



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

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Volume 2: Inquiry Framework
Volume 3: Evidence

**Dept. of Taoiseach
DOT: Core Book 33**

January 2016

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THEME: C3

Appropriateness and effectiveness of the Department of Finance actions during crisis

LINE OF INQUIRY: C3b

Appropriateness of the bank guarantee decision

SECRET

Telephone Call with Prime Minister Brown

The Taoiseach spoke by telephone with Prime Minister Brown on Tuesday evening at 8.45pm. Following a discussion about current issues in respect of Northern Ireland, the PM raised the question of the Government's announcement of a guarantee in respect of Irish-owned financial institutions.

The PM said that he was very concerned at the impact this was having and would have on British-owned and other foreign-owned banks operating in Ireland. He felt that it was having a direct impact on competition, that this would be illegal and would be challenged in Brussels and in the courts. He felt it would damage Ireland as a financial services location since institutions would leave on the basis that the Government was favouring Irish-owned organisations over foreign-owned competitors. He repeated these points on a number of occasions and said that he was seeking confirmation that the guarantee would be extended to other institutions operating in Ireland and that this should be reflected in the legislation currently being debated. He said that he would have to say publicly that this was being considered.

In response, the Taoiseach pointed out the very difficult situation that had faced the Government on Monday evening and the consequences which would have arisen if the action had not been taken. The announced guarantee in respect of Irish-owned institutions was in line with the long-established principles regarding regulatory responsibility. He was mindful of the points which the PM had made about other institutions operating here, which were valuable and well-regarded participants in the Irish economy. The legislation had been prepared in a way which did not rule out the extension of the guarantee to institutions other than those named. Time would be required to consider whether this could or should be done and he could give no undertaking in the meantime.

The PM indicated that he would contact the Taoiseach again in coming days to discuss the matter further.



Dermot McCarthy
1 October 2008

Suggested Speaking Points

Prime Minister: You are clearly very engaged with the financial market crisis, and we appreciate your leadership on this issue – we are all of us responding to a dynamic situation in a dynamic way – there are no right answers, but you are right to be very proactive in dealing with the situation.

Bank liquidity is under pressure around Europe – UK and Ireland no exception. Irish economy is an issue, and we are making big strides in getting to grips with the fiscal position through a partnership approach – hope to be announcing good news shortly.

Meanwhile, there is a growing sense in Ireland that the UK authorities are seeking to reduce the access of Irish institutions to UK deposits. There have been certain specific actions in this regard, which are a cause of concern, but we are equally concerned with the general trend.

Must be remembered that these institutions are very significant lenders in the UK – in fact they lend considerably more than they have in deposits.

A forced reduction in deposits is, naturally, destabilising at a time when liquidity is essential for all institutions.

There may be a sense that a reduction in deposits to Irish –based institutions will add to ‘protection’ for UK depositors, but it is clear that confidence among large and small UK depositors about banks in general is currently fragile, and attempts to differentiate between banks based on their headquarter location or any other factor are actually very damaging to confidence overall

We are therefore very concerned at the messages we are getting from UK authorities – likely to be destabilising for everyone at a time when stability is important – we should try to stand together. This is the message I am trying to get to my own system, would appreciate if you would do the same.

It would be helpful if you would speak to the relevant authorities in the UK and stress the importance of ensuring stability. It cannot be helpful to either country if guaranteed or supported institutions are being ‘talked down’.

Background note

The UK FSA has written to Anglo Irish bank to tell it to stop advertising high deposit rates – Anglo has always had high deposit rates as it does not have an extensive branch network – the reasons given for this action lean in part on a negative perception of Ireland as a whole

UK FSA has also in writing warned that if Permanent TSB seeks to extend its deposit taking in the UK it will make it ‘economically unviable’ for them to do so.

We have reports of UK FSA officials questioning institutions as to why they are maintaining deposits with Irish banks

Note on Guernsey

Guernsey authorities have written, on foot of their understanding of actions taken by UK FSA, to Bank of Ireland to say that it should advise all of its depositors via Guernsey that their deposit protection is given by the Irish Government guarantee – referring to the ‘viability of the Irish State’. The letter demanded is to be put in the context of “the continuing ability of the Irish State to guarantee the Bank of Ireland’s liabilities. It is demanding other actions in effect demanding, that amount to a total reduction of the Guernsey depositors’ exposure to Ireland.

Basic facts

Main Irish retail banks' positions in the UK

	Deposits from the UK system	Loans to the UK system
Anglo	€14.87bn	€18.3bn
AIB	€15.7bn	€28.26bn
BOI	€29bn	€50.9
ILP	€3.7bn	€8.5bn
INBS	€0.693bn	€4.419bn
	€63.96	€110.38

These Banks are therefore significant net lenders to the UK

Irish Banks' Presence in the UK

Anglo: 1 Branch (No of Rep Offices)

No Subsidiary

Gains a lot of its deposits by ensuring it gets 'profile' as one of the higher deposit rates available.

AIB: AIB (GB) is a subsidiary bank

First Trust in Northern Ireland (subsidiary)

AIB London branch

BOI: Branch into UK, this branch operates a joint venture with UK Post Office

ILP: Provision of services into UK. (No branch, but can provide services on a cross border basis). Lending is conducted through a non bank lender= Capital Home Loans

INBS: Branches in London & Belfast, mainly for lending. Seeking to open a branch in Bristol

UK Banking Presences in Ireland

Subsidiaries of UK Banking Groups

Royal Bank of Scotland and Bank of Scotland and Barclays Bank have banking subsidiaries in Ireland with a total balance sheet size of €118 billion at end-December 2008. The Irish subsidiaries of Royal Bank of Scotland and Bank of Scotland are net borrowers from their UK parents and are therefore net lenders to Ireland. Barclays' subsidiary is also a net lender in Ireland.

Deposit-taking branches of UK Banks

There are 5 UK banks with deposit taking branches established in Ireland. This includes the recently established branch of Nationwide Building Society together with HSBC Bank, Investec Bank (UK) Limited, Leeds Building Society and Northern Rock. Between them, these branches held over €2 billion in non-Government deposits at end-December 2008 which was matched by lending to affiliates of the same amount.

There are also 6 non-deposit taking branches.

Points for Discussion with Mr Salmond

We know there are concerns about the steps taken by the Irish authorities yesterday in relation to guarantees for certain banks.

The first thing to be said is that a situation has been developing around Europe and globally which no sensible Government could ignore – the domestic impact of that in Ireland was to cause increasing strain on the liquidity of banks, despite their being solvent and well capitalised. Developments in the US and in the UK had exacerbated that pressure. It was essential that some intervention take place.

Remember, contagion in the banking system is not just domestic – just as the problems in the UK banks had real impacts here, failure of the Irish Government to move decisively could have led to real damage to Irish and UK institutions

You will notice that we have moved not only to ensure that Irish depositors are protected, but we also guaranteed that UK customers of the relevant institutions will be protected. We did this in the knowledge that making our guarantee cross-border increases our risks, but we are aware of our broader responsibilities.

Remember, too, that when other countries have moved to protect the institutions headquartered in their jurisdictions, this has competitive implications, too – the obvious case in the Irish situation is Northern Rock, which takes deposits in Ireland as well as the UK.

The ideal solution to the competitive issues that you are talking to me about is that there should be some broader solution around Europe

I know the UK authorities have been struggling with their own issues – not all of the outcomes of the banking problems in the UK have been ideal in their impact on us, but we understand that each state has to protect its economy and its financial stability.

In the meanwhile, officials have been meeting with subsidiaries of RBS/HBOS etc and are seeking to understand the issues that have arisen for them, with a view to seeing if anything can be done to help.

Background

- ◇ About 12 institutions in trouble around the globe in past 3 weeks alone
- ◇ Huge difficulty in accessing funds for many smaller institutions – and in global terms all the Irish banks are relatively small
- ◇ Small countries having particular difficulties
- ◇ Pressure to ‘take out/nationalise’ one or two smaller institutions in Ireland – but real risk that speculative pressures and liquidity withdrawals would just move on to the bigger institutions
- ◇ Example of other countries – Fortis followed by Dexia in Belgium, Northern Rock followed by HBOS, B&B in UK; long succession of institutions in US
- ◇ Lehmans messed up the world market, but -
- ◇ Bradford and Bingley created real difficulty for Ireland, given that some Irish institutions have similar, though better quality, UK assets
- ◇ Greatest ever one day decline in Irish Stock Exchange indicated that the market’s attach on Irish stocks could easily threaten the whole economic future
- ◇ Each country has been dealing with this crisis on a national basis – unfortunate, but perhaps inevitable - so had to deal with this nationally
- ◇ Our Conclusion – real danger that only a bold and decisive intervention would halt decline in Ireland – no corporate finance solutions (seeking buyers etc) available in the time frame – had to act

John Callinan/EUAFF/DOT
01/10/2008 10:18

To "Lorcan Fullam" <lorcan.fullam@taoiseach.gov.ie>, "Dermot
McCarthy" <Dermot.mccarthy@Taoiseach.gov.ie>
cc
bcc
Subject Fw: Points for T discussion with sarkozy

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

From: "Cardiff, Kevin" [Kevin.Cardiff@finance.gov.ie]
Sent: 01/10/2008 10:17 CET
To: "Hogan, John" <John.Hogan@finance.gov.ie>
Cc: John Callinan; <tony.grimes@centralbank.ie>; <john.hurley@centralbank.ie>; <jhurley@centralbank.ie>
Subject: Points for T discussion with sarkozy

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Mura tusa an duine a bhfuil beartaithe leis an teachtaireacht seo a fháil, scrios é le do thoil agus cuir an seoltéir ar an eolas. Is leis an t-údar amháin aon dearcadh nua tuairim a léirítear.
Scanadh an r-phost seo le MailMarshal agus deimhníodh go raibh sé saor ó víoras leis an bpatrónchomhad atá in úsáid faoi láthair. Níl fíidír a rath leis seo náfach nach bhfuil á bhar mailseach ann.



Points for Discussion with Mr Sarkozy.doc

Points for Discussion with Mr Sarkozy: European Implications of Irish Decision and Next Steps

Know there are concerns among some of European partners about our move
'economic' concern about competition
'political' concern about the pressures it puts them under

Background

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- ◇ Small countries having particular difficulties
- ◇ Pressure to 'take out/nationalise' one or two smaller institutions in Ireland – but real risk that speculative pressures and liquidity withdrawals would just move on to the bigger institutions
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Offsetting measures

- ◇ Need to let institutions take some deposits to make up for some of the more extreme losses in recent weeks
- ◇ But there will be pricing – this will not come free to institutions
- ◇ We are already looking at the control measures that will be required – and at what restructuring will be necessary to wean these institutions off support

What can Europe do?

- ◇ The competition issues arising from the Irish, UK, Belgian and other Governments support of selected institutions comes direct from the fact that there is no overall European approach
- ◇ Think that an overall European approach on the lines of what we have just done could help – could of course be more sophisticated and deal much better with cross border issues
- ◇ Might need a European vehicle to work with – perhaps an offshoot of EIB or some other institution could act as intermediary for the Union and the Member States?

- ◇ In the meanwhile, would be helpful if ECB broadened the base for access to liquidity and perhaps also made longer term funds available – the huge reliance on short term ECB funds can add to instability in the market (though in the absence of the ECB, all of Europe would have been in worse position)
- ◇ Commission/member state work on EU responses to the financial crisis has been positive, but perhaps focussed too far into the future – Europe needs a response – definitive and far-reaching, more quickly. We will do our best to help.

Investec 1bn deposits from Irl, lend 700m to Irish developers etc.

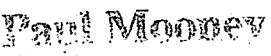
30 October 2008

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

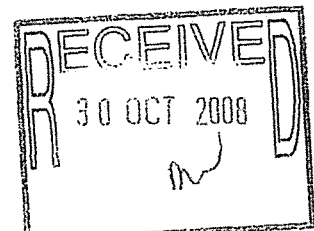
Dear Mr. Trichet,

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>

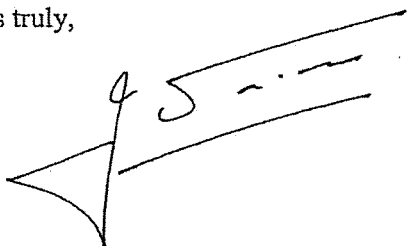
² 'Declaration on a concerted European action plan of the euro area countries', available on the website of the French Presidency at www.ue2008.fr.

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.

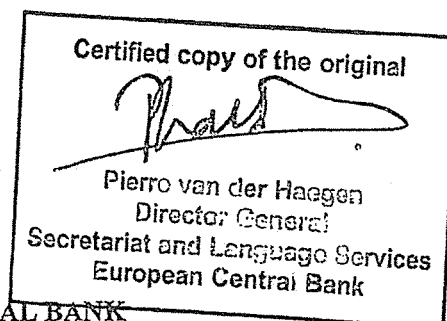
I am writing to underline the importance that the ECB attaches to the exclusion of interbank deposits with a maturity of up to three months from the liabilities covered by the draft scheme. I would wish that the Irish Government would maintain such an exclusion until this matter has been fully coordinated 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 'J. Hurley', written over a set of horizontal lines. The signature is slanted 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.

President Jean Claude Trichet
European Central Bank
Kaiserstrasse 29,
60311 Frankfurt am Main
Germany

14 November 2008

Dear President Trichet

Thank you for your letter of 16 October to An Taoiseach regarding the Credit Institutions (Financial Support) Scheme 2008 and in particular the inclusion of interbank deposits with a maturity of up to three months as covered liabilities under the Scheme.

At the outset, it is important to stress that your letter was received subsequent to the approval of the Scheme by the European Commission the preceding weekend and its presentation to the Irish Parliament for approval was already listed for the next day. The parliamentary process to provide legal certainty in relation to the guarantee provided by the Government to the Irish banking system did not allow for any amendment to the Scheme to be taken. In addition, further discussions with the European Commission would have been required which we understand could have necessitated re-notification of the Scheme and would in any event have given rise to further delay in finalising its status.

In addition, notwithstanding the strong desire of the Irish banks to obtain more secure longer-term funding, credit market conditions were such that there was a high degree of reliance on interbank deposits of a relatively short maturity for meeting their ongoing liquidity needs. In this context, there was a concern that any change in the scope of the guarantee at a late stage could impact adversely on the liquidity and stability of the Irish banking system and indeed on the credibility and reputation of the guarantee overall.

The Irish authorities strongly share your concern regarding the importance of ensuring that national measures do not create distortions in the euro area money market or the implementation of euro area single monetary policy. In establishing and implementing the Scheme I have been acutely conscious to ensure that the Irish Scheme does not give rise to any such issues. Consequently when I invited the eligible credit institutions to join the Scheme on 22 October, I emphasised to them the importance of ensuring that their institution's recourse to interbank deposits with a maturity up to

three months was balanced and proportionate with its overall funding needs so as to ensure consistency with the management of liquidity by the Eurosystem and compatibility with its operational framework. My Department highlighted this important issue as a key requirement of the Scheme in bilateral meetings at CEO level with the participating credit institutions on 7/8 November last and it has been included as a specific requirement for ongoing reporting by the covered institutions under the Scheme.

I wish to advise you that each of the relevant credit institutions has assured my Department that it is a particular priority for them in terms of their funding strategy overall to seek to secure longer-term debt financing with the support of the Government's guarantee and to progressively reduce their dependence on shorter-term interbank deposits over time.

I also wish to confirm that my Department, liaising closely with the Central Bank and Financial Services Authority of Ireland, will closely monitor the banks' recourse to shorter-term interbank deposits over the coming months. The Irish authorities will of course act quickly to address any risk that the Irish segment of the euro area money market is subject to any substantial distortion on account of excessive short-term debt issuance based on the broad nature of the guarantee provided under the Irish Scheme.

I trust that this information alleviates your concern regarding this matter. I will of course keep you advised of any relevant developments in this area, in the context of the review of the Scheme to be carried out after six months.

Yours sincerely

BRIAN LENIHAN

Brian Lenihan TD
Minister for Finance

cc An Taoiseach, Mr. Brian Cowen TD

Mr. John Hurley, Governor of the Central Bank and Financial Services
Authority of Ireland

Briefing for Visit of M. Jean-Claude Trichet, President of the ECB

Opening Comment: The Irish Government is committed to working with the European Central Bank and the institutions of the European Union to frame a common approach and to develop appropriate solutions to the unprecedented difficulties in international financial systems. In particular, the Government is working with the EU towards the development of a common framework on recapitalisation and the development of a common approach to bad debt resolution. Ireland recognises that it is crucially important for all EU members to co-ordinate their responses and support measures for stabilisation and recovery at this decisive juncture.

In Ireland, the Government's approach to the crisis in global financial markets has been structured and considered. We have sought advice and counsel from various qualified sources, have kept in close contact with the EU and ECB and have at all times sought to protect depositors in Irish banks, the Irish financial system and Irish taxpayers.

Background to the need for Government Intervention

- The global financial crisis which took hold in August 2007 resulted in unprecedented difficulties in international funding markets. This is a global problem, and Governments across the world have repeatedly intervened in domestic banking systems in order to preserve financial stability.
- Irish banks, reliant on international funding have suffered as a result of the reduced availability of credit. Government intervention was necessary to secure the liquidity of our banks.
- Concerns about the quality of assets held by banks and possible impairment levels have also focused the attention of international markets on the level of capital that banks hold. Most developed economies including Ireland have had to commit State funds to recapitalise their banks.

- The downturn in the global economy is also having a negative effect on banks. At a time when the financial position of banks is fragile, poor earnings prospects and concerns that asset quality will deteriorate further, does little for confidence in the banking system.

High Level Principles of Government's Approach

- The Irish Government's approach has been based on two broad principles;
 - Firstly, not to let any systemically relevant financial institution fail, this involves protecting depositors and creditors.
 - Secondly, any State involvement in the financial institutions will protect taxpayers' interests.
- In deciding policy approaches regarding the banking sector, the Government has taken advice from and consulted with the Central Bank, the Financial Regulator, the National Treasury Management Agency and its legal and financial advisors.
- The Government in its actions has sought to reflect agreed principles at EU level and comply with State aid guidance.

What Action has the Government Taken?

Bank Guarantee Scheme (30 September 2008)

- The contraction in the availability of funding particularly following the collapse of Lehman Brothers proved challenging for financial systems across the world. Ireland acted decisively to guarantee until September 2010 the liabilities of relevant institutions in order to ensure banks could maintain their normal liquidity position in interbank lending and debt markets.
- The Central Bank, the Government and its advisors continue to closely monitor the liquidity position of all relevant institutions.
- In the context of the six month review of the guarantee Scheme to be completed by mid-April 2009, the Government will examine how the Scheme could be revised, subject to European Commission approval and consistent with EU State aid requirements, to achieve a reduction in risk overall, including by supporting longer-term bond issuance by the covered institutions.

Recapitalisation Announcement (21 December 2008)

- As part of the increased engagement with the banks following the announcement of the guarantee Scheme, and in view of increased market focus on the capital position of banks

towards the end of 2008, a detailed assessment of the loan books and capital position of the Irish banks was undertaken.

- The Financial Regulator commissioned PwC to report on the financial position of the six relevant institutions. This report contains an analysis of likely loan impairment rates in these institutions up to 2011 and the impact of various stress tests on capital levels.
- On 21 December the Government announced its proposals to invest an initial €1.5 billion of core tier one capital into Anglo Irish Bank with an assurance to provide further support as required, and €2 billion into both Bank of Ireland and Allied Irish Banks.

Nationalisation of Anglo Irish Bank (Announced 15 January 2009)

- Anglo Irish Bank is a major financial institution whose viability is of systemic importance to Ireland. Anglo has a balance sheet of some €100bn with a substantial deposit base which the State is determined to safeguard.
- Issues relating to loans to Directors at the bank continued to undermine confidence in, and weaken the funding position of, the bank even after the Government's proposed recapitalisation was announced.
- Furthermore, information that came to light in the due diligence exercise undertaken as part of the planned recapitalisation required the Government to take the necessary action to take the bank into full State ownership.
- Anglo Irish bank will continue to operate on a commercial basis at arms length from Government.

Recapitalisation of AIB & BOI (Announcement 11 February)

- In view of the continuing turmoil in global financial markets, the Government initiated further intensive discussions with Allied Irish Bank and Bank of Ireland with a view to securing the position of these two banks. This resulted in the announcement of a revised recapitalisation package in February 2009.
- The PwC report on the covered institutions was supplemented by work undertaken for the Financial Regulator by Jones Lang LaSalle (JLL), a firm of independent valuers. JLL assessed elements of the bank's property based loan portfolio and the value of the collateral underlying it and this information was used by PwC to make a further assessment of the loan books of the covered institutions.

- This was a structured approach, and following this assessment the Government put forward detailed recapitalisation proposals with regard to our two main banks, Bank of Ireland and Allied Irish Bank.
- The total amount to be invested, €7 billion or €3.5 billion for each bank, was determined following consideration of likely trends in property values and various stress scenarios for the economy and property values. The State's investment will significantly strengthen the Core Tier 1 capital of these banks, bringing it well up in excess of regulatory limits. Existing reserves will be supplemented by ongoing profits and so the banks are more than adequately equipped to deal with the expected losses.
- The Government is also in discussion with other relevant institutions about their capital position.

The Issues Factored into the Government's Actions

Protecting Taxpayers

- The Government's actions have always been guided by the principle of protecting taxpayers.
- The Government's guarantee Scheme includes a charge on the banks for this facility and ensures a significant return for taxpayers. There are significant fees of about €1 billion payable by banks on foot of the guarantee.
- Anglo Irish Bank is a major financial institution whose viability is of systemic importance to Ireland. Anglo has a balance sheet of some €100bn with a substantial deposit base which the State is determined to safeguard. The Government's commitment to protecting taxpayers, depositors and creditors was again highlighted when taking this bank into public ownership.
- The investment of €3.5m each into AIB and Bank of Ireland is not unconditional. The investment generates a significant return for the State and includes conditions and obligations that the banks have signed up to. Both banks will pay interest of 8% on the preference shares and this will amount to about €560m per annum. If this amount is not paid in cash, the banks are required to transfer ordinary shares of equivalent value. The preference shares also have warrants attached giving the State an option to buy shares in five years time at a predetermined price, thus providing the State with the potential for a significant return.

Ensuring Credit Availability and Helping Bank Customers

- The Government's recapitalisation proposals included various measures on credit supply and requirements on banks in their dealings with customers. The main features are:

Business Lending

- Lending capacity to small to medium enterprises to be increased by 10%
- AIB and Bank of Ireland will both commit a further €15m each to new or existing seed capital funds, in collaboration with Enterprise Irelands Seed and Venture Capital Programme, to further create and develop indigenous enterprise.
- The recapitalised banks agreed to work closely with the IDA, Enterprise Ireland and with State agencies to ensure the supply of appropriate finance to contractors engaged on major projects sponsored by them.
- More generally, the banks have agreed to engage in a 'clearing group' chaired by a Government representative and including representation from business interests and State agencies. The purpose of this group will be to identify specific patterns of events or cases where the flow of credit to viable projects appears to be blocked and to seek to identify credit supply solutions.
- Code of practice for business lending to small and medium enterprises – this was published by the Financial Regulator on 13 February and applies to all banks. The code includes a requirement for banks to offer their business customers annual review meetings, to inform customers of the basis for decisions made and to have written procedures for the proper handling of complaints. Decisions to grant, refuse or alter credit must be taken on a case by case basis. Where a customer gets into difficulty the banks will give the customer reasonable time and seek to agree an approach to resolve problems and to provide appropriate advice. This is a statutory code and Banks will be required to demonstrate compliance.
- The recapitalised banks have agreed to fund an independent review of credit availability which will be managed jointly by the banks, Government and business representatives. The banks have undertaken to co-operate fully with this review and to engage constructively in implementing any recommendations made.
- €100m fund to support environment friendly investment and innovations in clean energy.

Mortgage Lending

- Additional 30% capacity for lending to first time buyers to be made available in 2009. If the extra capacity available for mortgages is not taken up in any quarter, it will be redirected to SMEs in the following quarter.
- Code of practice on Mortgage Arrears: - also published by the Financial Regulator on 13 February. This statutory code applies to all mortgage lending on a customer's principal private residence. A lender may not seek repossession until every reasonable effort has been made to agree an alternative repayment schedule with the borrower. The Code will ensure that mortgage lenders can only commence legal action for repossession six months from the time arrears first arise. This code now applies to all members not just the covered institutions.
- The recapitalised banks have further agreed that they will not commence court proceedings for repossession of a principal private residence within 12 months of arrears appearing, where the customer maintains contact and cooperates reasonably and honestly with the bank.

Remuneration

- Pay restraint is important not only in the context of the financial supports being provided by the taxpayer to the banking sector. It is also important in the overall context of the economy and the message it sends to ordinary workers who are suffering as a result of the current global crisis.
- Under the guarantee Scheme the remuneration packages of directors and executives, including total salary, bonuses, pension payments and any other benefits are subject to review by Covered Institution Remuneration Oversight Committee (CIROC). CIROC's report is expected by 5 March 2009.
- As part of the Government's recapitalisation proposals, total remuneration for all senior executives will be reduced by at least 33% and non-executive director fees by at least 25%. No performance bonuses will be paid for these senior executives and no salary increases will be made in relation to 2008 and 2009.
- The Minister for Finance has written to CIROC recommending that an overall cap be introduced for executive pay in banks benefiting from State support.

- It is imperative that this regime is organised in such a way that any rewards in the sector are structured to meet the long-term objectives of both the banking institutions themselves and the overall health of the Irish financial system.

Co-Ordination at EU level

- The Government's interventions in the banking system have sought to reflect agreed principles at EU level such as the European Commission Recapitalisation Communication.
- The Government engaged with the European Commission and the ECB on the development of a common framework on recapitalisation and is contributing to the development of a common approach to bad debt resolution.
- The Government is committed to working with the EU on an ongoing basis to frame a common approach to the issues faced by the financial services sector.

Anglo Irish Bank

- Matters at Anglo including loans to Directors, certain transactions with Irish Life and Permanent and loans to finance the purchase of shares are under investigation by a number of statutory authorities.
- These ongoing investigations may have a criminal dimension and caution should be exercised to ensure that potential future actions are not prejudiced.
- The Government is keen to ensure that unacceptable practices at Anglo are disclosed and dealt with appropriately so that the bank can set about re-establishing itself as a reputable financial service provider.
- The Government made clear when bringing the relevant legislation through the Houses of the Oireachtas that Anglo Irish Bank would continue to be run as a going concern, at arms length from Government. To drive this process forward, the new Board is preparing a comprehensive business plan which will be required to demonstrate how the Board will oversee the continued commercial operation of the bank.

Next Steps

Banking Regulation

- Work has begun on forging a new model to govern the conduct and behaviour of the financial sector both here and internationally. Ireland will play its part internationally and particularly at EU level in seeking to ensure that the re-design of the financial system and

in particular of financial regulation is consistent with the objectives that underlie a strong, stable and functioning national banking system.

- Following the implementation of the Credit Institutions (Financial Support) Scheme, the oversight of the banks concerned has been greatly intensified. This new regime provides for a heightened direct engagement with each of the covered institutions and new reporting arrangements including the provision of Scheme compliance certificates by the covered institutions themselves and by their external auditors.
- The Bank Guarantee Scheme requirements and conditions are the first step in a new system of financial regulation and supervision. The joint Boards of the Central Bank and Irish Financial Services Regulatory Authority have submitted to the Minister for Finance a report on reform of the regulatory structures. This report is currently being considered by the Minister.
- In addition, a number of regulatory reviews are underway at an international level. The Minister for Finance proposes to take account of the various reviews that are underway on regulatory reform when all relevant issues have been considered fully, bring proposals for reform to Government.

Dealing with Impaired Assets

- Much of the concerns over assets quality internationally have revolved around toxic financial assets whose value is now highly questionable. By contrast, concerns over asset quality in Irish banks relate to property based lending here and in the UK – generally land and development lending.
- The Government will examine proposals to manage and reduce the risks on these specific exposures, having regard to international developments and ongoing work at ECB-level and in the EU on this issue. Loan insurance and a ‘bad bank’ approach are among these options.
- Any arrangement on asset risk management would require detailed preparatory work to define the categories of assets covered, and the State’s role in managing and reducing risk associated with these assets. The Minister for Finance has appointed Mr Peter Bacon to work in conjunction with the NTMA to report and advise him on the best solutions in this area.
- The Government will ensure that any commitments on the availability of public funds for risk management will contribute to the stability of our financial system and our economy generally.

Concluding Remarks:

At all times, the Irish Government's interventions in the banking system have sought to reflect agreed principles at EU level such as the European Commission Recapitalisation Communication. The Government has engaged with the European Commission and the ECB on the development of a common framework on recapitalisation and is contributing to the development of a common approach to bad debt resolution. The Government fully committed to working with the EU on an ongoing basis to frame a common approach to the issues faced by the financial services sector.

Some Speaking points for meeting with Mr Trichet

Current position

- ◇ Very appreciative of facilities extended by ECB
- ◇ Reactions of ECB have been essential in maintaining fiscal stability
- ◇ In a very difficult cycle – economic situation exacerbating banking situation and vice versa
- ◇ We are working to get the fiscal situation under control
- ◇ However, liquidity pressures continue – no immediate problem but the pressures are serious, and we have to have a contingency plan
- ◇ One institution on the brink of ELA
- ◇ Others may get there in time, if current trends continue.

What we are doing about it

- ◇ Getting to grips with the fiscal situation – very important in terms of reassuring bond markets.
- ◇ Our actions in this regard are planned and determined, but the situation is fluid
- ◇ We are passing legislation to apply a pension levy to public servants – in effect a pay cut of 7-10% for the public service
- ◇ We will be taking further actions for next year.

In the meanwhile we are taking actions in relation to liquidity:

- ◇ Banks are being encouraged to assemble appropriate collateral
- ◇ Stronger banks helping the weakest
- ◇ Recapitalisation plan for two largest in place and being worked through
- ◇ Open to extending our guarantee to allow for longer term borrowing under guarantee (not clear this will work immediately)
- ◇ Looking at risk mitigation measures – risk insurance or good/bad bank

What if liquidity pressures continue?

- ◇ In the situation that liquidity pressures continue, more banks will fall into ELA, and the State itself will have great difficulty in funding.
- ◇ We would consider, in an attempt to avert this happening, a large scale asset swap programme with Government paper issued in return for bank-held assets which are not ECB eligible. This would add considerably to the Government debt in issue, and would not be easily sold on the open market – yields would go up but inevitably most of the paper would be used as collateral with ECB.

The downsides of this approach

- ◇ There is a danger, however, that this very large overhang of Government paper would make it impossible for the Government to fund itself, even at much higher yields – if that were to happen the Government would immediately find itself in the same liquidity difficulties as the banks.
- ◇ This would also leave our banking system in further reliance on the ECB

What might ECB/Europe do to help

Firstly, it would be very helpful to us if the cooperation and facilities of the ECB continue to be made available

Secondly, it would be helpful also if you would signal where appropriate the importance for Ireland of making progress on our fiscal objectives

Thirdly, we would appreciate your views on the availability of ELA if matters continue to worsen

Fourthly, we would appreciate your views on the asset swap arrangements we would contemplate using *in extremis*

Finally, we wonder what your views are of other developments within the ECB or European systems, which might be of use in regard to the developing situation.

10 Downing Street
Hoggia.

10 DOWNING STREET

LONDON SW1A 2AA

www.number10.gov.uk

THE PRIME MINISTER

8 October 2008

Dear Nicolas

I am announcing today measures to ensure the stability of the banking system in the UK. I attach the HM Treasury notice setting out these measures in more detail. We are taking three steps:

- the Bank of England is extending and widening the availability of short term liquidity under the special liquidity scheme;
- the Government is establishing a facility which will make capital available in appropriate form to UK incorporated banks (including UK subsidiaries of foreign institutions) with substantial business in the UK;
- and we will make available to those institutions, on appropriate commercial terms, a Government guarantee of new short and medium term debt issuance required to assist in refinancing maturing wholesale funding obligations.

These steps are consistent with the principles agreed by EU Finance Ministers in Luxembourg yesterday.

I wanted particularly to draw your attention to the last of these steps, because this is an area where a concerted international approach could have a very powerful effect.

The market for medium term funding is currently frozen across the globe, with potentially serious economic consequences. Our scheme aims to restart the market by restoring confidence that loans to financial institutions will be repaid. Because the guarantees will be for new lending only, and will be priced at market-determined rates, it will avoid

windfall gains or subsidies either to existing or new lenders or to bank shareholders. It will be time-limited, non-discriminatory and is designed to avoid distortion of competition.

This is an issue which affects us all. A concerted approach with national schemes respecting the above basic principles would address this problem.

I attach a note setting out more details of how a concerted approach might work. My officials will be contacting yours to discuss how we can best coordinate action on an international basis.

More generally, I believe we need a concerted international effort to strengthen supervision and regulation and reform the governance of the global financial system. A good first step would be the immediate establishment of colleges of supervisors to oversee cross border firms. Our Finance Ministers should address these issues with their international partners at their meeting in Washington next week.

I am copying this to all EU Heads and the European Commission.

Yours sincerely

A handwritten signature in dark ink, reading "Gordon Brown". The signature is written in a cursive, slightly slanted style.

His Excellency Monsieur le President Nicolas Sarkozy

A concerted approach to restarting the international funding market

1. Rationale

The wholesale money markets have effectively closed down both in the US and EU. Latest spreads/credit quality indicators are all at record levels:

TED spread (3 month \$LIBOR – T-bill)	351bp
3 months EUR LIBOR – OIS	148 bp
iTraxx investment grade CDS	123 bp

The closing of the interbank markets reflects that banks do not want to lend to each other for fear of counterparty risk – fear of default of the party they are lending to. Unsecured interbank lending has effectively vanished, even at the overnight maturity. Secured interbank lending only occurs against very high-grade collateral and at increasingly shortening maturities.

The economic consequences are likely to be very serious in the short to medium term – much more so than the fall in share prices (which effectively reflect the funding problems). When banks do not lend to each other, they cannot transfer surpluses from savers to those who need funding for spending: households and non-financial corporations. Lending to households and the corporate sector is slowing and forecast to slow in many countries with consequent risks to economic growth. This problem will get worse as banks seek to roll over maturing loans, bonds, callable bonds, and other sources of wholesale market funding.

To restart the global market for bank funding the authorities need to intervene to restore trust. Banks must have confidence in each other's solvency and liquidity. One possibility is for the central bank to become the universal counterparty/clearing house for interbank lending. This is effectively what has already happened for overnight lending as a consequence of the massive expansion in short-term central bank liquidity operations. An alternative is a scheme under which the government rather than the central bank guarantees new unsecured wholesale bank lending.

2. Principles and objectives

Such a scheme needs to satisfy the following criteria:

- it needs to achieve the objective of restarting wholesale money markets by restoring confidence that loans to financial institutions will be repaid;
- it needs to avoid windfall gains or subsidies to existing or new lenders, to bank shareholders
- it must clearly disincentivise any attempt to exploit the public sector by borrowing excessively with government guarantee and using the

- proceeds either for dividends, excessive compensation, or further imprudent lending
- it follows therefore that it should be for new lending only, and that the guarantee should be charged for at a price related to market conditions (recognising that market prices may not be available in present circumstances)
- it must not distort competition between banks or between financial centres either for wholesale funding or for deposits
- it must both be time limited and if possible allow a clear exit strategy for government when market conditions permit.

3. A possible approach

The UK proposes to implement a scheme consistent with these principles. The UK Government believes that these principles could be the basis for a concerted approach to the problem of restarting the funding market. Such action would comprise a set of national guarantees to a broadly similar design.

- **each participating country offers a guarantee of new issuance of term funding (senior unsecured debt) by financial institutions and their subsidiaries within its jurisdiction to assist in refinancing maturing wholesale funding obligations as they fall due. Such debt may be denominated in any freely convertible currency; in the UK, we propose to allow issuance of sterling, US\$ or Euros;**
- **each country shall decide whether or not to make use of this facility and which institutions should be eligible, ensuring there is no discrimination. In the UK, we will ensure that all UK incorporated banks and building societies (including UK subsidiaries of foreign institutions) are eligible to apply to make use of the facility on a basis which does not discriminate;**
- **each country shall decide any necessary preconditions for eligibility for its own scheme, for example including restrictions on dividends, requirements to raise new capital, and restrictions on executive compensation. In the UK, the facility will be contingent on appropriate steps being taken by institutions to enhance capital positions;**
- **to address potential distortion of competition, funding (i.e. the cost of the guarantee plus the cost of borrowing) shall be determined by reference to market prices. Market prices can be determined by reference to past prices of the outstanding debt and/or credit default swaps on the debt of the qualifying institutions. So, for example, prices could be determined by reference to the median senior 5 year CDS spread over a**

specified period. The price shall remain constant for the duration of the scheme;

- schemes shall last no more than a specified and limited period. Any bank issuance within that period and using the scheme should be of a term that expires before the end of the scheme. In the UK we envisage that the term of such lending would be no more than 36 months;
- If market conditions permit, holders of guaranteed financial instruments may enter into agreements with countries for repurchase of the guarantee at a price equal to or less than the issue price.

8 October 2008

Treasury statement regarding financial support to the banking industry

After consultation with the Bank of England and the Financial Services Authority, the Government announces that it is bringing forward specific and comprehensive measures to ensure the stability of the financial system and to protect ordinary savers, depositors, businesses and borrowers.

In summary the proposals announced today are intended to:

- Provide sufficient liquidity in the short term;
- Make available new capital to UK banks and building societies to strengthen their resources permitting them to restructure their finances, while maintaining their support for the real economy; and
- Ensure that the banking system has the funds necessary to maintain lending in the medium term.

In these extraordinary market conditions, the Bank of England will take all actions necessary to ensure that the banking system has access to sufficient liquidity. In its provision of short term liquidity the Bank will extend and widen its facilities in whatever way is necessary to ensure the stability of the system. At least £200 billion will be made available to banks under the Special Liquidity Scheme. Until markets stabilise, the Bank will continue to conduct auctions to lend sterling for three months, and also US dollars for one week, against extended collateral. It will review the size and frequency of those operations as necessary. Bank debt that is guaranteed under the Government's guarantee scheme will be eligible in all of the Bank's extended-collateral operations. The Bank next week will bring forward its plans for a permanent regime underpinning banking system liquidity, including a Discount Window facility.

In addition the Government is establishing a facility, which will make available Tier 1 capital in appropriate form (expected to be preference shares or PIBS) to "eligible institutions". Eligible institutions are UK incorporated banks (including UK subsidiaries of foreign institutions) which have a substantial business in the UK and building societies. However applications are invited for inclusion as an eligible institution from any other UK incorporated bank (including UK subsidiaries of foreign institutions). In reviewing these applications the Government will give due regard to an institution's role in the UK banking system and the overall economy.

Following discussions convened by HM Treasury, the following major UK banks and the largest building society have confirmed their participation in a Government-supported recapitalisation scheme. These institutions comprise:

Abbey
Barclays
HBOS
HSBC Bank plc
Lloyds TSB
Nationwide Building Society
Royal Bank of Scotland

Standard Chartered

These institutions have committed to the Government that they will increase their total Tier 1 capital by £25bn. This is an aggregate increase and individual increases will vary from institution to institution. In order to facilitate this process the Government is making available £25bn to be drawn on by these institutions if desired to assist in this process as preference share capital or PIBS and is also willing to assist in the raising of ordinary equity if requested to do so. The above institutions have committed to the Government that this will be concluded by the end of the year.

In addition to this, the Government stands ready to provide an incremental minimum of £25bn of further support for all eligible institutions, in the form of preference shares, PIBS or, at the request of an eligible institution, as assistance to an ordinary equity fund-raising.

The amount to be issued per institution will be finalised following detailed discussions. If the Government is to provide the capital, the issue will carry terms and conditions that appropriately reflect the financial commitment being made by the taxpayer. In reaching agreement on capital investment the Government will need to take into account dividend policies and executive compensation practices and will require a full commitment to support lending to small businesses and home buyers.

The Government will take decisive action to reopen the market for medium term funding for eligible institutions that raise appropriate amounts of Tier 1 capital. Specifically the Government will make available to eligible institutions for an interim period as agreed and on appropriate commercial terms, a Government guarantee of new short and medium term debt issuance to assist in refinancing maturing, wholesale funding obligations as they fall due. Subject to further discussion with eligible institutions, the proposal envisages the issue of senior unsecured debt instruments of varying terms of up to 36 months, in any of sterling, US dollars or Euros. The current expectation is that the guarantee would be issued out of a specifically designated Government-backed English incorporated company. The Government expects the take-up of the guarantee to be of the order of £250bn, and will keep this under review alongside ongoing monitoring of capital positions and lending volumes.

To qualify for this support the relevant institution must raise Tier 1 capital by the amount and in the form the Government considers appropriate whether by Government subscription or from other sources. It is being made available immediately to the eight institutions named above in recognition of their commitment to strengthen their aggregate capital position.

The Government has informed the European Commission of these proposals and is actively talking to other countries about extending these proposals and has committed to work together with them to strengthen the international system.

The Government is moving ahead immediately with the internationally agreed proposal for colleges of supervision and other measures to improve supervision of the system. After discussions with the major economies at the G7 meeting on Friday, the Government and other countries agreed on the need for a meeting at heads of Government level.

FAX

26/1/09

TG

Deputy McCarthy

Fina

Deputy Gleeson

AIB

Re: BANK Captivation.



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An Taoiseach
Brian Cowen TD
Department of An Taoiseach
Government Buildings
Merrion Street
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26 January 2009

Dear Taoiseach,

In a week when I am certain that your time is at an all time premium, I am writing on the instruction of the Board of Allied Irish Bank plc to convey the Board's deep and urgent concern that a course of action which we understand is about to be announced and embarked upon in relation to bank recapitalisation may unwittingly and unintentionally put in peril a vital interest of the State.

You will be aware that we have been in conversation with the Minister for Finance and his officials and advisers in relation to a recapitalisation scheme that is about to be announced in respect of Bank of Ireland. We have conveyed to them in a series of written and oral communications the grave misgivings of the Board as to the efficacy of the proposals to protect the vital interests that are shared by both AIB and the State in preserving our capacity to fund ourselves, assisting in funding Anglo Irish Bank and supporting the State in accessing funds from the international markets.

We have a clear and evident self interest at stake here which I make no effort to disguise. However, we believe that if the arrangements described are announced there is a serious risk of them being seen as a first step in a creeping nationalisation process. This we believe will arise:

- (a) because of the extent of the equity stake; and,
- (b) because of the way in which the preference shares have been designed; market analysts are already characterising them as non core tier 1 capital.

The risks identified pose significant challenges to our capacity to fund ourselves and to help fund the State.

The level of State ownership in the banks is a central consideration for the market. The level proposed is unprecedented for preference shares. This matter is compounded by the proposed cash dividend alternative which could see Government ownership increase automatically to a majority. Despite any assurances that Government might seek to provide, this impression of creeping nationalisation risks causing investors and depositors to flee with far reaching consequences for the State and AIB.

In relation to the preference shares the focus has moved very definitively to what the market views as Core Tier 1 as opposed to a regulatory interpretation of this.

Throughout all our interactions with the Department and the NTMA we have been at pains to point out the crucial importance of this issue and why it is essential that the Preference shares are appropriately constructed. Indeed as outlined in discussions with the NTMA, the amendments we are seeking have limited consequences for the State and we feel are inconsequential in the context of what is otherwise at risk.

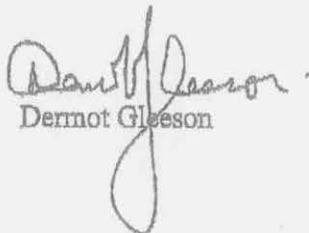
We believe the adjustments that we are suggesting to the size of the stake, the character of the shares and an indication of a willingness to provide risk insurance would bring the plans more in line with schemes which have been successfully set up in the US and continental Europe. These adjustments would markedly reduce the risk of adverse market reaction, share price falls and impaired funding capacity. We have taken advice from our funding experts, our London broker Merrill Lynch and from Morgan Stanley, all of whose advice has served to amplify these concerns.

In relation to the proposed deal we find it difficult to understand how the same terms could be offered to both ourselves and Bank of Ireland given the relative difference in size, profitability and market capitalisation of the two banks. In particular the market will struggle to see why warrants of 25% would be given over AIB and Bank of Ireland when AIB's market capitalisation is over 50% greater than that of Bank of Ireland.

We remain anxious to find a formula which would allow us to be part of a comprehensive recapitalisation solution and recognise that this is in the best interest of all stakeholders. However further changes are needed to ensure that such a deal will find favour with the market. We fully understand that ways have to be found to create upside for taxpayers. Here again there are ample precedents. We would, for example, be open to discussing an increase in the dividend in return for other changes.

We wish you well in the extremely difficult decisions that are that are at hand. Notwithstanding the institutional self interest which I have already acknowledged, it is my belief and that of the Board that vital national interests are at stake. We hope that our communications on this topic including this letter may assist you in arriving at decisions on these difficult matters.

Yours sincerely,


Dermot Gleeson

Visit to Sweden by An Taoiseach, Mr Brian Cowen T.D.,**28 November 2008****Fiscal Stimulus Package in the Irish Context**

1. From an Irish perspective the Budget has recently been published. The Budget set out a medium-term strategy to stabilise and restore balance to the public finances as soon as possible by, amongst other things, reducing and prioritising public expenditure and adjusting taxation levels to reflect the changed realities of lower economic growth. Restoring order and stability to the public finances will underscore Ireland's well-earned international reputation as a good place to do business.
2. The economy as a whole is adjusting to lower levels of economic activity and this is reflected in the performance of tax receipts this year. Taxes in 2008 are expected to be €6½ billion behind target leading to a borrowing requirement of €11½ billion and a General Government Balance of -5.5% of GDP in 2008. Budget 2009 forecast that the fiscal situation in 2009 will be even more challenging and it will be necessary to borrow almost €13½ billion resulting in a forecast General Government Balance of -6.5% of GDP.
3. Recognising these significant budgetary challenges, the Budget was carefully constructed as a first step in restoring the public finances to sustainability while avoiding depressing economic growth further. It provided for –
 - current expenditure of €55.8 billion in 2009 - €1.9 billion above the 2008 level;
 - spending on Social Welfare to grow by 8.4% in 2009 to €19.6 billion;
 - spending on Education to increase by 2.7% to €8.7 billion in 2009;
 - spending on Health to increase by 2.1% to €15.8 billion; and
 - a capital expenditure package of €8.2 billion, over 5% of GNP.
4. In addition, while budgetary circumstances meant it was necessary to introduce a significant revenue raising tax package of almost €2 billion in the Budget, the package was structured to ensure that in as far as possible it did not negatively impact on the economy – the package was spread over a number tax heads, the income tax bands were increased, a number of measures were introduced to support enterprise etc. This package had the impact of just marginally increasing the forecast tax yield in 2009 by 1% above the very poor 2008 performance, an indication of the underlying weakness in the economy and consequently how scarce resources are.

5. In considering the introduction of a further fiscal stimulus package, the realities of the current budgetary situation, and especially the current scale of borrowing must be taken into account. Current budget projections indicate that at least €45 billion will have to be borrowed between 2008 and 2011 to sustain the current level of public services, of which over €9 billion will be used to fund day-to-day spending. The total capital investment programme now has to be borrowed. Up until last year we were paying for much, and in some years all, of our capital investment from current revenues.
6. Borrowing on this scale leads to very high interest costs and it is forecast that over 11% of tax revenue will go on servicing the national debt in 2011, up from around 4½% in 2007. This is not sustainable. Debt servicing costs have a first call on resources and an increasing debt interest burden will reduce our productive capacity, increase unemployment, over-burden the taxpayer and undo past efforts to help the vulnerable.
7. Any EU proposals, should they be advanced, will have to take into account national budgetary circumstances. To adopt a policy that requires further borrowing is not the solution at this stage, the most important task for the Government is to restore the public finances to a sustainable position, otherwise the long term competitiveness and international reputation of the economy will suffer.

Department of Finance

25 November 2008

UK Response to the Financial and Economic Crisis.

Overview

After a slow start, the UK has addressed the crisis in a comprehensive way including recapitalisation of the main retail banks, interest rate cuts and a Budget package which cut VAT and committed to borrowing heavily to stimulate spending. In addition PM Brown has been to the forefront in encouraging other leading economies to take concerted action to stimulate the global economy and to improve regulation of financial services. UK will host the next G20 meeting in April 2009.

Ireland's Bank Guarantee

When Ireland moved to guarantee deposits in its banking institutions, the UK was one of the first to criticise the "beggar thy neighbour" approach. Their concern was twofold: (a) that it would cause a run on UK high street banks because the UK State guarantee at the time was considerably lower and (b) because the UK was advocating the need for multilateral rather than unilateral action to tackle the banking crisis. Of interest however is the fact that Ireland's action was broadly appreciated in business and banking circles in the UK. When the Scottish First Minister (in the course of the Scottish by election) suggested that smaller independent countries were better placed to cope with the situation, UK politicians used the opportunity to further criticise the Irish initiative and to suggest that the Celtic Tiger was a one-hit wonder.

UK Action

Since then the UK Government has taken a number of initiatives firstly to bail out the banking sector and subsequently to stimulate the economy. In October the Government announced a £37 billion investment in the major retail banks, effectively a part nationalisation of the banks concerned. In November the Bank of England cut interest rates by 1.5 points to 3%. In last weeks Pre-Budget Report, the Chancellor announced a 2.5 point cut in VAT rates, as well as increased investment in roads, schools etc. These measures will be funded by substantial new borrowing in the short term. To alleviate concerns among business and the markets it was also announced that the borrowing levels would be cut back from 2010 onwards (effectively admitting that there will have to be tax increases from that time).

UK Economy

The measures to stimulate the economy have to be seen against the background of very gloomy UK economic data. Some commentators have expressed the view that

the UK will be the worst affected by the global banking/economic crisis. The City, alone, is forecast to shed some 40-50,000 jobs.

- Economic growth is forecast at -1% next year. Optimists believe that the recovery will begin in the 2nd half of '09.
- Consumer spending is expected to fall by up to 2% in 2009.
- Business investment will drop by 5% in 2009 and confidence is at its lowest in 30 years.
- Despite the weakness of Sterling UK exports are not expected to grow next year.
- Unemployment, at 5.8%, is at an 11 year high.
- House prices fell by up to 10% in 2008 and are forecast to decline similarly in 2009.

International Efforts

PM Brown played a leading role in calling for concerted international action both to address the banking crisis and to improve international regulation of financial services as well as a coordinated approach, especially with the US, in taking measures to stimulate the economy. Brown regarded the G20 outcome as international acceptance of lower taxes and increased spending as the way to tackle the economic situation. UK will host the follow up G20 in April 2009.

There is less agreement at EU level, where Germany in particular, is showing reluctance to take action. Without German agreement, any EU Recovery Package is likely to be of modest impact. The UK is broadly supportive of the approach which allows for a VAT cuts and spending/investment stimulus. The UK will, of course, argue that it has already done so and that others should follow suit.

Financial Crisis including details on Commission Stimulus Package

Summary

The Commission communication on a European Recovery Plan for growth and jobs was launched on 26 November. It was discussed at Ecofin on December 2 in advance of the EU Council meeting of 11-12 December.

The Commission are recommending that Member States agree a coordinated fiscal stimulus package of €200 bn (1.5% of EU-27 GDP) to boost demand of which €170bn (1.2% of GDP) would come from Member State budgetary actions and the remaining €30bn from EU support. It should be **timely, temporary and targeted** on areas likely to have the most rapid and significant impact on demand and that could be implemented immediately. It is a menu of revenue and expenditure actions, from which Member States can choose, that could rapidly stimulate demand, with the emphasis on expenditure. Members States are also encouraged to direct their short-term fiscal actions towards reinforcing competitiveness and investment in energy and environmental sustainability.

The Commission accepts that all Member States are not in the same position and that some will have more scope than others to act. They also point out that, where for some Member States these additional measures may lead to a General Government deficit in excess of 3%, these deficits will have to be corrected “in a time frame consistent with the recovery of the economy” and in line with the requirements of the revised SGP; effectively, giving them more time than the usual 1 or 2 years to return to a sustainable position.

The main elements of the Commission stimulus package are set out in the background note, together with a comment on its relationship to the Stability and Growth Pact. A further background note on the fiscal stimulus package in an Irish context is also provided.

Ireland's position

The Communication makes no direct reference to countries like Ireland with large general government deficits well in excess of the 3% reference value. However, it is clear that the requirement to get the excessive deficit corrected within a time framework consistent with the recovery of the economy (3 years) leaves little or no room for an additional fiscal stimulus in such cases. Ireland is already at the extreme end in terms of its projected deficit, with the risks on the downside, and further increases in Government debt could increase borrowing costs. Ireland may, of course, benefit from a fiscal stimulus elsewhere in Europe.

Putting the public finances back on a sound footing over the medium-term cycle was set out as a priority by the recent Budget, while public investment is being kept at about 5% of GNP. Also, the recently published Finance Bill sets out a number of measures that are targeted at the enterprise and environment sectors, such as the R&D tax credit and capital allowances for energy efficient equipment. Finally, in this regard, the proposed economic recovery strategy document that is currently being drafted will also go towards communicating to the public the overall Government economic and budgetary strategy for the years ahead.

The Communication also presents proposals for front-loading EU expenditure to support jobs, business and investments. The EIB will also increase its activity in the Community by €30bn over the next two years with a number of measures aimed at supporting SMEs.

Views of other Member States:

The UK sees the measures announced in its Pre-Budget Report as clearly in line with the Plan. France and Germany both of which have announced stimulatory measures in recent weeks support the Plan although media reports suggest that they envisage a more lax implementation of the SGP than suggested in the communication. Germany is reportedly unenthusiastic about tax reductions (VAT was increased by 2% in 2007)

13/09/08 JL

Taoiseach,

AIB and Bank of Ireland are requesting an urgent meeting with yourself and the Minister for Finance this evening.

The Chair and CEO of both banks would attend.

B of I lost €2 billion in wholesale deposits today. AIB are having difficulty in getting cash in the overnight money market.

They say that action is needed urgently and that there needs to be clarity in relation to what is being proposed ie the terms of any proposed guarantee, etc.

Joe L

This is an account of the events of last Monday in relation to the Government guarantee and the meetings surrounding it. On Monday evening the 29th September I telephoned Kevin Cardiff in the Department of Finance around 5pm/6pm asking him if it was possible to meet with the Minister for Finance that evening. This was in coordination with the Bank of Ireland who were making a similar call to arrange to meet the Taoiseach. Cardiff responded that the Minister wanted to see us that evening and he suggested a time of 21.30pm in Government buildings.

At 21.30pm I attended a meeting in Government buildings with Dermot Gleeson, Richard Burrows and Brian Goggin. When we arrived in Government buildings we were ushered into a side room and subsequently called into a meeting attended by the Taoiseach, the Minister for Finance, the Attorney General, Dermot McCarthy from the Taoiseach's office, Kevin Cardiff, David Doyle, Eugene McCague and John Hurley the Governor of the Central Bank.

We were invited at this start of the meeting to present our analysis of the current situation. We had agreed in advance that the order of presentation would be firstly Richard Burrows, then Dermot Gleeson, and then followed by myself and Brian Goggin. All the speakers outlined a serious situation on the systemic stresses facing the Irish Banking system and indeed the international funding situation for banks worldwide. When it came to my presentation I stressed that AIB was in a reasonably strong position but it was experiencing the stresses in the market but that we had adequate liquidity to meet our regulatory requirements up to the end of October.

Brian Goggin presented an similar outlook also stressing that the situation was deteriorating and we were a number of weeks away from both the banks being funding all of its requirements in the overnight market which while a viable option was highly undesirable and fraught with risk.

After our presentation there was a discussion with those in the room on what could be done about the situation and we mentioned that the situation needed to be stabilised and one way to do it would be for the Government to guarantee, the obligations of the Irish Banks on a temporary basis. At that time we were asked to leave the room and the members of the cabinet were to discuss the position as presented by the Banks with their officials. We were out of the room for over an hour and then called back.

When we were called back the position of other banks was discussed particularly to the degree that they might be under more stress than we were.

We outlined in detail our view that Anglo Irish Bank and Irish Nationwide were in a very weak position and represented a contagion threat to the rest of the system and they had to be dealt with very severely in terms of being closed down, nationalised or put into a some sort of run off position and ring fenced from the rest of the institutions. During that meeting Tony Grimes from the Central Bank was called in and he said that Anglo Irish Bank needed a billion in funding to meet their obligations the following morning, immediately in the morning time and could need three to four billion later on during the day. At this point John Hurley said it was impossible to bring down a bank of that size in the middle of the week, that accidents could occur and a fumble could occur and that what we needed to do was to get enough funding to keep Anglo in business until the weekend when other actions could be taken.

Both of the Banks present stressed that we felt we had to preserve all the liquidity we had to meet our own needs especially as we had already outlined that the funding position was weakening on a daily basis. The Government responded by saying that we had to come up with a solution that they didn't have that attitude to intervene at this stage and that we needed to lend money to Anglo. The meeting was quite heated at this stage as we maintained that we couldn't help beyond very small amounts of money. We were asked to leave the room and give serious consideration to the Governments requests bearing in mind the threats we all faced. We left the room and worked with our colleagues in treasury in both sides and put back the issues to working groups that we had offsite. In AIB's case that comprised a group of John O'Donnell, Colm Doherty and Eamonn Hackett who were looking at the issues back in Bankcentre. I believe Bank of Ireland had a similar group working at their end. The two banks worked separately at this stage as we were both in relatively different positions vis-à-vis our responsibility to respond to the Governments request.

After about an hour's discussion AIB was able to come up with a solution which involved bidding up for substantial funds in the ECB auction due on the Tuesday the seven day auction where we could bid up to 6 billion against qualifying collateral that we had in our possession. This would require us to move substantial amounts of collateral from our Euro clear accounts into the auction process.

In addition we had other qualifying assets which we were prepared to submit to the Central Bank and use the draw down funds against the marginal lending facility. In addition to that we were prepared to make a suggestion to the Government that treble A type assets that we hold in our securities portfolio which do not meet ECB qualifying criteria could be given to NTMA in return for a gilt which we would then give to the Central Bank as a QLA and ask them to raise money against it in the ECB. We would get the cash and give the cash back to the NTMA who would give it to Anglo. This mechanism could generate up to 8 to 10 billion if we moved all our securities.

We were called back into the room after a long period. Both banks made proposals which in broad terms amounted to about 5 billion each that we could give to Anglo until the end of the week and that didn't include the NTMA proposal which was made which could be an additional 8 billion. We both stressed that whatever the outcome either bank could not be on risk for Anglo and that we needed an absolutely guaranteed back stop facility, promissory note or exercisable instrument with Government guarantee to get our money back at the latest on the following Monday.

The Government responded quite positively to our response and recognised I believe that a reasonable effort had been made by the Banks to try and solve the problem. At that stage the discussion moved on to the form of the guarantee that we had earlier discussed which everybody in room agreed was necessary in one form or another. The Government submitted a form of guarantee (copy attached) which in our view while inspirational in terms in what we were all looking for fell short on lack of specificity. We had drawn up an alternative form which included language which was more specific and also included a definite timeline. There was quite a bit of debate about this. Clearly there was concern on the Government side that this was too specific and would move the obligations very pointedly from the banks to the Governments balance sheets.

After many points been raised on both sides of the table it was eventually accepted that a change in the original Government draft was required. We were asked to leave the room while this drafting process was undertaken. During that period there were a number of exchanges between both sides which included issues relating to subsidiaries. In general there was a gradual movement towards an agreed form. There were also issues in the Government's draft which we were uneasy about relating to attestations by the FR that the system was solvent and that all banks were solvent. We felt there was clearly a risk in this statement if market participants purchased shares in companies once the guarantee was issued and it subsequently transpired that these companies were not as strong as contended.

There was a final meeting on the guarantee and we went back into another session and we didn't hear from the other side and we were told that the meeting was over at approximately 3.30am. Subsequently at 3.50am on Tuesday morning the guarantee was issued and the announcement was made to the markets. There was no other contact with the Government during that day Tuesday.

**Notes of events occurring on Monday & Tuesday (29th & 30th September 2008)
(Dictated, on weekend or 3rd to 5th October)**

In the afternoon of Monday the 29th September I received a phone call from Richard Burrows the Governor of the Bank of Ireland. At that stage there was extreme turmoil in the markets particularly in relation to the Anglo share price which was down almost 50%. There have been various feedback between senior members of Management team and various echelons of Government and the Regulator and there was a clear impression (without anything explicit being said) that Anglo was in serious trouble and that the plan of the authorities was to take Anglo and Irish Nationwide (who had different problems) into some sort of State care and provide some sort of support for the remaining four banks.

Richard indicated that he felt that matters were so difficult that we should seek to speak with the Taoiseach and the Minister for Finance. He indicated that even if AIB were not going to attend that Bank of Ireland would be making this approach anyway. I consulted the CEO and we agreed that it would be a good idea to go and speak to the Government given the fraught state of the situation which was compounded, shortly after, by the decision of the House of Representatives not to support the Paulson Plan. Both Richard Burrows and myself had received phone calls from Sean Fitzpatrick during the afternoon of the 29th.

We had a very brief conference call between myself and Richard and the two CEO's; there was very little discussion; what was needed was fairly clear; it was agreed that Richard would set the broader context and I would set the narrower local context but that the technical submissions to the Government would be largely left to the CEO's. We arrived at Government buildings at 21.30pm and an official indicated that what was expected was that we would set out our views on what should be done; we would then be asked to withdraw and the authorities would consider the situation.

Notes of events occurring on Monday & Tuesday (29th & 30th September 2008)
(Dictated, on weekend or 3rd to 5th October)

We were given the facility of a room to wait in (what I knew as the new cabinet room) and we were then taken to the conference room immediately adjoining the Taoiseach's office where we were met by the following;

- a) The Taoiseach
- b) The Minister for Finance
- c) The Attorney General
- d) The Governor of the Central Bank
- e) The Secretary General of the Taoiseach's Department and of the Department of Finance
- f) Mr. Cardiff from the Department of Finance
- g) Mr. Eugene McCague of Arthur Cox and Company
- h) At one stage later in the evening we were joined by Mr. Tony Grimes from the Central Bank and in the later stages of the night when Governor Hurley had to leave, Mr. Grimes took his place.

Richard Burrows gave a brief introduction for a couple of minutes covering the deteriorating national and international situation and then I spoke for a couple of minutes. I had prepared some very rough notes on two pages which I retain. The contextual points I made were as follows:

- The Paulson Plan turned down.
- Rumour on New York Stock Exchange that Irish Stock Exchange would not open the next morning.
- A question from an English newspaper to our press office as to whether our shares were going to be suspended.
- I said that the contagion was spreading from the infected patients to the healthy (the analogy of infected patients ■
■ Oireachtas ■ had been used in various exchanges involving the Central Bank and the Government).

Notes of events occurring on Monday & Tuesday (29th & 30th September 2008)
(Dictated, on weekend or 3rd to 5th October)

- I indicated that markets were beginning to ask why Irish Nationwide had not been dealt with and why Anglo had not been dealt with; was there some systemic issue in Ireland that prevented them being dealt with; I indicated that the decisive action that had been taken for example in relation to Fortis in Belgium, Holland and Luxembourg and in relation to Dexia also beginning to contrast unfavourably with the absence of action in Ireland.
- I indicated that Irish Nationwide had got under the radar because they had no share price, their bonds were trading at 0.20c on the Euro and their credit default swaps were 27% over Libor.
- If the market believes that all Irish Banks are in some way connected (which they are not) and that the weakness of Anglo and Nationwide, was misunderstood by the market as in some way affecting the stronger banks.
- I indicated that the remedial action which we propose (this had been agreed with Bank of Ireland) was that the sick banks by which I meant Anglo and Nationwide should be taken out, (by which I meant nationalisation) or taken into some sort of administratorship (or some other form of protective custody) and some sort of guarantee provided for the remaining banks; this is not the first time that the Government would have heard this conversation and it had been generated in the course of that day and previous day in conversations between Regulators and AIB as well as other banks.
- I said that there was a danger that if the two weak banks were not dealt decisively, there could be a market conclusion that the authorities here were in denial and that both the guarantee and the taking out of weak banks was needed; the guarantee wasn't certain to work but it had a better chance of working if the two weak banks were taken out.

Notes of events occurring on Monday & Tuesday (29th & 30th September 2008)
(Dictated, on weekend or 3rd to 5th October)

- The final point I made related to the form of the guarantee; an initial draft had been furnished (I think by Bank of Ireland) and was in a form which we thought was too bare; I mentioned that a guarantee had to read correctly to technical eyes in Foreign Central Banks (I mentioned Peru, Libia and Russia). We furnished a more extensive formula (which we had brought with us) as to the sort of instruments and deposits that should be covered. (This formula was eventually adopted later in the night pretty well word for word).

Eugene Sheehy and Brian Goggin elaborated the suggestions in the current situation. All of this was done at the invitation of the Taoiseach. There was very little response from the official side and we were thanked and asked to withdraw. We went back a number of times during the night but there were long gaps sometimes for an hour up to almost two hours.

When we went back there was more response from the official side, especially from Governor Hurley, the Minister and Secretary General Doyle. Governor Hurley was very clear that it would be dangerous to take down an Institution (and the reference here was clearly to Anglo; Nationwide has in our view deep seated trouble but it was not urgent trouble) in the middle of the week. I specifically remember Governor Hurley saying that it could be "disorderly" and that there could be "a fumble" if it was done mid week. He indicated that the priority was to get to the weekend; things could be dealt with "in an orderly manner". He asked us to indicate what liquidity we could provide to Anglo on Tuesday and for the rest of the week. This was all in the context of a guarantee going to be provided by the Government. We furnished our draft guarantee to the Government at a very early session. We left the meeting and Eugene and I were given a separate room by Mr. Lennon the Taoiseach's programme manager in one of the side corridors. Eugene contacted John O'Donnell and Colm Doherty and the treasury team and I understand Brian Goggin was doing the same with his team.

**Notes of events occurring on Monday & Tuesday (29th & 30th September 2008)
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After a lot of toing and frowning we came up with a number of formulae which would allow us to extend the liquidity which we could provide to Anglo. Particularly we could bid at an ECB auction the following day provided our collateral was processed by the Central Bank during the night. Mr. Grimes indicated that he would need a billion in the morning for Anglo and 4 billion later in the day. Because the auction was on the following day (Tuesday) if the bids were successful, the funds would not become available until Wednesday. The Central Bank indicated that they had some funds which could be used to supplement ours on the Wednesday. A key requirement is that the Government, the Central Bank or the NTMA would guarantee to return the 5 billion to us on Monday 6th October. A promise from Anglo would not be acceptable.

Eventually it was concluded that AIB and Bank of Ireland could each produce 5 billion to tide Anglo over to the weekend. Before the end of the night steps were taken to start putting the collateral together to allow us to be ready for the ECB bid process in the morning; we would agree that we would bid up and pay a high price to get this extra liquidity on behalf of Anglo.

In the course of the evening Eugene also made another suggestion which had come from our Treasury people namely that non qualifying assets (of which we had about 10 billion) could be used with the NTMA, to provide further liquidity; as I understand it (I may not be fully correct in this) the NTMA would apply a haircut to our collateral, they would give us Government bonds which we would present to the Central Bank which they in turn would present to the ECB which would result in a generation of further liquidity.

**Notes of events occurring on Monday & Tuesday (29th & 30th September 2008)
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It is certainly the case that Eugene emphasised to the Treasury team that we were to search every nook and cranny for the extra liquidity and come up with the best ideas possible and I am absolutely satisfied that we did this and responded fully to the request from the Governor of the Central Bank made in the presence of the Taoiseach to assemble as much liquidity as we could to help Anglo to the end of the week. This is notwithstanding the self evident fact that we were now stretching our own liquidity to help a competitor.

It was all done however on foot of the very clearest representations from the Central Bank Governor made in the presence of the Government (although not endorsed by the Government) that an orderly dealing with Anglo would occur at the weekend. The Government made clear that they were not making any agreement with us simple hearing submissions. And the Government would then make their own decision. The Attorney General said to me personally that I should understand that the Government were not undertaking to do anything with any particular institution and I said I understood that.

During the course of the night we suggested to the authorities that a sentence in their draft statement about the guarantee which said something like "the Financial Regulator has informed the Government that all the Irish Banks are solvent" was probably unnecessary and possibly dangerous in the sense that Anglo shares would be traded on foot of it, which could lead to complications for the Government.

Notes of events occurring on Monday & Tuesday (29th & 30th September 2008)
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There were some other people present in the corridors or in adjoining rooms who I met. I met Mr. Neary and had a short and fully agreeable personal chat with him (he introduced me to one of his colleagues whose name I don't remember) and I also met Pdraig O'Riordan in the corridor who is the Managing Partner of Arthur Cox and as I understand it was part of Mr. McCague's team assisting the State. I gained the impression (and it is only that) that the Government were satisfied with our response on providing liquidity and that at least in principle the decision to provide the guarantee might have been made in advance of our arrival; I am less sure about the position of the Government in relation to saving the two troubled institutions but quite clear that Governor Hurley's request to the Banks was to allow the authorities, time to arrange to take those two institutions into some sort of care.

Interpretation

1. In this Act –

“Assessor” means a person appointed under section X;

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

“Governor” means the Governor of the Central Bank and Financial Services Authority of Ireland, as defined in the Central Bank Act 1942, as amended

“Minister” means Minister for Finance

“membership rights” means the rights of membership provided for by the Building Society Act 1989 as amended

[“securities” includes –

- (a) shares and stock,
- (b) debentures, including debenture stock,
- (c) loan stock, bonds, certificates of deposit and other instruments creating or acknowledging indebtedness, and
- (d) warrants or other instruments entitling the holder to subscribe for, or otherwise acquire, securities to which paragraph (a), (b), or (c) relate]

“subsidiary”, in relation to a body, has the same meaning as it has in section 155 of the Companies Act 1963

Note:

- We have deleted the definition of examiner, credit institution, friendly societies, credit unions, and the Irish Financial Appeals Tribunal
- The compensation appeal regime significantly simplified

Questions

1. What powers has the Minister for Environment that might need to be accommodated?
2. Is the definition of “membership rights” sufficient?
3. What is the corporate structure of Xfi – does the Group own the Building Society?

Additional questions identified by AGO

The Attorney has asked

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[Redacted text block]

[Redacted text block]

Head 1

Functions exercisable by the Minister in respect of certain credit institutions

1. The functions of the Minister under this Act shall not be exercised in relation to **Xfi** unless-

- (a) after consultation with the Governor, whether before or after the passing of this Act, the Minister is of the opinion that-
 - (i) there is or would be a serious threat to the stability of **Xfi** if those functions were not exercised, and
 - (ii) the exercise of those functions is necessary for maintaining the stability of the financial system in the State,or
- (b) after consultation with the Governor, the Minister is of the opinion that is necessary for protecting the public interest in circumstances where-
 - (i) whether before or after the passing of this Act the Minister or the Authority has provided financial assistance or guarantees directly or indirectly to **Xfi** for the purpose of maintaining the stability of the financial system in the State, and
 - (ii) any such assistance has not been repaid or otherwise cancelled and any such guarantees are continuing in whole or in part.

[2. A petition to wind-up Xfi, under section 109 of the Building Societies Act 1989, as amended, shall not be made following a transfer of shares under Head 2 of this Act]

3. Nothing in this Act will inhibit the exercise by the Authority of its powers in relation to **Xfib**.

4. In this section –

“financial assistance”, in relation to Xfi, includes any financial assistance provided by the Authority to the institution in respect of which the Minister has given a guarantee, or has otherwise assumed any financial liability

“guarantee”, in relation to a credit institution, means a guarantee under Head Y and includes any undertaking by the Minister that he or she will (to the extent indicated [in the undertaking]) put in place or cause to be put in place a guarantee in respect of which the Minister or the State will assume responsibility

“transfer date” means the date in respect of which the shares are transferred under section 3

Head 2

Transfer of shares to the Minister

1. As and from [the passing of this Act], the shares of **Xfi** are transferred to the Minister (in this section referred to as the “transferee”
|
2. All funds subscribed for these shares will be converted to ordinary deposits accounts [deposits] in **Xfi**
3. As and from [the passing of this Act], the membership of borrower members as provided for in section 16(2)(b) of the Building Societies Act 1989, as amended is disapplied.
4. The Minister may at any time transfer some or all of the shares to which this section relates to a nominee of the Minister
5. [In respect of shares [securities] transferred by virtue of this section–
 - (a) they shall be free from all trusts, liabilities and encumbrances, including any equitable charge on or loans of the securities concerned,
 - (b) as from the transfer date, the transferee shall be entitled to the rights, benefits and privileges arising from or relating to transferred securities, whether or not the transferred has been so registered.
 - (c) They shall take effect despite –
 - (i) the absence of any consent or concurrence to or with the transfer, or
 - (ii) any restriction relating to the transfer of the securities [shares]
 - (d) the transferee shall be entitled to be entered in any register of securities concerned without the need for delivery of any instrument of transfer;
 - (e) the person maintaining any such register shall register the transferee in the register.]

[Question whether table required – legislation provides for shares in different denominations]

Questions

1. **The affect of this Head must be that the Minister is unambiguously the sole member of the building society. Do provisions 1, 2 and 3 provide sufficiently for this?**
2. The object of 2 above is convert share accounts to ordinary deposit accounts following the transfer of shares. Are there any obstacles to this?

3. Do share accounts pay dividends? If so do we need to provide for compensation for this dividend or will interest on deposit accounts be adequate recompense?
4. Is provision 5 still necessary? Whether this is needed will depend upon a better understanding of what is being transferred over.

Head 3

Extinguishment of certain rights in relation to shares

1. The following rights are extinguished:
 - (a) rights to share options arising from or in connection with an individual's employment or office with or the provision of services to **Xfi** or any of its subsidiaries
 - (b) other share options or other rights held by a person to subscribe for, or otherwise acquire shares in **Xfi** or any of its subsidiaries
 - (c) rights to shares arising from the holding of the position of Director
 - (d) rights to rewards or benefit in recognition of the period for which they have been members of the society or the extent to which a person has availed of the services of the society as provided for in section 16 2D of the Building Societies Act 1989, as amended.
-

Note: as indicated in question 1 Head 2, the overriding object of these Heads is to ensure that the Minister becomes the sole member of **Xfi**.

[New Head]

Appointment of assessor

1 On the transfer of the securities of Xfi to the Minister shall appoint an assessor to determine the value (if any) at the date of transfer attaching to the interest/shares of the former members of Xfi based on the [net asset value] and on the basis that

- (a) on the transfer date Xfi was unable to continue as a going concern
- (b) all financial assistance provided directly or indirectly by the Minister to Xfi up to and including on the transfer date had not been made
- (c) no financial assistance would in future be provided directly or indirectly by the Minister to Xfi, and
- (d) any relevant undertaking by the Minister had not been made to the extent that it is in excess of any guarantee provided by the deposit protection account {?} or otherwise (apart from this Act) provided by law in respect of deposits.

2 Where the assessor determines that the value of Xfi in accordance with this Head is positive the Minister shall establish a compensation scheme in accordance with Head [following]

Note:

- This is a new Head to determine before individual compensation amounts are determined if there is any residual former share holder worth to be distributed.

Question

1. Is net asset value the appropriate basis for the Assessor to establish the value of Xfi?

Head 4

Compensation Scheme for securities transferred, etc.

1. The Minister will set out and present to the Oireachtas, within three months of the transfer:
 - (a) procedure by which the Assessor shall determine the disbursement of the amount identified in Head X above amongst the former members of the Xfi
 - (b) system of appeal
2. Subject to subsection (3), the Assessor is independent in the exercise of his or her function under this Act
3. The Minister shall, on notification by the Assessor of compensation assessments under this Head, make arrangements for payments to former members from the Central Fund
4. The Minister shall pay such remuneration and reimburse such expense of the person appointed as Assessor as the Minister shall determine.

Note:

- this is proposed to replace Head 4 in its entirety

Note – the foregoing simpler regime is proposed instead to the following detailed text)

Head 4 (part)

E. (1) Where securities are transferred by virtue of section B91), or rights are extinguished by virtue of Section D, the Minister shall, within X months of the transfer date [and after consulting with [the Authority, the Stock Exchange and such other persons as he or she considers appropriate in the circumstances]] [subject to subsection ##), draw up a scheme (in this Act referred to as the “Compensation Scheme”) for the purpose of assessing the amount of compensation payable (if any) –

- (a) to persons whose securities were transferred under section C,
- (b) to individuals whose rights to share options [arising from or in connection with their employment or office with or the provision of services to Xfi or any of its subsidiaries] were extinguished under section D(a), and
- (c) to persons whose rights to share options or other rights were extinguished under section D(b),

[(2) The Compensation Scheme may also provide for –

(a) records to be kept by the Assessor in ...] **HOW MUCH OF THIS IF ANY DO WE WANT TO RETAIN?**

(3) The Minister may apply to the High Court for an extension of time within which to prepare [and publish] the Compensation Scheme, or any part of it in respect of any class or classes of securities, because of –

- (a) the complexity of the matter concerned,
- (b) the need to seek further information, or the consideration needed of information so sought and received, by the assessor or the Minister in respect of the securities or any class of such securities, or
- (c) any other reason by the Minister,

And where the Court consider it just and equitable in the circumstances, it may order the extension of that time to a specified date in respect of the securities concerned]

Head 4 (part)

Assessor

F. (1) Where securities are transferred by virtue of section B(1), or rights are extinguished by virtue of section D, the Minister shall, within X months of the transfer date [and after consulting with the Authority, the Stock Exchange and such other persons as he or she considers appropriate in the circumstances]), (b) appoint a person (referred to in this Act as an “Assessor”) in accordance with section FA to determine in accordance with this [section][Act] and the Compensation Scheme the amount of compensation payable to those to whom paragraph (a) relates.

(2) Subject to subsection (3), the Assessor is independent in the exercise of his or her function under this Act.

(3) (a) The minister shall pay such remuneration and reimburse such expense of the person appointed as Assessor as the Minister shall determine.

(b) In the event of a dispute between the person appointed as Assessor and the Minister concerning the remuneration, or reimbursements, or both, to which paragraph (a) relates, an appeal shall lie to the IFSAT **GONE**

(c) For the purposes paragraph (b) .. **GONE**

Criteria**FA. [GONE?]**

The Assessor may make procedural rules in relation to the assessment of any compensation including, subject to this Act and the Scheme, procedures for the review by him or her of any assessment under section H and to which section I relates. Proposed rules under this section shall not be made by the Assessor until approved by the Minister.

Determination of compensation. (Head 4 part)

G(1) In determining the amount of compensation (if any) payable in respect of securities transferred or rights extinguished under section C, the Assessor shall do so on the basis that –

- (a) on the transfer date Xfi was unable to continue as a going concern
- (b) all financial assistance provided directly or indirectly by the Minister to Xfi up to and including on the transfer date had not been made
- (c) no financial assistance would in future be provided directly or indirectly by the Minister to Xfi, and
- (d) any relevant undertaking by the Minister had not been made to the extent that it is in excess of any guarantee provided by the deposit protection account {?} or otherwise (apart from this Act) provided by law in respect of deposits.

And shall otherwise do so on the basis of this Act and the Compensation Scheme.

(2) Nothing in subsection (1)(d) shall be read as applying to any ordinary financial market assistance given by the Authority in the ordinary course of its business and which is subject to its normal terms [and conditions].

Provisional assessment by Assessor. (Head 4 part)

H. (1) THIS GOES?

Reviewed assessment by Assessor . (Head 4 part)

I. (1) THIS GOES?

Appeals to the Irish Financial Services Appeals Tribunal. (Head 4 part)
J. **THIS GOES?**

~~Final~~ Assessment by Assessor . (Head 4 part). **AMENDED.**

K (1) Where the Assessor has made his assessment the he may issue a notice of assessment to each person concerned.

(2) The information given in every notice of assessment, shall also be made available by the Assessor to –

(a) the Minister, and

(b) any body holding, at the date the notice was issued, any securities by virtue of section C(4)

And may, or shall a the request of the Minister or that body, be given by the Assessor to the Minister or that body in a composite form distinguishing between each class of security or rights concerned.

Payment of compensation by the Minister (Head 4 part)

NO CHANGE in TEXT HERE?

L(1) Where the Assessor is of the opinion that –

(a) any amount payable in respect of any class or classes of securities to which section C relates, or any class or classes of rights extinguished by virtue of section D, for which a notice of assessment has been issued, and

(b) the payment of any such class would not financially prejudice the payment of all other classes,

Then the Assessor may advise the Minister accordingly and the Minister shall exercise his or her functions under subsection (2).

(2) The Minister shall pay, or cause to be paid. All amounts by virtue of the final notice of assessment.

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.

25/WB/03

Anglo Irish Bank Corporation plc

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Dublin 2
Ireland

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

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.



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.

7/10/10

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.

3

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Note for the Minister's Information on financial market developments for Government meeting 3 September 2008

Overview

International

- Difficulties are continuing in international financial markets with credit availability restricted, the cost of funds elevated and no near term prospect of markets returning to their pre-crisis levels. The general view is that there is no immediate prospect of a reversal of this position. The more optimistic commentaries refer to the current position as being 'the end of the beginning'.

- The problems that began in August 2007 with US sub-prime mortgage lending have worked their way throughout the financial system. The banks that originated many of sub-prime mortgage products have had to bring losses to book, currently estimated at €500 million, but with the IMF estimating eventual losses at \$1 trillion. Concerns as to where losses will eventually be realised have led to a reluctance by investors to lend money to the financial sector, putting pressure on banks that fund their retail lending from wholesale financial markets.

- Against this background the last year has seen a succession of bad news - nationalisation of Northern Rock in the UK, virtual collapse of Bear Stearns in the US, rescue of SachsenLB and IKB in Germany, takeover of Roskilde Bank in Denmark by a combination of the Central Bank and other Danish banks and fears that in the US, Fannie Mae and Freddie Mac, which together own or guarantee \$5.3 trillion in US mortgages, may have to be re-nationalised. Such events have seriously weakened investor sentiment.

- Recent comments suggesting a tightening of the availability of liquidity from the ECB and the prospect of major international banks having to roll-over an estimated \$800 billion in finance over the next few months have added to the negative picture. As banks compete for funds to pay off their borrowings, or sell assets to raise cash, these actions could exacerbate strains in financial markets. Banks that turn to shorter-term loans will have to renew their borrowings more frequently, increasing the risk that they will not be able to get money when they need it.

Ireland

- Though having no direct exposure to US sub-prime lending, Ireland cannot not hope to completely escape the impact of international developments. The tightening and increased cost of credit, which has coincided with a significant correction in construction activity, has thrown into sharp relief the reliance of domestic retail banks on wholesale financial markets to finance mortgage and property lending.

- - There is little international investor appetite for investment in Irish financial institutions, which are perceived to be vulnerable to the real economy impacts of the credit crisis and correction in construction activity. The resulting fall in the share prices of Irish financials has outpaced those in other countries. The decline in

the ISEQ financial index since Q2 2007 is 69% as against falls of 44% in the UK FTSE and 47% in the US Dow Jones financial indices. A series of recent reports (CB Richard Ellis describing sharp fall in commercial property deals down from €1.9bn to €0.4 bn, Goldman Sachs pointing to likely increased impairment of loans by Irish banks reducing 34pc off their earnings estimates for the sector between 2008 and 2010) have underlined the position.

Summary

- The international financial market background is one of major losses from sub-prime mortgage products, the collapse/rescue of major banks and the prospect of further difficulties. Irish banks have weathered international developments to-date and the correction in domestic construction activity and property prices, but are under ongoing pressure. Credit continues to be scarce and expensive, putting pressure on institutions to fund their activities with varying level of stress in different institutions. The Irish banks continue to state they are open for business; the level of lending to (x date), at €r billion, though down on the comparable period in 2007 would tend to support the contention that credit continues to be available, though clearly lending conditions are tightening.

- Key to sustaining the position of Irish banks this far has been the maintenance of confidence. The strong endorsement of the position of the Irish banks in terms of capitalisation, liquidity, etc., by the Central Bank, IMF and OECD at the commencement of the present period was vitally important. Going forward, the maintaining confidence is vital and the banks have indicated they would not wish any action by Government that might be interpreted in financial markets as an indication of perceived weaknesses.

- The assessment underlines the importance of Government's role in maintaining confidence and providing a stable economic and financial climate through sound management of the economy, prudent responsible budgetary policies and a focus on labour cost competitiveness

- The CBFSAI continues to monitor developments closely and the Domestic Standing Group (DSG) on Financial Stability is continuing to meet to coordinate information exchanges between the Central Bank, the Financial Regulator and the Department.

A more detailed note is attached.

Financial Market Developments

International

International financial markets remain depressed reflected in massive falls in bank share prices, little investor interest in financial markets and continuing elevated interest rates and constrained liquidity. The generally held expectation is that the dislocation in financial markets, which has already spilled over into the real economy, will continue for at least another year. Over the last twelve months markets have received a succession of bad news:

- **US Sub-Prime** crises is now estimated by the IMF to be likely to reach \$1 trillion in losses (approx \$500 million already written off) which has massively impacted major international financial institutions which have had to bring these losses to book (e.g. UBS, Citibank, Lehmans, etc.).
- Standard & Poor reported on 22 August that that **mortgage delinquency rates** on many better quality US mortgages in July outpaced those on the subprime loans that helped to spark the housing crisis. Total delinquencies on two categories of prime loans rose at rates of 7% and 9% from June while the rate for subprime loans rose by 7%.
- In the US, **Fannie Mae and Freddie Mac**¹, which together own or guarantee \$5.3 trillion in US mortgages (almost half of the US mortgage market) have been badly damaged by increased mortgage default. Because of the losses from the worsening situation in the US housing market both companies have sought to raise funds but investors fear they may not be able to raise enough to cover liabilities as they have to pay out if homeowners cannot meet their mortgage repayments. This led to recent heightened speculation that Freddie & Fannie would be nationalised. In light of the Bear Stearns events in March, the market is waiting to see how they will be recapitalised and how this might impact on their share holders. The US Treasury Secretary announced in mid July that the US Government's primary focus was supporting the two firms in their current form, but continuing deterioration in underlying mortgages is focusing speculation that both will have to be rescued by the Federal authorities (re-nationalisation). Investors may have been somewhat reassured in recent days by the successful sales of short-term debt by the two bodies.
- In Europe, **collapse in the value of certain banks**, leading to the nationalisation of Northern Rock in the UK, rescue of SachsenLB and IKB in Germany by other German banks and most recently the takeover of Roskilde bank in Denmark by a combination of the Central Bank and other Danish banks have left investors with little appetite for the financial sector.
- **Euribor rates** - The interest rates in the interbank money market remain elevated, with the Euribor 3-month rate 0.72% above the ECB base rate of 4.25% at 4.965%. The spread between this rate and the Eonia rate indicates how much of the spread of the Euribor above the base rate is due to the market turmoil. This spread was

¹ Federal Home Loan Mortgage Association (Fannie Mae) and Federal National Mortgage Association (Freddie Mae) - originally established as Federal authorities to ensure funding to mortgage lenders through the secondary mortgage market, but subsequently privatise.

approximately 0.6% at the start of the month. This is lower than its peak of 0.9% during this market dislocation, but far higher than the spread of only 0.07% before the onset of the turmoil in August 2007.

Against the background of persistent bad news, markets have recently been contemplating two prospective concerns:

- A key stabilising influence over the last twelve months has been **additional liquidity** made available by international central banks (ECB, Federal Reserve, Bank of England and Swiss Central Bank). However, recent public comments by the President and members of the ECB that banks must make greater efforts to return financial markets to some form of normality has led to speculation that such liquidity will become less available² as the ECB tightens its lending criteria. This would lead to greater pressure on banks, particularly smaller banks where these are perceived to be otherwise vulnerable (e.g. exposed to property markets) to find finance at an acceptable price.
- **Banks' funding requirement;** It is estimated that financial institutions will have to pay off almost \$800 billion in floating-rate notes (securities used to borrow money) and other medium-term obligations before the end of 2009, i.e. either find replacement funding in this amount or realise assets to pay off these monies.. By the end of this year, big banks and investment banks such as Goldman Sachs Group Inc., Merrill Lynch & Co, Morgan Stanley, Wachovia Corp., and HBOS PLC must each redeem more than \$5 billion in floating-rate notes. As banks compete for funds to pay off their borrowings, or sell assets to raise cash, these actions could exacerbate strains in financial markets. Banks that turn to shorter-term loans will have to renew their borrowings more frequently, increasing the risk that they won't be able to get money when they need it.

The effects of past and anticipated events are reflected in major falls in share price indices across international markets (see attached graph at appendix 1) especially banks, increased prices for Credit Default Swaps (CDS, i.e. the price at which a guarantee of repayment of loan in the event of default by a borrower can be bought (details attached at appendix 2) and spillover into real economies with decline in consumer confidence and economic growth.

Ireland

Irish banks had little or no direct exposure to the US sub-prime crises. However, original hopes that the consequences of those problems could be avoided if the crisis was short lived and spill-over into real economies avoided have not been realised. In the context of a general loss of confidence in the financial sector, the vulnerabilities of our domestic financial sector to high levels of exposure to the property and construction sector have come into sharp focus, amplified by the correction now underway in construction activity.

² Media reports point to increasing creativity of Banks in order to benefit from the ECB regime. The UK's Nationwide Building Society for example has announced plans to expand into Ireland to make use of the eurozone's funding opportunities. Spanish banks are reported to have scaled up their use of mortgage-backed securities to obtain funding from the ECB as they cannot find investors for these securities. All of these have been unhelpful.

- As a small banking market significantly involved in property lending particularly in the commercial sector, Irish banks have been hit hard by negative investor sentiment. The decline in the ISEQ financial index since Q2 2007 is 69% as against falls of 44% in the UK FTSE and 47% in the US Dow Jones financial indices.
- The share prices of individual financial institutions have been highly volatile, in general the share prices of individual banks are worth about 1/3 of their price at the start of 2007, but have fallen precipitously at different times over the last year.
- Irish banks are under pressure to maintain dividends, with IL&P declaring a dividend of 22 cents per share for H1 2008 on an income of 12 cents per share in the same period.
- Domestic Irish banks continue to state they are open for business and are interested in proposals that offer real opportunity for added value. However, figures released by the Central Bank on 29 August show that the annual rate of increase in private-sector credit reached a six-year low of 13.3 per cent in July 2008. There has been a decline in levels of lending; mortgage lending has declined from €x billion in the first six months of 2007 to €y billion in the same period in 2008, a decline of r%, and most banks have radically altered their loan product line and required increased equity input from prospective borrowers.

Against this background there is little international investor appetite for investment in Irish financial institutions. Goldman Sachs recently issued a report pointing to likely increased impairment of loans by Irish banks, expecting Irish lenders to write off 3pc of loans to property developers next year alone and reducing by 34pc their earnings estimates for the sector between 2008 and 2010. While the extent of write-offs is significant, it is close to the forecasts by the individual institutions and Goldman Sachs expects the three main banks Allied Irish Banks, Bank of Ireland and Anglo Irish Bank to remain profitable. All of the Irish banks have stressed they are working closely with key borrowers to monitor developments and manage financing needs. Nonetheless, the overall assessment reinforces investor reluctance to support Irish banks.

In the context of international concerns of growth in dependence by banks on liquidity from Central Banks, it should be noted that while the overall level of ECB funding availed of by banks in Ireland has increased from €24.5 bn to €31 bn, domestic banks have reduced their dependence from €15 bn to €13 bn.

Financial Stability Report 2008

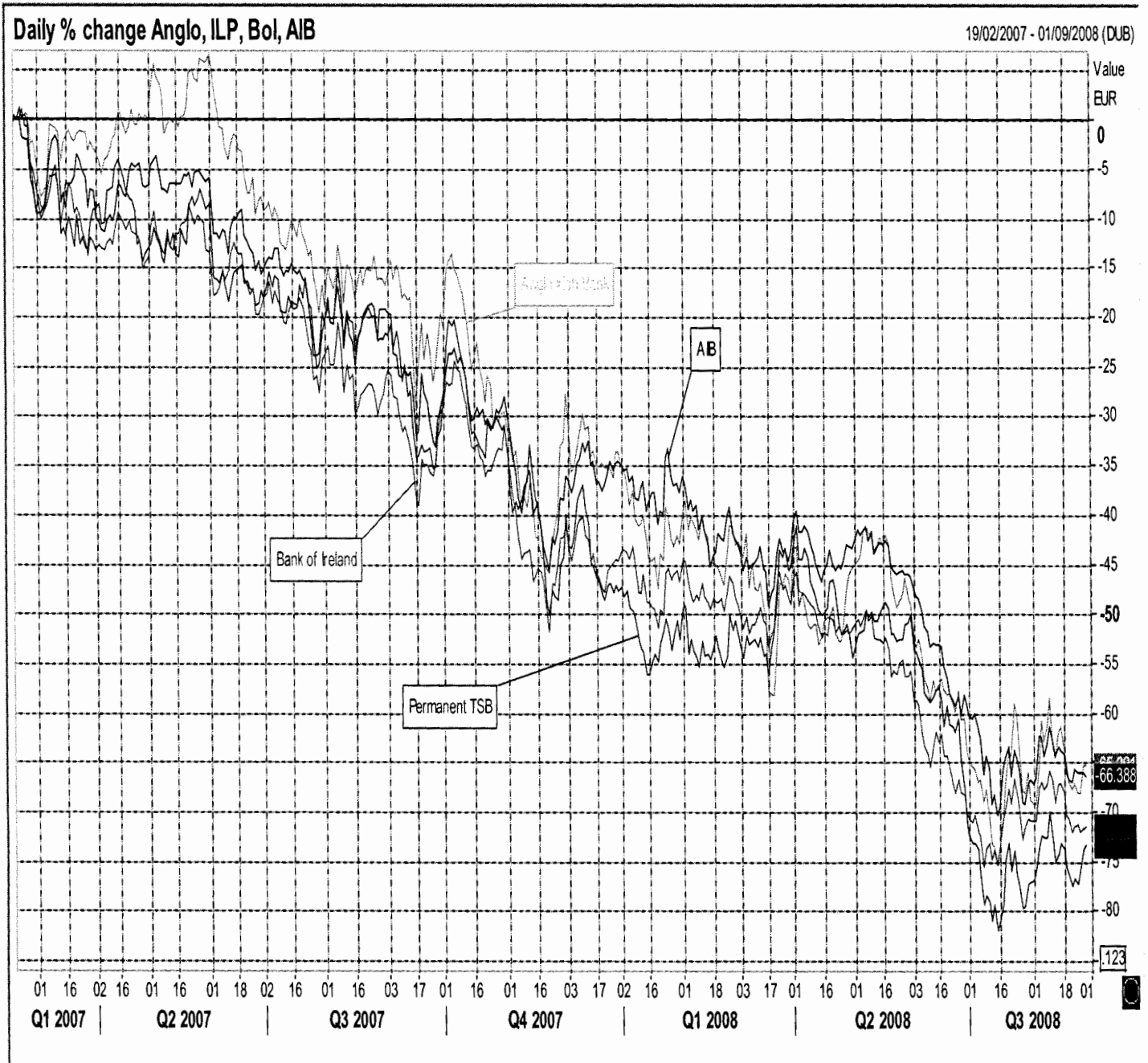
The CBFSAI's Financial Stability Report (FSR) for 2008 will be published in mid November. This arises from our membership of the European System of Central Banks which requires the ECB and national Central Banks to foster financial stability in the euro zone. The objective of the Report is to set out the CBFSAI's overall assessment of the stability of the domestic financial system; it does not relate to monetary policy matters. The FSR provides the CBFSAI's view on the economic outlook generally and macroeconomic risks arising. It focuses on issues for the Domestic Financial System and its overall health. The overall conclusion of the FSR

for 2007 was that the shock-absorption capacity of the banking system left it well placed to withstand pressures from possible adverse economic and sectoral developments. Clearly the extended period of dislocation in financial markets, spillover into the global economy and correction in the construction sector will be reflected in the FSR 2008. While it is too early yet to anticipate the content of the CBFSAI's report for 2008, the Department will liaise closely with the CBFSAI to identify key issues. [The emergence of this report shortly before the Budget will make it important that the key messages are responded to.]

August 2008

cc Secretary General, Mr Cardiff, Ms Herbert

Share performance of Irish banks from the highs of February 2007

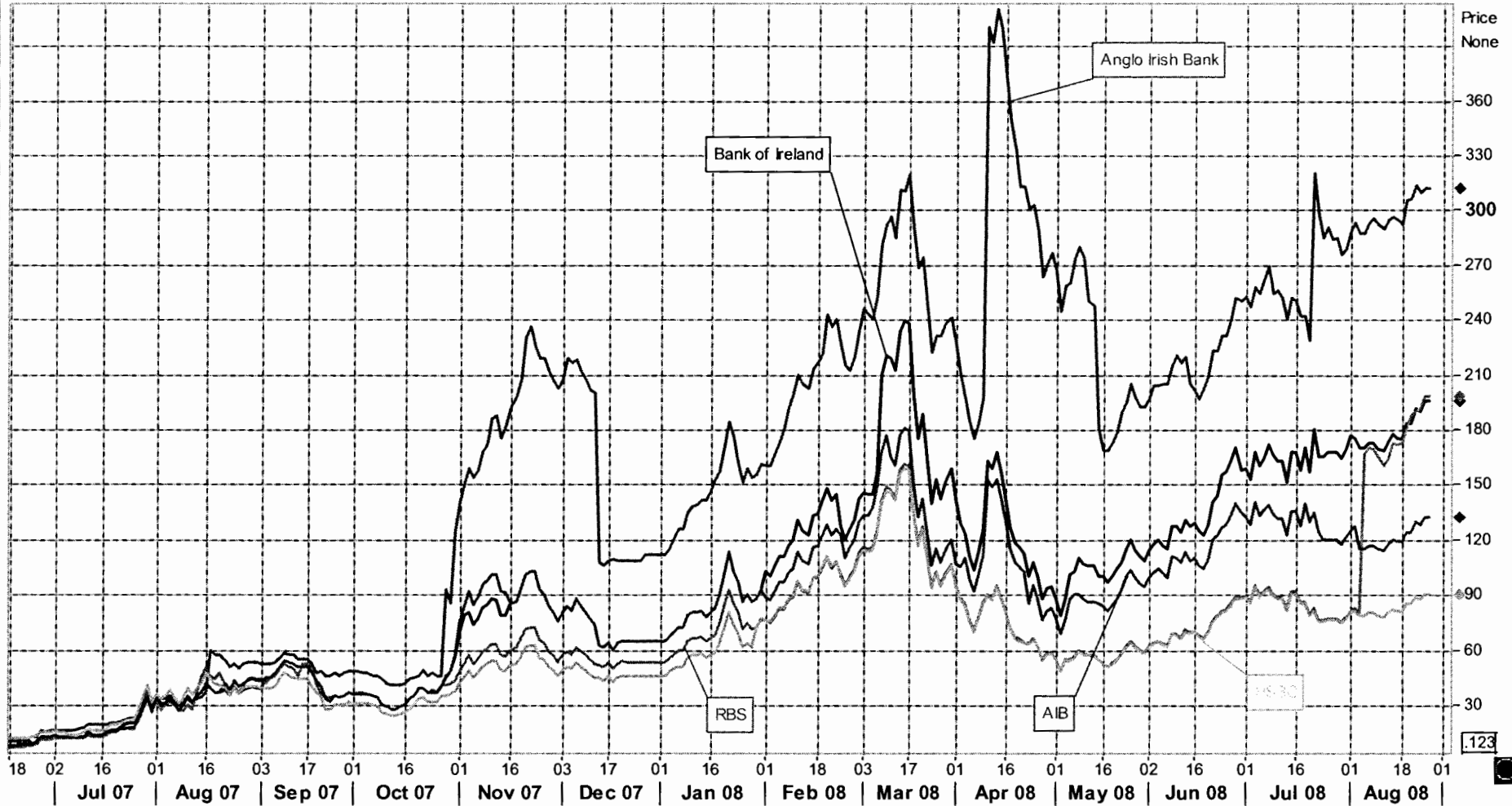


Appendix 2

**CDS spreads for AIB, Bank of Ireland, Anglo Irish Bank and HSBC and
RBS**

Daily QBKIR5YEUAM=FN, QANGL5YEUAM=FN, QBSCT5YEUAM=FN, QAIB5YEUAM=FN, QHSBA5YEUAM=FN

18/06/2007 - 03/09/2008 (LON)



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.

WIP 19/9/08 1527 hrs. [REDACTED]
[REDACTED] revised text based on Building Society Bill [REDACTED] of 17 Sept 08]

[REDACTED]

Draft of

BILL
entitled

XXX Bank (Protection) Bill 2008

WIP 22/9/08 1600 hrs. [REDACTED]

[REDACTED]

[REDACTED]

Note also numbering and Arrangement of Sections still not revised.

Draft of

BILL

entitled

XXX Bank (Protection) Bill 2008

XXX Bank (Protection) Bill 2008

BILL

entitled

An Act to provide, in the public interest, for maintaining the stability of the financial market in the State and for that purpose to provide that the whole issued share capital of XXX Bank be transferred to Minister for Finance, to extinguish certain rights in that Bank, to disapply certain provisions of the Companies Acts and other enactments in so far as they relate to that Bank or to that Minister as sole shareholder, to provide for the removal of persons from offices, positions or employment with that Bank and the appointment of persons to certain offices, positions or employment with that Bank, to provide for the appointment of an assessor to assess fair and reasonable compensation (if any) to be paid to certain persons whose shares were transferred to that Minister or whose rights were so extinguished, to provide for the payment of any such compensation, to provide for guarantees or loans by that Minister in respect of that Bank and to provide for connected matters.

BE IT ENACTED BY THE OIREACHTAS AS FOLLOWS:

| *WIP 18/09/08 DOF and NTMA comments*

Draft of

BILL
entitled

XX Building Society (Protection) Bill 2008

XX Building Society (Protection) Bill 2008

BILL

entitled

An Act to provide, in the public interest, for maintaining the ~~stabilisation~~ stability of the financial market system in the State and for that purpose to extinguish certain rights in XY Building Society, to provide that the Minister for Finance be the sole shareholder and member of that Society, to disapply certain provisions of the Building Societies Act 1989 and other enactments in so far as they relate to that Society or to that Minister as sole shareholder and member, to provide for the removal of persons from offices, positions or employment with that Society and the appointment of persons to certain offices, positions or employment with that Society, to provide for the appointment of an assessor to assess fair and reasonable compensation (if any) to be paid to certain persons whose rights were so extinguished, to provide for the payment of any such compensation ~~(if any)~~, to provide for guarantees or loans by that Minister in respect of that Society and to provide for connected matters.

Commented [REDACTED]

BE IT ENACTED BY THE OIREACHTAS AS FOLLOWS:

Provision of guarantees and loans.

J (1) The Minister may after the relevant daydate passing of the Act provide guarantees or loans in such form and manner and on such terms and conditions as the Minister sees fit, including either or both on commercial terms and on the payment of a fee, in respect of the borrowings, liabilities, rights and obligations of the Society to the Bank or any person.

(2) The Minister may withdraw or revoke a loan or guarantee as the Minister see fit

(3) All moneys to be paid out by the Minister on foot of a guarantee or loan provided by the Minister under this section shall be paid from the Central Fund or the growing produce thereof.

(4) (a) Moneys paid by the Minister under a guarantee or loan under this head shall be repayable to the Minister, with interest, as and when such moneys are available to the Society.

(b) Moneys paid by the Society 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.

(5) The Minister [has a continuing obligation][shall endeavour] to use all reasonable means to recover amounts paid out under guarantees or loan-loans provided under this section.

(6) In the event that moneys paid out under a guarantee or loan under this section are not recovered, the amount outstanding shall be repaid to the Central Fund from moneys voted by the Oireachtas.

(7) As soon as practicable after the end of each year, the Minister shall lay a statement [report] report-statement before each House of the Oireachtas for the purpose of [fully] informing the members of each House on the situation with any guarantees or loans made under this section and the statement [report] report statement shall give particulars of—

(a) every guarantee or loan provided under this section where payments have been made by the Minister [or the National Treasury Management Agency],

(b) the amount of payment and the amount (if any) repaid to the Minister [or the National Treasury Management Agency] on foot of the payment; and

(c) the amount of money covered by a guarantee or loan that was outstanding at the end of that year.

(8) The First Schedule to the National Treasury Management Agency Act 1990 is amended by the addition of the following paragraph after paragraph (r) :

Commented [redacted]
[redacted]
[redacted]

Commented [redacted]tion
[redacted]

Commented [redacted]
[redacted]

**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.

13

F9/25/08, D
Rec 13

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]

From: Brendan McDonagh
Sent: 11 October 2008 11:13
To: Beausang, William; Cardiff, Kevin; Buttimore, Jonathan; Moloney, Damien; brian.halpin@centralbank.ie; Horan Con
Cc: Cormac Kissane; Robert Cain; John Meade; jhurley@centralbank.ie; Doyle, David; Manley, Michael; Pdraig Oriordain; John Corrigan
Subject: RE: URGENT: State Aid policy issues

William,

I will only comment on item 3, dated subordinated debt as the other matters are policy issues to be resolved between the Department, Central Bank and FR.

I think I understand where the Commission is coming from as they may believe that the Irish covered institutions could issue for a longer term because of the guarantee than other countries institutions could. This may or may not be the case as it is only the debt providers who can make that assessment based on their risk/reward parameters.

I believe it is important to include dated subordinated debt under the guarantee as the problems we are dealing with here were caused by the financial institutions having too great a mismatch between their asset and liability profiles, to such an extent that they were funding long term assets with too much reliance on short term funding, be it Commercial Paper, interbank deposits and corporate deposits.

Surely the objective of the guarantee of this dated subordinated debt from our point to view is to give the covered institutions the ability to access at least 2 year term funding to reduce their reliance on short term funding thereby avoiding the liquidity squeeze. If any covered institution was to issue term debt with a maturity longer than 2 years then the market would want to be compensated for that by an appropriate step up in the interest rate pricing and that would be entirely commercial.

Also the investors in dated subordinated debt while receiving a reasonable return commensurate with the risk are not equity type investors and invest on the basis that they expect their original principal to be returned at maturity whereas equity investors take the risk of losing their equity but also have the very real possibility of receiving a multiple of their equity investment through dividend income and capital appreciation.

In my view investors in undated subordinated debt e.g. perpetual debt are more akin to equity type investors.

Regards

Brendan

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

**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**

Indecon (Ireland), Indecon House, 4 Fitzwilliam Place, Dublin 2, Ireland.
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directors: P.Mullarkey (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.

Note for the Minister's Information on financial market developments for Government meeting of 3 September 2008

Overview

International Situation

- Financial market conditions remain extremely difficult and the international financial sector remains under significant stress with credit availability restricted, the cost of funds elevated and little immediate prospect of markets returning to their pre-crisis levels.
- There are few real indications that any sustained improvement will be achieved for some time. The more optimistic commentaries characterise the current position as 'the end of the beginning'.
- The concerns that led to the credit markets seizing-up last August persist and there is evidence that in the US the delinquency problems that affected sub prime loans are spreading to the prime loan sector.
- Major financial institutions continue to disclose major write-downs and the IMF has estimated eventual losses at \$1 trillion.
- International initiatives and in particular the activities of the FED and the ECB/Eurosystem have helped to stabilise financial market conditions at particular junctures. However, recent comments suggesting clarification (?) of the criteria relating to collateral pledged when drawing liquidity from the ECB and the prospect of major international banks having to roll-over an estimated \$800 million in finance over the next few months have added to the negative picture.
- International efforts to resolve the crisis (e.g. by promoting increased transparency or clearer approaches to the valuation of problematic assets held by banks) have yet to be finalised and will in any event take some time to bear fruit.

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 Deleted: tightening
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Irish Financial System

- As reiterated by the Governor of the Central Bank on 10 July, Irish banks meet all the conventional measures of financial health – solvency, liquidity, profitability, asset quality. Their strong performance over recent years leaves them well-placed to deal with the current difficult financial market environment.
- However, Irish banks are subject to specific pressures and stresses – over and above those applying more generally internationally – owing to wide-spread international concern regarding their exposure to the property market.
- Though having very limited direct exposure to US sub-prime lending, Ireland cannot hope to completely escape the impact of international developments. The tightening and increased cost of credit, which has coincided with a significant correction in construction activity, has thrown into sharp relief the fairly significant reliance of domestic retail banks on wholesale financial markets to finance mortgage and property lending.
- There is little international investor appetite for investment in Irish financial institutions, which are perceived to be vulnerable to the real economy impacts of the credit crisis and correction in construction activity. The resulting very significant fall in the share prices of Irish financials has outpaced those in other countries. The decline in the ISEQ financial index since Q2 2007 is 69% as

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against falls of 44% in the UK FTSE and 47% in the US Dow Jones financial indices.

- Another indicator of investors' negative view of Ireland is that the yield spread of Irish Government Bonds over German Government Bonds now stands at 47bps whereas before the financial market turmoil Ireland was normally at the low end of a 5 to 10 bp range over Germany.
- In circumstances, ~~where the financial system finds it more difficult to~~, access funds from the wholesale market, the only viable commercial strategy is to significantly restrict their lending activities. Retrenched lending has the obvious potential to impact adversely on the economy.

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Conclusion

The **international financial market background** is one of major losses from sub-prime mortgage products, the collapse/rescue of major banks and the prospect of further difficulties. Irish banks have weathered international developments and the correction in domestic construction activity and property prices, but are under ongoing pressure. Credit continues to be scarce and expensive, putting pressure on institutions to fund their activities with varying level of stress in different institutions.

The Irish banks continue to state they are open for business. However, the **Private Sector Credit** annual rate of increase in July was 13.3% - the lowest annual growth rate since July 2002, ~~although reasonably high by international standards~~. The Central Bank said on 29 August that the annual growth of Irish residential mortgages, inclusive of securitised residential mortgages, dropped 9.6% in July. The last time the annual rate of increase in such mortgages was in single figures was at December 1987.

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Key to sustaining the position of Irish banks this far has been the **maintenance of confidence**. The strong endorsement of the position of the Irish banks in terms of capitalisation, liquidity, etc., by the Central Bank, IMF and OECD has been helpful. However, maintaining confidence is vital and challenging and the banks have indicated they would not wish any action by Government that might be interpreted in financial markets as an indication of perceived weaknesses.

The foregoing assessment underlines the importance of the **Government's role** in maintaining confidence and providing a stable economic and financial climate through sound management of the economy, prudent budgetary policies and a focus on labour cost competitiveness.

The CBFSAI continues to monitor developments closely and the Domestic Standing Group (DSG) on Financial Stability is continuing to meet to coordinate information exchanges between the Central Bank, the Financial Regulator and the Department.

A more detailed note is attached.

Financial Market Developments

International

International financial markets remain depressed reflected in very significant falls in bank share prices, little investor interest in financial markets and continuing elevated interest rates in the euro area and constrained liquidity. The generally held expectation is that the dislocation in financial markets, which has already spilled over into the real economy, will continue for at least another year. Over the last twelve months markets have received a succession of bad news:

- **US Sub-Prime** crisis is now estimated by the IMF to be likely to reach \$1 trillion in losses (approx \$500 million already written off) which has massively impacted major international financial institutions which have had to bring these losses to book (e.g. UBS, Citibank, Lehmans, etc.).
- Standard & Poor reported on 22 August that that **mortgage delinquency rates** on many better quality US mortgages in July outpaced those on the sub prime loans that helped to spark the housing crisis. Total delinquencies on two categories of prime loans rose at rates of 7% and 9% from June while the rate for sub prime loans rose by 7%.
- In the US, **Fannie Mae and Freddie Mac**¹, which together own or guarantee \$5.3 trillion in US mortgages (almost half of the US mortgage market) have been badly damaged by increased mortgage default. Because of the losses from the worsening situation in the US housing market both companies have sought to raise funds but investors fear they may not be able to raise enough to cover liabilities as they have to pay out if homeowners cannot meet their mortgage repayments. This has led to recent heightened speculation that Freddie & Fannie would be nationalised. In light of the Bear Stearns events in March, the market is waiting to see how they will be recapitalised and how this might impact on their share holders. The US Treasury Secretary announced in mid July that the US Government's primary focus was supporting the two firms in their current form, but continuing deterioration in underlying mortgages is focusing speculation that both will have to be rescued by the Federal authorities (re-nationalisation). [Investors may have been somewhat reassured in recent days by the successful sales of short-term debt by the two companies.]
- In Europe, **severe difficulties for certain banks**, leading to the nationalisation of Northern Rock in the UK, rescue of SachsenLB and IKB in Germany by other German banks and most recently the takeover of Roskilde bank in Denmark by a combination of the Central Bank and other Danish banks have left investors with little appetite for the financial sector.
- **Euribor rates** - The interest rates in the interbank money market remain elevated, with the Euribor 3-month rate 0.718% above the ECB base rate of 4.25% at 4.965%. The spread between this rate and the Eonia rate indicates how much of the spread of the Euribor above the base rate is due to the market turmoil. This spread

¹ Federal Home Loan Mortgage Association (Fannie Mae) and Federal National Mortgage Association (Freddie Mae) - originally established as Federal authorities to ensure funding to mortgage lenders through the secondary mortgage market, but subsequently privatised.

was approximately 0.6% at the start of August 2008. This is lower than its peak of 0.9% during this market dislocation, but far higher than the spread of only 0.07% before the onset of the turmoil in August 2007.

Against the background of persistent bad news, markets have recently been contemplating two prospective concerns:

- A key stabilising influence over the last twelve months has been **additional liquidity** made available by international central banks (ECB, Federal Reserve, Bank of England and Swiss Central Bank). However, recent public comments by the President and members of the ECB that banks must make greater efforts to return financial markets to some form of normality has led to speculation that such liquidity will become less available as the ECB tightens its lending criteria². This would lead to greater pressure on banks, particularly smaller banks where these are perceived to be otherwise vulnerable (e.g. exposed to property markets) to find finance at an acceptable price.
- **Banks' funding requirements:** It is estimated that financial institutions will have to pay off almost \$800 billion in floating-rate notes (securities used to borrow money) and other medium-term obligations before the end of 2009, i.e. either find replacement funding in this amount or realise assets to pay off these moneys. By the end of this year, large banks and investment houses such as Goldman Sachs Group Inc., Merrill Lynch & Co, Morgan Stanley, Wachovia Corp., and HBOS PLC must each redeem more than \$5 billion in floating-rate notes. As banks compete for funds to pay off their borrowings, or sell assets to raise cash, these actions could exacerbate strains in financial markets. Banks that turn to shorter-term loans will have to renew their borrowings more frequently, increasing the risk that they won't be able to get money when they need it.

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The effects of past and anticipated events are reflected in major falls in share price indices across international markets especially banks (see graph at appendix 1), increased prices for Credit Default Swaps (CDS, i.e. the price at which a guarantee of repayment of loan in the event of default by a borrower can be bought –see graph at appendix 2) and spill-over into real economies with decline in consumer confidence and economic growth.

Ireland

Irish banks had little or no direct exposure to the US sub-prime crises. However, original hopes that the consequences of those problems could be evaded if the crisis was short lived and spill-over into real economies avoided have not been realised. In the context of a general loss of confidence in the financial sector, the perceived vulnerabilities of the Irish domestic financial sector to high levels of exposure to the property and construction sector have come into sharp focus, amplified by the correction now underway in construction activity.

² Media reports point to increasing creativity of Banks in order to benefit from the ECB regime. The UK's Nationwide Building Society for example has announced plans to expand into Ireland to make use of the eurozone's funding opportunities. Spanish banks are reported to have scaled up their use of mortgage-backed securities to obtain funding from the ECB as they cannot find investors for these securities. All of these have been unhelpful.

- As a small banking market significantly involved in property lending particularly in the commercial sector, Irish banks have been hit hard by **negative investor sentiment**. The decline in the ISEQ financial index since Q2 2007 is 69% as against falls of 44% in the UK FTSE and 47% in the US Dow Jones financial indices.
- A further indicator of investors' negative sentiment towards Ireland is that the **yield spread of Irish Government Bonds** over German Government Bonds now stands at 47bps whereas before the financial market turmoil Ireland was normally at the low end of a 5 to 10 bp range over Germany.
- The **share prices of individual financial institutions** have been highly volatile, in general the share prices of individual banks are worth about 1/3 of their price at the start of 2007, but have fallen precipitously at different times over the last year.
- Irish banks are under **pressure to maintain dividends**, with IL&P declaring a dividend of 22 cents per share for H1 2008 on an income of 12 cents per share in the same period.
- Domestic Irish banks continue to state they are open for business and are interested in proposals that offer real opportunity for added value. However, there has been a **decline in the rate of increase (?) in lending**; new mortgage lending has declined from €16.542 billion in the first six months of 2007 to €13,832 billion in the same period in 2008, a decline of 16%, Most banks have **adopted more cautious lending practices (?)** and require increased equity input from prospective borrowers.

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Against this background there is little international investor appetite for investment in Irish financial institutions. Goldman Sachs recently issued a report pointing to likely increased impairment of loans by Irish banks, expecting Irish lenders to write off 3pc of loans to property developers next year alone and reducing by 34pc their earnings estimates for the sector between 2008 and 2010. While the extent of write-offs is significant, it is close to the forecasts by the individual institutions and Goldman Sachs expects the three main banks Allied Irish Banks, Bank of Ireland and Anglo Irish Bank to remain profitable. All of the Irish banks have stressed they are working closely with key borrowers to monitor developments and manage financing needs. Nonetheless, the overall assessment reinforces investor reluctance to support Irish banks.

In the context of international concerns of growth in dependence by banks on liquidity from Central Banks, it should be noted that while the overall level of ECB funding availed of by banks in Ireland has increased from €39.5 bn (Dec 2007) to €44 bn (July 2008), domestic banks have reduced their dependence from €15 bn to €13 bn.

Financial Stability Report 2008

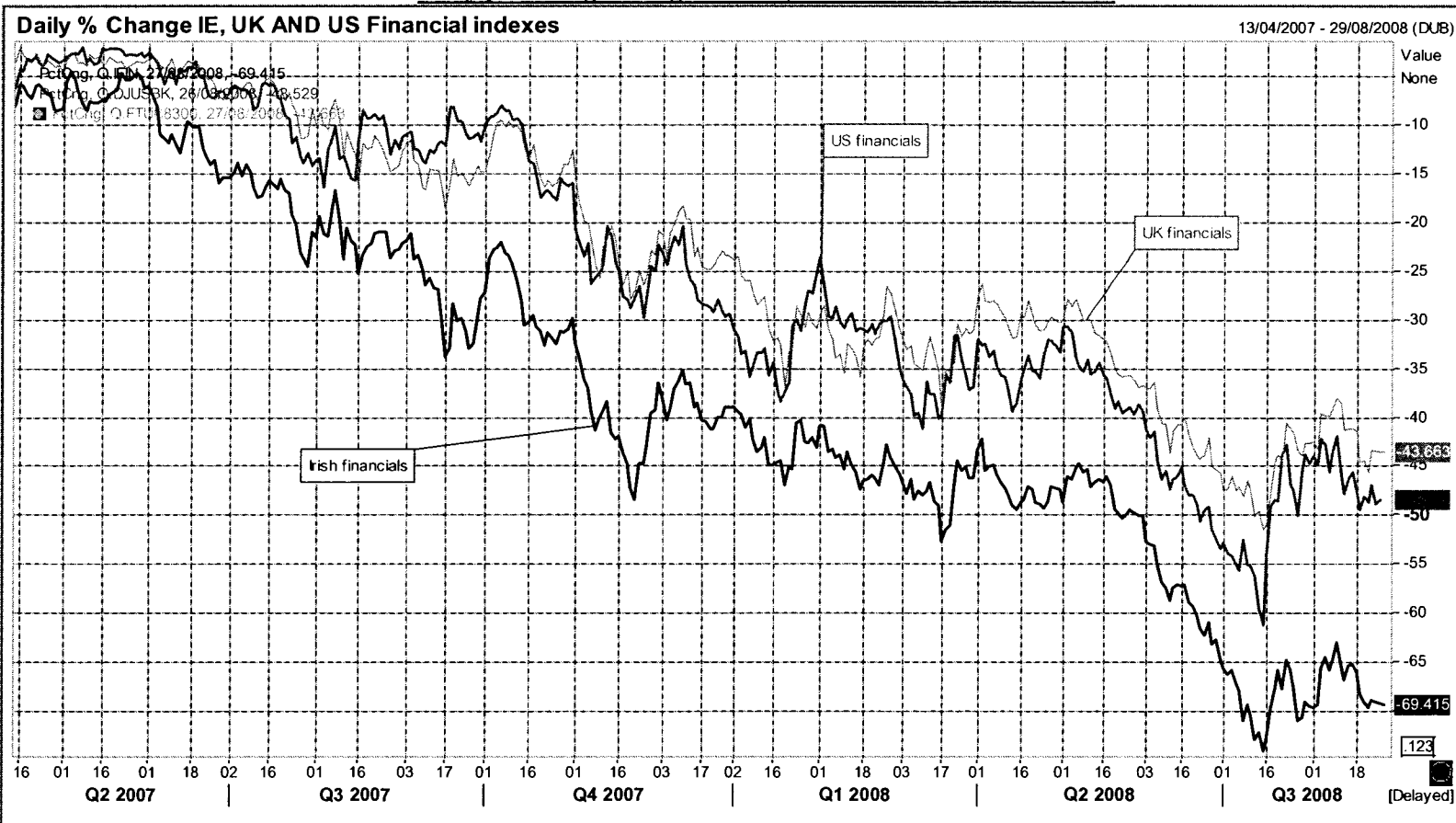
The CBFSAI's Financial Stability Report (FSR) for 2008 will be published in mid November. This arises from our membership of the European System of Central Banks which requires the ECB and national Central Banks to foster financial stability in the euro zone. The objective of the Report is to set out the CBFSAI's overall assessment of the stability of the domestic financial system; it does not relate to

monetary policy matters. The FSR provides the CBFSAI's view on the economic outlook generally and macroeconomic risks arising. It focuses on issues for the domestic financial system and its overall health. The overall conclusion of the FSR for 2007 was that the shock-absorption capacity of the banking system left it well placed to withstand pressures from possible adverse economic and sectoral developments. Clearly the extended period of dislocation in financial markets, spill-over into the global economy and correction in the construction sector will be reflected in the FSR 2008. While it is too early yet to anticipate the content of the CBFSAI's report for 2008, the Department will liaise closely with the CBFSAI to identify key issues.

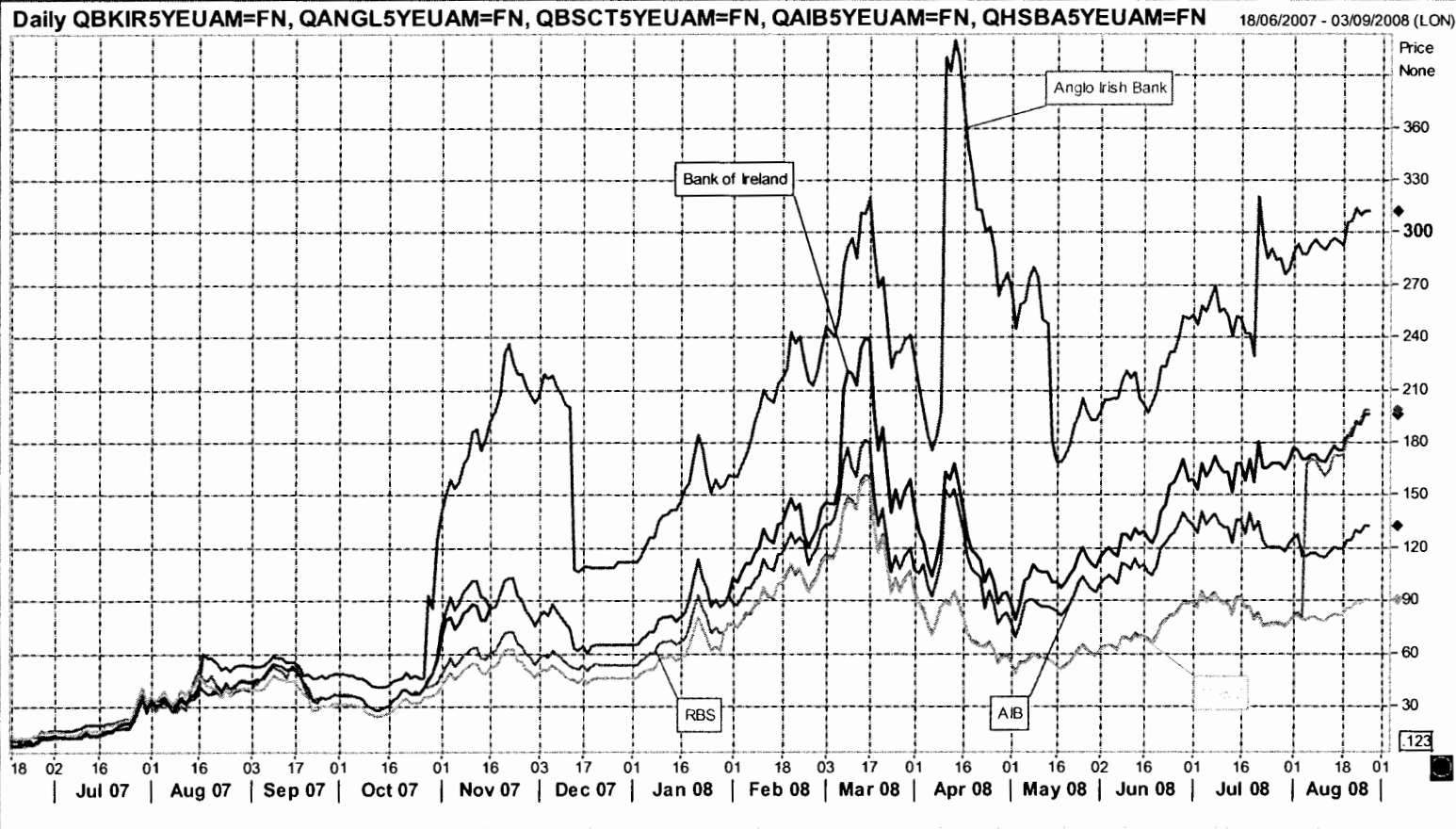
August 2008

cc Secretary General, Mr Cardiff, Ms Herbert

Daily percentage change in Irish, UK and US financial indices



CDS spreads for AIB, Bank of Ireland, Anglo Irish Bank and HSBC and RBS



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.

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Oireachtas-P

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.

(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

Briefing for Taoiseach on Government's Interventions to Protect Irish Banking System

The Government's approach to the unprecedented crisis in global financial markets has been structured and considered. We have sought advice and counsel from various qualified sources and have at all times sought to protect depositors in Irish banks, the Irish financial system and Irish taxpayers.

A. Why was there a need for Government Intervention?

- Unprecedented difficulties in international funding markets have impacted on Irish banks. Concerns about the quality of assets held by banks and possible impairment levels have also focused the attention of international markets on the level of capital that banks hold.
- This is a global problem, and Governments across the world have intervened with little success to attempt to rebuild confidence in financial markets.
- The Irish Government's approach has been based on two broad principles: First, not to let any systemically relevant financial institution fail, this involves protecting depositors and creditors, and secondly, any State involvement in the financial institutions will protect taxpayers' interests.
- In deciding policy approaches regarding the banking sector, the Government has taken advice from and consulted with the Central Bank, the Financial Regulator, the National Treasury Management Agency and its legal and financial advisors.

B. What Action has the Government Taken?

Bank Guarantee Scheme

- The contraction in the availability of funding particularly following the collapse of Lehman Brothers proved challenging for financial systems across the world. Ireland acted decisively to guarantee until September 2010 the liabilities of relevant institutions in order to ensure banks could maintain their normal liquidity position in interbank lending and debt markets.
- The Central Bank, the Government and its advisors continue to closely monitor the liquidity position of all relevant institutions.

- In the context of the six month review of the guarantee Scheme to be completed by mid-April 2009, the Government will examine how the Scheme could be revised, subject to European Commission approval and consistent with EU State aid requirements, to achieve a reduction in risk overall, including by supporting longer-term bond issuance by the covered institutions.

Recapitalisation

- As part of the increased engagement with the banks following the announcement of the guarantee Scheme, and in view of increased market focus on the capital position of banks towards the end of 2008, a detailed assessment of the loan books and capital position of the Irish banks was undertaken.
- The Financial Regulator commissioned PwC to report on the financial position of the six relevant institutions. This report contains an analysis of likely loan impairment rates in these institutions up to 2011 and the impact of various stress tests on capital levels. Work was also undertaken for the Financial Regulator by Jones Lang LaSalle, a firm of independent valuers, to assess elements of the bank's property based loan portfolio and the value of the collateral underlying it.
- This was a structured approach, and following this assessment the Government put forward detailed recapitalisation proposals with regard to our two main banks, Bank of Ireland and Allied Irish Bank.
- The total amount to be invested, €7 billion or €3.5 billion for each bank, was determined following consideration of likely trends in property values and various stress scenarios for the economy and property values. The State's investment will significantly strengthen the Core Tier 1 capital of these banks, bringing it well up in excess of regulatory limits. Existing reserves will be supplemented by ongoing profits and so the banks are more than adequately equipped to deal with the expected losses.
- The Government is also in discussion with other relevant institutions about their capital position.

C What Issues were Factored into the Government's Actions?

Protecting Taxpayers

- The Government's actions have always been guided by the principle of protecting taxpayers.
- The Government's guarantee Scheme includes a charge on the banks for this facility and ensures a significant return for taxpayers. There are significant fees of about €1billion payable by banks on foot of the guarantee.
- Anglo Irish Bank is a major financial institution whose viability is of systemic importance to Ireland. Anglo has a balance sheet of some €100bn with a substantial deposit base which the State is determined to safeguard. The Government's commitment to protecting taxpayers, depositors and creditors was again highlighted when taking this bank into public ownership.
- The investment of €3.5m each into AIB and Bank of Ireland is not unconditional. The investment generates a significant return for the State and includes conditions and obligations that the banks have signed up to.

Ensuring Credit Availability and Helping Bank Customers

- The Government's recapitalisation proposals included various measures on credit supply and requirements on banks in their dealings with customers. The main features are:

Business Lending

- Lending capacity to small to medium enterprises to be increased by 10%
- AIB and Bank of Ireland will both commit a further €15m each to new or existing seed capital funds, in collaboration with Enterprise Ireland's Seed and Venture Capital Programme, to further create and develop indigenous enterprise.
- The recapitalised banks agreed to work closely with the IDA, Enterprise Ireland and with State agencies to ensure the supply of appropriate finance to contractors engaged on major projects sponsored by them.
- More generally, the banks have agreed to engage in a 'clearing group' chaired by a Government representative and including representation from business interests and State agencies. The purpose of this group will be to identify specific patterns of events or cases where the flow of credit to viable projects appears to be blocked and to seek to identify credit supply solutions.

- Code of practice for business lending to small and medium enterprises – this was published by the Financial Regulator on 13 February and applies to all banks. The code includes a requirement for banks to offer their business customers annual review meetings, to inform customers of the basis for decisions made and to have written procedures for the proper handling of complaints. Decisions to grant, refuse or alter credit must be taken on a case by case basis. Where a customer gets into difficulty the banks will give the customer reasonable time and seek to agree an approach to resolve problems and to provide appropriate advice. This is a statutory code and Banks will be required to demonstrate compliance.
- The recapitalised banks have agreed to fund an independent review of credit availability which will be managed jointly by the banks, Government and business representatives. The banks have undertaken to co-operate fully with this review and to engage constructively in implementing any recommendations made.
- €100m fund to support environment friendly investment and innovations in clean energy.

Mortgage Lending

- Additional 30% capacity for lending to first time buyers to be made available in 2009. If the extra capacity available for mortgages is not taken up in any quarter, it will be redirected to SMEs in the following quarter.
- Code of practice on Mortgage Arrears: - also published by the Financial Regulator on 13 February. This statutory code applies to all mortgage lending on a customer's principal private residence. A lender may not seek repossession until every reasonable effort has been made to agree an alternative repayment schedule with the borrower. The Code will ensure that mortgage lenders can only commence legal action for repossession six months from the time arrears first arise.
- The recapitalised banks have further agreed that they will not commence court proceedings for repossession of a principal private residence within 12 months of arrears appearing, where the customer maintains contact and cooperates reasonably and honestly with the bank.

Remuneration

- Pay restraint is important not only in the context of the financial supports being provided by the taxpayer to the banking sector. It is also important in the overall context of the economy and the message it sends to ordinary workers who are suffering as a result of the current global crisis.
- Under the guarantee Scheme the remuneration packages of directors and executives, including total salary, bonuses, pension payments and any other benefits are subject to review by Covered Institution Remuneration Oversight Committee (CIROC). CIROC's report is expected shortly.
- As part of the Government's recapitalisation proposals, total remuneration for all senior executives will be reduced by at least 33% and non-executive director fees by at least 25%. No performance bonuses will be paid for these senior executives and no salary increases will be made in relation to 2008 and 2009.
- The Minister for Finance has written to CIROC recommending that an overall cap be introduced for executive pay in banks benefiting from State support.
- It is imperative that this regime is organised in such a way that any rewards in the sector are structured to meet the long-term objectives of both the banking institutions themselves and the overall health of the Irish financial system.

Co-Ordination at EU level

- The Government's interventions in the banking system have sought to reflect agreed principles at EU level such as the European Commission Recapitalisation Communication.
- The Government engaged with the European Commission and the ECB on the development of a common framework on recapitalisation and is contributing to the development of a common approach to bad debt resolution.
- The Government is committed to working with the EU on an ongoing basis to frame a common approach to the issues faced by the financial services sector.

D Anglo Irish Bank

- Matters at Anglo including loans to Directors, certain transactions with Irish Life and Permanent and loans to finance the purchase of shares are under investigation by a number of statutory authorities.

- These ongoing investigations may have a criminal dimension and caution should be exercised to ensure that potential future actions are not prejudiced.
- The Government is keen to ensure that unacceptable practices at Anglo are disclosed and punished appropriately so that the bank can set about re-establishing itself as a reputable financial service provider.
- The Government made clear when bringing the relevant legislation through the Houses of the Oireachtas that Anglo Irish Bank would continue to be run as a going concern, at arms length from Government. To drive this process forward, the new Board is preparing a comprehensive business plan which will be required to demonstrate how the Board will oversee the continued commercial operation of the bank.

E Next Steps

Banking Regulation

- Work has begun on forging a new model to govern the conduct and behaviour of the financial sector both here and internationally. Ireland will play its part internationally and particularly at EU level in seeking to ensure that the re-design of the financial system and in particular of financial regulation is consistent with the objectives that underlie a strong, stable and functioning national banking system.
- Following the implementation of the Credit Institutions (Financial Support) Scheme, the oversight of the banks concerned has been greatly intensified. This new regime provides for a heightened direct engagement with each of the covered institutions and new reporting arrangements including the provision of Scheme compliance certificates by the covered institutions themselves and by their external auditors.
- The Bank Guarantee Scheme requirements and conditions are the first step in a new system of financial regulation and supervision. The joint Boards of the Central Bank and Irish Financial Services Regulatory Authority have submitted to the Minister for Finance a report on reform of the regulatory structures. This report is currently being considered by the Minister.
- In addition, a number of regulatory reviews are underway at an international level. The Minister for Finance proposes to take account of the various reviews that are underway on regulatory reform when all relevant issues have been considered fully, bring my proposals for reform to Government.

Dealing with Impaired Assets

- Much of the concerns over assets quality internationally have revolved around so called toxic assets – structured products related to US subprime lending. By contrast, concerns over asset quality in Irish banks relate to property based lending here and in the UK – generally land and development lending.
- The Government will examine proposals to manage and reduce the risks on these specific exposures, having regard to international developments and ongoing work at ECB-level and in the EU on this issue. Loan insurance and a ‘bad bank’ approach are among these options.
- Any arrangement on asset risk management would require detailed preparatory work to define the categories of assets covered, and the State’s role in managing and reducing risk associated with these assets. The Minister for Finance has appointed Mr Peter Bacon to work in conjunction with the NTMA to report and advise him on the best solutions in this area.
- The Government will ensure that any commitments on the availability of public funds for risk management will contribute to the stability of our financial system and our economy generally.

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 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 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

Here: Sent to Minister 30 Aug
Discussed between Ministers & Taoiseach 30 Aug
Considered by MITC 1 Sept.

F43/1/08

3 September 2008

Office of the Minister for Finance

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Update on the Emerging Economic and Fiscal Position
2008-2011

DECISION SOUGHT

1. The Minister for Finance requests the Government to:
 - (i) note that the economic slowdown has continued and become more pronounced over the summer;
 - (ii) agree that the current state of the public finances and its future trajectory if left unchecked is untenable;
 - (iii) agree that it is essential that necessary action, in addition to all that was agreed by the Government in July, is now urgently required; and
 - (iv) to work on the plan of actions as set out below.

INTRODUCTION

2. The Government in July adopted measures to make savings of €440 million in 2008 and €1 billion in 2009. This was on the assumption of a shortfall of €3 billion in tax revenue for this year and GDP growth of 1¼% for 2008 with growth averaging 3½% over the 2009-2011 period.
3. Since then the overall picture has deteriorated -
 - tax revenue in both July and August showed significant weakness;
 - all economic data, such as retail sales, labour market figures, housing starts, confidence data etc, show the economy is slowing. The prospect for 2009-2011 is now considerably weaker;
 - further spending pressures have emerged despite the Government decision in July to make adjustments of €440 million in 2008; and
 - it is now certain that the end-year tax shortfall will be substantially higher than previously expected. The Department of Finance is currently factoring in a shortfall of €5 billion in tax receipts for the year as a whole and it could be higher.

OUTLOOK FOR 2008

The Economy

4. A revised GDP forecast of 0.5% for this year was published alongside the half-yearly Exchequer figures in July. In broad terms economic activity is now at a standstill and may well be actually contracting. The only area that is likely to show growth is the external high-tech sector and while this is welcome this will

not compensate for the shortfall in taxes and employment that is materialising as the property market adjusts to a more sustainable level.

Tax Revenue - 2008

5. Over the summer months tax revenue has continued to disimprove and by end-August a tax shortfall of almost [€3] billion has materialised. There are significant and growing tax targets for the coming months with November being a key payment date for Corporation Tax, Capital Gains Tax and self-employed Income Tax. As a result the Department of Finance is currently factoring in a shortfall of €5 billion in tax receipts for the year as a whole.

6. This projected tax shortfall of €5 billion may not be enough and will be reviewed in the light of the September data and it is far from certain that this current working estimate is sufficient. The Department of Finance will, as is customary, publish its latest tax call at the end-third quarter Exchequer press conference.

Expenditure - 2008

7. Pressures of over €1 billion have been signalled to the Department during the summer. When account is taken of the Government decision to make adjustments of €440 million the underlying spending pressures amount to almost €680 million. The vast majority of this potential expenditure overrun relates to welfare payments and spending pressures in the health area. In addition in the agricultural area there is a potential significant overrun on the capital side.

Overall Budgetary Position - 2008

8. The table below sets out the position in June and the current working assessment.

Table 1: Main Budgetary and Fiscal Aggregates 2008

2008	June	Now
GDP (%)	1.3%	½%
Current Expenditure	€52.8 billion	€53½ billion
y-on-y %	8.2%	9½ %
Tax Revenue	€45.9 billion	€44 billion
y-on-y %	-2.8%	-7%
Current Bal.	+ €1.9 billion	-€350 million
Exchequer Bal.	- €7.7 billion	-€10 billion
GGB (% of GDP)	-2.7%	-4½%

9. In June the Minister indicated that based on the position as it then stood, a General Government Deficit of around 2¼% of GDP was likely. Taking the further developments on taxation and expenditure as outlined above into account, a General Government Deficit of at least 4½% of GDP now seems likely for this year. If either tax revenue weakens further or additional spending pressures are identified then this very weak position will worsen.

OUTLOOK FOR 2009-2011

10. The table sets out the current working forecasts

Table 2: Macro-economic forecasts 2008 – 2011 (% change)

	2008	2009	2010	2011
GDP	½%	1%	3%	3¾%
GNP	½%	¾%	2½%	3½%
CPI inflation	4½%	3%	2½%	2¼%
HICP inflation	3¼%	2 ½%	2¼%	2%
Employment growth	9,000	-8,000	10,000	24,000
Employment	½%	-½%	½%	1¼%
Unemployment	5½%	6¼%	6½%	6%

11. The Department of Finance is currently working on the economic growth and fiscal forecasts for the period 2009-2011 and will be firming up on its assessment during the month of September as more economic and fiscal data becomes available. These forecasts are normally published in the Pre-Budget Outlook in October which then forms the basis of the opening position for the Budget.

The Economy

12. In terms of 2009, the indications are that the pace of economic growth will be about 1%. As a result of this significantly below potential growth it is very likely that there will be significant further increases in unemployment. This expected weak growth will have negative implications for the public finances, on both the revenue and expenditure sides.
13. When last presenting to Government, it was hoped that the economy would return to its trend rate of growth - which is estimated to be nearly 4% per annum - by 2010. At this stage, this is becoming increasingly unlikely and it now appears that it will be 2011 before the economy returns to potential. Even this is contingent upon restoring international confidence in the Irish economy (through for instance prudent management of the public finances) and on implementing measures to restore our cost competitiveness.

Tax Revenue

14. The poor tax performance in 2008 feeds into the base and this coupled with lower economic growth means that the projected receipts for future years are much lower than was previously forecast. The current working assumption is that after a decline of 7% in tax revenue this year, the best that can be hoped for in terms of tax revenue is that 2009 will equal 2008. This means that tax revenue for 2009 is now forecast to be almost €8 billion lower compared with the view at last Budget. This has obvious implications in terms of the scope that the Government has in relation to future Budget policy.

Expenditure

15. The latest Department of Finance estimates provide for current expenditure to expand by 3½% next year which is considerably lower than the outcome in recent years. This is based on the assumption that the almost €1 billion savings identified for 2009 and agreed by Government last July are delivered in full. The 2009 estimate does not allow for any service improvements.

Overall Budgetary Position likely to emerge without corrective action

16. When the above tax revenue and expenditure factors are taken account of the overall Budgetary position points to a General Government Deficit of around 5¼% of GDP in 2009 and remaining at this level in the subsequent two years on the assumption that is no change in policy. As the Exchequer moves further into deficit there is a real likelihood that by 2011 the debt will have more than doubled in nominal terms from the end 2007 level. **On this basis the public finances would be in an unsustainable and untenable position and the Minister for Finance will not accept this.**

17.

Table 3 – Key Economic and Fiscal Aggregates 2008-2011

	2008	2009	2010	2011
GDP (%)	½%	1%	3%	3¾%
Expenditure y-on-y. %	€53½ billion 9½ %	€55¼ billion 3½%	€56½ billion 2¼%	€58½ billion 3 ½ %
Tax Revenue y-on-y %	€44 billion -7%	€44 billion 0%	€45¼ billion 4½%	€48¾ billion 6½%
Current Bal.	-€350 million	-€3 billion	-€2¼ billion	-€1¼ billion
Exchequer Bal.	-€10 billion	-€12¾ billion	-€13½ billion	-€13½ billion
GGB (% of GDP)	-4½%	-5¼ %	-5½%	-5¼%

18. As outlined previously, allowing the Budget position to drift has serious implications such as:
- loss of domestic confidence;
 - loss of international confidence in the Irish economy;
 - increased costs of money supply to Irish companies and borrowers generally, including the cost of Public Service borrowing;
 - a build up of problems which by 2011-2012 would lead to very significant enforced and widespread cuts in public services; and
 - very significant tax increases to bring the budget path down to a sustainable level.
19. This has long-term implications for Ireland's economy. In addition, allowing the General Government Balance to deteriorate in this manner would have significant implications for Ireland's reputation. While it is fair to say that other EU and in particular euro area countries have breached the 3% limit in the past and some are likely to do so in the immediate future, the significant deterioration in Ireland's case from surpluses in recent years to such a large deficit will attract very substantial negative attention. Furthermore, the possibility that Brussels would make recommendations in advance of Budget 2009 designed to ensure that the fiscal is immediately reversed cannot be ruled out. The Minister will update his European colleagues in October.

Actions now urgently needed

20. The measures agreed in July are now wholly inadequate. In order to halt the very significant deterioration in the public finances and to then put them back on a sustainable footing over the medium-term the following actions are urgently required –

Current Expenditure

- The expenditure savings agreed for 2008 and 2009 must be implemented in full.
- No new discretionary spending measures should be taken.
- The Minister finds it difficult to see how any pay increase for the public sector can be afforded in 2009.
- An immediate embargo on public sector recruitment, except in exceptional circumstances to be sanctioned by the Department of Finance.

Capital Expenditure

- The 2009 capital plan cannot be implemented in full. Priority will be given to those projects that enhance the productive capacity of the economy. The ongoing capital review will identify such priority projects.

Further Action

- The Minister intends to immediately appoint an independent group to advise him on all expenditure for 2009 and report back to him by the end of September.
21. Ministers have been asked to report to the Minister for Finance by 15 September on the basis of no increase in funding for 2009 over the 2008 adjusted figure. While this is still required, it is now clearly not enough and the results of this will be reviewed by both his Department and the independent review group mentioned above. On receipt of this analysis and in the light of further fiscal and economic data, the Minister will then work to develop a credible plan to ensure that the current deterioration is arrested and the overall public finances are put back on a sound footing over the medium-term.
22. The Minister would like to remind his colleagues that if action is not taken now through the deferral or cancellation of spending plans (current and capital) wide-scale tax increases are inevitable and over the medium-term further additional increases will be required to finance increasing borrowing. It must be borne in mind that the position is not sustainable even in the short-term and the Minister cannot rule out tax increases in the context of the forthcoming Budget. Wide-scale tax increases are not the preferred option and would be counter-productive and are not the best solution as doing so lowers the rate of future growth.
23. Provided the necessary budgetary adjustment is secured the Minister for Finance would consider what options exist to allow the Government to specifically take further steps to underpin economic confidence and growth and in particular to further enhance productivity and give help to the export sector.