill make within x months a compensation scheme for shareholders whose rights have been extinguished at heads 2 or 3.

Provide that compensation for securities transferred under head 2 or subscription rights extinguished under head 3 will be determined by a compensation scheme which will make provision:

- for the appointment by the Minister for Finance of an independent assessor to determine the amount of compensation to be paid by the Minister and make provision as to the remuneration of the assessor, etc.

- that the assessor must, in assessing compensation payable by the Minister for Finance to any person in accordance with Heads 2 or 3, assess compensation on the basis that at the date of announcement of the transfer of securities, Xfi —

- (a) is unable to continue as a going concern,

- (b) is in Examinership and being wound up

- (c) that all financial assistance provided by the Minister for Finance to Xfi has been withdrawn (whether by the making of a demand for payment or otherwise), and

- (d) that no financial assistance would in future be provided by the Minister for Finance to the deposit-taker in question (apart from ordinary market assistance offered by the CBFSAI subject to its usual terms)

- (e) that any guarantee given under law or in any case where the Minister for Finance has announced that he would if necessary put in place depositor guarantee arrangements in relation to Xfi, that such a guarantee has been revoked.

Provide that the assessor is required to determine the amount of any compensation payable by the Minister in accordance with the compensation scheme and communicate his determinations by means of “notices of assessment” which must include the reasons for the assessor’s decision.

Provide that where the Minister or any person affected by the determination of the amount of any compensation which is contained in a notice of assessment is dissatisfied with the assessment, they may require the assessor to reconsider his determination. Where the assessor is required to reconsider his determination he is required to issue a revised notice of assessment setting out,

- (a) the date on which the notice is issued;

- (b) either notification that the assessor has upheld the assessment; or notification that the assessor has varied the assessment;

(c) the amount of any compensation determined by the assessor as being payable; and

(d) the reasons for the assessor's decision.

The assessor shall send a copy of the revised assessment notice to the Minister.

Provide that where the Minister or any person affected by a determination of the amount of any compensation which is contained in a revised notice of assessment is dissatisfied with the revised assessment, they may refer the matter to the Irish Financial Services Appeals Tribunal for the assessment to be appealed. The assessor in these circumstances acts as a respondent in the Tribunal proceedings.

Provide that where the Tribunal concludes that the decision as to the amount of any compensation shown in the revised notice of assessment was not reasonable, the Tribunal must remit the matter to the assessor for reconsideration in accordance with such directions (if any) as the Tribunal considers appropriate. The assessor must then reconsider his determination in accordance with any such directions.

Payment of compensation

Provide that the Minister will pay the amount of compensation determined by the assessor to be payable to a person in respect of a class or description of shares /securities. The Minister will not be required to make a payment in accordance with the foregoing until he has received a copy of the notice of assessment or revised notice of assessment or in the case of a reference to the Tribunal that the matter has been disposed of.

Compensation assessment procedures

Provide that the assessor may make such procedural rules in relation to the assessment of any compensation (including the procedure for the reconsideration of any decisions relating to the assessment of compensation) as he considers appropriate but that the procedure followed by the assessor must be fair. Provide that the procedures shall be approved by the Minister for Finance before being used.

The drawing up of the procedural rules will be a matter for the assessor in the first instance but must cover such matters as communications between the assessor and interested parties, the handling of evidence, deadlines etc. The assessor will also act as the respondent in any proceedings before the Tribunal. The assessor will be expected to act so as to facilitate the smooth operation of the appeals process.

Remuneration of Assessor

Provide that the assessor will be paid such remuneration and reimbursed such expenses as the Minister may determine.

Criteria for appointment as assessor

Provide that persons to be appointed as assessor should be able to satisfy the following criteria:

Potential conflicts of interest:

To be eligible for appointment as assessor persons must be able to confirm

- they have no actual or potential conflict between any personal or business interests and functions as an assessor that could influence, or be reasonably perceived to influence, their judgement in performing functions as an assessor in respect of Xfi.
- will not engage any staffs who, to the best of their knowledge having made reasonable enquiries, have any such actual or potential conflict.
- they will take appropriate steps to ensure that, if appointed, neither they nor any staff are placed in a position where there is any actual or potential conflict between any personal or business interests and their or their functions that could influence, or be reasonably perceived to influence, them or their judgements in performing their functions as assessor.
- that they will disclose to former shareholders, the Minister and other interested parties full particulars of any such actual or potential conflict of interest that may arise.

Knowledge and Experience

To be eligible for appointment to the position of assessor persons should

- (a) have extensive professional financial company valuation skills. In order to be able draw on a range of professional expertise, including accountancy, investment banking and legal, the assessor should have a high standing and credibility in their profession.
- (b) be able to demonstrate that they have the capacity and resources to undertake the task of assessing any compensation payable and managing a compensation scheme in a timely and efficient manner;

Termination of office

The Minister may terminate the appointment of an assessor by notice in writing with immediate effect on the grounds of incapacity or serious misbehaviour. Where an appointment is terminated or vacated (howsoever arising) the assessor must provide free of charge such assistance as may reasonably be requested by any person appointed to the position of assessor to facilitate an effective and timely handover of all work then in progress.

If an assessor vacates office other than in circumstances outside his control he will reimburse the Minister such amount as is reasonably required to provide for any additional costs arising out of the change of assessor. For the avoidance of doubt, an assessor moving to another firm, the identity of which, by reason of its involvement with Xfi or otherwise, prevents his continuing as assessor, will not be treated as circumstances outside his control.

Head 5: Removal from/ Appointments to (i) membership of the Board of Xfi and (ii) senior executive positions within Xfi.

Provide that as sole shareholder in Xfi the Minister may remove persons from and appoint persons to:

(a) the Board of Xfi including to/from the position of Chairman of the Board.

(b) the positions of Chief Executive and Chief Finance Officer of Xfi:

Provide that the directors of Xfi will hold office for such duration and upon such terms and conditions as the Minister may determine.

Note

Other key executive positions might be included depending on the staff structure of the particular credit institution involved. It may also be appropriate to include the position of Deputy Chairman again depending on the particular institution concerned.

Head 6 - Definitions

Provide as appropriate for necessary definitions (for example for terms such as 'credit institution', guarantee, etc.)

Head re amendment of the Competition Act 2002

Purpose

The purpose of this Head is to allow in certain circumstances for a declaration by the Minister for Finance that a proposed merger or acquisition of a credit institution* is approved for purposes of the Competition Act having regard to the need to maintain the stability of the financial system in Ireland. [** as defined in Regulation 1 of the European Communities (Deposit Guarantee Scheme) Regulations 1995 (SI 168 of 1995) but to include a credit union as defined in section 2 of the Credit Union Act 1997.*]

Head

Provide in relation to a merger or acquisition within the meaning of section 16 of the Competition Act 2002 that involves a credit institution which does not affect trade between EU Member States, that the Minister for Finance may declare that the proposed merger or acquisition is necessary to maintain the stability of the financial system in Ireland and the effect of such declaration will be to remove the power of the Competition Authority to make a determination as to whether the merger or acquisition would be in breach of the prohibition on anti-competitive agreements, decisions and concerted practices in sections 4 and 5 of the Competition Act 2002.

Provide that the power of the Minister to make such declaration may be exercised only where it appears to him to be necessary for any or all of the following purposes:

- maintaining the stability of the financial system in Ireland where the Minister considers that there would be a serious threat to its stability if the power were not exercised;
- protecting the public interest in circumstances where financial assistance or a guarantee has been provided by the Minister to a credit institution involved in the merger or acquisition in question for the purpose of maintaining the stability of the financial system in Ireland.

Note

Section 4 of the 2002 Act contains the general prohibition on anti-competitive agreements, decisions and concerted practices. Section 5 prohibits the abuse of dominant position. Subsection 5(3) exempts from the prohibition mergers for which provision is made in Part 3 of the Act.

Where the takeover, merger, etc of a distressed financial institution arises, the question of competition approval may arise under EU or domestic law. If the annual turnover of the combined business exceeds specified thresholds in terms of global and European turnover, the proposed merger must be notified to the European Commission which must examine it. Below these thresholds, the national competition authorities in the EU Member States may review the merger. The threshold most likely to apply in the case of a takeover of a domestic financial institution is aggregate worldwide turnover of 5bn and Community turnover of €250m (unless each of the businesses achieves at least two-thirds of its turnover within the same Member State).

HIGHLY CONFIDENTIAL**Outline Heads of a Bill to provide for the Irish Authorities (Minister for Finance) to take action in relation to an Irish financial institution to:**

- (i) take into public ownership of, and**
- (ii) possible provision of a guarantee in respect of a distressed credit institution**

Purpose

(Long Title?)

The purpose of the Bill is to give the Minister for Finance power to transfer the ownership of a particular distressed credit institution¹ authorised to operate in Ireland (the institution is referred to as 'Xfi' in these heads). The Bill should provide that the Minister may transfer the securities (including shares) [or business]² of a particular credit institution into public ownership, i.e. to the Minister for Finance.

[Questions:

- Should provision also be made to provide power to transfer ownership to another body in the public or private sector?
- Should provision be made to provide power to transfer ownership of a building society to a public/private body or Minister for the Environment, Local Government and Heritage (or Finance)?]

The Bill is also to provide that the Minister may also transfer a credit institution brought into public ownership back to the private sector. [Has the CBFSAI power to give financial assistance Irish registered building societies?].

The Bill may also need to provide for necessary or consequential provisions, i.e.:

- Delisting of shares in the Xfi as well as enabling the Minister to remove and appoint directors, and make other modifications of the rules for holding of meetings of the company.
- Extinguishing of the existing share options
- Providing for the any amendment necessary in consequence of the impact of transfer of ownership on rights or obligations of lenders, bondholders, swap counterparties or suppliers which would be triggered by the act of bringing the financial institution into temporary public ownership. (Apparent from UK NR legislation that a range of contractual arrangements that NR had previously entered into were impacted by the transfer of ownership and required provision in the legislation to address these issues/ensure these were not triggered – may have to be dealt with on a specific case by case basis)
- Resolution of pension issues.

¹ 'Credit institution' as defined in regulation 1 of the European Communities (Deposit Guarantee Scheme) Regulations 1995 [SI 168 of 1995] i.e. "... an undertaking other than a credit union or friendly society whose business it is to receive deposits or other repayable funds from the public and to grant credit on its own account. This definition encompasses both banks and building societies.

² The UK Banking (Special Provisions) Act 2008 refers to 'securities' of an institution and seems to differentiate these from the 'business' (e.g. property, rights and liabilities). However, the Northern Rock plc Transfer Order 2008 made under the Act is concerned with only the transfer of shares to the Treasury Solicitor. No order has yet been made under the UK Act in relation to transfer of property, rights and liabilities.

Head 1 - Circumstances in which powers under the Bill would be exercisable by the Minister for Finance

Provide that the Minister for Finance may exercise powers under the Bill in relation to Xfi only where it appears to him to be necessary for any or all of the following purposes:

- maintaining the stability of the financial system in Ireland where the Minister [, having consulted with the CBFSAI (in view of CB's statutory role in relation to financial stability)] considers that there would be a serious threat to its stability if the power were not exercised;
- protecting the public interest in circumstances where financial assistance or a guarantee has been provided by the Central Bank or Minister to Xfi for the purpose of maintaining the stability of the financial system in Ireland³.
- where the Minister has been notified by the Central Bank and Financial Services Authority of Ireland that it intends [following an assessment⁴] to use its powers under Section 3(2)(b) of the Companies Act 1990 to petition the Court to appoint an examiner, or under Section 48(1) of the Central Bank Act, 1989 to petition the Court to have the holder of a licence wound up. (Would it be necessary to amend both of these Acts to require the CBFSAI to give the Minister advance notice of its intention to use these provisions)

"Financial assistance" for the purposes of this Head would include

(i) any case where the CBFSAI has provided financial assistance to Xfi and the Minister assumed a liability in respect of that assistance but excluding ECB open market operations and other forms of liquidity support made available on the basis of the CBFSAI's own balance sheet without the need for it to seek an indemnity from the Minister for Finance [can the latter actually arise?],

"guarantee" for the purpose of this Head would include

(i) Any case where the Minister for Finance has announced that the Minister for Finance [the Department of Finance] (whether acting alone or with the CBFSAI) would if necessary put in place depositor guarantee arrangements in relation to Xfi.

(ii) A guarantee under head 7 of this Bill Act /or through an amendment of the Central Bank Act 1942 [Head 7 could be included as part of this Bill or be enacted separately with more general application depending on circumstances]

³ It needs to be clarified whether it is necessary to define "stability of the financial system" having regard to the convention in legal drafting that the purpose of a definition is to achieve clarity without needless repetition. It follows then that it is not necessary to define words that are used in their usual dictionary meaning. Financial Stability is not defined in the UK's Financial Services Management Act 2000 or it's Banking (Special Provisions) Act 2008.

⁴ It is not clear that the CBFSAI is required to conduct an assessment before it uses its powers under Sn 3(2)(b) of the Companies Amendment Act 1990 or Sn 48 (1) of the Central Bank Act 1989.

Head 2: Transfer of securities

Provide that by virtue of this head the securities [shares] in Xfi are transferred to the Minister for Finance [or his nominee, other public/private body] and that the securities shares are transferred

- free of any trusts, liabilities and encumbrances
- together with all the rights, benefits and privileges which relate to the shares transferred.
- The head should enable securities [shares] to be transferred to the CBFSAI, a nominee of the Minister, a company wholly owned by the CBFSAI or the Dept of Finance [can CB and Dept legally own a company?], or any other body public or private.

The head should provide that the transfer of securities will be effective notwithstanding;

- the absence of any consent otherwise required
- Any restriction otherwise applicable to the transfer
- [absence of the delivery of any instrument representing securities transferable by delivery (a "bearer instrument")]

The head should provide that any shares 'lent' or otherwise assigned, e.g. to a hedge fund, will on the transfer, transfer to the Minister or other public/private body

Securities [shares] for the purposes of this head may need to be defined widely having regard to the credit institution concerned but would be likely to include;

- shares and stock,
- debentures, including debenture stock,
- loan stock, bonds, certificates of deposit and other instruments creating or acknowledging indebtedness;
- warrants or other instruments entitling the holder to acquire such securities.

Head 3: Registration of shares and issue of certificates

Provide that Xfi shall take all necessary steps to ensure that the Minister is registered as the holder of the shares and that he is to have all rights and advantages of a member of the company pending registration (i.e. even while not yet registered).

[Questions

- Is it necessary to make explicit provision to require that the Stock Exchange accept the Minister (etc.) as the registered owner of the securities?
- Are those elements that are to address provisions in Xfi's constitution/contractual arrangements that might otherwise frustrate the transfer more appropriate to this head or head 2?]

This head is required (?) to ensure the Minister (etc.) is clearly identified as the owner of Xfi.

Head 4: Extinguishing of subscription rights

If appropriate in relation to Xfi, provide for the extinguishing of

- share options or other rights held by persons to subscribe for, or otherwise acquire, securities of Xfi, or any of its subsidiaries.
- rights to shares arising from or in connection with a person's employment or office or provision of services with or to Xfi or one of its subsidiary [or connected entities]

This power might be necessary in a case where persons have an enforceable right to be issued with or otherwise acquire shares or other securities of Xfi or any of its subsidiaries. This power may be necessary depending on the financial institution involved as the existence of, and exercise of, such rights might frustrate the purposes of a transfer to the Minister or his nominee.

Compensation for securities transferred

There may be at least two options to deal with the determination for compensation for securities transferred.

1. Defer making compensation arrangements
2. Set out detailed compensation determination rules/procedures in the Bill to nationalise the institution

1. The UK Banking (Special Provisions) Act 2008 provides that the Treasury will develop a compensation scheme up to three months after the transfer of securities. i.e. (Sn5) "...the Treasury must...make a scheme determining the amount of any compensation payable by the Treasury to persons who held the securities immediately before they were so transferred [and for subscription] rights extinguished...". Broadly similar provisions are provided in relation to transfer of property (Sn 7) supplemented by Sn 9, which sets out areas to be covered in compensation schemes – manner and procedure of assessment, appointment of independent valuer, appeals, expenses, etc. Generally under Sn 5 the UK authorities have 3 months within which to make a scheme of compensation in relation to the transfer of securities⁵.

This approach has the advantage that there may be issues specific to a particular institution that need examination/analysis before a specific compensation provision can be drafted. However the Oireachtas may be less willing to approve a transfer of assets without knowing the terms on which people will be compensated. There may also be constitutional issues.

2. An alternative approach would be to provide for payment of compensation to persons who held the securities immediately before they were transferred based on a valuation of the securities on the date falling before the day on which this Bill is passed.

Regardless of which approach is taken, subject in the case of option 1 to the addition of a text to state the compensation provisions will be brought forward at a later date, the substantive provisions are likely to have a broadly common format as set out at draft Head 5 following

⁵ Notwithstanding the provision to enable the separation by up to three months, the Northern Rock Plc Transfer Order was made on 21 February 2008 and the NR Plc Compensation Scheme Order on 12 March, 2008.

Head 5: Compensation for securities transferred

[Provide that the Minister for Finance will bring forward within x months a compensation scheme for shareholders whose rights have been extinguished at heads 2 or 4.

(Note, it is envisaged that such a scheme would be part of a Bill (perhaps a "No.2 Bill") rather than a Statutory Instrument)]

Provide that compensation for securities transferred under head 2 or subscription rights extinguished under head 4, will be determined by a compensation scheme (depending on the financial institution concerned) which will make provision for:

- the appointment of an independent arbiter to assess [determine?] the amount of compensation to be paid by the Minister for Finance [and make provision as to the remuneration of the arbiter, the appointment of staff by him etc.].

- that the arbiter must, in assessing compensation payable by the Minister for Finance to any person in accordance with Sections 2 or 4, assess compensation on the basis that at the date of announcement of the transfer of securities Xfi —

- (a) is unable to continue as a going concern,

- (b) is in Examinership and being wound up

- (c) that all financial assistance provided by the Minister for Finance to Xfi has been withdrawn (whether by the making of a demand for payment or otherwise), and
 - (d) that no financial assistance would in future be provided by the Minister for Finance to the deposit-taker in question (apart from ordinary market assistance offered by the CBFSAI subject to its usual terms)

- (e) that any guarantee given under or in any case where the Minister for Finance has announced that the Minister for Finance would if necessary put in place depositor guarantee arrangements in relation to Xfi, that such a guarantee has been removed [revoked?].

- the arbiter to make such rules as to the procedure in relation to the determination of compensation as s/he considers appropriate,

- a system of review by the Arbiter of assessment of compensation at the request of the person who receives the assessment or the Minister (i.e. a system of internal review)

- a system of appeal whereby if a person in receipt of an assessment or revised assessment notice or the Minister are dissatisfied with the revised assessment notice they may make a reference to [the Investor Compensation Tribunal/ Financial Services Appeals Tribunal] for the notice to be reviewed.

Head 6: Further transfers

Provide that where any securities of Xfi that have been transferred to the public sector under head 2, these may be transferred by the Minister to any person.

This would enable the institution to be transferred back to the private sector (or within the public sector). The securities issued by a company wholly owned by the CBFSAI or the Minister may also be transferred. This gives the Minister a legislative route for transferring all or part of Xfi back to the private sector, or for restructuring Xfi within the public sector.

Head 7: Guarantees in respect of credit institutions in distress

Depending on circumstances, this head could be enacted separately to perhaps provide a general power to give guarantees in respect of distressed credit institutions or it could be directed at a particular credit institution. The text following is on the basis of a general power.

Amend the Central Bank 1942 (as amended) to provide as follows:

(a) Power of Minister

Provide that the Minister for Finance may guarantee in such form and manner and on such terms and conditions as he sees fit, any or all of the following -

- (i) payment to the Central Bank of the principle of and any interest on, any moneys advanced by the Central Bank under the terms of a guarantee given by the Central Bank in respect of a credit institution
- (ii) the borrowings and liabilities of a credit institution
- (iii) deposits in a credit institution subject to appropriate interaction with the Deposit Protection Scheme under the Deposit Guarantee Schemes Directive 94/19 EC enacted here in the S.I. No. 168 of 1995 / European Communities (Deposit Guarantee Schemes) Regulations 1995 (as amended).

(b) Circumstances where power is exercisable

Provide that the Minister may exercise the power at (a) above only in circumstances where it appears to him that it is necessary for any of the following purposes:

- (i) maintaining the stability of the financial system in Ireland where the Minister considers that there would be a serious threat to its stability if the power was not exercised;
- (ii) [protecting the public interest by] safeguarding depositors' funds in a credit institution where the Minister considers that such deposit funds would be under serious threat if the power was not exercised;
- (iii) providing the Board of a credit institution and its shareholders with an opportunity to find and consider potential private sector solutions where the Minister considers that this would be facilitated by the exercise of the power.

(c) Provide that a Guarantee under this Section will have effect from the date announced by the Minister as the date from which it will have effect, but not before the date of the announcement, regardless of whether that announcement is made before the passing of this Act.

(d) Provide that all moneys to be payed out by the Minister on foot of a guarantee provided by him under this section will be paid from the Central Fund or the growing produce thereof.

(e) Provide that moneys paid by the Minister to the Central Bank under a guarantee under this head are repayable to the Minister, with interest, as and when such moneys are recovered by the Central Bank. Moneys paid by the Central Bank to the Minister are to be paid into [or disposed of for the benefit of] the /Central Fund Exchequer [in such manner as the Minister thinks fit].

(f) Provide that the Minister and /or the Central Bank as appropriate will have a continuing obligation to use all reasonable means to recover amounts paid out under guarantees provided under this head.

(g) Provide that in the event that moneys paid out under a guarantee under this section are not recovered, the amount outstanding will be repaid to the Central Fund from moneys voted by the Oireachtas. This is designed to ensure sound accounting principles and provide transparency.

(h) Provide that the Minister is required to lay a statement before each House of the Oireachtas every year to fully inform members on the situation with any guarantees made under this Head⁶. The Minister's report to give particulars of each guarantee; where payments have been made by the Minister or the Central Bank, the amount of payment and the amount (if any) repaid to the Minister on foot of the payment; and the amount of money covered by a guarantee that was outstanding at the end of that year.

Explanatory Note:

The nature, duration etc of a guarantee are important factors in the context of EU State Aid rules. It is envisaged that these factors would be encompassed in "... such terms and conditions ..." at (a) above. The criteria laid down in the EU Rescue and Restructuring Guidelines can be summarised as:

- the beneficiary has to be a firm in difficulty and may not have received rescue or restructuring aid during the past 10 years,
- the aid should normally consist of liquidity support and should be restricted to the minimum necessary to keep the firm in business for the rescue period,
- the aid must be granted in the form of loans or loan guarantees,
- the aid must be limited to a period of maximum 6 months,
- if the Member State communicates to the Commission within these 6 months a restructuring plan or liquidation plan, then the rescue aid can normally continue for the time needed by the Commission to examine this plan.

It should be noted that in moving to the restructuring phase the Commission have emphasised that aid must be the minimum necessary and there must be appropriate compensatory measures.

⁶ Part One of the annual Finance Accounts comprises financial statements of Exchequer receipts and issues and guaranteed liabilities.

In relation to (a)(i) of the head, the CBFSAI has power to grant Emergency Liquidity Assistance (ELA) under Section 5B(d) of the Central Bank Act 1942. This empowers the CBFSAI to “*provide loans and other kinds of financial accommodation to credit institutions and other persons on the security of such assets and on such terms and conditions as the Board considers appropriate*”. Advice from the Attorney General’s Office refers to the general supplementary powers of the CBFSAI under Section 5A (2) and (3) of the CBA 1942 to do all that is necessary or reasonably incidental to the performance of its functions in accordance with normal banking practice. The AG’s Office advice is that the terms and conditions of any assistance under 5B(d) are the subject of a wide discretion of the CBFSAI subject to the ESCB requirements. CBFSAI might also be asked to confirm this position is consistent with its own view, i.e. that it has sufficient legislative powers in relation to the giving of guarantees. Any deficiencies in this regard could be remedied in this head or an associated head.]

In regard to (b)(i) of the head, it may not be necessary to define “stability of the financial system” (see footnote 3).

The provision at (d) is required as otherwise it would be necessary for the Minister to arrange a Vote in the Department’s Estimate for the purpose or more likely a Supplementary Estimate which would be dependent on the Dáil being in session and would be subject to a possible vote thus not providing sufficient certainty as to the outcome of the process. The text is modelled on section 9(5) of the Bretton Woods (Amendment) Act 1999.

Subparagraph (e) is based on section 9(6) and (9) of the Bretton Woods (Amendment) Act 1999.

Subparagraph (f) is based on section 9(7) of the Bretton Woods (Amendment) Act 1999.

Subparagraph (g) is based on section 9(8) of the Bretton Woods (Amendment) Act 1999.

Subparagraph (h) is modelled on section 9(10) of the Bretton Woods (Amendment) Act 1999.

**Draft Material for use by Government Senators in Seanad
Debate – 8 October 2008**

Government Decision to safeguard the Irish Banking System

The Guarantee arrangements:

- The Government, following the advice of the Central Bank and Financial Regulator, decided to guarantee the retail, wholesale, dated term debt, secured borrowings and interbank deposits of the six domestic credit institutions (AIB, BoI, Anglo-Irish, Irish Life and Permanent, Irish Nationwide, EBS).
- In taking this action the Government is acting first and foremost in the interest of the stability of the Irish economy and the long term interest of the taxpayer. A secure and stable financial sector is essential for the Irish economy and it is in the best interests of the Irish people.
- It is important to note that this guarantee is intended to secure the funding of these institutions. Equity investors and those holding junior debt will take first charge on the risk of any losses in these institutions over time under the guarantee provided by the State is not intended to insulate them from the risks that they have taken on.
- The measure is being taken as a response to the severe dislocation in the international credit markets, which has impacted worldwide.
- Since the onset of the current period of turmoil in 2007, the Government has stressed its commitment to the stability of the Irish financial system. The Minister has highlighted in recent weeks that money placed with an Irish credit institution would not be placed at risk.

Legislation

The President signed the Credit Institutions (Financial Services) Bill to give effect to the Government decision last Thursday after it was debated in the Dáil and amended in this House.

Extent of financial exposure of taxpayers

- It is important to stress that the risk of any potential financial exposure is significantly mitigated by a very substantial buffer made up of the equity and near-equity (high yielding subordinated debt). There is, therefore, a significant buffer before there is any question of credit impairments impacting on the Exchequer on foot of the guarantee.
- The asset quality in our financial institutions is good with a strong concentration in residential mortgages with a relatively low loan-to-value ratio (LTV) on average. While Ireland along with all developed economies has experienced a sharp decline in its property market there is very significant capacity within the institutions to absorb any losses.

Protections in place for Irish Taxpayers:

- Firstly, I would stress that this guarantee was not given lightly. It was informed by the strong advice of the Central Bank and Financial Regulator that on account of unprecedented disruption in international financial markets the system-wide State guarantee was required to
 - ensure that Irish financial institutions has access to the normal liquidity and funding to effectively operate their day-to-day business
 - provide confidence to depositors and wholesale lenders that they should continue to transact their business as usual with the institutions concerned.
- The interests of taxpayers will be very firmly safeguarded from any risk of loss form the very substantial warranty that the State is now providing.
- The scheme which is to be brought forward to implement the Act will set out the specific terms and conditions, including fees, in relation to a guarantee provided.

- On foot of a Seanad amendment brought forward by the Minister for Finance, the draft scheme must be approved by a resolution of the Houses under section 6(5) of the Act.
- The intensified scrutiny and oversight of financial institutions which has been put in place since the onset of the current turmoil will be maintained and strengthened further to ensure that high regulatory standards are achieved in Ireland and that the quality of corporate governance in these institutions is a bulwark against any risk of loss for the State.
- As far as the question of ‘moral hazard’ is concerned, it will be a priority for the Government to ensure that the highest regulatory standards and standards of corporate governance apply in all of the institutions concerned including in relation to lending practices to safeguard the interests of taxpayers against any risk of financial loss

Possibility of a return to Taxpayers from this intervention

- This guarantee will not be a free lunch. Legislation which is to be brought forward to underpin this guarantee will provide for specific terms and conditions, including fees, in relation to a guarantee provided.
- In taking this action the Government is acting first and foremost in the interest of the stability of the Irish economy and the long term interest of the taxpayer.
- A secure and stable financial sector is essential for the Irish economy and it is in the best interests of the Irish people.
- The protection of taxpayers’ interests is the primary focus of this measure.
- If the guarantee is not called upon, the Exchequer will benefit to the extent of the charges received from the institutions.

Benefits to the Government for the guarantee:

- The first and most important point to be made is that the measure helps secure the stability of the Irish banking system. As is clear from the impact of the international credit crunch on the Irish economy, the financial system overall plays a central role in the economy and in the day-to-day lives of ordinary people.
- So the Government's objective for the guarantee is to stabilise the Irish financial system as much as possible against the backdrop of the very uncertain and volatile international environment at present so that individuals and businesses can transact their normal financial business in a normal way.
- The Government's announcement makes clear that the guarantee will be provided at a charge to the institutions concerned and will be subject to specific terms and conditions so that the taxpayers' interest can be safeguarded.
- The Minister of Finance will be drawing on the advice of the Central Bank and NTMA to put a fee mechanism in place to pay for the guarantee taking into account such factors as the possibility of increased funding costs for the Exchequer, the economic value for the institutions and need to support the investor confidence in the Irish financial system overall.
- In current highly abnormal market conditions it is not considered useful to speculate on what might be described as commercial rates for the guarantee. It is important to be clear that it is only the State that could provide such a warranty; no market mechanism would of course provide it.
- The State in its approach to costing the guarantee will wish to take all relevant factors into account including to ensure that in the medium-term the Irish economy supports a strong and viable banking system, the benefit and value it creates for the financial sector and above all else that the Exchequer suffers no financial loss from having provided it.

30/09/08

T, BL, AG, DMc, WB, DD, KC, JF, PN, TG, JH

D Drumm CEO Anglo

- will need funds up to 2 billion tomorrow
 - Board of Directors must be concerned
- Anglo lost 2 billion today – 2 more tomorrow
Strong advice from CB – move now – looks like cannot wait until Friday.

FR - view is something has to be done now

- JF -
- sooner a guarantee is provided the better
 - guarantee of State has the best chance of stabilising the situation
 - terms for guarantee would have to be worked out
 - management issues in Anglo to be addressed
 - preferable to avoid nationalisation
 - clear view of authority very serious situation
 - guarantee for 6 months until notice of withdrawal – ideally should be for 1 year or more
 - to be paid for by banks – would prompt fee – 2 big ones pay more
 - Anglo needs management changes.

- BL -
- Anglo is now a bank with no cash and with fiduciary obligations
 - but Anglo representing
 - NR[?] – Treasury xxx get xxxx xxx
 - CB: if spend 2 billion could just be wasted
 - guarantee might be seen as a xxxx
 - need a clean out to have market credibility.

- T -
- go direct to nationalisation route
 - will be seen internationally to have failed.

State guarantee for temporary period
- need xxxxx explicitly to make it

PN - advising guarantee – authority are saying nationalisation is not the right option

T - guarantee first

DD - seriously contemplate bond swap issue?

T - yes

DD - NPRF?

T - more contingency plans, not a decision yet

- BL - is CB assuming that any money out to Anglo tomorrow is secure
- TG - yes – big haircut
- T - guarantee – to be paid for by the banks with different prices

[DMcC want very clear statement of pros and cons of each]



EUROPEAN CENTRAL BANK
EUROSYSTEM

F916/09
T4

F009/006/09 Post 2
Record 1

Jean-Claude TRICHET
President



5 November 2008

Mr Brian Lenihan T.D.
Minister for Finance
Department of Finance
Office of the Minister
Upper Merrion Street
Dublin 2
Ireland

Consultation on amendments to the Deposit Guarantee Scheme

Dear Minister,

I hereby confirm receipt, on 30 October 2008, of your letter requesting an opinion of the European Central Bank on the above-mentioned draft legislative provisions.

This Opinion will be forwarded to you in due course. I should be grateful if you would communicate any changes made to the legislative provisions during the consultation period.

Yours sincerely,

08/0687/MF
Mr M Beausang
referred for association,
please.
P Scanton 11/11/08

35d/BK/01

From: Thompson, John
Sent: 18 November 2008 15:14
To: McKeon, Mary; Carrigan, Aidan
Cc: Finn, Brian; Fox, Brendan
Subject: Meeting with FR Wed 11am

Mary/Aidan

Some thoughts on ground we might cover.

John Thompson

Meeting with FR Wed 19th Nov 08

Points we might cover.

What measures are used/cd. be used to show how close to illiquidity, or insolvency the banks are? How often is data available?

What sudden events cd. precipitate a crisis? What early warning might be possible? How much is known about "events of default" on bank bonds/debt? Has the standard changed in recent times?

What measures of risk level are there? Can we see risk reducing? What figures are available? How often? How is risk measurement adjusted to changing situation?

How can we interpret published figures, balance sheets etc. in terms of liquidity & solvency? How is risk adjustment done?

Contingent liabilities/Off balance sheet items etc. What figures are there? How is risk measured ?

Lending – how can we measure the continued availability of finance to business & private customers? New loans, plus any significant changes re. existing loans?

Profitability – what measures are available? (Prime way to increase shareholders funds).

How much do we know about banks proprietary trading? How much exposure, what risk?

How much do we know about banks loans to other banks etc. – especially non-covered banks? Therefore, can we measure "domino" risk.

Is anything available on other indebtedness (i.e. to non-covered banks) of largest debtors?

Modus operandi: We will need contact details of the leaders of the FR teams dealing with the covered banks. Need to specify what info we need from what they already collect. Also, what new info should we ask for?





Merrill Lynch

Global Markets & Investment Banking Group

Merrill Lynch Financial Centre, 2 King Edward Street, London EC1A 1HQ

Facsimile Transmission

Date: 26 September 2008

To: Kevin Cardiff
Fax No: +353 1 678 5622

From: Henrietta Baldock
Tel No: +44 207 995 4886
Fax No: +44 207 995 2157

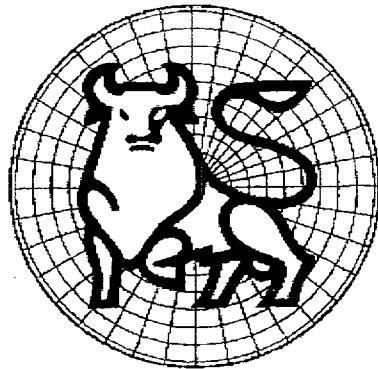
No of Pages 9
to Follow:

Dear Mr Cardiff,

Please see following document. We will give you a call to discuss.

Confidentiality Note.

The information contained in this facsimile transmission is privileged and confidential and intended only for the use of the addressee named above. If the reader of this message is not the intended recipient, you are hereby notified that any retention, dissemination, distribution or copying of this facsimile is strictly prohibited. If you have received this facsimile in error, please immediately notify us by telephone and return the original transmission to us at the address above via postal service. We will reimburse the reasonable costs you incur in notifying us and returning the transmission to us. Thank you.



Presentation to
National Treasury Management Agency

26 September, 2008



Global Markets & Investment Banking Group

Strategic Options

	Secured Lending Scheme	Good Bank, Bad Bank	Protective Custody of ANG / INWE	Guarantee for 6 Primary Regulated Irish Banks	Liquidation
Pros	<ul style="list-style-type: none"> Converts non ECB-eligible collateral into liquidity Deals with immediate liquidity problem / buys time Leaves Irish Nationwide / Anglo Irish temporarily as going concerns Benefits the whole financial system "Positive" for Ireland Inc. from outsiders' point of view 	<ul style="list-style-type: none"> Deals with the most problematic assets causing headline risk Will help restore confidence and help banks carry on business Promotes orderly unwind / minimises asset deflation 	<ul style="list-style-type: none"> Deals decisively with the most problematic institutions Demonstrates implicit commitment to Irish banks as a whole Interim step before formal guarantee if needed Protects senior / subordinated creditors Deposit guarantee will stem outflows and may result in inflows 	<ul style="list-style-type: none"> Best / most decisive / most impactful from market perspective Deposit guarantee will stem outflows and may result in inflows Protects senior and subordinated creditors 	<ul style="list-style-type: none"> Does not have an immediate cost to the Exchequer, but likely to be longer term implications
Cons	<ul style="list-style-type: none"> Does not deal with problem that monoline / lowly rated business are unlikely to work Irish Government could / will likely end up funding the entire Anglo Irish / Irish Nationwide balance sheets (€84bn - €120bn?). Even with zero usage by other Irish banks 	<ul style="list-style-type: none"> No critical mass remaining at Irish Nationwide / Anglo Irish Most complex option for Government - will require more time <ul style="list-style-type: none"> Capital / liquidity hits (€80bn+) 	<ul style="list-style-type: none"> Government ends up funding combined balance sheet Irish tax payer exposed beyond shareholders' equity Potential negative impact on share price of Bank of Ireland / Allied Irish Banks / ILP 	<ul style="list-style-type: none"> Will market find it credible given scale (€500bn+)? Can Ireland afford it? Ratings impact? Will it pass the test with other EU countries given broader implications? How long will it last? 	<ul style="list-style-type: none"> Significant read across to other banks Mark assets down at other banks to liquidation levels Capital and liquidity impact Investor perception of Ireland Inc. and financial stability more generally Perception that authorities not in control of developments
Considerations	<ul style="list-style-type: none"> Commercial vs. penal rate funding Over-collateralisation possible Appropriate tenure Shareholder control maintained as well as management structure 	<ul style="list-style-type: none"> Should it be available to all Irish banks? Can be structured to place government capital injection ahead of existing Equity If this is the chosen path, most likely to be a second stage solution Will require guarantee for senior / subordinated debt holders 	<ul style="list-style-type: none"> Irish Nationwide / Anglo Irish to be taken into state control Will require guarantee for senior / subordinated debt holders Put business into run-off 	<ul style="list-style-type: none"> Irish Nationwide / Anglo Irish to be taken into state control All cards played immediately Equity market perception? 	<ul style="list-style-type: none"> Option discounted due to impact on state / other financial institutions



Strategic Options

	Secured Lending Scheme	Good Bank, Bad Bank	Protective Custody of INWE / ANG	Guarantee for 6 Primary Regulated Irish Banks	Liquidation
Quantification	<ul style="list-style-type: none"> Anglo has €3.3bn of loans on the watchlist A 10% fall in commercial property value would result in an additional provision of €7bn €23bn liquidity deficit by the end of the year Additional €17bn of liquidity expected to be lost once information becomes public → Total €40bn 			<ul style="list-style-type: none"> INBS has €11.7bn of loans Writedowns of 30% - 60% results in an impairment of €3.6bn - €7bn Liquidity of €3bn to end-2008 out of total creditors of €16bn Losing €50m - €100m of deposits per day 	
Legal	<ul style="list-style-type: none"> Relatively straightforward (subject to checking existing powers) NTMA to be granted relevant powers in current bill Properly structured, should not encounter a state aid issue (commercial terms and as non-selective as possible) 	<ul style="list-style-type: none"> Very difficult to identify and address all legal issues in immediate timeframe New legislation required 	<ul style="list-style-type: none"> Legislation in hand Preferred share approach could be accommodated in timeframe Guarantee based on either (a) rescue aid basis, applying for approval for restructuring aid within 6 months; and/or (b) Art 87 (3)(b) to remedy serious disturbance to the economy Legislative power to be drafted into current bill to provide further guarantees if necessary Clear statement by Minister of intent to provide further aid as necessary should not attract additional state aid problems 	<ul style="list-style-type: none"> Legislation in hand Preferred share approach could be accommodated in timeframe Rescue aid rules applicable to the intervention with Anglo / INBS General guarantee to banking system would be based on Art 87(3)(b) – serious disturbance to the economy (systemic risk) Should investigate whether on basis of Art 87(3)(b), guarantee limited to the 6 banks would be allowable Danger that the Commission would not accept this basis for the general guarantee 	<ul style="list-style-type: none"> N/A



Strategic Options

	Secured Lending Scheme	Good Bank, Bad Bank	Protective Custody of INWE / ANG	Guarantee for 6 Primary Regulated Irish Banks	Liquidation
Impact on Primary Regulated Banks	<ul style="list-style-type: none"> ■ ILP – Potentially €4bn limit on collateral available under ECB facility, insufficient to fund forthcoming funding needs so ILP likely to be part of the solution ■ AIB / BoI – Deposit base fine, could use ECB facility to fund ILP ■ AIB / BoI could be encouraged to buy out ILP / EBS with State funding ■ EBS theoretically viable as an independent institution, though concerns remain regarding funding given size and scale 				
Impact on Non-Primary Regulated Banks	<ul style="list-style-type: none"> ■ Restrict collateral to commercial real estate and to primary regulated banks to deter foreign-owned institutions 	<ul style="list-style-type: none"> ■ N/A 	<ul style="list-style-type: none"> ■ Other institutions scope for possible complaints but no legal grounds ■ Long-term reputational issues for Ireland 	<ul style="list-style-type: none"> ■ Other institutions scope for possible complaints but no legal grounds ■ Long-term reputational issues for Ireland 	<ul style="list-style-type: none"> ■ N/A
Systemic European Impact	<ul style="list-style-type: none"> ■ No effect 	<ul style="list-style-type: none"> ■ No effect 	<ul style="list-style-type: none"> ■ No effect 	<ul style="list-style-type: none"> ■ Most contentious 	<ul style="list-style-type: none"> ■ No effect
Timing	<ul style="list-style-type: none"> ■ Immediate liquidity issues need to be addressed ■ Maximum 2 week window, more likely 7 – 9 days ■ No reason to expect significant liquidity improvement in the market ■ TARP issues in US still to work through ■ 30 September quarter end money market redemptions will prevent any meaningful change in market conditions 				



Strategic Options

Observations

- Analysis is based on the information from and conversations with:
 - PwC regarding Anglo
 - Goldman Sachs regarding Irish Nationwide
 - Limited verbal information from the Ministry of Finance and IFSRA
- We have not spoken to the management at any of the Irish Banks
- Scope has been evolving
 - Initially focused on Anglo and INBS, but now encompasses ILP, EBS and the effects on BoI and AIB given recent developments
- Must calibrate long-term impact on Ireland as a financial centre and implications for sovereign rating
- Every action should be assessed with respect to impact on share prices of AIB / BoI
 - Note rating agencies' concern that declining share price represents lack of confidence in the bank as a counterparty which can contribute to a downgrade
 - Impact on ability to raise capital
- Need to consider deposit guarantee in any event



Market Backdrop For Financial Institutions

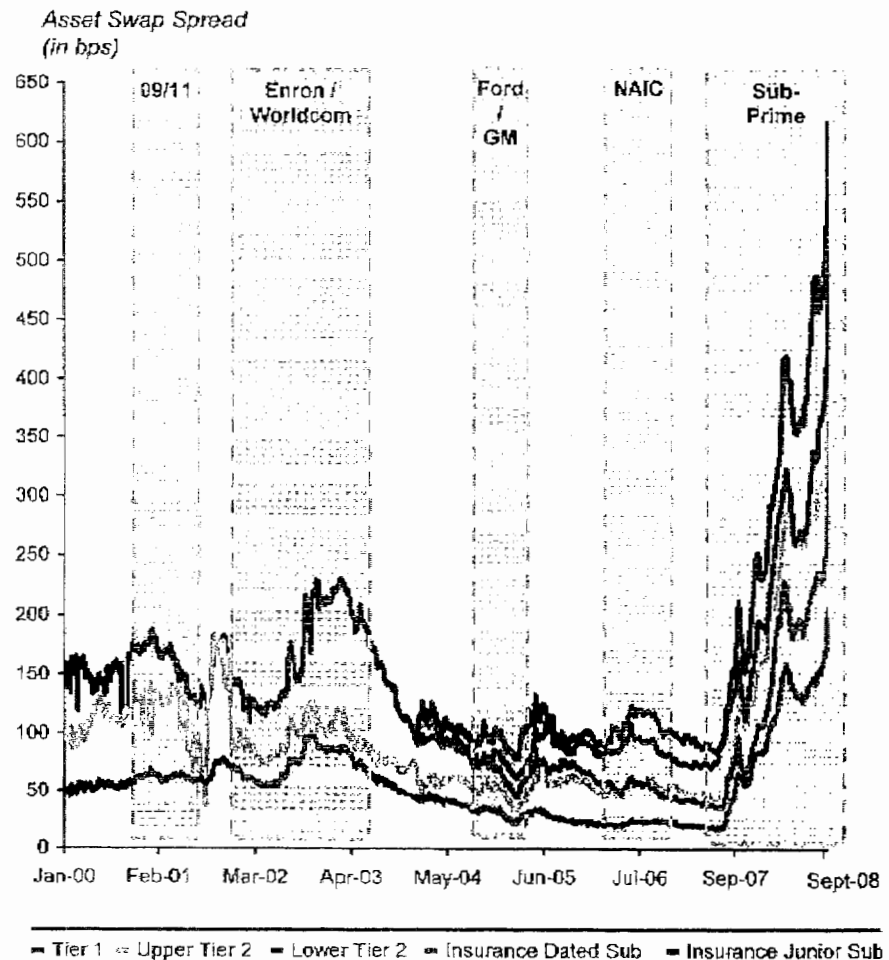
Severe Stresses In The Financial Markets Remain Amidst Volatility

Aggregate Spread Performance By Asset Class

- Over the last few weeks we have seen a dramatic worsening of market conditions. Uncertainty regarding the faith of financial institutions have lead to a total paralysis of the capital markets with only overnight funding currently available
 - USCP volumes circa 90% now only placed overnight
 - Massive flight to quality with the 2 yr Tbill currently yielding 2% nearing the lows reached at the time of the Bear Sterns collapse
 - Banks deposited £6bn in low yielding facility with BoE on Thursday 26th September (vs historical maximum of £1bn) rather than lend to each other

Asset Class	Product Type	Jan / Jun 07	Sept / Oct 07	Nov / Dec 07	Current
CP	A1/P1	-7 / -4 bps	-5 / -10 bps	Flat / -5	Flat / +30 bps
	US CP Outstanding	\$2.2 trillion	\$1.8 trillion	\$1.8 trillion	\$1.77 trillion
ABCP	A1/P1	-2 / +5 bps	20 / 30 bps	20 / 40 bps	40 / 50 bps
	US ABCP Outstanding	\$1.2 trillion	\$892bn	\$800bn	\$761bn
Senior Unsecured	5y AA CDS	8 / 12 bps	35 / 40 bps	45 bps	100 / 150 bps
	5y A CDS	15 / 25 bps	60 / 70 bps	70 / 80 bps	150 / 200 bps
Covered Bonds	10y Mortgage Backed	7 bps	17 bps	20 / 30 bps	60 bps
	10y Public Sector	-2 bps	3 bps	5 / 6 bps	30 / 35 bps
Securitisation	AAA	10 / 12 bps	35 bps	75 bps	130 / 150 bps
	BBB	45 bps	250 bps	300 bps	400 bps
Bank Capital	Sterling Tier 1 (AA)	70 bps	140 / 170 bps	210 / 230 bps	500 550 bps
	Euro Tier 1 (AA)	80 bps	150 / 180 bps	220 / 250 bps	500 / 600 bps
	US\$ Tier 1 (AA)	80 bps	150 / 180 bps	220 / 250 bps	500 / 600 bps
Insurance Capital	Subordinated (A/AA)	90 bps	130 / 150 bps	225 bps	250 / 300 bps
iTRAXX	5y Senior Index	8 / 10 bps	30 bps	50 / 55 bps	135 bps
	Crossover Index	200 bps	300 / 310 bps	370 bps	580 bps
VIX	Equity index	14 points	24 points	28 points	35 points
Government Bonds	2 year Treasury Yield	4.617%	4.157%	3.781%	2.043%

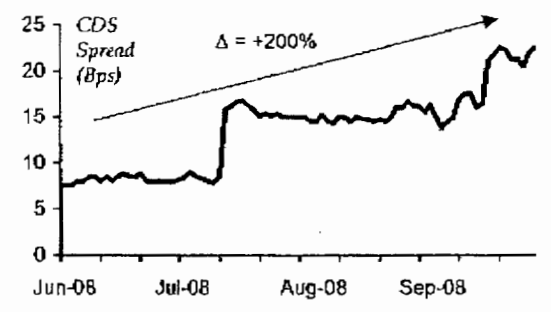
Current Cycle Much More Severe Than Previous



Market Backdrop For Financial Institutions

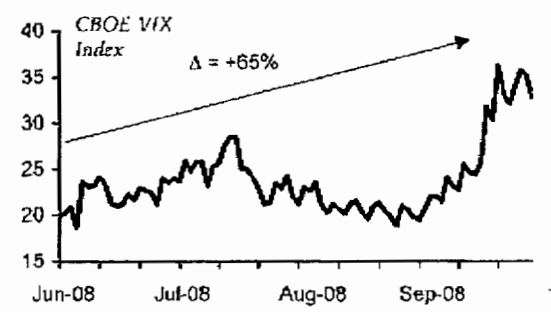
Severe Stresses In The Financial Markets Remain Amidst Volatility

10-Year US Treasury CDS



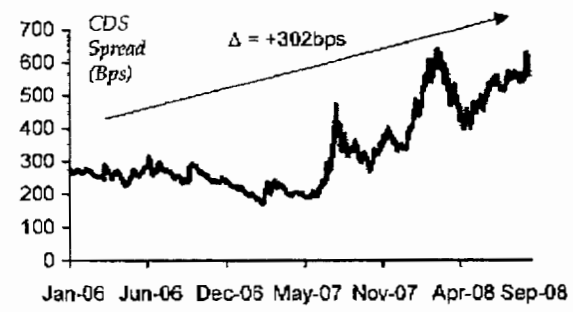
The cost to insure the debt of 10 year US treasuries has risen to an all time high as over the US fiscal position

VIX Volatility Index



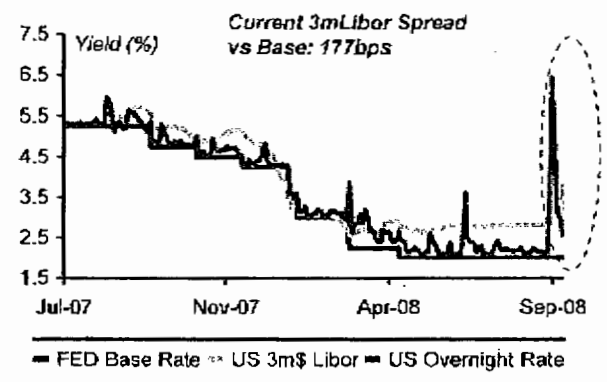
The VIX volatility index, one of the best guides to risk in the market rose close to six year highs as risk aversion jumped

iTRAXX Cross-Over

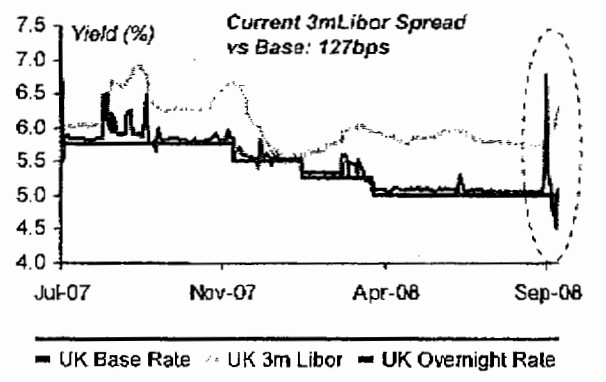


The iTRAXX Cross-over index has again breached the 600 mark with substantial pressure being seen on secondary spreads

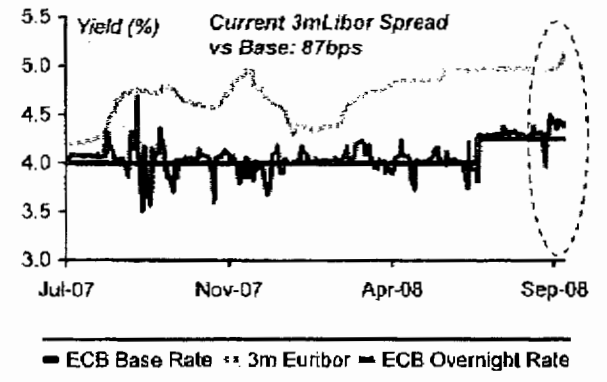
US Interbank Rates



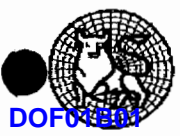
UK Interbank Rates



EUR Interbank Rates



Interbank rates have reached recent highs with a large collapse in market liquidity and generally a period being seen. Furthermore, tension is rising as companies and banks face the end of the third quarter. Next week Money market funds, have traditionally been large sources of liquidity in both the interbank and commercial paper markets but these lenders have seen substantial fund outflows



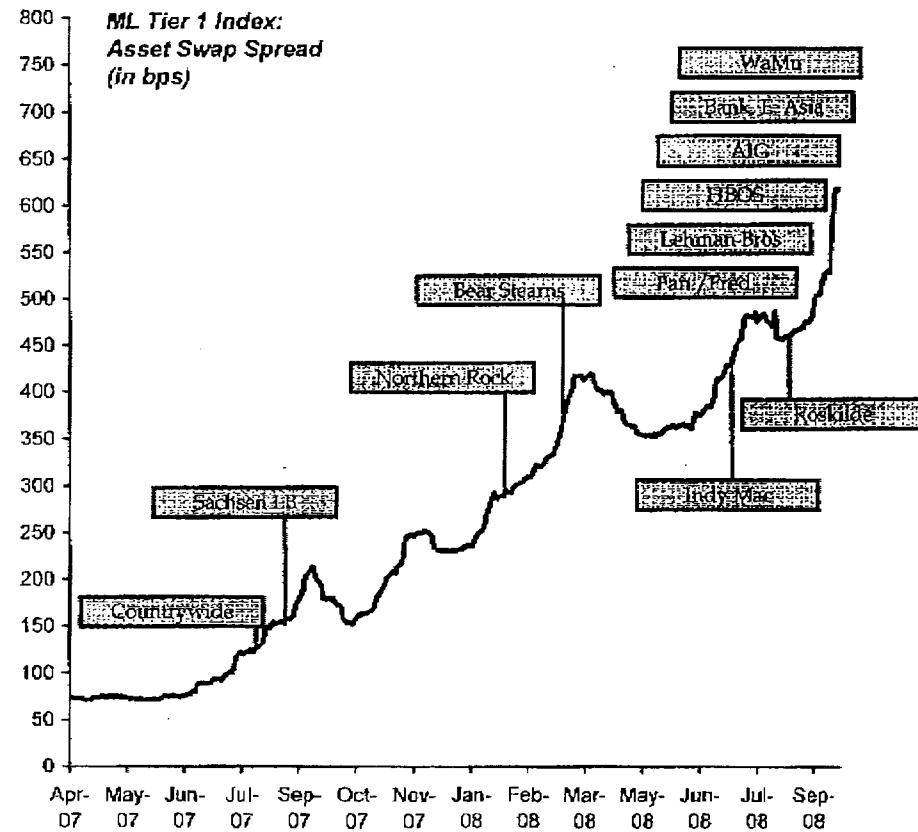
Market Backdrop For Financial Institutions

Acceleration of Bank Failures & Impact on Capital Markets

List of Key Bank Failures

- Washington Mutual (Put into receivership on 26th September, 2008)
 - \$19bn of expected losses on portfolio - ratings downgrade to non-investment grade - deposit withdrawals and liquidity crisis
- Bank of East Asia (Hong Kong Central Bank support on 25th September 2008)
 - Run on the bank following rumours of insolvency
- AIG (Federal Reserve intervention on 17th September 2008)
 - Concerns over subprime / CDS exposures & liquidity pressure - \$85bn liquidity shortfall
- HBOS (acquired by Lloyds TSB on 16th September 2008)
 - Concerns regarding ability to fund - funding gap estimated at c £200bn
- Lehman Brothers (Filed for Chapter 11 on 15th September 2008)
 - Concerns regarding insolvency led to liquidity crisis -
- Fannie Mae & Freddie Mac (Federal Reserve Intervention on 8th September 2008)
 - Mounting defaults on portfolio lead to concerns regarding insolvency - US stepped in explicit manner to ensure both entities continue to fund
- Roskilde (Danish Bank resumed control on 25th August 2008)
 - No longer met solvency requirements. Bought by Danish Central Bank after no external buyers found
- Indy Mac (Filed for chapter 11 on 11th July, 2008)
 - Depositors withdrew at elevated levels post profits warning. Subsequently seized by US regulators after viewed to fail
- Bear Stearns (acquired by JPM Morgan on 16th March, 2008)
 - Concerns regarding exposure to subprime and level of capitalisation triggered a rapid and non-reversible liquidity crisis
- Northern Rock (Nationalised by UK Government on 15th February 2008)
 - Capital markets dislocation lead to impossibility to meet funding gap
- Sachsen LB (acquired by LBBW on 25th August, 2007)
 - Received emergency funding following the inability of Sachsen LB's ABCP to fund in the CP markets
- Countrywide Financial (Acquisition by Bank of America 16th August, 2007)
 - Drew on \$11.5B from 40 global banks and liquidity providers following inability to fund in wholesale markets. Subsequently acquired by Bank of America

Bank Failures Substantially Impact Credit Markets



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Oifig an Aire Airgeadais

Ref no:

7 October 2008-10-06

Memorandum for the Government
Government Decision to approve a Scheme for the provision of a
Guarantee to certain banks designated by Order to safeguard the
Irish banking system

Decision sought:

The approval of the Government is sought for:

- the list of credit institutions to which the Government's guarantee of all depositors and some creditors as announced on 30 September applies
- an Order to specify that these credit institutions are covered by the Government's guarantee
- a Scheme, the purpose of which is to outline mechanisms to protect the State from the impact of financial stability, protect the Exchequer guarantee by outlining the details of the terms and conditions of the guarantee.
- any amendments to the Scheme arising from the consultation currently underway on the Scheme with the European Central Bank and the European Commission
- briefing and discussing the Scheme to the opposition spokespeople on Finance
- laying the Order and Scheme before the Houses of the Oireachtas, for their approval by resolution.

This decision is necessary to apply
A summary of the Scheme is attached at Tab A

Government Decision to safeguard the Irish Banking System

Key Points:

The Guarantee arrangements:

- The Statement issued by the Government today states that following the advice of the Central Bank and Financial Regulator, the Government has decided to guarantee the retail, wholesale, dated term debt, secured borrowings and interbank deposits of the six domestic credit institutions (AIB, BoI, Anglo-Irish, Irish Life and Permanent, Irish Nationwide, EBS).
- In taking this action the Government is acting first and foremost in the interest of the stability of the Irish economy and the long term interest of the taxpayer. A secure and stable financial sector is essential for the Irish economy and it is in the best interests of the Irish people.
- Normal practice is that the guarantee would extend to wholly owned subsidiaries within the Irish bank's group, but this is subject to confirmation of status of the relevant entity to the Government by the bank and FR
- It is important to note that this guarantee is intended to secure the funding of these institutions. Equity investors and those holding junior debt will take first charge on the risk of any losses in these institutions over time under the guarantee provided by the State is not intended to insulate them from the risks that they have taken on.
- Since the onset of the current period of turmoil in 2007, the Government has stressed its commitment to the stability of the Irish financial system. The Minister has highlighted in recent weeks that money placed with an Irish credit institution would not be placed at risk.
- The measure is being taken as a response to the severe dislocation in the international credit markets, which has impacted both in the US and the EU.

Extent of financial exposure of taxpayers

- It is important to stress that the risk of any potential financial exposure is significantly mitigated by a very substantial buffer made up of the equity and near-equity (high yielding subordinated debt). There is, therefore, a significant buffer before there is any question of credit impairments impacting on the Exchequer on foot of the guarantee.
- The guarantee provided by the State relates to the liability side of the institutions' balance sheets - some €400bn or so in deposits - retail, corporate and wholesale - and their senior and dated subordinated debt. These liabilities are supported by €500bn in assets.
- Owing to the importance from the point of view of market sensitivity of putting definitive figures into the public domain, the Minister for Finance has asked the CBFSAI to confirm detailed figures.
- The asset quality in our financial institutions is good with a strong concentration in residential mortgages with a relatively low loan-to-value ratio (LTV) on average. While Ireland along with all developed economies has experienced a sharp decline in its property market there is very significant capacity within the institutions to absorb any losses.

Protections in place for Irish Taxpayers:

- Firstly, I would stress that this guarantee was not given lightly. It was informed by the strong advice of the Central Bank and Financial Regulator that on account of unprecedented disruption in international financial markets the system-wide State guarantee was required to
 - ensure that Irish financial institutions has access to the normal liquidity and funding to effectively operate their day-to-day business
 - provide confidence to depositors and wholesale lenders that they should continue to transact their business as usual with the institutions concerned.

- The interests of taxpayers will be very firmly safeguarded from any risk of loss form the very substantial warranty that the State is now providing.

- Legislation which is to be brought forward to underpin this guarantee will
 - provide for specific terms and conditions, including fees, in relation to a guarantee provided
 - provide a very useful mechanism, alongside existing regulatory powers, to ensure that the Irish financial institutions are managed and operated in a manner which it fully consistent with their long-term sustainability

- The intensified scrutiny and oversight of financial institutions which has been put in place since the onset of the current turmoil will be maintained and strengthened further to ensure that high regulatory standards are achieved in Ireland and that the quality of corporate governance in these institutions is a bulwark against any risk of loss for the State.

- As far as the question of ‘moral hazard’ is concerned, it will be a priority for the Government to ensure that the highest regulatory standards and standards of corporate governance apply in all of the institutions concerned including in relation to lending practices to safeguard the interests of taxpayers against any risk of financial loss

Possibility of a return to Taxpayers from this intervention

- This guarantee will not be a free ride. Legislation which is to be brought forward to underpin this guarantee will provide for specific terms and conditions, including fees, in relation to a guarantee provided
- In taking this action the Government is acting first and foremost in the interest of the stability of the Irish economy and the long term interest of the taxpayer.
- A secure and stable financial sector is essential for the Irish economy and it is in the best interests of the Irish people.
- The protection of taxpayers' interests is the primary focus of this measure.

Option of taking an equity stake in the banks assisted

- This intervention is about enabling Irish banks to meet their liquidity needs in the current very difficult international financial circumstances to allow them to work through these difficulties and realise the value in their loan books.
- This guarantee will be paid for and the taxpayer who ultimately underwrites this support will be paid for the support provided.
- The commercial terms will ensure that the taxpayer gets value for money.
- We are not subsidising the banks as they are receiving the guarantee on commercial terms.
- The purpose of this measure is to provide security to all depositors and ensure confidence in the Irish Banking System. This confidence is essential in order that our citizens can access the liquidity that is crucial for the effective operation of our economy

Benefits to the Government for the guarantee:

- The first and most important point to be made is that the measure helps secure the stability of the Irish banking system. As is clear from the impact of the international credit crunch on the Irish economy, the financial system overall plays a central role in the economy and in the day-to-day lives of ordinary people.
- So the Government's objective for the guarantee is to stabilise the Irish financial system as much as possible against the backdrop of the very uncertain and volatile international environment at present so that individuals and businesses can transact their normal financial business in a normal way.
- The Government's announcement makes clear that the guarantee will be provided at a charge to the institutions concerned and will be subject to specific terms and conditions so that the taxpayers' interest can be safeguarded.
- The Minister of Finance will be drawing on the advice of the Central Bank and NTMA to put a fee mechanism in place to remunerate the guarantee taking into account such factors as the possibility of increased funding costs for the Exchequer, the economic value for the institutions and need to support the investor confidence in the Irish financial system overall.
- In current highly abnormal market conditions I don't think it is useful to speculate on what might be described as commercial rate for the guarantee. It is important to be clear that it is only the State that could provide such a warranty; no market mechanism would of course provide it.
- The State in its approach to costing the guarantee will wish to take all relevant factors into account including to ensure that in the medium-term the Irish economy supports a strong and viable banking system, the benefit and value it creates for the financial sector and above all else that the Exchequer suffers no financial loss from having provided it.

Department of Finance
30 September, 2008

Supplementary Speaking Points

Aggressive marketing by some Irish banks / inflows of deposits

Important to point out that in the debate on the guarantee legislation in the Irish parliament the Minister said that he "...will have no tolerance for any financial institution which seeks to exploit competitive advantage from this guarantee"

Instances of abuse that have come light to light have been referred to the Irish Financial Regulator

[The Financial Regulator is taking immediate actions to stamp these practices out

Urgent consideration is being given by the Minister to steps to cap the Government's liability under the guarantee which might otherwise increase owing to excessive inflow]

Are Credit Unions covered?

Credit Union deposits of up to €100,000 are already guaranteed.

What are the difficulties that have occurred?

- Global problems in relation to how credit institutions are funded have lead to a lack of liquidity across the global financial environment.
- Because of the global credit crunch, Irish institutions have had difficulty raising the funds they need to lend to customers.
- In a normal environment, as its own borrowings on the wholesale money markets (where banks lend to each other) fall due for repayment they would either be continued (rolled over) or new loans taken to replace them. But with the credit crunch new funds are no longer available.

Where is the money coming from? Commercial terms – what is the rate?

- The Exchequer will be remunerated by the financial sector for giving the guarantee to ensure that no financial liability is permanently borne by the taxpayer.
- The commercial terms will be market rates.

How will it be transacted?

The Central Bank will secure funding/liquidity to those banks that seek it and fulfil the commercial terms required.

Why now, why not last week or next week?

- The continued uncertainty in the financial markets has come to a head over the weekend as evidenced by difficulties for a number of banks throughout the global economy, including in Germany, Belgium, Holland, the UK and the US.
- This measure has been heavily influenced by the further uncertainty created by the failure of the US Congress to agree a package.
- This is a measure which is within our remit. It is important that we do whatever we can to secure our financial interests.

Will this be enough to secure the Irish banks? How do you know?

- This is a pre-emptive measure to secure confidence in the Irish banking system. It will give certainty to customers and the market about the ability of Irish Financial Institutions to honour their financial commitments.

What happens if this isn't enough?

- The Government, in conjunction with the Central Bank and the Financial Regulator has made this decision as it is viewed as the most appropriate measure at this time.
- The Government, in conjunction with the Central Bank and the Financial Regulator, has taken steps to plan for alternative scenarios and will act as necessary to ensure the stability of the Irish financial environment.

Will they help people and businesses to get loans?

- Access to liquidity will only improve when the difficulties in the Financial sector are resolved. This decision should remove any uncertainty on the part of counterparties and customers of Irish institutions.

- Greater confidence in our financial system will increase the liquidity of the Irish financial system, thus improving the prospects for people and businesses in accessing loans.

Are there any consequences for those banks that have given bad loans? Aren't you just bailing out bad banks and bad management?

- The difficulties faced by all global financial institutions are related to lack of liquidity throughout the entire global financial markets.
- The Government is acting first and foremost in the interests of the Irish economy and taxpayer.
- A secure and stable financial sector is essential for the Irish economy and it is in the best interests of the Irish people.

SECRET
Oifig an Aire Airgeadais

Ref No.

Date: 30 September, 2008

Memorandum for the Government
Government Decision to Safeguard Irish Banking System

Decision sought:

The approval of the Government is sought for:-

- a. Approval of a Bill to give legislative effect to the Government's announcement to guarantee all deposits and certain creditors of the six domestic Irish banks subject to circulation of the draft Bill to Government in advance of publication and presentation to the Oireachtas
- b. Approval for further legislative measures to support the maintenance of financial stability for inclusion in this Bill as follows:-
 - The establishment of a mechanism to enable the NTMA to issue Government gilts which can be lent on a secured basis to Irish financial institutions to facilitate their access to ECB and market funding.
 - Disapplication of the requirement for approval by the Competition Authority of mergers and acquisitions involving domestic financial institutions which fall under domestic competition law.
 - Such other matters as the Minister for Finance considers appropriate

Attachments:

TAB A

Draft Heads to give effect to:

- i. general guarantee (**Head 36**)
- ii. the proposed funding mechanism (**Head 36**) and
- iii. the disapplication of approval by the Competition Authority (**Head 37**)

TAB B

A copy of the Government's press release

TAB B

Government Decision to Safeguard Irish Banking System

The Government has decided to put in place with immediate effect a guarantee arrangement to safeguard all deposits (retail, commercial, institutional and interbank), covered bonds, senior debt and dated subordinated debt (lower tier II), with the following banks: Allied Irish Bank, Bank of Ireland, Anglo Irish Bank, Irish Life and Permanent, Irish Nationwide Building Society and the Educational Building Society and such specific subsidiaries as may be approved by Government following consultation with the Central Bank and the Financial Regulator. It has done so following advice from the Governor of the Central Bank and the Financial Regulator about the impact of the recent international market turmoil on the Irish Banking system. The guarantee is being provided at a charge to the institutions concerned and will be subject to specific terms and conditions so that the taxpayers' interest can be protected. The guarantee will cover all existing aforementioned facilities with these institutions and any new such facilities issued from midnight on 29 September 2008, and will expire at midnight on 28 September 2010.

The decision has been taken by Government to remove any uncertainty on the part of counterparties and customers of the six credit institutions. The Government's objective in taking this decisive action is to maintain financial stability for the benefit of depositors and businesses and is in the best interests of the Irish economy.

The Financial Regulator has advised that all the financial institutions in Ireland will continue to be subject to normal ongoing regulatory requirements.

This very important initiative by the Government is designed to safeguard the Irish financial system and to remedy a serious disturbance in the economy caused by the recent turmoil in the international financial markets.

Ends

1. Mr Beausang
2. Runai Aire

**Subject: Note for the information of the Minister for Government meeting
Financial market developments**

Key Points

- The ECB, Bank of England and Federal Reserve have signalled a greater focus on inflationary concerns and the likelihood of interest rate increases.
- Significant change in sentiment in financial markets has stalled the nascent recovery in the share prices of financials as markets factor in anticipated increases in interest rates and further sub-prime losses.
- Estimates of the ultimate losses from US sub-prime crises are now starting to exceed \$1 Trillion and are expected to extend well into 2009.
- Losses disclosed to date total circa \$380 Billion; markets believe there are major losses still to be absorbed and financial stocks remain in deep disfavour.
- Irish financials have seen a 25% approx. fall in their share prices since mid March (Bear Stearns) and are viewed as significantly exposed to further decline in property values (residential and commercial).
- Bank of Ireland successfully issued a €1.2 Billion bond, but at a significant premium (112 basis points) to normal market rates.

A more detailed note, based on discussion at the meeting of the domestic Standing Group of 19 June is attached.

Michael Manley
23 June, 2008

Note for the information of the Minister for Government meeting
Financial market developments

Background

There has been a significant change in sentiment in financial markets since early June, driven by statements from the ECB, Bank of England and Federal Reserve that increasingly identify inflation as a policy concern to which the Central Banks will if necessary respond with interest rate increases. Additionally market expectations are that further losses on sub-prime loans will be more than double the \$380 billion already disclosed leading to pressures on bank earnings and the likelihood of banks needing to raise capital to restore their balance sheets.

Financial Sector

Market volatility has significantly increased as markets seek to anticipate how these factors will impact, resulting in large changes in share prices on a daily basis, but with a persistent downward trend overall.

Ireland

Irish bank shares have fallen significantly in the last month (AIB -22%; BoI - 25%; Anglo -27%; IL&P -24%). The recent issue of a research note to investors by Keefe, Bruyette Woods Ltd (KBW) stating Bank of Ireland and Anglo Irish Bank have lower tier 1 capital, a measure of financial strength, than most European banks lead to a 6% fall in BoI share value on Wednesday 18 June. The bank suffered heavily in the sell-off of financial stocks and by the close of business, its shares were down 6 per cent as it shed 42 cent to €6.56.

Irish banks are considered highly exposed to property (residential and commercial) with BoI cited as having 70% of its lending tied to 'bricks and mortar'. It is unlikely there will be any significant recovery in share prices until property values start to recover; equally, any further falls in property prices are likely to put additional stress on the share prices of Irish financials.

A number of banks remain on negative ratings watch by Ratings Agencies indicating they may be may be downgraded. A key issue in any downgrading would be the extent of ratings change; a significant downgrading would increase the costs of funding for an institution, put share prices under further pressure and may lead to certain larger depositors transferring funds out of the institution.

International

Financial shares internationally have declined significantly with US and UK Financial share price indices down by 16% and 20% respectively (mid-May to mid-June) and significant individual falls by major banks , e.g. Royal Bank of Scotland (UK) and UBS (Swiss) both down 25% (Confirm). These banks are generally being impacted by the sub-prime crisis and changed expectations in relation to international growth.

Lonergan, Ciara

From: Lonergan, Ciara
Sent: 24 April 2008 17:43
To: Manley, Michael; Nolan, Kevin
Subject: State Guarantee Act 1954

Michael/Kevin

You asked me to examine the potential for amending the State Guarantee Act 1954 to allow the Minister to provide a guarantee to an financial institution or the CBFSAI should it be required.

The SGA 54 provides for the Minister to guarantee the borrowings of specified bodies. The bodies that the Minister can provide a guarantee to are listed in a Schedule to the Act. Section 9 gives the Minister the power to amend by order this Schedule by changing the maximum amount of the guarantee specified in the Schedule, by deleting a body from the Schedule, or by adding a body and its maximum guarantee to the Schedule.

[REDACTED]

There are a number of issues that arise if we wish to amend the SGA 54:

- The purpose of the SGA 54 is to provide for "guarantee by the Minister for Finance in respect of moneys borrowed by certain bodies". It specifies the maximum amount of any guarantee to specific bodies and it **does not provide the circumstances under which the Minister would undertake such a guarantee**. If we want to use this structure for a guarantee of a financial institution, following the McCreevy judgement, the principles and polices under which an Order that added this institution to the Schedule (thus making it eligible for a guarantee) was made would need to be stated in the Act. However, the principles and polices required for the type of guarantee the Minister might undertake to provide in order to manage financial stability would not necessarily be appropriate for other guarantees provided for in the Act as it currently stands.
- In additions the Act provides for the guarantee of borrowings, while the Minister might wish to guarantee the deposits of an institution in addition to its borrowings.
- The requirement to set out the maximum amount that be guaranteed could possibly restrict the types of guarantees that would be provided by requiring that a limit be set out in advance of the guarantee being entered into.

Given these concerns it may be easier and clearer to simply draft legislation to provide for the Minister to give guarantees which relate to financial stability management, outlining the possible circumstances in which such a guarantee could be considered, the criteria (non-exhaustive) that would apply to such a decision by the Minister, and the purpose that such a guarantee would be expected to fulfil. This could be inserted into existing legislation such as the Central Bank Act 1942, or it could be a stand alone piece of legislation.

Ciara

**Strictly Personal and Confidential
Addressee Only**

Mr. Kevin Cardiff,
Second Secretary,
Department of Finance,
Government Buildings,
Upper Merrion Street,
Dublin 2.

STRICTLY CONFIDENTIAL

20th October, 2008

RE: Risk Management and Exit Strategy Re Government Guarantee

Dear Kevin,

I know that having just prepared the terms of the Scheme underpinning the Government Guarantee it is hard to have to now focus on starting the effective risk management for the Guarantee and the exit strategy. However, as I know you are aware, the day we give a time limited guarantee is the day we need to plan for exiting.

To that end I have been thinking fundamentally about what are the key elements of this risk management strategy. (These are in addition to the ongoing regulatory process issues of effective monitoring, assessment, quantification and control of conduct). In this context I think it is worthwhile to consider what strategies may or may not be needed and in this context it is useful to consider three different possible strategies, namely:

- Actions to increase the capitalisation of the Irish institutions
- Actions to reduce capital requirements by increasing availability of liquidity
- Actions to reduce capital requirements by reduced lending in certain institutions.

I attach my thoughts on the specifics of each of these which I have sent to John Hurley and Jim Farrell but I thought you should see these on a confidential basis. (I have also sent these on a personal basis to David Doyle).

It is important to stress that these actions may to some extent be alternatives and for example the need for any additional capital will depend on the level of lending, the level of liquidity and how the loan books perform. Some of these actions might also not be needed if the world's markets returned to one whereby corporate and inter bank funding was readily available to the Irish banks but my judgement is that this is unlikely and cannot be basis for prudent planning.

I hope this is of help.

Kind personal regards,

Yours sincerely,



Alan W. Gray
Managing Partner

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directors: P.Mulroney (Chairman), A.W.Gray (Managing), D.S.King, P.Muller, J.McGuire.

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POSSIBLE OPTIONS RE RISK MANAGEMENT AND EXIT STRATEGY RE GOVERNMENT GUARANTEE

1. INCREASES CAPITAL IN IRISH INSTITUTIONS

<i>Options</i>	<i>Comments</i>
1.1 Facilitate or incentivise sale of specific institutions to either international or Irish institutions who have greater levels of capital or better access to retail or inter bank funding	Smaller institutions in particular should be actively encouraged to consider this option although it is accepted that this is a very difficult time to foster such transactions but this merits ongoing priority.
1.2 Restrictions on Dividends	Appropriate for certain institutions but will impact on share values. The benefits of the Guarantee in terms of potentially lower funding costs could increase profits greater than would have been the case. This with dividend restrictions will result in some increase in capital in the banks.
1.3 Sale of Selected Parts of Bank Businesses including Consideration of Sale of International Operations	Should be actively encouraged in certain institutions.
1.4 Rights issue by Irish Banks	Should be pursued in discussion with banks but likely to be very difficult.
1.5 Partial State capital injection from NPRF or other sources in exchange for preference equity shares	May or may not ultimately be needed but this needs careful consideration. May be worth thinking of merits or otherwise of a joint state-private sector preference share injection. Detailed planning needed.
1.6 Nationalisation and State Capital Injection	Believe this is least beneficial option but may ultimately be required as a last resort.

2. REDUCE CAPITAL REQUIREMENTS BY INCREASING AVAILABILITY OF LIQUIDITY

<i>Options</i>	<i>Comments</i>
2.1 Changes in ECB Eligibility Criteria	Liquidity problem is now a global issue and ECB responses merit renewed attention.
2.2 Packaging of Assets to Meet ECB Eligibility Criteria	This will take time and require ratings which may be difficult. Not all assets will be eligible but this should be pursued.
2.3 Improve Perceptions of Future Loan Deficits	This could potentially be achieved by increasing provisions but this has risks although some increases in provisions will be needed. Better information available to the market may also be desirable. However, mistake to think this on its own will solve the problem.
2.4 Facilitating Banks to Convert Lending to Commercial Developers into Residential Mortgages which are ECB eligible	This would increase liquidity and also has merits in reducing risk. <u>Innovative ways of facilitating this should be considered.</u>
2.5 Wider EU Action to Increase Availability of Liquidity	Merits increased attention at EU level.
2.6 Increase in the Levels of Deposits of €100,000 or less in Irish institutions	This should be actively pursued by Banks and facilitated by regulations as the funding guarantee will remain on deposits below €100,000 and so these funds are less mobile.

3. REDUCE CAPITAL REQUIREMENTS BY REDUCING LEVELS OF LENDING

<i>Options</i>	<i>Comments</i>
3.1 Restrictions on Future Lending	If increased capital or increased liquidity is not secured such restrictions may be necessary but this will impact on wider economy.
3.2 Active Management to Reduce Loan Book	This is essential and should be carefully monitored.
3.3 Incentivise Selected Large Commercial Borrowers of Banks to Repay Loans at Discounted Levels	Some commercial borrowers may have credit lines internationally or may have options to sell assets to repay loans but may not have any incentive to do so. It might be appropriate for certain banks to offer discounts for early repayment of loans including reductions on the principal amounts.
3.4 Sale of Parts of Loan Book to Other Institutions	This may not be feasible in certain cases but requires active management.



EUROPEAN COMMISSION

Competition DG

Markets and cases III: Financial services and Health-related markets
Acting Director

Brussels, 30/09/2008

DG COMP/D/NP/D/8469

Mr Kevin Cardiff

Kevin.cardiff@finace.gov.ie

Dear Mr Cardiff,

I am writing to you regarding the terms of the Irish Government declaration to guarantee all deposits with the six Irish banks, about which there has been contact between our officials.

It is my understanding that the government guarantee will cover all deposits: retail, commercial, institutional and interbank, as well as covered bonds, senior debt and dated subordinated debt (lower tier II) with six specified banks: Allied Irish Bank, Bank of Ireland, Anglo Irish Bank, Irish Life and Permanent, Irish Nationwide Building Society and the Educational Building Society and some of these banks' subsidiaries located abroad. I understand that the guarantee, provided against a remuneration, will cover all existing aforementioned facilities with these institutions and any new such facilities issued from midnight on 29 September 2008, and will expire at midnight on 28 September 2010. This measure is motivated by the need to remove any uncertainty on the part of counterparties and customers of the six credit institutions in order to maintain financial stability, to safeguard the Irish financial system and to remedy a serious disturbance in the economy caused by the recent turmoil in the international financial markets.

In view of the current situation in financial markets, I share your concerns about ensuring financial stability and the need to take adequate action.

In our ongoing discussions, we have been attentive to the need to limit repercussions for other financial institutions and Member States. First, this relates to the possible effects of the designation of six beneficiary banks, for which Ireland is the consolidated supervisor. It seems that the subsidiaries of foreign banks operating in Ireland under the Irish banking licence are not covered, and neither are branches of foreign banks operating under the licence of another EU Member State. I take note of the argument that Ireland has no supervisory oversight over the branches of foreign banks operating in Ireland and thus could not control for any possible abuse of the credit covered by the guarantee. The situation may be different for subsidiaries of foreign banks holding an Irish banking licence.



In order to assist in assessing this issue, I would be grateful if you could provide my services up-to-date information on the flows of funds to and from the relevant categories of banks, and in particular on unusual levels of such flows, if any, since the announcement of the guarantee measure.

Second, the guarantee seems to be unlimited in scope as it guarantees not only all existing deposits but also all future credit to these six banks. Moreover it is meant to operate for two years apparently without a review clause. We would invite you to provide my services with information regarding the necessity and proportionality of guaranteeing all future business of the beneficiary banks for two years, including how undue competition distortion in the internal market can be avoided.

I look forward to our cooperation on this case.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'I. Schwimann', with a stylized initial 'I'.

Irmfried Schwimann



From: Beausang, William
Sent: 26 September 2008 14:48
To: Doyle, David
Cc: Cardiff, Kevin; Manley, Michael
Subject: FW: URGENT Query from SG

-----Original Message-----

From: Brendan McDonagh [mailto:BMcDonagh@ntma.ie]
Sent: 26 September 2008 14:22
To: Beausang, William
Cc: Oliver Whelan; Cardiff, Kevin; Michael J Somers
Subject: Re: URGENT Query from SG

William

This is very difficult to answer as the potential real exposure to the Exchequer of writeoffs is not yet independently quantified.

The rating agencies will be taken aback at the scale of the state involvement in any clean up operation and the speed of it occurring. Clearly the length of the workout will be an important factor in their assesment of Ireland's credit rating also. We expect to be put immediately on negative watch and probably soon after be downgraded, how many notches from AAA we just don't know.

Combining the takeon of banks Balance sheets of Anglo and Inbs of 110bn and guaranteeing the others of over 420 bn with a deteriorating budget deficit will lead at least in our estimation, an increase in the cost of funding of perhaps at least 1 percent in funding costs. If the state is funding a 50bn national debt and a 110 nationalised bank then a 1 percent increase in funding costs would cost cost a 1.6 bn extra pa

For your information Greece with a single A rating is trading at 76 pa over germany and Ireland is at 44 in 10 year area. We expect to pay a lot more than Greece due to the scale relative to our GNP as the market will be unforgiving about our problems.

The credit rating agencies have pointed out the housing issue and its impact on the banks as a key concern which would negatively impact our credit ratings.

I hope this answers the query.

Regards

Brendan

-----Original Message-----

From: Beausang, William <William.Beausang@finance.gov.ie>
To: Brendan McDonagh
CC: Oliver Whelan; Cardiff, Kevin <Kevin.Cardiff@finance.gov.ie>
Sent: Fri Sep 26 13:26:19 2008
Subject: URGENT Query from SG

Brendan

We met with the SG this morning and he is raised the following issue for us to follow-up with the NTMA.

He said he want an analysis from the NTMA to crystallise the issues that might be expected to arise for our sovereign rating in the event that the State provides a guarantee for all the deposits / credits of the domestic banking system or would have to provide substantial funding (e.g. ML analysis suggests this could run up to €100bn?) for institutions taken into the protection regime and for the banking system more generally (e.g. ILP / EBS on assumption that AIB and BOI can meet their own

needs).

There appears to be two views on when the system wide guarantee option might arise:-

1. As a last resort following-on to a public intervention (with liquidity support) and 'soft' guarantee (i.e. Minister confirms intention to provide guarantee if required) which did not resolve the situation and the other big banks were under very significant stress. In this case you could clearly make the case for a "serious economic disturbance" and forbearance under State aid rules
2. As part of a resolution package with funding being provided for all banks in need of it (from the CBFSAI / NTMA 'war-chest') you would provide a system-wide guarantee. This is likely to be more problematic from a State aid perspective as the case for either "serious economic disturbance" and rescue aid would be a good deal less clear-cut.

A funding issue of the scale indicated above could presumably arise under any of the scenarios we are looking at.

It would be useful, therefore, to have your views taking into account the different scenarios that might arise (as outlined above) and any others that may occur to you.

thanks

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Sunday 28th September

Memorandum from Merrill Lynch

1) Introduction

The Department of Finance and NTMA have been working with the Financial Regulator and the Central Bank of Ireland to establish the current liquidity and financial position of the Irish banking sector. They have appointed PwC accountants to investigate the liquidity position and asset quality of the loan books of Irish Nationwide Building Society (“Irish Nationwide”), Anglo Irish Bank (“Anglo”) and Irish Life & Permanent. They engaged Merrill Lynch on 24 September to advise on the liquidity and strategic options available to the Government and Arthur Cox to advise on legal aspects. This is the initial report of Merrill Lynch based on information as at 6pm on Sunday 28th September.

The analysis has been undertaken in a short period of time and is based only on information from and conversations with the three institutions. The implications for the broader financial sector have also been considered as well as the impact on Ireland as a financial centre and as a sovereign issuer.

The markets on a global basis are witnessing unprecedented levels of volatility. In the past two weeks many major financial institutions have either filed for bankruptcy (Lehman, Wamu, Roskilde) or have had to be rescued by either the state (Fannie, Freddie, AIG) or acquired by a rival (HBOS, Alliance & Leicester). Libor levels have, in the past week, risen to highs since 1992 with banks choosing to hoard cash or deposit it with central banks. The Bank of England last Thursday was holding £6bn of bank deposits against a long term average of around £1bn. Much of the Commercial Paper market (circa 90%) is currently rolling overnight. The Irish financial sector is experiencing extreme difficulties with wholesale market access all but non-existent. Even post the quarter end (30 September 2008) we feel this is unlikely to improve in the context of a worsening macro economic environment and a general backdrop of deteriorating asset quality.

While Irish banks have not had the same exposure as other banks to structured credit and US mortgage/real estate risks, their loan assets are concentrated in residential and commercial property where asset values have been falling and are expected to continue to fall as the international economy contracts. The liquidity issues facing Irish banks are compounded by investor concerns with regard to the high concentration of commercial property risk in their respective asset portfolios.

The three institutions where these liquidity issues have been most pronounced have been Irish Nationwide, Anglo Irish Bank and Irish Life & Permanent. AIB, Bank of Ireland and EBS, while experiencing reduced access to liquidity continue to have access to wholesale funding (for example with the ECB) and do not have such acute near-term liquidity issues based on the information provided to the Financial Regulator. EBS as a smaller institution is likely to be more vulnerable as time goes on.

It is important to stress that at present, liquidity concerns aside; all of the Irish banks are profitable and well capitalised. However, liquidity for some could run out in days rather than weeks. Anglo Irish has recently approached the Central Bank with a proposal to create a new funding facility that the Central Bank would accept commercial mortgage assets in return for cash. Anglo are rapidly approaching the point where they have exhausted all possible sources of liquidity available via the market or their ECB eligible collateral is close to being fully utilised..

This memo sets out the strategic options available to the Government. There is no right or wrong answer and the situation is very fluid with financial institutions experiencing difficulty and being supported by governments on a daily basis. Preserving flexibility is key and the solution may be different for each institution. The important issue is for the Government to preserve the stability of the Irish financial system overall and to safeguard the interests of individual bank customers to avoid widespread panic. That said, there is a limit on the financial resources available to the Government and there may be a need to preserve firepower as events unfold. The implications of each option in terms of whether it constitutes State Aid also needs to be carefully considered.

It is clear that certain lowly rated monoline banking models around the world, where there is concentration on a single asset class (such as commercial property) are likely to be unviable as wholesale markets stay closed to them. This has inevitably had an impact on our conclusions and we believe it is important to act quickly to deal with these institutions to avoid a systemic issue.

2) Summary description of the reviewed institutions

Further information is contained in Appendix A

Irish Nationwide Building Society

INBS is primarily a retail deposit funded, commercial property lender with a relatively small residential mortgage book of just over €2 billion. The asset quality of the commercial loan book is regarded as being generally good. Based on their own management projections, INBS have liquidity sufficient to meet their needs for around one to two months depending on the level of withdrawals. However there are concerns over the influence of the Chief Executive. In the extreme stress case analysis the total writeoffs including loss of interest income would just deplete most of INBS reserves of €1.8 billion.

Anglo Irish Bank

Anglo are a commercial property lender with loan assets of Eur 72bn. Only 3% of the loan book is currently regarded as impaired by Anglo management however falling property prices are likely to impact their book particularly where they have lent on speculative development. If one was to apply the INBS stress case scenario the writeoffs would by deplete ordinary shareholders and other lower category subordinated debt of €7.5 billion. The main issue for Anglo is a pressing need for liquidity as a result of a sustained outflow of corporate deposits and overnight funding

being unavailable to banks of their credit rating. Based on current market conditions, management is projecting a funding deficit of €0.1bn on Tuesday 30th September growing to €4.9bn by 24th October. Anglo have formally requested a short term liquidity advance of €1.7bn from the Central Bank on Friday 26 September for the end of the month.

Irish Life and Permanent

IL&P is a bancassurer with a leading life insurance company and a retail bank focused on providing residential mortgages. The asset quality is good but IL&P rely heavily on wholesale funding and are approaching the limit of their eligible collateral at the ECB. Under a “worst case” scenario, where interbank cannot be rolled and corporate deposits are withdrawn upon maturity whilst retail deposits remain flat, Irish Life & Permanent would have a negative net cash position of €2.1bn by 9th October 2008.

3) Strategic options

The strategic objective is to address the immediate liquidity issues of the three institutions and allow the situation to unfold. Given current instability in financial markets this could happen quite quickly and there could be a need to implement a combination of the options below. All solutions require financial resources from the Government and could add pressure to the sovereign credit rating and the borrowing costs of the Irish Government.

Whilst we set out the various strategic options within this memo, we have also fully considered, and ultimately discounted, one additional outcome - allowing an Irish bank to fail and go into liquidation without any government intervention. Whilst this option would initially have no financial impact to the government, the resulting shock to the wider Irish banking system could, in our view, be very damaging. The ensuing ‘firesale’ of assets could precipitate dramatic asset deflation and hence force other Irish banks to take significant write downs on their own asset portfolios thus depleting their capital positions. The significant volatility in the equity and capital markets that would likely follow would mean access to any form of new capital for Irish banks would be severely restricted for a protracted period. Therefore, in order to minimise the impact of any bank failure on the rest of the broadly sound domestic financial institutions, we strongly advocate a more controlled interventionist approach.

(a) Immediate Liquidity Provision

The short-term liquidity issues for the banks need to be immediately addressed, most notably at Anglo which may have a net deficit as early as Tuesday 30 September. The wholesale markets are closed and the three banks have limited access to the ECB facility as self originated commercial property assets are not accepted as collateral and Irish Life & Permanent is reaching the limit of its available eligible collateral. If the ECB were to change this stance and accept a broader type of collateral then arguably there would be no need for the Central Bank to offer any additional liquidity.

If that is not the case, the Central Bank should be prepared to provide auxiliary overnight liquidity facilities at **a penal interest rate** to the banks that request it. There is then the question of whether this becomes known to the market. We believe

it could be sensible to let it be known that the Central Bank has been asked to provide additional liquidity to certain financial institutions so that debt and equity investors do not criticise the Government if/when further State intervention needs to take place, in particular if equity is acquired in the institutions for zero value. Taking the worst case scenarios of each bank we estimate there could be an immediate funding requirement of €5bn.

(b) State protective custody

The additional liquidity provided would allow Anglo and Irish Nationwide to offset any continuing deposit outflows with liquid assets. However, even if markets stabilise both institutions are likely to find it hard to fund themselves independently and the penal interest rate if they use the Special Liquidity Scheme (outlined below) will deteriorate their earnings. For that reason and to avoid systemic risk, the Government should make preparations for State intervention in either or both institutions, once it becomes evident to the market that they need to intervene. This could occur over a very short period of time i.e. within days, but at the point at which it occurs it will not be a surprise to debt or equity investors as knowledge of the institution's financial position will be obvious and they should expect such intervention in the absence of a private sector solution. At Anglo the majority of equity and debt investors are Irish, UK and US institutional holders, but there are significant retail interests including a major shareholding by Sean Quinn.

Irish Nationwide and Anglo either together or separately could be taken into State custody using either (i) common equity and/or (ii) a preferred plus warrants investment akin to the one used in the Freddie Mac and Fannie Mae situation.

A State guarantee would be given to all depositors and senior creditors as well as dated subordinated debt holders (given the crossover between these two holders) which would again send a strong implicit message to the investor community that this level of protection would be afforded to all other Irish banks. The business would be run off with no new loans extended and it would be logical to use this entity for the base for the "Bad bank" in Option (d) below. Equity holders and undated junior subordinated debt holders would receive nothing providing a capital cushion of €1.4 billion in the case of Irish Nationwide and €7.5 bn in the case of Anglo. It is important that all other creditors are reimbursed to avoid a contagion effect with the other Irish banks that continue to raise capital in the senior and subordinated debt markets.

The investment by State can be in the form of preferred instrument and/or common equity. In either case the Government will own and control the bank and its decision making. The advantage of the preferred investment is that it establishes a clear priority ranking for the government's investment over shareholders, the existing preferred investors, and undated subordinated debt holders. The preferred effectively leaves the shares outstanding, would still require the government to hold public shareholder meetings as well as file regular statements. This may be considered impractical. If the Government were to take over the equity in its entirety there would be no need to report on an ongoing basis and hold any AGMs.

A common equity investment effectively either dilutes or completely removes the existing shareholders and places the government's investment pari passu with the existing common shareholders and below any preferred investment; therefore, it provides the potential for any upside at the expense of the existing common holders who either are heavily diluted or completely removed. This equity investment does not necessarily need to be the funding instrument. As the common ownership does make the State a direct shareholder (and likely the majority or sole shareholder) in the bank and thus responsible for the corporate governance, it can have the bank issue a subordinated instrument that effectively has clear priority ranking to any existing preferred investors and undated subordinated debt instruments. This will provide the government with downside protection as well as current yield. This form of common equity investment is effectively taking over the company and providing funding in consideration. The Fannie and Freddie investments by the US Government is similar in nature and combined the two instruments (see description in appendix C) with a preferred investment coupled with warrants in order to maximise the benefits of the two instruments. It is likely situation specific in terms of what the appropriate form of the investment should be. The State should have flexibility to pursue either or both.

(c) Secured Lending Scheme (“SLS”)

In conjunction with the State protective custody option, it is also recommended that the Government introduce a secured lending scheme which would accept both commercial property and non ECB eligible tradable securities as collateral to be either exchanged for government bonds or cash. This would be based on the following terms:

Available:	All Irish Building Societies and Banks listed on the Irish Stock Exchange. Available only once ECB eligible collateral is exhausted by an individual financial institution.
Tenure:	Liquidity provided for any term up to 9 months
Assets eligible:	Irish, UK Commercial loans secured with a first legal charge and certain securities tradable on a recognised exchange
Advance Rate:	No more than 60% of outstanding loan balance for commercial loans / no more than 75% of the lesser of last observable trade / currently marked price of the tradable securities
Size:	€20bn
Cost:	Minimum cost will be Euribor +[150]bps
Disclosure:	System announced but no publication of individual usage to market

Advantages

- Converts non ECB-eligible collateral into immediate liquidity

- The existence of a public announcement of an additional liquidity facility benefits whole financial system and is positive for Ireland
- May assist Irish Life & Permanent's, EBS, AIB, BOI [or INBS] short-term liquidity issues post any action on protective custody of Anglo [and INBS].

Disadvantages

- Of itself does not deal with longer-term funding issues associated with lowly rated monoline businesses whose model is unlikely to be sustainable long-term
- Irish Government could end up funding over €100bn albeit at a highly attractive rate for an unknown period
- Money supply from the Irish Central Bank must be co-ordinated with ECB operations for injecting liquidity

The SLS scheme is recommended because it would offer immediate liquidity and stabilise the sector. The option to subsequently own or separate assets out of the banks into State ownership or to stronger banks will be preserved, and can be done with full market support.

The announcement of the creation of this SLS facility should be made public to the market in order to maximise the impact it could have of promoting confidence that all Irish financial institutions have access to an additional liquidity facility provided by the State for its own institutions. All banks should be coerced to publicly support the SLS facility as a strong indicator of State support for the Irish banking system and no one institution should confirm or deny its use of SLS. However, SLS will only be considered positive for the market if the individual financial institution usage is not made public. Any institution seen or rumoured to be relying on this SLS liquidity facility will likely suffer a dramatic loss of confidence by the wholesale market and result in significant outflows of deposits and will be unable to refinance its short term debt if it is perceived as a substitute or as sign of an inability to obtain longer term funding.

It is an interim solution until either the market settles or a suitor in some cases is found to acquire or stabilise the individual institution. In any event the identity of any individual institution using SLS could become known in a small country and the move into Emergency Lending Access (ELA) could happen sooner than expected.

The Central Bank of Ireland's Emergency Lending Access already performs the role of providing liquidity of **last resort** in a way that would become known to the market due to the fortnightly reporting requirement of the Central Bank. A Bank in ELA in reality is close to the end of its existence because the market will not longer regard it as suitable credit risk to provide funding to.

The SLS would require new legislation which is currently being drafted and should be available before the end of the week. In the meantime the Central Bank is working on auxiliary measures which would allow the primary regulated Irish banks to post security backed by commercial property assets in return for cash or securities at a penal interest rate. This could be announced if needed to stabilise concerns about the remaining Irish banks immediate liquidity.

(d) Good banks / Bad banks

If the financial situation worsens there is the possibility of allowing other banks to contribute their bad commercial property loans to the State Banks(s) to allow a State-controlled orderly unwind of property holdings and limit asset deflation. This would also help restore investor confidence in the now ‘cleansed’ banks and enable them to continue in business.

The structuring of this option would be the most complex and time consuming. Considerations such as third party management required, upside/downside for tax payers, purchase price of the assets and the impact that would have on marks for other bank portfolios would have to be carefully thought through. This system was used in Scandinavia in the early 1990’s but only as the second phase of the state rescue of the banks. It is also difficult to predict how long the work out of the assets would take but recent Bank of Ireland published projections show a three to five year period is required to recover 80% – 90% of book value.

(e) Consolidation of financial institutions

Irish Life & Permanent has a good business franchise with a leading life insurance company and a residential mortgage book similar to Bank of Ireland and AIB, which is not experiencing significant arrears. It may be that they can come through the crisis unscathed. However if this looks unlikely, at the same time as providing short-term liquidity facilities, the other large banks can be approached to be ready to acquire and integrate the Irish Life & Permanent business in a private sector transaction. Similarly EBS could be easily acquired and absorbed by an entity with a larger balance sheet. Depending on the acquirer, the competition issues may need to be addressed by the State as they were on the Lloyds TSB / HBOS transaction in the UK.

(f) Guarantee for six Primary Regulated Banks

The alternative to a SLS facility is to offer a complete State guarantee to all depositors and senior creditors of the six primary regulated financial institutions. This should stem outflows and encourage inflows of deposits. However, the scale of such a guarantee could be over €500bn. This would almost certainly negatively impact the State's sovereign credit rating and raise issues as to its credibility. The wider market will be aware that Ireland could not afford to cover the full amount if required. It might also be poorly perceived by other European states if they come under pressure to do the same as liquidity flows migrate. A coordinated response across Europe could make this option more viable. Comments in such regard have already been made by the several European governments.

4. Conclusion

The extension of a discreet emergency facility is important to stabilise Anglo [and INBS] and avoid immediate contagion risk. The market environment is highly uncertain with international developments adding to the pressure on Irish financial institutions. Even if the situation stabilises, the immediate outlook for monoline,

single asset class, lenders is increasingly uncertain. In this context, it is important for the Government to be prepared to act quickly and decisively as required to step in and prevent a systemic problem.

SCENARIO

"PROTECTION"

CONTROL

GOING CONCERN BASIS

PROPERTY RIGHTS ADDRESSED

LEGISLATION REQUIRED

RECALL DAIL AND SEANAD

3 STAGES DAIL
SAME SEANAD
URGENCY MOTION
PRES SIGNS

Interim stage.

CAN BE FAST, BUT THERE IS A TIME FRAME

PHASES OF ACTION

need for EIA - dipping point
what cost level - higher?

DISTRESS PHASE 1 DAY ---- ?

pressure on liquidity
on mgt
preparatory activity
ACTION ON LIQUIDITY
ACTION ON COMMS
ACTION WITH MGT/STAFF
ACTION/REP RE OTHER INSTITUTIONS
WORK ON OTHER/BETTER OUTCOMES

"RED BUTTON" PHASE (E.G FRI ---- MONDAY)

DECISION TO GO - Minister, Government, CBFSA, NTMA.
INVOKED PLANS AND ADJUST AS REQ.
TAKE CONTROL INCL. Subs. - need enough control to cover risk.
START LEG PROCESS (incl recall Dail, Seanad
COMMUNICATE DECISIONS

- ↓
 - public
 - depositors
 - corporate and interbank
 - mgt and staff
 - EU bodies
 - MOU counterparts
-
- 5 'c's - message needs to be coherent

- need statement of intention from Minister before mkt opens.

- can't trade if known to be insolvent.

Can we provide

is needed to be worried about bank values in other institution

- comprehensive
- credible
- consistent
- coming from all rescue parties - FR bank Min GIS Taois NTMA and, v. important, INBS
- consistent with everyone else's message
- internet
- mass media
- PR firms
- usual investor channels
- direct contact - phones, branches email

Significant not to public first but way

~~direct contact~~
v. important

REGULATOR CONTROL PHASE -- DAYS?

Cbfsai POWER AND INFLUENCE DIRECT ALL ACTIVITY THROUGH A TEAM PUT IN AND DIRECTLY (esp if resistance) - what powers available?

ACTION CONTINUES ON COMMS AND LIQUIDITY
ACTION TO PROTECT ASSETS IF NEEDED - business as usual but don't want to lose assets
ACTION TO REASSURE MGT AND STAFF
LEG PROCESS IN TRAIN

NEED TO PLAN ALSO AGAINST CONTAGION - other institutions implications

MINISTERIAL PROTECTION PHASE STARTS

- President signs

TEAM ALREADY IN SITU - put in place by R/ICB - some team from by minister
VERY CLOSE COOPERATION WITH CBF/NTMA/INBS
COMMS/LIQUIDITY/REASSURANCE CONTINUES
ANTI-CONTAGION ACTIVITY
EXAMINATION OF STATUS/STOCKTAKING

Could legislation be easily adapted to this?

CONSOLIDATE AND DIG-IN AGAINST "BACKLASH"
KEEP MESSAGES POSITIVE

- CHECKLIST
- GROUPS - bullet points then details
 - WORKPLAN
 - REPORT BACK

guarantee on deposits
↓
will have to be able to cover equal

- contagion → pricing of bank digger → contagion
→ could be positive contagion if do well.

- equity reason to keep money in will be fine
liquidity needs will have to account of this

head map

Timing crucial - need triggers

15/10/10

DIF

DIF

Workstreams for Nationalisation Contingency

D.H

DIF

D.H

1. Legislation	2. Governance	3. Press/PR/Consumer	4. Market and Investor Relations	5. ECB and EU	6. Liquidity	7. Supervision post nationalisation
<p>Advise on drafting of legislation</p> <p>How will the legislation be triggered?</p> <p>How will compensation (if any) be determined?</p>	<p>Identify potential candidates to chair inst</p> <p>With Chair, identify management needed and potential candidates</p> <p>Identify any changes required in existing management arrangements</p>	<p>Prepare Statements and Information packs for media & Consumers</p> <p>Handle calls</p> <p>Design media strategy</p>	<p><i>Nicholas, John, Steve, Foster</i></p> <p>Identify external advisors on how to present to market</p> <p>Identify key information to be made available on request.</p> <p>Identify market expectations of information to be provided/covenants to be addressed</p>	<p>Identify potential areas of EU law that need to be addressed</p> <p>Identify obligations in respect of ECB</p>	<p>Identify liquidity requirements for initial business plan</p> <p>Identify sources of contingent liquidity to provide support as required</p> <p>What expertise is required within the institution to manage liquidity?</p> <p>What collateral can be generated for market transactions?</p>	<p>Identify which supervisory requirements should be applied to nationalised entity</p> <p>Identify any legislative amendments required</p> <p>Identify any administrative notices affected/directions required</p> <p>Identify any foreign supervisors that would need to be informed</p>


Each team will be shadowed by an Authority Director
 Each stream will require administrative support for file searching, typing and photocopying/faxing

Checklist

What is / who is
the role of Mon management??
Control of INBS website

operational
not gives away
/ so let keep

- * 1. Legislation in place
- 2. Deposit maturity profile - daily
- 3. Debt Maturity Profile - daily
- 4. Take full possession of all assets - J.V. 5 + nominee companies
Finger says does not have control of bank subsidiaries
- 5. Press Statement to cover
 - Management - new CEO → informed by Bill
 - New Board (6)
 - Depositors
 - Debt holders
 - Future of INBS
 - State Guarantee of INBS Liabilities
 - Nationalisation Protection
 - Profit/Losses - sharing of risk
 - Legal Advisors
 - Staff of INBS
 - IFSRA/Central Bank
 - Setup Hotline and arrange PR Agency
- 6. Contact major depositors in advance of media announcement?
- 7. Accountants KPMG - what do they know
- 8. Credit Ratings of INBS - advise CRA's
- 9. Credit Ratings of Ireland - advise CRA's
- 10. Appoint Corporate Finance Advisors
- * 11. Power of Attorney & appoint Legal advisors ? ~~watermark~~ v. 1.
- 12. Analysis of Assets & Liabilities
- 13. Overseas subsidiaries/ trusts - can we access all assets/liabilities and information - check subsidiary definition (question)
- 14. Use of Loan Book as collateral with Central Bank
- 15. Refinancing
- 16. Cash available at Branches
- 17. Impact on other Financial Institutions, get them to also issue press releases

-
18. INBS staff – who knows what?
 19. Cooperation of current INBS Senior Management
 20. Contact ECB
 21. Contact European Commission
 22. Central Bank support of other Financial Institutions – cash/assurance
 23. Role of Central Bank/IFRSA
 24. DOF role
 25. NTMA role
- 

XFI Protection Bill

- Head 5
 - Appointment of Assessor
 - Minister required to appoint assessor within X months to determine compensation (if any) payable in respect of membership/extinguished rights
 - Assessor to be independent
 - Assessor to be paid such remuneration etc as the Minister shall determine

XFI Protection Bill

- Head 6
 - Determination of compensation as if
 - Society cannot continue as a going concern (to be wound up)
 - No assistance/guarantee by the State
 - Further criteria for determination of fair and reasonable compensation
 - Process for consultation with Minister/those affected
 - Process for advising of outcome

XFI Protection Bill

- Head 7
- Scheme of compensation
 - Calculation of amount payable
 - Process of payment
 - Principles/policies of scheme (Assumptions to be made, rules of procedure)
- Scheme to be laid before Houses of Oireachtas for approval; permanent unless motion annulling passed within 21 days

XFI Protection Bill

- Head 8
 - Power for Minister to make Guarantee/loan (incl. to do so on commercial terms/fee)
 - Provision for recovery, charging to Central Fund, reporting to Oireachtas

XFI Protection Bill

- Head 9
 - Misc
 - Power for the minister to incur expenses

XFI Protection Bill

- Schedule
 - Powers of Assessor
 - To require giving of evidence and production of documents
 - Conduct of proceedings
 - Proceedings in private
 - Offence of failing to appear
 - Offence of refusing to answer
 - Protection of those appearing before Assessor

Xfi Protection Bill

12 September, 2008

XFI Protection Bill

- Protection of depositors and lenders by taking Xfi into public ownership.
- Maintain Xfi as a going concern
- State as owner to have to have all the powers, rights and obligations of ownership
- Relevant prudential rules and requirements applied by the Financial Regulator to continue to apply
- Ensure that State's capacity to manage isn't inappropriately constrained by procedural rules
- Provision of fair compensation (if any)
- Minister enabled to provide guarantee/loan
- Misc - expenses

XFI Protection Bill

- Head 1
 - Minister given functions under the Bill (after consultation with Governor) where the Minister is of the opinion that
 - There is or would be a serious threat to the stability of the Society if these functions are not exercised and
 - The exercise of those functions is necessary, in the public interest, for maintaining financial stability in the State
 - CBFSAI's functions in relation to the Society continued

XFI Protection Bill

- Head 2
 - Existing shareholdings to become deposits
 - Existing membership rights to be extinguished
 - Minister to become sole member
 - Rights (of lenders or borrower) to acquire shareholding extinguished
 - Procedural aspects of BS Act '89 (as amended) disappplied.
 - Existing Society rules disappplied
 - Ensure sufficient power of BS Act '89 (as amended) are maintained to ensure ordinary business can be carried on post transfer
 - Provide power to amend, repeal rules of the

XFI Protection Bill

- Head 3
 - Power to remove/appoint
 - Directors
 - Chairman
 - CEO
 - Employees
 - Nominees to comply with Ministerial request
- Head 3B
 - Directors to hold office for such duration and on such terms as minister may determine.

XFI Protection Bill

- Head 4
 - Extinguishment of rights to acquire shares (by virtue of being an employee, director, etc.) at a future date
 - Extinguishment of rights to dividend arising out of any shareholding

Draft Preliminary Analysis



Presentation to

National Treasury Management Agency

26 September, 2008



Global Markets & Investment Banking Group

Strategic Options

Observations

- Merrill Lynch has been engaged with the NMRA and the Department of Finance for 48 hours
- Analysis is based on the information from and conversations with:
 - PwC regarding Anglo
 - Goldman Sachs regarding Irish Nationwide
 - Limited verbal information from the Ministry of Finance and IFSRA
- We have not spoken to the management at any of the Irish Banks
- Scope has been evolving
 - Initially focused on Anglo and INBS, but now encompasses ILP, EBS and the effects on BoI and AIB given recent developments
- Must calibrate long-term impact on Ireland as a financial centre and implications for sovereign rating
- Every action should be assessed with respect to impact on share prices of AIB / BoI
 - Note rating agencies's concern that declining share price represents lack of confidence in the bank as a counterparty which can contribute to a downgrade
 - Impact on ability to raise capital
- Need to consider deposit guarantee in any event
- The following considerations are therefore preliminary and subject to further consideration

Draft Preliminary Analysis

Strategic Options

	Secured Lending Scheme / ELA	Good Bank, Bad Bank	Protective Custody of ANG / INWE	Guarantee for 6 Primary Regulated Irish Banks	Liquidation
Pros	<ul style="list-style-type: none"> Converts non ECB-eligible collateral into liquidity Deals with immediate liquidity problem / buys time Leaves Irish Nationwide / Anglo Irish temporarily as going concerns Benefits the whole financial system "Positive" for Ireland Inc. from outsiders' point of view 	<ul style="list-style-type: none"> Deals with the most problematic assets causing headline risk Will help restore confidence and help banks carry on business Promotes orderly unwind / minimises asset deflation 	<ul style="list-style-type: none"> Deals decisively with the most problematic institutions Demonstrates implicit commitment to Irish banks as a whole Interim step before formal guarantee if needed Protects senior / subordinated creditors Deposit guarantee will stem outflows and may result in inflows 	<ul style="list-style-type: none"> Best / most decisive / most impactful from market perspective Deposit guarantee will stem outflows and may result in inflows Protects senior and subordinated creditors 	<ul style="list-style-type: none"> Does not have an immediate cost to the Exchequer, but likely to be longer term implications
Cons	<ul style="list-style-type: none"> Does not deal with problem that monoline / lowly rated business are unlikely to work Irish Government could / will likely end up funding the entire Anglo Irish / Irish Nationwide balance sheets (€84bn ~ €120bn?). Even with zero usage by other Irish banks 	<ul style="list-style-type: none"> No critical mass remaining at Irish Nationwide / Anglo Irish Most complex option for Government – will require more time <ul style="list-style-type: none"> Capital / liquidity hits (€80bn++) 	<ul style="list-style-type: none"> Government ends up funding combined balance sheet Irish tax payer exposed beyond shareholders' equity Potential negative impact on share price of Bank of Ireland / Allied Irish Banks / ILP 	<ul style="list-style-type: none"> Will market find it credible given scale (€500bn+)? Can Ireland afford it? Ratings impact? Will it pass the test with other EU countries given broader implications? How long will it last? 	<ul style="list-style-type: none"> Significant read across to other banks Mark assets down at other banks to liquidation levels Capital and liquidity impact Investor perception of Ireland Inc. and financial stability more generally Perception that authorities not in control of developments
Considerations	<ul style="list-style-type: none"> Commercial vs. penal rate funding Over-collateralisation possible Appropriate tenure Shareholder control maintained as well as management structure ELA or AIB / BoI ECB access could also be used 	<ul style="list-style-type: none"> Should it be available to all Irish banks? Can be structured to place government capital injection ahead of existing Equity If this is the chosen path, most likely to be a second stage solution Will require guarantee for senior / subordinated debt holders 	<ul style="list-style-type: none"> Irish Nationwide / Anglo Irish to be taken into state control Will require guarantee for senior / subordinated debt holders Put business into run-off 	<ul style="list-style-type: none"> Irish Nationwide / Anglo Irish to be taken into state control All cards played immediately Equity market perception? 	<ul style="list-style-type: none"> Option discounted due to impact on state / other financial institutions



Draft Preliminary Analysis

Strategic Options

	Secured Lending Scheme / ELA	Good Bank, Bad Bank	Protective Custody of INWE / ANG	Guarantee for 6 Primary Regulated Irish Banks	Liquidation
Quantification	<ul style="list-style-type: none"> ■ Anglo has €3.3bn of loans on the watchlist ■ A 10% fall in commercial property value would result in an additional provision of €7bn ■ €23bn liquidity deficit by the end of the year ■ Additional €17bn of liquidity expected to be lost once information becomes public ■ → Total €40bn 			<ul style="list-style-type: none"> ■ INBS has €11.7bn of loans ■ Writedowns of 30% - 60% results in an impairment of €3.6bn - €7bn ■ Liquidity of €3bn to end-2008 out of total creditors of €16bn ■ Losing €50m - €100m of deposits per day 	<i>All redacted</i>
Legal	<ul style="list-style-type: none"> ■ Relatively straightforward (subject to checking existing powers) ■ NTMA to be granted relevant powers in current bill ■ Property structured, should not encounter a state aid issue (commercial terms and as non-selective as possible) 	<ul style="list-style-type: none"> ■ Very difficult to identify and address all legal issues in immediate timeframe ■ New legislation required 	<ul style="list-style-type: none"> ■ Legislation in hand ■ Preferred share approach could be accommodated in timeframe ■ Guarantee based on either (a) rescue aid basis, applying for approval for restructuring aid within 6 months; and/or (b) Art 87 (3)(b) to remedy serious disturbance to the economy ■ Legislative power to be drafted into current bill to provide further guarantees if necessary ■ Clear statement by Minister of intent to provide further aid as necessary should not attract additional state aid problems 	<ul style="list-style-type: none"> ■ Legislation in hand ■ Preferred share approach could be accommodated in timeframe ■ Rescue aid rules applicable to the intervention with Anglo / INBS ■ General guarantee to banking system would be based on Art 87(3)(b) – serious disturbance to the economy (systemic risk) ■ Should investigate whether on basis of Art 87(3)(b), guarantee limited to the 6 banks would be allowable ■ Danger that the Commission would not accept this basis for the general guarantee 	<ul style="list-style-type: none"> ■ N/A



Draft Preliminary Analysis

Strategic Options

	Secured Lending Scheme	Good Bank, Bad Bank	Protective Custody of INWE / ANG	Guarantee for 6 Primary Regulated Irish Banks	Liquidation
Impact on Primary Regulated Banks	<ul style="list-style-type: none"> ■ ILP – Potentially €4bn limit on collateral available under ECB facility, insufficient to fund forthcoming funding needs so ILP likely to be part of the solution ■ AIB / BoI – Deposit base fine, could use ECB facility to fund ILP ■ AIB / BoI could be encouraged to buy out ILP / EBS with State funding ■ EBS theoretically viable as an independent institution, though concerns remain regarding funding given size and scale 				
Impact on Non-Primary Regulated Banks	<ul style="list-style-type: none"> ■ Restrict collateral to commercial real estate and to primary regulated banks to deter foreign-owned institutions 	<ul style="list-style-type: none"> ■ N/A 	<ul style="list-style-type: none"> ■ Other institutions scope for possible complaints but no legal grounds ■ Long-term reputational issues for Ireland 	<ul style="list-style-type: none"> ■ Other institutions scope for possible complaints but no legal grounds ■ Long-term reputational issues for Ireland 	<ul style="list-style-type: none"> ■ N/A
Systemic European Impact	<ul style="list-style-type: none"> ■ No effect 	<ul style="list-style-type: none"> ■ No effect 	<ul style="list-style-type: none"> ■ No effect 	<ul style="list-style-type: none"> ■ Most contentious 	<ul style="list-style-type: none"> ■ No effect
Timing	<ul style="list-style-type: none"> ■ Immediate liquidity issues need to be addressed ■ Maximum 2 week window, more likely 7 – 9 days ■ No reason to expect significant liquidity improvement in the market ■ TARP issues in US still to work through ■ 30 September quarter end money market redemptions will prevent any meaningful change in market conditions 				

Draft Preliminary Analysis

Market Backdrop For Financial Institutions

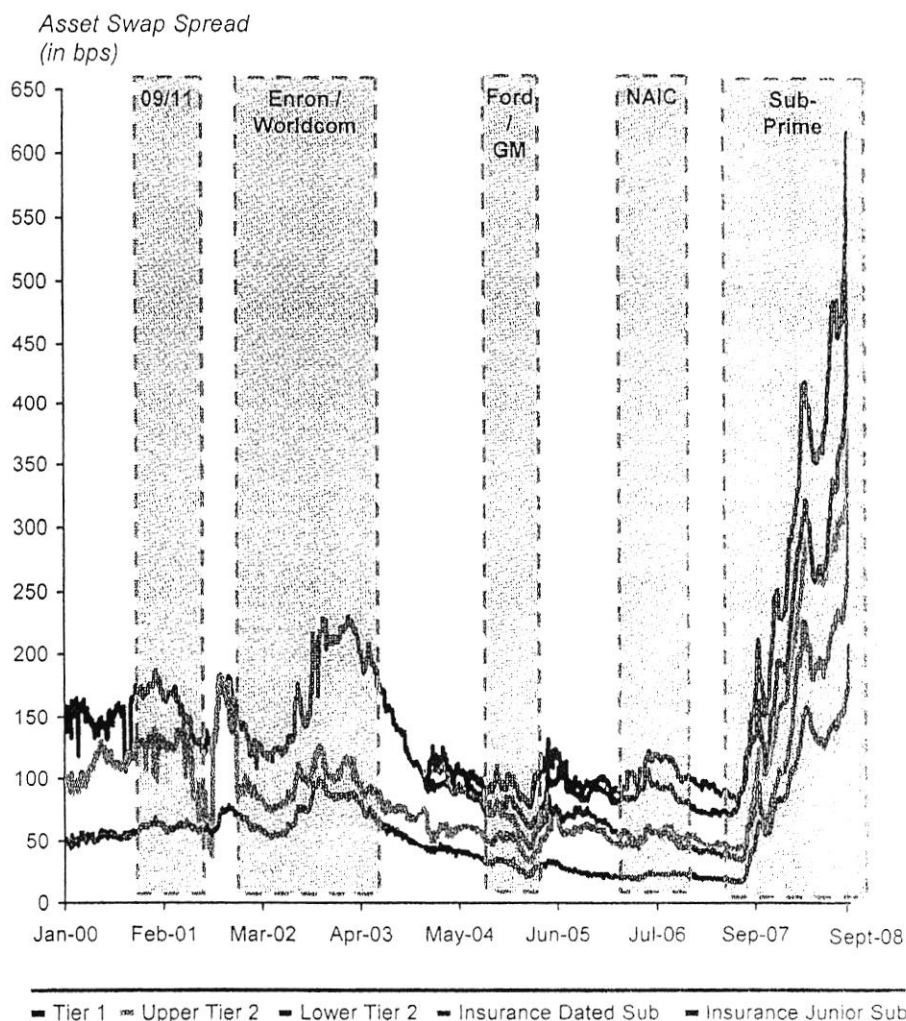
Severe Stresses In The Financial Markets Remain Amidst Volatility

Aggregate Spread Performance By Asset Class

- Over the last few weeks we have seen a dramatic worsening of market conditions. Uncertainty regarding the faith of financial institutions have lead to a total paralysis of the capital markets with only overnight funding currently available
 - USCP volumes circa 90% now only placed overnight
 - Massive flight to quality with the 2 yr Tbill currently yielding 2% nearing the lows reached at the time of the Bear Sterns collapse
 - Banks deposited £6bn in low yielding facility with BoE on Thursday 26th September (vs historical maximum of £1bn) rather than lend to each other

Asset Class	Product Type	Jan / Jun 07	Sept / Oct 07	Nov / Dec 07	Current
CP	A1/P1	-7 / -4 bps	-5 / -10 bps	Flat / -5	Flat / +30 bps
	JS CP Outstanding	\$2.2 trillion	\$1.8 trillion	\$1.8 trillion	\$1.77 trillion
ABCP	A1/P1	-2 / +5 bps	20 / 30 bps	20 / 40 bps	40 / 50 bps
	JS ABCP Outstanding	\$1.2 trillion	\$892bn	\$800bn	\$761bn
Senior Unsecured	5y AA CDS	8 / 12 bps	35 / 40 bps	45 bps	100 / 150 bps
	5y A CDS	15 / 25 bps	60 / 70 bps	70 / 80 bps	150 / 200 bps
Covered Bonds	10y Mortgage Backed	7 bps	17 bps	20 / 30 bps	60 bps
	10y Public Sector	-2 bps	3 bps	5 / 6 bps	30 / 35 bps
Securitisation	AAA	10 / 12 bps	35 bps	75 bps	130 / 150 bps
	BBB	45 bps	250 bps	300 bps	400 bps
Bank Capital	Sterling Tier 1 (AA)	70 bps	140 / 170 bps	210 / 230 bps	500 550 bps
	Euro Tier 1 (AA)	80 bps	150 / 180 bps	220 / 250 bps	500 / 600 bps
	US\$ Tier 1 (AA)	80 bps	150 / 180 bps	220 / 250 bps	500 / 600 bps
Insurance Capital	Subordinated (A/AA)	90 bps	130 / 150 bps	225 bps	250 / 300 bps
	5y Senior Index	8 / 10 bps	30 bps	50 / 55 bps	135 bps
iTRAXX	Crossover Index	200 bps	300 / 310 bps	370 bps	580 bps
VIX	Equity index	14 points	24 points	28 points	35 points
Government Bonds	2 year Treasury Yield	4.617%	4.157%	3.781%	2.043%

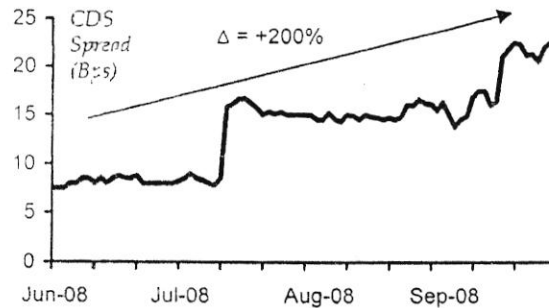
Current Cycle Much More Severe Than Previous



Draft Preliminary Analysis

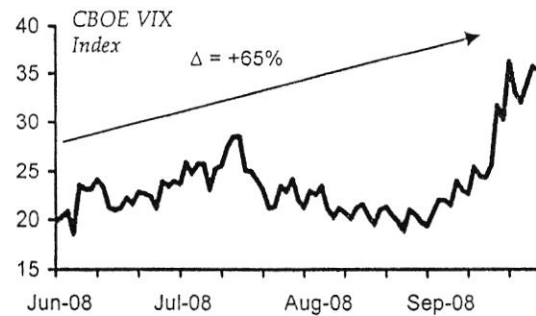
Market Backdrop For Financial Institutions Severe Stresses In The Financial Markets Remain Amidst Volatility

10-Year US Treasury CDS



The cost of insuring the world's 10-year US Treasury has risen to a new all-time high as a result of the US fiscal position.

VIX Volatility Index



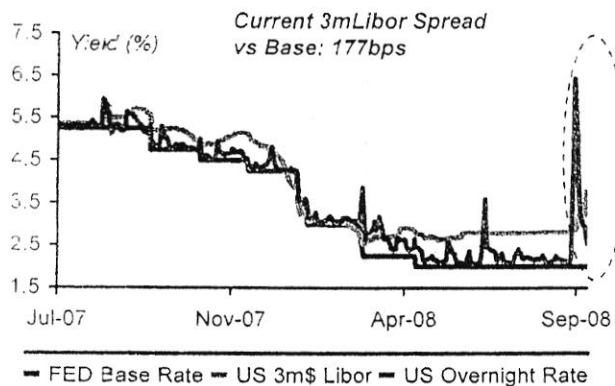
The VIX volatility index, a measure of the market's expectation of volatility, rose close to six-year highs as risk aversion jumped.

iTRAXX Cross-Over

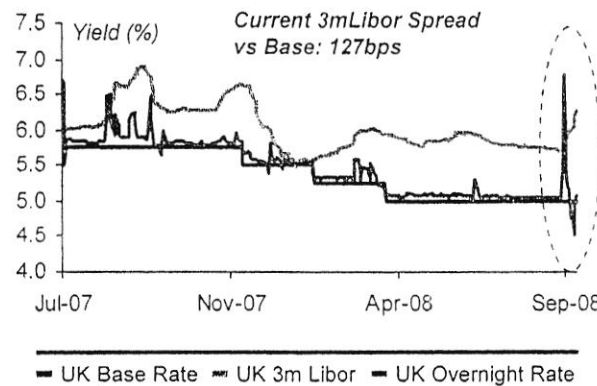


The iTRAXX cross-over index has now breached the 600 mark with substantial pressure being seen on secondary spreads.

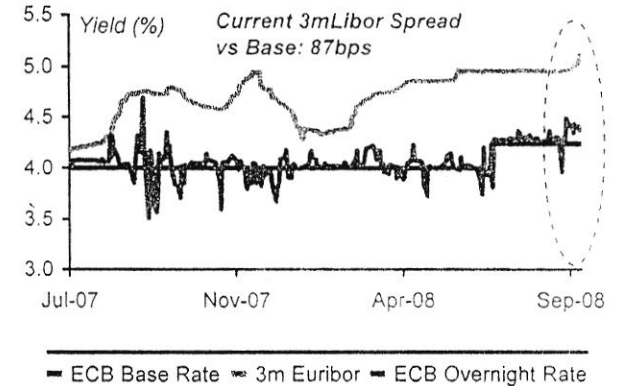
US Interbank Rates



UK Interbank Rates



EUR Interbank Rates



Interbank rates have fallen significantly since the start of the year, with a sharp rise in late August. In addition, severe insolvencies have been seen. Furthermore, tens of thousands of companies and banks have filed for protection in the last few weeks. Money market funds have traditionally been large sources of liquidity in both the interbank and commercial paper markets but these lenders have seen substantial fund outflows.



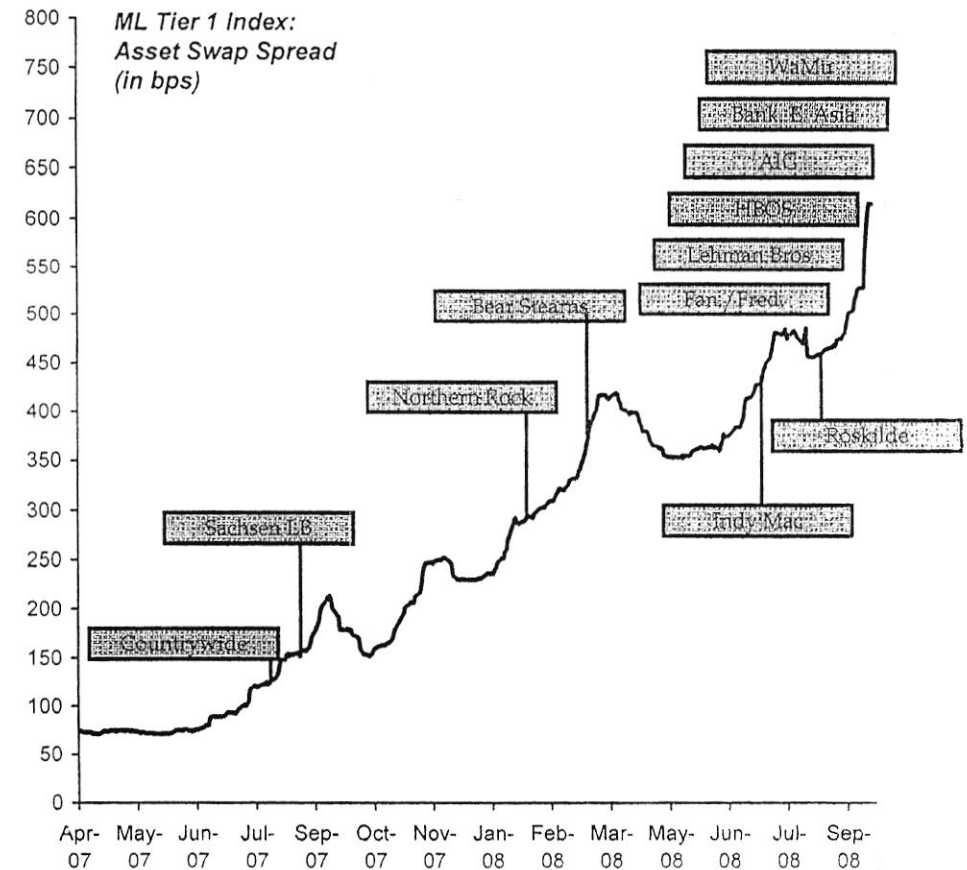
Draft Preliminary Analysis

Market Backdrop For Financial Institutions Acceleration of Bank Failures & Impact on Capital Markets

List of Key Bank Failures

- Washington Mutual (Put into receivership on 26th September, 2008)
 - \$19bn of expected losses on portfolio - ratings downgrade to non-investment grade - deposit withdrawals and liquidity crisis
- Bank of East Asia (Hong Kong Central Bank support on 25th September 2008)
 - Run on the bank following rumours of insolvency
- AIG (Federal Reserve intervention on 17th September 2008)
 - Concerns over subprime / CDS exposures & liquidity pressure - \$85bn liquidity shortfall
- HBOS (acquired by Lloyds TSB on 16th September 2008)
 - Concerns regarding ability to funding - funding gap estimated at c £200bn
- Lehman Brothers (Filed for Chapter 11 on 15th September 2008)
 - Concerns regarding insolvency led to liquidity crisis -
- Fannie Mae & Freddie Mac (Federal Reserve Intervention on 8th September 2008)
 - Mounting defaults on portfolio lead to concerns regarding insolvency - US stepped in explicit manner to ensure both entities continue to fund
- Roskilde (Danish Bank resumed control on 25th August 2008)
 - No longer met solvency requirements. Bought by Danish Central Bank after no external buyers found
- Indy Mac (Filed for chapter 11 on 11th July, 2008)
 - Depositors withdrew at elevated levels post profits warning. Subsequently seized by US regulators after viewed to fail
- Bear Stearns (acquired by JPM Morgan on 16th March, 2008)
 - Concerns regarding exposure to subprime and level of capitalisation triggered a rapid and non-reversible liquidity crisis
- Northern Rock (Nationalised by UK Government on 15th February 2008)
 - Capital markets dislocation lead to impossibility to meet funding gap
- Sachsen LB (acquired by LBBW on 25th August, 2007)
 - Received emergency funding following the inability of Sachsen LB's ABCP to fund in the CP markets
- Countrywide Financial (Acquisition by Bank of America 16th August, 2007)
 - Drew on \$11.5B from 40 global banks and liquidity providers following inability to fund in wholesale markets. Subsequently acquired by Bank of America

Bank Failures Substantially Impact Credit Markets



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Options:

<p>INBS, EBS, and ILP brought together <i>State guarantee on INBS book, + Liquidity Support</i></p> <p>Anglo <i>Liquidity Support</i></p> <p>BoI and AIB as now</p>	<p>INBS broken up EBS, ILP and INBS retail go together INBS - commercial property nationalised <i>Financing required for INBS commercial</i></p> <p>Anglo <i>Liquidity Support</i></p> <p>BoI and AIB as now</p>	<p>INBS taken by Anglo <i>State guarantee on INBS book, + Liquidity Support for whole</i></p> <p>ILP <i>Liquidity Support</i></p> <p>BoI, EBS and AIB as now</p>	<p>INBS taken by EBS <i>State guarantee on INBS book, + Liquidity Support for whole</i></p> <p>Anglo <i>Liquidity Support</i></p> <p>ILP <i>Liquidity Support</i></p> <p>BoI, EBS and AIB as now</p>	<p>No mergers, nationalisations or take-overs</p> <p>INBS <i>Liquidity support</i></p> <p>Anglo <i>Liquidity Support</i></p> <p>ILP <i>Liquidity Support</i></p> <p>BoI, EBS and AIB as now</p>	<p>Badbank approach</p> <p>INBS <i>Assets put aside, Liquidity Support if needed</i></p> <p>Anglo <i>Assets put aside, Liquidity Support if needed</i></p> <p>ILP <i>Liquidity Support</i></p> <p>BoI, EBS and AIB as now</p>	<p>Combined Asset Swap and Badbank approach</p> <p>INBS <i>Swap IrGovtbonds for INBS assets at book value, but require INBS to swap out assets that do not perform – but with a maximum pace for doing so.</i></p> <p>Anglo <i>Same as for INBS</i></p> <p>ILP <i>Liquidity Support</i></p> <p>BoI, EBS and AIB as now</p>
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Other possibilities:

AIB and Bank could be brought together

EBS in appropriate combination with others could seek external taker

ILP could seek external taker

(12)

F9/25/08, D
Record 12

30 September 2008

Attendance: T, BL, AG, DMcC, KC, DD, JM, E McCague, xxxx Burrows Sheehy,
Gleeson

Burrows

- Rapidly deteriorating situation everywhere – fully caught up in it
- Situation threatens the stability of our organisations
- Rumour in NYSE that Dublin won't go tomorrow
- Contagion from weaker to strong
- 2 institutions in terminal decline
- Why has INBS not been dealt with? Afraid people will assume INBS & Anglo tied in to the healthier outfits.
- Reminded action: 2 elements (a) guarantee for surviving (b) troubled patients to be taken out
- Can't guarantee that any guarantee will work
- Eventually impartial guarantee should register as good among Central Banks around the world – language must be unmistakable
- Higher difficulty with funding – slight resistance to overnight funding today (heard from Eamonn Hackett, Treasury).

Sheehy

- On positive side, retail guarantee has been very successful – no effect on wholesale depositors.
- Trend has been increasing – more and more difficult “no quote for Dublin”.
- People we've been dealing with for decades pulling back – 1 month we will be funding bank overnight. Bad if can't even get that, disaster – bankruptcy.
- Market is saying that Anglo is bust.
- Guarantee in xxxx will not help equity markets, but may help liquidity a bit.
- Want price to be in cash.

Hurley

- Guarantee required tomorrow
- Needs to be priced
- Anglo now asking for 4 bn tomorrow
- Will give them 1 ½ in the morning
- Might be necessary tonight to call in the banks
- Will have to be told that the use of the guarantee requires them to close down their businesses
- If further funds required AIB & Bank should contribute
- If rates for Anglo are significant, give them ELA from Central Bank.

PN & JR

- Guarantee absolutely xxxx
- Price of guarantee 0.25 and 0.5 of a point
- Min asked FR did they agree with AIB/BofI that 2 need to be nationalised first, FR (PN) did not agree.

T

- State guarantee best way to underpin deposits
- Want clarity of what is to be done in light of international events
- Go off and do it – Chairman & CEO

PN

- Will put in significant conditions

Governor

- If provide funding, need conditions – need to reduce risks of State

PN

- Everybody who has had a look at the banks is saying there is value in them over time
- Accepts this is a ‘throw of the dice’

00.41 on 30 September 2009

AIB & BofI back in

- Use MLF[?] for AIB – 1 ½ billion best can do 4. 6 best do
- Another idea – non eligible assets
- 10bn ABS & AAA – bring to NTMA – give gilts for it – say 8bn assuming a haircut – have to get it back next Monday.

Goggin

- Tomorrow is ½ year end
- So already managing for tomorrow
- Can't get cash xxxx Wed in xxxx
- Very nervous about how own deposits will hold up
- Could produce 4-5bn by Wed if get tender
- Will not use MLF[?]
- Capacity to consider
- Very strong preference not to xxxx
- Prefer to get it back close of business on Friday
- Could not xxxx

Meeting of 26 September 2008

Merrill Lynch presented a number of options – see document of 26 September 2008

Attendance:

ML X3 = Prasath, Baldock, Andreas Orcelli
Bob O’Hara
Con Horan
K Cardiff
D Doyle
Minister

5

ML points

- Worst credit crisis ever
- Need break a bad cycle
- French Government has indicated it will guarantee deposits
- However, number of situations where blanket guarantee may not add up having regard to numbers
- Liquidity is moving very very quickly
- Ireland is not an isolated case – other Governments also seeking ML advice, for example
- Management teams tend to try to play out to the end, because Government intervention tends to change the team, the advisers etc – their incentive therefore is to be over optimistic
- But it can create difficulties to go in without being asked in.

Presented a central scenario as follows

- (a) provide liquidity on ‘penal’ terms – must not be easy money
- (b) intervention

Difficulties – scale of intervention required.

Dangers with blanket guarantee – credibility and prolonging of weak institutions

Question of who should be protected in interventions – at least depositors in serious debt – possibly dated subordinate debt.

Big question is how to navigate between intervening early to protect deposits and minimise costs and giving time to markets and management to realise there is a problem and adjust to that reality (can happen in days). But corporate deposits can exit very quickly in the meantime.

On a blanket guarantee for all banks – ML felt could be a mistake and hit national rating and allow poorer banks to continue.

Liquidation – ML said this was the worst thing that could be done – accelerating trouble for all other institutions.

More generally, institutions should be encouraged to sell assets and get equity.

Next week is likely to be a very bad one in markets: Fortis, B&B, Dexia all having difficulties – EU will have to look at some more generalised action.

Minister asked that the options be articulated clearly over weekend so as to be ready to present to Government.

The Minister left and there was a discussion on allocation of work. To recommence at NTMA Sunday morning.

Government Decision to safeguard the Irish Banking System

Speaking points for the Taoiseach, 30 September, 2008

What are the Guarantee arrangements announced by the Government?

- The Statement issued by the Government today states that following the advice of the Central Bank and Financial Regulator, the Government has decided to guarantee the retail, wholesale, dated term debt, secured borrowings and interbank deposits of the six domestic credit institutions (AIB, BoI, Anglo-Irish, Irish Life and Permanent, Irish Nationwide, EBS).
- In taking this action the Government is acting first and foremost in the interest of the stability of the Irish economy and the long term interest of the taxpayer.
- A secure and stable financial sector is essential for the Irish economy and it is in the best interests of the Irish people.
- Normal practice is that the guarantee would extend to wholly owned subsidiaries within the Irish bank's group, but this is subject to confirmation of status of the relevant entity to the Government by the bank and FR
- It is important to note that this guarantee is intended to secure the funding of these institutions. Equity investors and those holding junior debt will take first charge on the risk of any losses in these institutions over time under the guarantee provided by the State is not intended to insulate them from the risks that they have taken on.
- Since the onset of the current period of turmoil in 2007, the Government has stressed its commitment to the stability of the Irish financial system.
- The Minister has highlighted in recent weeks that money placed with an Irish credit institution would not be placed at risk.

- The measure is being taken as a response to the severe dislocation in the international credit markets, which has impacted both in the US and the EU.

What is the extent of financial exposure of taxpayers?

- It is important to stress that the risk of any potential financial exposure is significantly mitigated by a very substantial buffer made up of the equity and near-equity (high yielding subordinated debt). There is, therefore, a significant buffer before there is any question of credit impairments impacting on the Exchequer on foot of the guarantee.
- The guarantee provided by the State relates to the liability side of the institutions' balance sheets - some €400bn or so in deposits - retail, corporate and wholesale - and their senior and dated subordinated debt. These liabilities are supported by €500bn in assets.
- Owing to the importance from the point of view of market sensitivity of putting definitive figures into the public domain, the Minister for Finance has asked the CBFSAI to confirm detailed figures.
- The asset quality in our financial institutions is good with a strong concentration in residential mortgages with a relatively low loan-to-value ratio (LTV) on average. While Ireland along with all developed economies has experienced a sharp decline in its property market there is very significant capacity within the institutions to absorb any losses.

What are the protections put in place to protect Irish Taxpayers?

- Firstly, I would stress that this guarantee was not given lightly. It was informed by the strong advice of the Central Bank and Financial Regulator that on account of unprecedented disruption in

international financial markets the system-wide State guarantee was required to

- ensure that Irish financial institutions has access to the normal liquidity and funding to effectively operate their day-to-day business
 - provide confidence to depositors and wholesale lenders that they should continue to transact their business as usual with the institutions concerned.
-
- The interests of taxpayers will be very firmly safeguarded from any risk of loss form the very substantial warranty that the State is now providing.
 - Legislation which is to be brought forward to underpin this guarantee will
 - provide for specific terms and conditions, including fees, in relation to a guarantee provided
 - provide a very useful mechanism, alongside existing regulatory powers, to ensure that the Irish financial institutions are managed and operated in a manner which it fully consistent with their long-term sustainability
 - The intensified scrutiny and oversight of financial institutions which has been put in place since the onset of the current turmoil will be maintained and strengthened further to ensure that high regulatory standards are achieved in Ireland and that the quality of corporate governance in these institutions is a bulwark against any risk of loss for the State.
 - As far as the question of 'moral hazard' is concerned, it will be a priority for the Government to ensure that the highest regulatory standards and standards of corporate governance apply in all of the institutions concerned including in relation to lending practices to safeguard the interests of taxpayers against any risk of financial loss

Will there be a return to Taxpayers from this intervention?

- This guarantee will not be a free ride. Legislation which is to be brought forward to underpin this guarantee will provide for specific terms and conditions, including fees, in relation to a guarantee provided

- In taking this action the Government is acting first and foremost in the interest of the stability of the Irish economy and the long term interest of the taxpayer.
- A secure and stable financial sector is essential for the Irish economy and it is in the best interests of the Irish people.
- The protection of taxpayers' interests is the primary focus of this measure.

Has consideration been given to taking an equity option in banks assisted?

- This intervention is about enabling Irish banks to meet their liquidity needs in the current very difficult international financial circumstances to allow them to work through these difficulties and realise the value in their loan books.
- This guarantee will be paid for and the taxpayer who ultimately underwrites this support will be paid for the support provided.
- The commercial terms will ensure that the taxpayer gets value for money.
- We are not subsidising the banks as they are receiving the guarantee on commercial terms.
- The purpose of this measure is to provide security to all depositors and ensure confidence in the Irish Banking System. This confidence is essential in order that our citizens can access the liquidity that is crucial for the effective operation of our economy

What will the Government get for the guarantee?

- The first and most important point to be made is that the measure helps secure the stability of the Irish banking system. As is clear from the impact of the international credit crunch on the Irish economy, the financial system overall plays a central role in the economy and in the day-to-day lives of ordinary people.
- So the Government's objective for the guarantee is to stabilise the Irish financial system as much as possible against the backdrop of

the very uncertain and volatile international environment at present so that individuals and businesses can transact their normal financial business in a normal way.

- The Government's announcement makes clear that the guarantee will be provided at a charge to the institutions concerned and will be subject to specific terms and conditions so that the taxpayers' interest can be safeguarded.
- The Minister of Finance will be drawing on the advice of the Central Bank and NTMA to put a fee mechanism in place to remunerate the guarantee taking into account such factors as the possibility of increased funding costs for the Exchequer, the economic value for the institutions and need to support the investor confidence in the Irish financial system overall.
- In current highly abnormal market conditions I don't think it is useful to speculate on what what might be described as commercial rate for the guarantee . It is important to be clear that it is only the State that could provide such a warranty; no market mechanism would of course provide it.
- The State in its approach to costing the guarantee will wish to take all relevant factors into account including to ensure that in the medium-term the Irish economy supports a strong and viable banking system, the benefit and value it creates for the financial sector and above all else that the Exchequer suffers no financial loss from having provided it.

Supplementary Speaking Points

Are Credit Unions covered?

Credit Union deposits of up to €100,000 are already guaranteed.

What are the difficulties that have occurred?

- Global problems in relation to how credit institutions are funded have led to a lack of liquidity across the global financial environment.
- Because of the global credit crunch, Irish institutions have had difficulty raising the funds they need to lend to customers.
- In a normal environment, as its own borrowings on the wholesale money markets (where banks lend to each other) fall due for repayment they would either be continued (rolled over) or new loans taken to replace them. But with the credit crunch new funds are no longer available.

Where is the money coming from? Commercial terms – what is the rate?

- The Exchequer will be remunerated by the financial sector for giving the guarantee to ensure that no financial liability is permanently borne by the taxpayer.
- The commercial terms will be market rates.

How will it be transacted?

The Central Bank will secure funding/liquidity to those banks that seek it and fulfil the commercial terms required.

Why now, why not last week or next week?

- The continued uncertainty in the financial markets has come to a head over the weekend as evidenced by difficulties for a number of banks throughout the global economy, including in Germany, Belgium, Holland, the UK and the US.
- This measure has been heavily influenced by the further uncertainty created by the failure of the US Congress to agree a package.
- This is a measure which is within our remit. It is important that we do whatever we can to secure our financial interests.

Will this be enough to secure the Irish banks? How do you know?

- This is a pre-emptive measure to secure confidence in the Irish banking system. It will give certainty to customers and the market about the ability of Irish Financial Institutions to honour their financial commitments.

What happens if this isn't enough?

- The Government, in conjunction with the Central Bank and the Financial Regulator has made this decision as it is viewed as the most appropriate measure at this time.
- The Government, in conjunction with the Central Bank and the Financial Regulator, has taken steps to plan for alternative scenarios and will act as necessary to ensure the stability of the Irish financial environment.

Will they help people and businesses to get loans?

- Access to liquidity will only improve when the difficulties in the Financial sector are resolved. This decision should remove any uncertainty on the part of counterparties and customers of Irish institutions.
- Greater confidence in our financial system will increase the liquidity of the Irish financial system, thus improving the prospects for people and businesses in accessing loans.

Are there any consequences for those banks that have given bad loans? Aren't you just bailing out bad banks and bad management?

- The difficulties faced by all global financial institutions is related to lack of liquidity throughout the entire global financial markets.
- The Government is acting first and foremost in the interests of the Irish economy and taxpayer.
- A secure and stable financial sector is essential for the Irish economy and it is in the best interests of the Irish people.

**Update note for the Minister in relation to financial institutions for
Government meeting 29 October, 2008.**

Summary/Speaking Points

1. The bank guarantee has achieved its objective of stabilising the liquidity position of the Irish financial institutions. Share prices of the Irish banks have continued to fall very sharply.
2. The Minister believes that banks should first look to their own business plans to secure their capital base, review dividend policy and measures (joint ventures, private placements) to raise capital. A critical part of their business planning is a realistic assessment of their loan book exposure and to determine the scale of any write downs. Ultimately they may need additional share capital. The State may have a role so it is prudent to engage in appropriate contingency planning to have a State supported capitalisation process prepared.
3. It may be that amalgamations of some institutions could be required, with State support, in some instances.
4. Mr Maurice O'Connell is reviewing the role of the NPRF for the future, including in relation to the extent to which the Minister might give policy directions, and whether it is appropriate to continue to invest each year. The Fund could ultimately be the investor in the banks.
5. The Minister's key concern is to ensure that Irish banks are sound and viable while also being in a position to meet the banking needs of both individuals and businesses and at the same time retain the confidence of the money markets. Currently there is a loss of confidence affecting demand for loans. But there is also evidence that banks are imposing much tighter lending criteria. They need to get the balance right.

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Impact of the Guarantee Scheme

The Guarantee announced on 30 September achieved its aim in stabilising the liquidity position of the covered institutions, but it has not given rise to any large net new sources of funding and the liquidity position of the banks is now at or about its late June position.

The share prices of the domestic banks are now circa 90% off their peak of 20 months ago, a markedly greater fall than in the case of a number of banks internationally, e.g. Banco Santander -53%, BNP Paribas -37% and HSBC -26%. Share prices have continued to fall sharply over the four weeks since the guarantee announcement of 30 September, and are typically down 40% in that four week period. (Table attached as appendix 1). In addition, Credit Default Swaps (CDS) rates for Irish banks remain

very high, suggesting that the markets are still very unsure about the long term future of the banks, in their current shape.

Market sentiment remains firmly negative on the Irish financials, with many investors holding the view that their profitability will fall dramatically as they absorb impaired loans and as the downturn bites further. This will directly impact earnings, but will also feed through to balance sheets as the expected scale of losses eats into capital reserves. Investors see relatively little prospect of dividends in the coming years and the prospect of equity stakes being diluted as fresh capital is raised. The real risk is that share price falls will trigger further concerns about Irish banks and that, despite the guarantee, liquidity issues will come back. The persistent lack of confidence in the Irish financial sector is a very significant issue.

Order Naming Covered Institutions

The order designating the first group of banks and building societies to participate in the Credit Institutions (Financial Support) Scheme 2008 was made on Friday 24 October, 2008. The covered institutions (subsidiaries and parents) have each executed a Guarantee Acceptance Deed as specified by the Minister, whereby they have undertaken to comply with the terms of the Guarantee Scheme and have given an irrevocable indemnity to the Minister.

Five subsidiary banks had sought to be included under the Guarantee scheme and the intention that they would be included was announced by press release on 9 October, 2008. At this stage, Halifax Bank of Scotland (HBOS) has announced it will not now join the scheme and two others (First Active and Ulster Bank) have indicated they may not join the scheme. Contacts are being maintained, but it is unclear how the HBOS decision will influence the others.

A significant number of institutions not covered by the guarantee have sought such coverage (e.g. certain IFSC firms, certain credit unions, certain lending companies). We are not recommending extension to these types of firms as there are trillions of Euro at stake which are beyond the capacity of the Irish State to guarantee. In any event these institutions do not pose a direct systemic threat to Irish banking.

Next Steps

The Minister considers that while the Guarantee Scheme has resolved immediate liquidity issues, it is important that the banks take immediate action to plan and work to meet their capital needs. In this regard, the development of restructuring plans is a condition of their participation in the guarantee scheme and this will be a priority focus of the information and monitoring processes under the Scheme.

The Minister would ideally like the banks to address their own capital needs. However the Minister believes it is necessary to consider, on a contingency basis, steps that would be necessary to allow a State capital provision in the event the banks are unable to secure adequate capital from the market. The steps to be considered include how State capital could be provided either directly through the NPRF or otherwise.

In this regard the Government might like to note that the Minister has requested Mr. Maurice O'Connell (former Governor of the Central Bank) to prepare a report on the appropriate role of the NPRF in the future. This will include consideration of the extent to which the Minister for Finance can give directions to the NPRF based on policy considerations and the extent to which contributions should continue to be made annually in cash terms or whether contributions might be given in kind (eg shares)

Summary

The Guarantee has achieved its objective of stabilising the liquidity position of the Irish financial institutions. The share prices of the Irish banks have continued to fall. This reflects investor belief that the likely write downs on impaired loans will eliminate profitability and threaten reserves to an extent that capitalisation will have to be addressed. The Minister believes that banks should first look to markets for any required capital. It is prudent for the State to engage in appropriate contingency planning to have a State supported capitalisation process prepared.

Appendix 1

Share price changes for quoted Irish financial institutions over the twenty months to October 2008 (i.e. fall since peak of financial share prices generally)

	BOI Price	BOI %Δ	AIB Price	AIB %Δ	IPM Price	IPM %Δ	ANGL Price	ANGL %Δ
Today	1.47	-	3.30	-	2.12	-	1.28	-
2w	2.35	-37.4	3.20	+3.1	4.00	-47.0	2.12	-39.6
30/09/2008	3.95	-62.8	5.90	-44.1	4.85	-56.3	3.84	-66.7
29/09/2008	3.27	-55.0	5.00	-34.0	3.57	-40.6	2.30	-44.3
3m	5.01	-70.7	7.40	-55.4	4.60	-53.9	5.36	-76.1
20m (peak)	18.65	-92.1	23.50	-86.0	22.80	-90.7	16.12	-92.1

(3)

Loneragan, Ciara

3

From: Baldock, Henrietta (IBK EMEA) [henrietta_baldock@ml.com]
 Sent: 29 September 2008 18:43
 To: Cardiff, Kevin
 Subject: RE: in meet with taoiseach - need note on pros and cons of guarantee a sap

Attachments: ML Memo 28 9 08 v8.doc



ML Memo 28 9 08
 v8.doc

This is the entire note.

Regards

Henrietta

-----Original Message-----

From: Cardiff, Kevin [mailto:Kevin.Cardiff@finance.gov.ie]
 Sent: 29 September 2008 18:37
 To: Baldock, Henrietta (IBK EMEA)
 Subject: in meet with taoiseach - need note on pros and cons of guarantee a sap

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Sunday 28th September

Memorandum from Merrill Lynch

1) Introduction

The Department of Finance and NTMA have been working with the Financial Regulator and the Central Bank of Ireland to establish the current liquidity and financial position of the Irish banking sector. They have appointed PwC accountants to investigate the liquidity position and asset quality of the loan books of Irish Nationwide Building Society ("Irish Nationwide"), Anglo Irish Bank ("Anglo") and Irish Life & Permanent. They engaged Merrill Lynch on 24 September to advise on the liquidity and strategic options available to the Government and Arthur Cox to advise on legal aspects. This is the initial report of Merrill Lynch based on information as at 6pm on Sunday 28th September.

The analysis has been undertaken in a short period of time and is based only on information from and conversations with the three institutions. The implications for the broader financial sector have also been considered as well as the impact on Ireland as a financial centre and as a sovereign issuer.

The markets on a global basis are witnessing unprecedented levels of volatility. In the past two weeks many major financial institutions have either filed for bankruptcy (Lehman, Wamu, Roskilde) or have had to be rescued by either the state (Fannie, Freddie, AIG) or acquired by a rival (HBOS, Alliance & Leicester). Libor levels have, in the past week, risen to highs not seen since 1992 with banks choosing to hoard cash or deposit it with central banks. The Bank of England last Thursday was holding £6bn of bank deposits against a long term average of around £1bn. Much of the Commercial Paper market (circa 90%) is currently rolling overnight. The Irish financial sector is experiencing extreme difficulties with wholesale market access all but non-existent. Even post the quarter end (30 September 2008) we feel this is unlikely to improve in the context of a worsening macro economic environment and a general backdrop of deteriorating asset quality.

While Irish banks have not had the same exposure as other banks to structured credit and US mortgage/real estate risks, their loan assets are concentrated in residential and commercial property where asset values have been falling and are expected to continue to fall as the international economy contracts. The liquidity issues facing Irish banks are compounded by investor concerns with regard to the high concentration of commercial property risk in their respective asset portfolios.

The three institutions where these liquidity issues have been most pronounced have been Irish Nationwide, Anglo Irish Bank and Irish Life & Permanent. AIB, Bank of Ireland and EBS, while experiencing reduced access to liquidity continue to have access to wholesale funding (for example with the ECB) and do not have such acute near-term liquidity issues based on the information provided to the Financial Regulator. EBS as a smaller institution is likely to be more vulnerable as time goes on.

It is important to stress that at present, liquidity concerns aside, all of the Irish banks are profitable and well capitalised. However, liquidity for some could run out in days rather than weeks. Anglo Irish has recently approached the Central Bank with a proposal to create a new funding facility that the Central Bank would accept commercial mortgage assets in return for cash. Anglo are rapidly approaching the point where they have exhausted all possible sources of liquidity available via the market or their ECB eligible collateral is close to being fully utilised.

This memo sets out the strategic options available to the Government. There is no right or wrong answer and the situation is very fluid with financial institutions experiencing difficulty and being supported by governments on a daily basis. Preserving flexibility is key and the solution may be different for each institution. The important issue is for the Government to preserve the stability of the Irish financial system overall and to safeguard the interests of individual bank customers to avoid widespread panic. That said, there is a limit on the financial resources available to the Government and there may be a need to preserve firepower as events unfold. The implications of each option in terms of whether it constitutes State Aid also needs to be carefully considered.

It is clear that certain lowly rated monoline banking models around the world, where there is concentration on a single asset class (such as commercial property) are likely to be unviable as wholesale markets stay closed to them. This has inevitably had an impact on our conclusions and we believe it is important to act quickly to deal with these institutions to avoid a systemic issue.

2) Summary description of the reviewed institutions

Further information is contained in Appendix A

Irish Nationwide Building Society

INBS is primarily a retail deposit funded, commercial property lender with a relatively small residential mortgage book of just over €2 billion. The asset quality of the commercial loan book is regarded as being generally good. However there are concerns over the influence of the Chief Executive. Based on their own management projections, INBS have liquidity sufficient to meet their needs for around one to two months depending on the level of withdrawals. In the extreme stress case analysis the total writeoffs including loss of interest income would just deplete most of INBS reserves of €1.8 billion.

Anglo Irish Bank

Anglo is a commercial property lender with loan assets of Eur 72bn. Only 3% of the loan book is currently regarded as impaired by Anglo management however falling property prices are likely to impact their book particularly where they have lent on speculative development. If one was to apply the INBS stress case scenario the writeoffs would deplete ordinary shareholders and other lower category subordinated debt by €7.5 billion. The main issue for Anglo is a pressing need for liquidity as a result of a sustained outflow of corporate deposits and overnight funding being

unavailable to banks of their credit rating. Based on current market conditions, management is projecting a funding deficit of €0.1bn on Tuesday 30th September growing to €4.9bn by 24th October. On Friday 26 September Anglo have formally requested a short term liquidity advance of €1.7bn from the Central Bank for the end of the month.

Irish Life and Permanent

IL&P is a bancassurer with a leading life insurance company and a retail bank focused on providing residential mortgages. The asset quality is good but IL&P rely heavily on wholesale funding and are approaching the limit of their eligible collateral at the ECB. Under a "worst case" scenario, where interbank cannot be rolled and corporate deposits are withdrawn upon maturity whilst retail deposits remain flat, Irish Life & Permanent would have a negative net cash position of €2.1bn by 9th October 2008.

3) Strategic options

The strategic objective is to address the immediate liquidity issues of the three institutions and allow the situation to unfold. Given current instability in financial markets this could happen quite quickly and there could be a need to implement a combination of the options below. All solutions require financial resources from the Government and could add pressure to the sovereign credit rating and the borrowing costs of the Irish Government.

Whilst we set out the various strategic options within this memo, we have also fully considered, and ultimately discounted, one additional outcome - allowing an Irish bank to fail and go into liquidation without any government intervention. Whilst this option would initially have no financial impact to the government, the resulting shock to the wider Irish banking system could, in our view, be very damaging. The ensuing 'firesale' of assets could precipitate dramatic asset deflation and hence force other Irish banks to take significant write downs on their own asset portfolios thus depleting their capital positions. The significant volatility in the equity and capital markets that would likely follow would mean access to any form of new capital for Irish banks would be severely restricted for a protracted period. Therefore, in order to minimise the impact of any bank failure on the rest of the broadly sound domestic financial institutions, we strongly advocate a more controlled interventionist approach.

(a) Immediate Liquidity Provision

The short-term liquidity issues for the banks need to be immediately addressed, most notably at Anglo which may have a net deficit as early as Tuesday 30 September. The wholesale markets are closed and the three banks have limited access to the ECB facility as self originated commercial property assets are not accepted as collateral and Irish Life & Permanent is reaching the limit of its available eligible collateral. If the ECB were to change this stance and accept a broader type of collateral then arguably there would be no need for the Central Bank to offer any additional liquidity.

If that is not the case, the Central Bank should be prepared to provide auxiliary overnight liquidity facilities at a penal interest rate to the banks that request it. There is then the question of whether this becomes known to the market. We believe it

could be sensible to let it be known that the Central Bank has been asked to provide additional liquidity to certain financial institutions so that debt and equity investors do not criticise the Government if/when further State intervention needs to take place, in particular if equity is acquired in the institutions for zero value. Taking the worst case scenarios of each bank we estimate there could be an immediate funding requirement of €5bn.

(b) State protective custody

The additional liquidity provided would allow Anglo and Irish Nationwide to offset any continuing deposit outflows with liquid assets. However, even if markets stabilise both institutions are likely to find it hard to fund themselves independently and the penal interest rate if they use the Special Liquidity Scheme (outlined below) will deteriorate their earnings. For that reason and to avoid systemic risk, the Government should make preparations for State intervention in either or both institutions, once it becomes evident to the market that they need to intervene. This could occur over a very short period of time i.e. within days, but at the point at which it occurs it will not be a surprise to debt or equity investors as knowledge of the institution's financial position will be obvious and they should expect such intervention in the absence of a private sector solution. At Anglo the majority of equity and debt investors are Irish, UK and US institutional holders, but there are significant retail interests including a major shareholding by Sean Quinn.

Irish Nationwide and Anglo either together or separately could be taken into State custody using either (i) common equity and/or (ii) a preferred plus warrants investment akin to the one used in the Freddie Mac and Fannie Mae situation.

A State guarantee would be given to all depositors and senior creditors as well as dated subordinated debt holders (given the crossover between these two holders) which would again send a strong implicit message to the investor community that this level of protection would be afforded to all other Irish banks. The business would be run off with no new loans extended and it would be logical to use this entity for the base for the "Bad bank" in Option (d) below. Equity holders and undated junior subordinated debt holders would receive nothing providing a capital cushion of €1.4 billion in the case of Irish Nationwide and €7.5 bn in the case of Anglo. It is important that all other creditors are reimbursed to avoid a contagion effect with the other Irish banks that continue to raise capital in the senior and subordinated debt markets.

The investment by State can be in the form of preferred instrument and/or common equity. In either case the Government will own and control the bank and its decision making. The advantage of the preferred investment is that it establishes a clear priority ranking for the government's investment over shareholders, the existing preferred investors, and undated subordinated debt holders. The preferred effectively leaves the shares outstanding, would still require the government to hold public shareholder meetings as well as file regular statements. This may be considered impractical. If the Government were to take over the equity in its entirety there would be no need to report on an ongoing basis and hold any AGMs.

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Loneragan, Ciara

From: Halpin Brian [Brian.Halpin@centralbank.ie]
Sent: 29 September 2008 20:57
To: Beausang, William
Subject: FW: Update on 4 banks

WILLIAM. Forgive format but this is our best information this evening. Brian

> -----Original Message-----

> From: Maher Michael
> Sent: 29 September 2008 15:40
> To: Grimes Tony; Halpin Brian; O'Hara Robert
> Subject: FW: Update on 4 banks

> Update on IL&P and Anglo

> IL&P
> Currently 0.5 billion short due to net outflows of 1.1 billion Plan to
> lower reserve requirement by 300m and draw 200m/300m on MLF Lost all
> interbank (586m) Lost 0.225 billion on corporate deposits (1.5
> billion of 1.7 billion rolled) Lost 0.26 billion from maturing CP/CD
> Down 100 million on O/n TAF

> Anglo
> Currently 1.6 billion short. Plan to lower reserve requirement by 600m
> and borrow 0.9 billion on MLF Lost 1.1 billion of corporates Interbank
> repo down 1.1 billion
> 0.2 on maturing CP
> 0.2 lower on o/n TAF

> -----Original Message-----

> From: Maher Michael
> Sent: 29 September 2008 11:53
> To: Grimes Tony; Halpin Brian; O'Hara Robert
> Subject: Update on 4 banks

> AIB
> No activity in Interbank this morning
> They had squared most of today's positions on Friday Highlighted large
> w/e deposit with ECB 28.1 billion and MLF of 6.8 billion as further
> evidence of crisis Glitner bank nationalised this morning Happy to see
> 5 week ECB operation. Difficult to know what rate(s) they should bid

> BoI
> Interbank market closed this morning as no one knows who could be next
> to fail
> 0.5 billion of CP and central bank deposits maturing today Still have
> 13/14 billion deposits rolling. These are o/n and call accounts Happy
> to see 5 week ECB operation. Difficult to know what rate(s) they
> should bid

> Anglo
> Short on day due to interbank (0.5) and corporate deposit (3.5
> billion) rolling,1.2 billion of euros maturing in o/n TAF and 0.2 of
> CP maturing Were long (0.8 billion) on reserve requirement over
> weekend which can be used against short position Got 1 billion of
> euros this morning in o/n TAF Expect to lose 0.1 billion retail
> Worried about Wachovia as it clears their \$ trades Happy to see 5 week
> ECB operation. Trying to access available collateral.Difficult to know
> what rate(s) they should bid

> IL&P
> Short 2 billion at opening
> Were long (0.7 billion) on reserve requirement over weekend which can

> be used against short position Have 500m of euro matruing in O/N TAF
> and got 400m in today's o/n Corporate deposits rolling of 1.7 billion
> Interbank rolling of 0.5 CP maturing of 0.2 Expect to bid for 5 week
> money with a number of bids between 4.6% and 4.90% (Market currently
> at 5%)
>
>

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"*****"

Tagann an ríomhphost seo ó Bhanc Ceannais agus Údarás Seirbhísí Airgeadais na hÉireann. Tá an ríomhphost, agus aon iatán a ghabhann leis, faoi rún agus faoi phribhléid agus ceaptha d' aontoisc le haghaidh úsáide an té nó na heagraíochta chun a ndíreofar iad.

Tá dianchosc ar chraobhscaoileadh, ar dháileadh nó ar chóipeáil neamhúdaraithe ar bith, díreach nó indíreach, an ríomhphoist seo nó aon iatán a ghabhann leis. Má tá an ríomhphost seo faighte agat trí dhearmad, cuir an seoltóir ar an eolas agus scríos an t-ábhar ó do chóras le do thoil.

"*****"

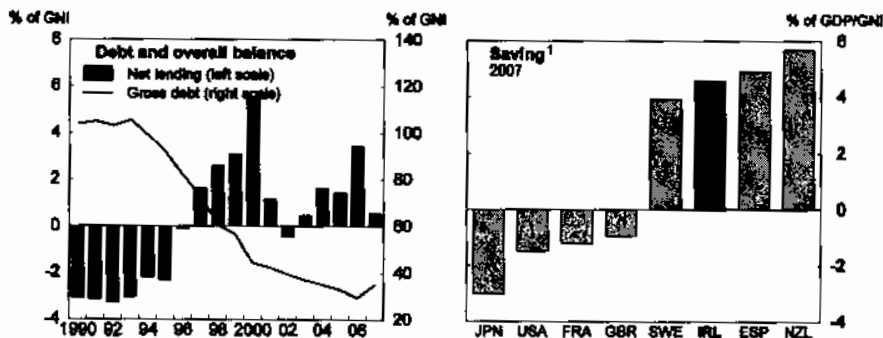
Fiscal policy should adapt to lower revenue growth

39. The fiscal position was strong in the years up to 2006, despite one of the largest increases in public spending in the OECD, owing to the rapid expansion in revenues (Chapter 4). The general government account has been close to balance or in surplus since 1995 and public debt has become very low (Figure 1.11). The level of public savings (current revenue minus current expenditure) was one of the highest in the OECD and this has left ample room to fund longer-term capital investment. Around 4% of GNI is being spent on new infrastructure and other public assets. By law, 1% of Irish GNP is put into a pension reserve fund in order to partly pre-fund future pension liabilities.

40. Revenue growth, however, slowed sharply in 2007 and the fiscal balance fell to around 0.6% of GNI from 3.4% the previous year. Stamp duty and corporation tax receipts were lower in 2007 than the previous year (CT was expected to be lower, due to negative cash flow implications of bring forward the payment date for preliminary CT). Stamp Duty receipts are expected to decelerate further in 2008. This weakness in revenues, alongside the planned slowdown in expenditure growth, is anticipated to lead to a deficit of around 1¼ per cent of GNI for 2008 and 2009. Recent developments highlight some fragility in elements of tax revenue (Chapter 4). In the longer term, distortionary and costly tax expenditure should be eliminated where these cannot be shown to be effective. A Tax Commission has been established to consider these issues, as well as others such as the financing of local government and a carbon tax.

41. Spending growth is planned to slow in the coming years but will continue to be fairly rapid in 2008. Implementation of the NDP and infrastructure investment has been given priority and fiscal plans remain prudent overall. However, it is important to avoid locking in generous long-term social expenditure and public sector wage commitments at this point of the revenue cycle.

Figure 1.11. Fiscal performance has weakened
General government sector



1. OECD estimates; current revenue less current expenditure. Ireland in per cent of GNI. Outlook projections for Ireland updated to include later information on the fiscal position.
Source: OECD (2007), *Economic Outlook 82 database* and OECD calculations.

42. With revenue growth likely to be constrained over the next few years, the public sector will need to give more emphasis to boosting efficiency and effectiveness. Steps have already been taken in this direction but more needs to be done. A review of the Irish Public Service by the OECD which has been commissioned by the Irish government is currently underway.

43. In the future, it is important that additional expenditure leads to increased volume and quality of public services rather than being absorbed in wages and prices. The second Public Sector Benchmarking

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- Deleted: Since 2000, between a quarter and a third of the increase in total tax revenues was related to the property boom. This amounts to more than 4% of GNI, and the total contribution is greater still when the spillover effects to the wider economy are taken into account. A further 1.5% of GNI now comes from corporation tax on the multinational sector. All in all, a substantial share of revenues is vulnerable to structural changes in the economy such as the current correction in the housing market or a shift in sentiment by foreign investors that could occur at any time
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THEME: C3

Appropriateness and effectiveness of the Department of Finance actions during crisis

LINE OF INQUIRY: C3c

Effectiveness of reviews of banks' loan books and capital adequacy

Section 2

Executive Summary

The assessment of loan loss provisions is difficult especially as previous economic downturns are not necessarily a guide to the present. IFRS impairment provisioning is prescriptive resulting in recognition lags and an expectation gap.

- There are a number of factors which make it difficult for banks to reliably assess the level of loan loss provisions required at present as set out below.
- Ireland and the UK have experienced benign credit conditions for the past 10 years which means there is no recent data on the impact of economic deterioration on loan impairment. Arguably, historic data from previous downturns is not relevant because it relates to a time when the scale and structure of the Irish economy were completely different, for example, Ireland had its own currency and interest rate and environment in the early 1990's but is now euro zone member.
- The level of deterioration has been triggered in part by a level of global financial turmoil that has never been experienced before and was unanticipated. Governments are working hard to stabilise the position and restore economic growth as quickly as possible. However, there are many variables to be considered resulting in a wide range of potential outcomes.
- IFRS provisioning is based on "incurred impairment". Incurred impairment is based on identified specific impairment factors (for example, loans overdue by 90 days) and statistically defined incurred but not reported (identified) impairment. There is an inherent lag between economic factors that indicate that loan losses will occur (for example, decline in property values, interest rate changes, unemployment etc.) and specific impairment factors which will crystallise the booking of a specific impairment provision.
- IFRS requires that internal models are adjusted where the past is no longer a reliable guide to the present in respect of the levels of impairment. However, it is very difficult to do this as both the timing and extent to which actual impairment can be correlated to a change in the external economic indicators cannot be calculated reliably. This lag process also gives rise to an expectation gap as to the timing of booking of impairment provisions, particularly, as regards some market commentators and the media.
- The areas where impairment provisions and expected losses are beginning to manifest themselves are in development land banks, residential development and to a lesser extent commercial real estate development. The impact on other sectors will be slower and more linked to general economic trends, that is, impairment provisions will tend to be recognised through 2009 and 2010 and later years if the economic downturn continues.

There are different business models and approaches and credit management criteria adopted by the 6 Institutions which means there are different attitudes to interest roll up, refinancing and security (1 of 2)

Area	Comment
<i>Interest roll up</i>	Most of the Banks provide interest roll up facilities, in particular, when providing development facilities. The extent to which interest roll up is permitted in any case is determined by policy limits, including the strength of the individual client, other cash flows and security and underlying asset values. The Bank's indicated that interest roll up is continually assessed by relevant lending and risk management. In some cases interest roll up may be extended where deemed appropriate, for example, as underlying asset values increase or to reflect the strength of a borrower or as part of a restructuring. This would be consistent with our sample reviews of the larger loans, particularly longer term Irish development land plays in some banks (Anglo and INBS in particular). In other cases IRU is ended after a specified time period (AIB), although there may be exceptions, and steps are taken to have cash repayment. Interest roll up and capitalisation is permitted under IFRS.
<i>Refinancing unencumbered assets</i>	Some banks had a policy of advancing further funds against unencumbered assets to provide borrowers with funds to meet shortfalls in cash interest or capital repayments and thereby maintain compliance with facility terms.
<i>Promoter capital</i>	During our review we noted a higher level of promoter equity invested in projects in some banks (AIB) when compared to others, for example, Anglo. This gives greater degree of comfort in such cases because there should be a larger cushion before provisioning arises.
<i>Use of own resources</i>	In a number of cases we observed that shortfalls in cash interest or capital repayments are being made up out of the borrower's other resources. In the event there is a prolonged economic downturn or inability to realise assets such borrowers could end up in a default position in the next few years. This could drive another round of impairment provisioning.
<i>Grading of borrowers</i>	The different banks use different grading systems. As a result grades are not necessarily directly comparable between the Banks. However, we noted cases where grades for the same borrower appear to differ between Banks. It should be noted that there may be genuine reasons for such differences in some cases.

There are different business models and approaches and credit management criteria adopted by the 6 Institutions which means there are different attitudes to interest roll up, refinancing and security (2 of 2)

Area	Comment
<i>Impairments</i>	We noted cases where there were impairment provisions against a borrower in one institution but not in others. This could be attributed to a harsher view being taken in some cases.
<i>Collateral differences</i>	The Banks take different approaches to loan security with cross collateralisation and recourse to personal guarantees being favoured by Anglo as against 'ring fenced' security packages being used by other lenders. It should be noted that a variety of approaches to security are taken by all lenders with all taking what they consider to be appropriate security at the time loans are issued. We noted no evidence of any of them having problems enforcing security in recent years, however, this can be attributed to a more benign economic environment.

Section 2.1

Capital and Stress Scenarios

The latest available capital information for the Banks shows current core Tier 1 ratios ranging from 5.9% (Anglo) to 8.6% (INBS) as at 30 September 2008 before any stress testing or scenario analysis

Capital and RWA

€ in millions	AIB	BOI	Anglo	INBS	ILP	EBS
	Sep-08	Sep-08	Sep-08	Sep-08	Sep-08	Sep-08
Tier 1 Capital	10,642	10,142	7,202	1,364	1,955	818
Non core	2,092	2,833	2,139	-	-	-
Core Tier 1	8,550	7,309	5,063	1,364	1,955	818
Tier 2 Capital	4,108	4,088	3,123	471	-	255
Total Capital	14,750	14,230	10,325	1,835	1,955	1,073
Risk Weighted Assets	141,883	116,179	85,853	15,812	19,426	9,791
Tier 1 Ratio	7.5%	8.7%	8.4%	8.6%	10.1%	8.4%
Core Tier 1 Ratio	6.0%	6.3%	5.9%	8.6%	10.1%	8.4%
Total Capital Ratio	10.4%	12.2%	12.0%	11.6%	10.1%	11.0%

Source: Management information

- The table opposite sets out the Banks' estimated capital ratios and risk weighted assets at the 30 September 2008.
- Core Tier 1 ratios vary from 5.9% (Anglo) to 8.6% (INBS).

PwC scenario analysis is based on a number of assumptions and, other than INBS, has not been reviewed by management in the Institutions. This scenario analysis is not our assessment of likely losses but is to illustrate sensitivity to increased levels of losses.

Scenario Analysis

Loan Category	Impairment bps	
	Scen 1	Scen 2
Residential Mortgages	15	15
RIPS	120	120
Commercial / Corporate	150	125
Development land without planning permission	1,000	1,500
Development land with planning permission	600	1,000
Consumer lending unsecured (incl credit cards)	300	300
Consumer lending secured	150	100

Source: Pw C scenario

This change has only a €7.5 million impact in the scenarios below.

Losses and bps - PwC Scenarios

€ in millions	Institution's Loss Scenario (2009)		PwC Scenario 1		PwC Scenario 2	
	Loss	bps	Loss	bps	Loss	bps
AIB	2,040	152	3,203	233	4,052	294
BOI	1,458	100	2,359	163	2,799	194
Anglo	1,450	200	2,255	303	2,980	401
ILP	52	13	316	76	320	77
EBS	19	13	105	62	125	74
INBS	138	121	387	346	N/A	N/A

Source: Pw C Analysis

The impact on RIPS of a 20 bps change in the sensitivity is circa €92.2 million. For Commercial / Corporate the impact of a 25 bps change in the sensitivity is €453.5 million. Note that this does not include INBS.

- On the following pages, in addition to management's assessment of worse case scenarios we have included estimates of loan losses based on PwC Scenario 1 set out in the table opposite. Note that this is not our assessment of the likely losses but is for illustrative purposes only to show the sensitivity of the Institutions to losses of this quantum.
- Except for INBS, the Banks have not seen these loan loss impairment charges. INBS management believe the PwC scenarios to be unrealistic.
- There were a number of assumptions made in allocating the balances to the categories opposite. These assumptions and the calculations have not been reviewed by management in the Banks (other than INBS who completed the calculations themselves) and may therefore include misclassifications which would therefore impact, potentially significantly, the estimated impairment charges. In addition, the charge is on the gross balance as information was not available in all cases to allocate impairment provisions to each category of loan.
- The table opposite sets out:
 - The loss for each institution based on their most severe stress scenario. These stresses were completed on different bases and at different times and are not therefore directly comparable; and
 - A summary of the application of PwC's Scenarios 1 and 2 to the Institutions' forecast loans to customers.
- AIB and Anglo have more significant development exposures and are therefore more severely impacted by the PwC development land loss scenarios.
- The move from PwC Scenario 1 to Scenario 2 is driven by impairment increases of €907 million on development land without planning permission and €1,592 million in relation to development land. This is offset by reductions of €446 million from commercial / corporate and €7.5 million on unsecured consumer lending.
- The impairment charges in bps are greater than historic peaks.

Assumptions in relation to future capital scenarios are based on different approaches to estimating RWAs and capital; the impact of AIB's approach is harsher than the Bol and Anglo own "worst case" scenarios. The difference cannot be estimated accurately.

Assumption	AIB	Bol	Anglo
<i>Loan Growth</i>	€1.2 billion of net additional loans assumed in FY10	No loan growth assumed in period 2009 to 2011	No loan growth assumed in period 2008 to 2010
<i>Risk Weighted Assets</i>	RWA to grow by €22.8 billion from 31 December 2008 to 2011 due to a one grade ratings downgrade of entire IRB book; two grades for property loans. This applies to 61% of book.	RWA to grow by €3.6 billion from 31 March 2009 to 2011. This is less than AIB which is in partially attributable to a larger mortgage book and a smaller land and development loan book.	RWA assumed to stay constant from 2008 to 2009 and 2010 subject to deductions for loan losses
<i>Guarantee cost</i>	Estimate of cost included	Estimate of cost included	Estimate of cost not included. Every €25 million of cost has a 3bps impact on core Tier 1 capital.
<i>Capital raising/ retention</i>	No capital raising assumed in period to 2010	€600 million of non core Tier 1 capital callable in 2011 is assumed to be replaced	No capital raising assumed in period to 2010
<i>Accounting losses greater than expected losses</i>	Expected losses in excess of accounting impairment provisions on IRB book are deducted from regulatory capital. Any excess accounting impairment can be added back but is not estimable, however, it should be positive for AIB.	Expected losses in excess of accounting impairment provisions on IRB book are deducted from regulatory capital. Any excess accounting impairment can be added back but is not estimable, however, it should be positive for Bol.	Anglo adopts the standardised approach to the entire book.

Assumptions used in calculating capital scenarios omit factors which could materially impact the calculation of capital ratios. PwC have adjusted Anglo's opening position for increased impairment provisions arising from the completion of the year end accounts.

Assumption

Comment

Expected losses

Expected losses have not been adjusted to reflect the deterioration implied by the increased impairment losses built into the PwC scenarios as we are not in a position to calculate these effects. No benefit has been given to AIB or Bol for expected losses in excess of accounting impairments which have been taken off AIB or Bol's worst case capital position. Where accounting impairment exceeds expected losses there is a potential add back to capital. As we have not been able to calculate the impact of the PwC scenarios on expected losses we cannot estimate the impact of any potential add back which is also subject to regulatory approval.

Impairment losses and RWA

It has been assumed loan impairment losses will have a one for one impact on RWA. This will not be the case, in particular, for IRB assessed loans.

Anglo opening position

The base capital position for Anglo was calculated prior to the finalisation of the 30 September 2008 financial statements which are still open. There has been a subsequent reduction of circa €600 million in core Tier 1 capital due to increases in impairment provisions since the date the capital scenarios were prepared.

Taxation

We have deducted the estimated impact of tax when adjusting capital for additional impairment provisions coming from PwC's Scenario 1. In relation to the Banks' own estimates only INBS have taken credit for the benefit of the tax allowable element of impairment charges.

Capital management options

We have not taken into account possible management actions to improve capital ratios in any of the Banks, for example, possible sale of M&T by AIB.

Core capital falls from 5.9% in FY08 to 5.6% in FY10 in AIB's worst case scenario and falls to 4.2% in 2010 under the PwC scenario; this improves to 4.9% core Tier 1 (Tier 1: 6.4%) when AIB's RWA are "normalised" to the Bol/Anglo RWA basis

AIB Profitability and "Worst case" Impairment

€ millions	2008	2009	2010
Retained earnings before impairments	2,127	2,060	2,060
Impairment	1,057	2,040	1,240
Retained earnings	1,070	20	820
Impairment charge in bps	80	152	93
Capital Ratios			
Core Tier 1	5.9%	5.5%	5.6%
Tier 1	7.4%	7.0%	7.0%

Source: Management PFI

PwC Scenario Analysis - Illustrative Only

€ millions	2008	2009	2010
Retained earnings before impairments	2,127	2,060	2,060
PwC Impairment	1,057	3,203	3,203
Retained earnings *	1,070	(1,143)	(1,143)
Impairment charge in bps	80	233	233
Difference from management "worst" case	-	(1,163)	(1,963)

Capital Ratios - Regulator's Request			
Core Tier 1	5.9%	4.9%	4.2%
Tier 1	7.4%	6.4%	5.5%
Capital Ratios - Bol/Anglo Basis			
Core Tier 1	6.1%	5.4%	4.9%
Tier 1	7.6%	7.0%	6.4%

* Note that the impact of the additional levels of losses on tax has not been adjusted in the AIB worst case scenario

Source: Management PFI and PwC Illustrative scenario analysis

- AIB prepared 2 stress scenarios for profitability and impairment charges. The worst case is set out opposite. This stress scenario forecasts retained earnings before tax and impairments of €2.1 billion for both FY09 and FY10 or consistent with FY08.
- The increase in impairment charges is assumed to take place primarily in FY09. The quantum of the charge was a management judgement. The impairment charge increases from €1.1 billion (80 bps) in FY08, to €2.0 billion (152 bps) in FY09 before falling to €1.2 billion (93 bps) in FY10.
- AIB have circa 61% of their book on IRB with the remaining 39% Standardised for capital purposes. AIB's 2 scenarios were based only on the IRB portfolio.
- The worst case stress test assumed that all IRB loans went down by 1 grade over the period to FY11 with all property loans moving down 3 grades. These downgrades were used to calculate expected losses. Capital was reduced where the expected losses exceeded the accounting impairment relating to the IRB loans.
- Whilst the stress of the IRB portfolio did not impact 39% of the loan book, management felt that the quantum of the charge in their scenarios was appropriate and that no further stress was therefore necessary.
- Core Tier 1 capital in the stress scenario is forecast to reduce from 5.9% in FY08 to 5.5% in FY09 and recover to 5.6% in FY10.
- The PwC loan loss scenario 1 would reduce retained earnings (pre tax) by a further €1.2 billion in FY09 and €2.0 billion in FY10 and increase impairment charges from 80 bps (FY08) to 233 bps (FY09 and FY10).
- AIB's RWA are forecast to increase more strongly than Bol or Anglo with an increase of €22.8 billion from 2008 to 2010 due to the aggressive IRB grade reduction noted above. To "normalise" this we have estimated AIB's capital ratios on a similar basis to Bol and Anglo by keeping RWA steady at the 2008 level subject to loan loss deductions. This improves AIB's capital ratios by circa 60 bps with a Core Tier 1 ratio of 4.9% estimated on this basis for 2010. (See lower box opposite.)

Bol has estimated a stressed loan loss scenario which indicates losses of 100 bps for FY10 and FY11. Core Tier 1 increases from 6.3% in FY09 to 6.6% in FY11 in Bol's worst case scenario and falls to 5.5% in 2010 under the PwC scenario (Tier 1: 7.3%).

BOI Profitability and "Worst case" Impairment

€ millions	2009	2010	2011
Profit before tax and impairments	1,674	1,692	1,767
Impairment	845	1,458	1,440
Profit before tax	829	234	327
Impairment charge in bps	58	100	100
Capital Ratios			
Core Tier 1	6.3%	6.4%	6.6%
Tier 1	8.7%	8.7%	8.9%

Source: Management PFI

PwC Scenario Analysis - Illustrative Only

€ millions	2009	2010	2011
Profit before tax and impairments	1,674	1,692	1,767
Impairment	845	2,359	2,359
Profit before tax	829	(667)	(592)
Impairment charge in bps	58	163	163
Difference from management "worst" case	-	(901)	(919)
Capital Ratios - Regulator's Request			
Core Tier 1	6.3%	5.8%	5.5%
Tier 1	8.7%	8.2%	7.3%

* Note that the impact of the additional levels of losses on tax has not been in the Bol worst case scenario

Source: Management PFI and PwC Illustrative scenario analysis

- BOI management are forecasting profit before tax and impairments of €1.7 billion for FY10 which is consistent with FY09 with an increase to €1.8 billion forecast for FY11.
- In August 2008 a loan loss scenario was prepared for each of the Bank's business units. The results of this loan loss scenario indicated a loss of 60 bps for the book in FY10. In the pre-close statement, the Bank indicated losses for FY10 between 60-90 bps.
- The loan loss scenario was revisited in October 2008, factoring in the significant market downturn. The bottom-up output was tested for ability to absorb the following stress factors:
 - House prices 30% below market peak for property development/ mortgage books;
 - Additional 18 month carrying period for development/landbank books;
 - 35% to 65% discounts for landbank as appropriate;
 - Unemployment 8%/9% range for Ireland/UK; and
 - Current interest rate levels.
- This results in an estimated impairment charge of €1.5 billion and €1.4 billion (circa 100 basis points each) for FY10 and FY11, respectively (FY09: 58 bps).
- Core Tier 1 Capital is forecast to increase from 6.3% (FY09) to 6.6% in FY11.
- The PwC loan loss scenario 1 reduces profit before tax by a further €0.9 billion in FY09 and FY10 and increases the impairment charge from 58 bps in FY09 to 163 bps for each of FY10 and FY11.
- We have adjusted capital for the impact of additional impairments and also deducted €600 million in FY11 on the assumption that capital maturing in that year will not be replaced. This reduces the core Tier 1 ratio to 5.5% in FY11.

Anglo's Core Tier 1 capital increases from 6.6% in FY08 to 7.0% in FY10 in its worst case scenario and falls to 5.2% in 2010 under the PwC scenario (Tier 1: 7.8%)

Anglo Profitability and "Worst case" Impairment

€ millions	2008	2009	2010
Profit before tax and impairments	1,485	1,639	1,737
Impairment	500	1,450	1,450
Profit before tax	985	189	287
Impairment charge bps	70	200	200

Capital Ratios			
Core Tier 1	6.6%	6.8%	7.0%
Tier 1	9.1%	9.3%	9.5%

Source: Management PFI

PwC Scenario Analysis - Illustrative Only

€ millions	2008	2009	2010
Profit before tax and impairments	1,485	1,639	1,737
Impairment	500	2,255	2,255
Profit before tax	985	(616)	(518)
Impairment charge bps	70	303	303
Difference from management "worst" case	-	(805)	(805)

Capital Ratios - Regulator's Request			
Core Tier 1	5.9%	5.5%	5.2%
Tier 1	8.4%	8.1%	7.8%

* Note that the impact of the additional levels of losses on tax has not been adjusted in the Anglo worst case scenario

Source: Management PFI and PwC Illustrative scenario analysis

- Anglo management have run models under 4 sets of assumptions (Base, Scenarios 1, 2 and 3) covering the forecast period to 2011. Scenario 3 is set out opposite. Anglo consider this Scenario to be unrealistic.
- The scenarios were based on the expected 2008 result which at that stage had not been finalised and is subject to audit. The current 2008 expected result contains higher impairment and IBNR provisions than in the Base case. We have not adjusted for these in Anglo's model, however, see below re PwC scenario analysis. The forecast underlying trading numbers were prepared on a high level basis. The management exercise focussed primarily on the impact on the Bank's capital position of increased impairment and funding cost scenarios.
- In relation to the forecast trading (pre-impairment) position the Base Case profit for 2009 was forecast at 96% of the 2008 estimated outturn. Scenario 3 assumes additional Treasury mark to market losses of €100 million and €50 million in 2009 and 2010, respectively.
- Any cost of the Government guarantee is not reflected in the numbers (every €25 million has a 3 bps impact on Tier 1 Equity).
- PwC's loan loss Scenario 1 reduces profit before tax by a further €0.8 billion in FY09 and FY10 and increases the impairment charge from 70 bps in FY08 to 303 bps for FY09 and FY10.
- The FY08 Base case was calculated prior to the finalisation of the FY08 financial statements. There has been a subsequent reduction of circa €600 million in core Tier 1 capital mainly due to increased impairment provisions since the date the Anglo capital scenarios were prepared. We have adjusted for this reduction in capital in the illustrative PwC scenario analysis.

INBS have run PwC's scenario on their own model. This shows a reduction in Core / Tier 1 capital from 8.3% to 7.1% from FY08 to FY10 due to higher impairment provisions partially offset by the effect of a reduction in RWA of circa 15%.

INBS Profitability and "Worst case" Impairment

€ millions	2008	2009	2010
Retained earnings before impairments	216	151	152
Impairment	104	138	129
Retained earnings	112	13	23
Impairment bps	86	121	121
Capital Ratios			
Core and Tier 1	8.3%	9.2%	9.9%

Source: Management PFI

PwC Scenario Analysis - Illustrative Only

€ millions	2008	2009	2010
Retained earnings before impairments	216	155	157
PwC Impairment	168	496	445
Retained earnings *	49	(341)	(289)
Impairment bps	124	346	342
Difference from management "worst" case	(64)	(355)	(312)

* Note that these calculations were carried out by management using the PwC provided loss assumptions

Capital Ratios - Regulator's Request			
Core Tier 1	8.3%	7.6%	7.1%
Tier 1	8.3%	7.6%	7.1%

Source: Management PFI and PwC illustrative scenario analysis

- INBS management have run models for 3 scenarios (Base, Stress and Extreme Stress) covering the 5 year forecast period to 2013, with Years 4 and 5 returning to more normal levels of stress. The table opposite sets out the extreme stress scenario.
- Retained earnings before impairments reduce from €216 million to €151 million from FY08 to FY09 and remains broadly at this level in FY10.
- The impairment charge increases from €104 million (86 bps) in FY08 to €138 million (121 bps) in FY09. Whilst there is some improvement in FY10 the charge is €129 million (121 bps). This reduction is largely as a result of the forecasted contraction in the loan book. RWA are budgeted to fall from €15.8 billion at 30 September 2008 to €13.4 billion at 31 December 2010 or a fall of 16%.
- The scenarios are based off the estimated 2008 result and have assumptions in relation to funding costs/sources, loan book contraction, fee income (significant levels), impairment charges and the guarantee cost.
- INBS also ran a stress scenario through their own model using the PwC Scenario 1 assumptions the results of which are detailed in the lower table opposite. INBS believe that PwC's stress scenarios are unrealistic.
- PwC loan loss scenario 1 reduces retained earnings by a further €355 million and €312 million in FY09 and FY10 respectively and increases the impairment charge from 124 bps in FY08 (INBS worst case is 86bps) to 346bps and 342bps in FY09 and FY10, respectively.

Whilst the ILP stress analysis has not been updated since May 2008, ILP management believe that their extreme case is broadly in line with the current economic outlook. Under the PwC Scenario 1 Tier 1 and Solvency ratios fall to 7.2%.

ILP Profitability and "Worst case" Impairment

€ millions	2008	2009	2010
Projected Profits	211	158	159
Impairment	32	92	87
Profit before tax	179	66	72
Impairment bps	9	23	21

Capital Ratios			
Tier 1	8.1%	8.2%	8.5%

Source: Management PFI

PwC Scenario Analysis - Illustrative Only

€ millions	2008	2009	2010
Profit before tax and impairments	211	158	159
Impairment	32	316	316
Profit before tax	179	(158)	(157)
Impairment bps	7	76	76
Difference from management "worst" case	-	(224)	(229)

Capital Ratios - Regulator's Request			
Core Tier 1	8.1%	7.5%	7.2%
Tier 1	8.1%	7.5%	7.2%

* Note that the impact of the additional levels of losses on tax has not been adjusted in the ILP worst case scenario

Source: Management PFI and PwC Illustrative scenario analysis

- At the Financial Regulator's request, on 29 May 2008, ILP management ran models for two scenarios (Base and Extreme Stress) covering the 3 year forecast period to 2011. The extreme stress results are set out opposite.
- The Base and Extreme Stress scenarios are based on macro economic assumptions provided by the Central Bank. The main assumptions in the Extreme Stress (Shock) are summarised as follows:
 - a downturn in world demand (4% fall in world trade);
 - a sharp appreciation of the euro exchange rate (10% rise);
 - a sharp fall in inward FDI;
 - a further downward correction in the housing market (housing output falls to circa 30,000 units per annum);
 - a deterioration in consumer confidence from worsening market conditions; and
 - A period of prolonged uncertainty in financial markets.
- Most of the shocks are front loaded in 2009 and 2010 and will unwind in 2011.
- We have compared the assumptions underlying the base and extreme stress scenarios to the Central Bank Quarterly Bulletin No.4 2008 (October), which is forecasting similar assumptions for 2008 and 2009 to those included in the Extreme Stress scenario with a number of assumptions being slightly worse. In management's view the three factors that impact the model are house price movements, interest rates and unemployment.
- PwC's loan loss scenario 1 in FY09 and FY10 reduces PBT by a further €264 million and €245 million and increases the impairment charge from 7 bps in FY08 to 76 bps for FY09 and FY10. This reduces Core Tier 1 and Tier 1 ratios to 7.2% by 2010. It does, however, have access to Life company funds to correct this.

EBS conducted a stress test at 30 June 2008 incorporating the ESRI mid term review's assumptions of May 2008. The PwC Scenario 1 stress results in a reduction in Core/Tier 1 capital to 8.9% by 2010.

EBS Profitability and "Worst case" Impairment

€ millions	2008	2009	2010
Impairment	19	105	105
Impairment charge bps	13	62	62

Capital Ratios			
Tier 1	9.2%	9.0%	8.9%

Source: Management PFI

PwC Scenario Analysis - Illustrative Only

€ millions	2008	2009	2010
Impairment	19	105	105
Difference from management "worst" case	-	-	-

Capital Ratios - Regulator's Request			
Core Tier 1	9.2%	9.0%	8.9%
Tier 1	9.2%	9.0%	8.9%

* Note that the impact of the additional levels of losses on tax has not been in the EBS worst case scenario

Source: Management PFI and PwC Illustrative scenario analysis

- EBS stress tests both its standardised and also its Internal Risk Based method of calculating its capital requirements. The stress test was last conducted at 30 June 2008 incorporating the ESRI Mid Term Review's (published May 2008) projected economic conditions for the next 3 years given a downturn scenario as a result of a credit crunch shock.
- The stressed scenario assumes the following which management indicate is a stressed but likely outcome in the current environment:

Scenario Assumptions

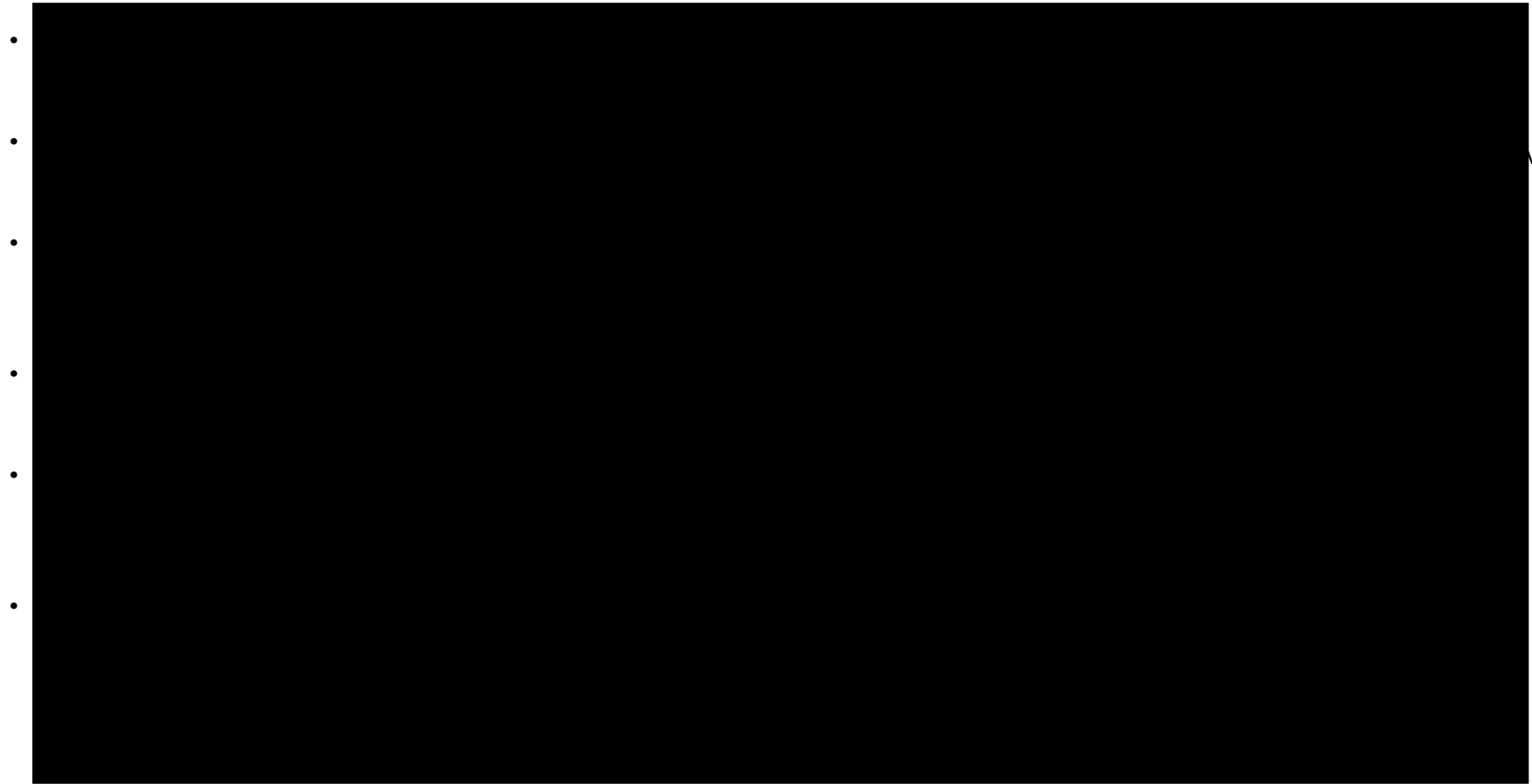
€ in millions	FY08	FY09
GDP Change	0.7	(0.6)
House Price growth %	(12.0)	(6.0)
Unemployment rate %	6.5	8.0
ECB %	3.5	2.5

Source: Management Information

IRB Approach (including Pillar II Risks)

- The stress test applied in this case reduced the Regulatory minimum by €95.6 million under Basel II requirements to €801.1 million. Under the standardised approach including Pillar II risks, the same result (€801.1 million) was also achieved.
- The table opposite sets out the provision for 2008 as being equal to 2007 (an estimate for 2008 is not available) and PwC Stress scenario 1. Stress scenario 1 would increase the impairment charge from €19 million (13 bps) in 2007 to €105 million (62 bps) in both 2009 and 2010.





The acquisition of large “trophy” development sites has put some major developers/property investors under significant cash flow pressure



Appendix D: Assumptions, Analyst Estimates and Trading Update

Recent Rating Agency Actions With Respect to Irish Banks

Rating Actions With Respect to Irish Banks Since 1 January 2008

Bank	Fitch	Moody's	S&P	Key Drivers
	<ul style="list-style-type: none"> Individual: B Senior long-term: AA- Outlook: Negative 14 Jul 2008: Outlook changed to Negative from Stable 	<ul style="list-style-type: none"> BFSR: B- Senior long-term: Aa2 Outlook: Stable 	<ul style="list-style-type: none"> Senior long-term: A+ Outlook: Negative 30 Jun 2008: Outlook changed to Stable from Positive 05 Nov 2008: Outlook changed to Negative from Stable 	<ul style="list-style-type: none"> Fitch: "The Negative Outlook reflects some uncertainty over the intensity and duration of the economic slowdown, which could cause AIB's profits and/or impaired loans to worsen more than expected" S&P: "The outlook revision to stable from positive reflects a more pessimistic assessment of the expected progression of AIB's property-backed commercial (P&C) loan portfolio now that the economic slowdown has accelerated" "The economic outlook presents further potential downside risks to asset quality and earnings, and there is no immediate capital support forthcoming from the guarantee scheme"
	<ul style="list-style-type: none"> Individual: B Senior long-term: A+ Outlook: Stable 	<ul style="list-style-type: none"> BFSR: C+ Senior long-term: A1 Outlook: Under Review 17 Oct 2008: Ratings placed on Review for Downgrade 	<ul style="list-style-type: none"> Senior long-term: A- Outlook: Credit Watch 30 Jun 2008: Outlook changed to Negative from Stable 05 Nov 2008: Rating downgraded from A- from A and placed on Watch Negative 	<ul style="list-style-type: none"> Moody's: "The rapid deterioration in the economic environment in Ireland and in the UK and the substantial reduction in property values leaves the bank vulnerable to increasing provisioning needs, and these factors have triggered this rating review" S&P: "The outlook revision has been triggered by the accelerating economic slowdown and an increasingly challenging operating environment. As a monoline business with concentration in commercial property-backed lending, and without a core deposit franchise, Anglo is more exposed than its higher rated peers to a precipitous deterioration in the economy. A rating outlook reflects our view that there is a one-in-three chance or greater of a change in the rating in the next two years" "The lowering of the long-term ratings on Anglo and IL&P by one notch reflects the backdrop of a deteriorating economic environment and, more specifically, the clear challenges facing these banks' respective business models in their current forms. The CreditWatch placement reflects current uncertainty around the scope and speed of the changes to their business and/or financial profiles"
	<ul style="list-style-type: none"> Individual: B Senior long-term: AA- Outlook: Stable 	<ul style="list-style-type: none"> BFSR: B- Senior long-term: Aa2 Outlook: Negative 19 Sep 2008: Outlook changed to Negative from Stable 	<ul style="list-style-type: none"> Senior long-term: A+ Outlook: Negative 30 Jun 2008: Outlook changed to Stable from Positive 05 Nov 2008: Outlook changed to Negative from Stable 	<ul style="list-style-type: none"> Moody's: "The negative outlook on the bank's BFSR primarily reflects the expected deterioration in the performance of the property and construction sectors in the UK and Ireland (which represent close to 26% of the bank's lending) and the consequent negative impact on the bank's asset quality which is expected to lead to higher provisioning requirements and weaker profitability" S&P: "The outlook revision follows a review of the ratings on Irish banks and reflects weaker near-term earnings prospects for BOI arising from the deterioration in the economic and market environment in Ireland and the UK, which renders the likelihood of an upgrade in the near term remote" "The economic outlook presents further potential downside risks to asset quality and earnings, and there is no immediate capital support forthcoming from the guarantee scheme"
	<ul style="list-style-type: none"> Individual: B Senior long-term: NR Outlook: Stable 	<ul style="list-style-type: none"> BFSR: C+ Senior long-term: Aa3 Outlook: Negative 07 Jul 2008: Outlook changed to Negative from Stable 	<ul style="list-style-type: none"> Senior long-term: A- Outlook: Credit Watch 14 Mar 2008: Outlook changed to Negative from Stable 30 Jun 2008: Rating downgraded to A from A+ 05 Nov 2008: Rating downgraded from A- from A and placed on Watch Negative 	<ul style="list-style-type: none"> Moody's: "The change in the outlook reflects: i) the bank's high reliance on market funding; ii) Moody's expectation of lower profitability; iii) the relatively high exposure to the buy-to-let sector in both Ireland and the UK; and iv) the deteriorating market environment in Ireland" S&P: "The outlook revision reflects Standard & Poor's view that ongoing market disruption and a higher cost of funding pressure the underlying financial performance of IL&P's banking operations" "The downgrade reflects ILP's challenged business and financial position in its banking division, arising from continued disruption in wholesale funding. With a primarily wholesale-funded balance sheet, and a competitive Irish mortgage sector constraining re-pricing, ILP has been affected more than other Irish banks, most of which have broader business profiles and more balanced funding bases in comparison" "The lowering of the long-term ratings on Anglo and IL&P by one notch reflects the backdrop of a deteriorating economic environment and, more specifically, the clear challenges facing these banks' respective business models in their current forms. The CreditWatch placement reflects current uncertainty around the scope and speed of the changes to their business and/or financial profiles"

