



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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January 2016

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THEME: C5

Appropriateness and effectiveness of international, Ireland-specific policy responses

LINE OF INQUIRY: C5a

European Union (EU) / International Monetary Fund (IMF) / European Central Bank (ECB) programme of assistance



22/11/2013

Ref:

Oifig an Aire Airgeadais
Memorandum for the Government
12th Review Mission of the EU-IMF Programme of Financial Support for
Ireland

1. Matter/Issue for Decision

1.1 Following completion of the twelfth and final quarterly review mission of the EU-IMF Programme from 29 October to 7 November 2013, the Minister for Finance asks the Government to agree:

- i) The draft Letters of Intent (LoI) to the IMF - **Annex A** - and to the EU- **Annex B**.
- ii) To give authority to the Minister for Finance to sign the Letters of Intent to the IMF and the EU.
- iii) To give authority to inform the Dáil accordingly.
- iv) To ensure that all remaining programme actions are prioritised; that commitments requiring legislation should be progressed in sufficient time to enable the orderly achievement of the relevant deadline; that all approvals necessary, including Government approval, are obtained by the end of quarter 4 deadline. The date for the end quarter 4 2013 deadline is **13 December 2013**.

And to note:

- v) As is normal for programmes of this nature, post programme monitoring will apply following the conclusion of the programme on 8 December for the EU and 15 December for the IMF (Refer to Section 7 for details).

2. Background

The EU/IMF Programme of Financial Support for Ireland stipulates that the provision of funding to Ireland is conditional on compliance with the conditions specified in the Programme documents (MOU, MEFP, TMU). The Government agreed on 13 May 2011 (S180/20/10/1379A) that all necessary action will be taken by the appropriate Ministers and their Departments to ensure that the targets to be met under the Programme are given the highest priority to ensure they are met on time as agreed under the Programme.

3. Mission Outcome

The key issues for Ireland on this mission were:

- **Elements of the 8 Point Plan:** The preliminary results of the BSA/AQR were made available on 31 October. Discussion on the preliminary results has continued through November. The final BSA/AQR results are expected by end November.
- **Stress Test:** It was agreed that the stress test for our banks would take place at the same time as the European wide exercise. The ECB announced its comprehensive assessment on 23 October, with a process that will start in November this year and will conclude in October 2014 prior to implementation of the SSM in November 2014
- **Fiscal Consolidation:** The Troika received extensive briefing on the implementation of Budget 2013 and the measures included in Budget 2014. They have indicated broad agreement to the approach adopted and stated that communication would be positive.

Overall, our strong programme performance was maintained with the completion of the Q3 2013 and end October deliverables bringing to over 260 the number of actions completed to date. The actions for the end-September/October 2013 deadlines have now been met with two exceptions (Water Services II Bill and the Health Identifier Bill which were not published by the appropriate deadline).

4. Timing of approval for 12th Review

i. IMF: The final part of the IMF's approval process, the Executive Board discussion and approval is scheduled to take place on 13 December 2013, with disbursement of funding and publication of the staff report expected within a few days of this discussion. In order to meet this timetable, the Letters of Intent will need to issue by 27 November. Some €600 million will be drawn-down on approval by the IMF.

ii. EU: The EU's approval process concludes with discussion by the Eurogroup Working Group/ and Economic and Financial Committee in early December with discussion by Finance Ministers at the Eurogroup and ECOFIN meetings on 09/10 December, and finally with the adoption of the Commission decision approving the 12th Review.

5. Key Remaining Commitments

There are 26 commitments due by the end of the year. The full list of remaining actions to be completed under the programme is attached at Annex C.

Fourteen commitments relating to Financial Sector Restructuring are due by the end of the year including the completion of the Balance Sheet Assessment and Asset Quality Review due at the end of November. The BSA/AQR is one of the critical deliverables for the programme.

Twelve commitments relating to Structural Reform are due by the end of the year. Commitments relating to the publication of legislation in respect of Health identifiers and Water Services along with progression of the Legal Services Bill are the main priorities.

6. Programme Exit

The Government agreed on 14 November 2013 to exit the Programme without a pre-arranged precautionary facility or backstop.

7. Post Programme Surveillance

Post Programme Surveillance has been a long standing feature of IMF programmes, and is also now a feature under the new EU governance rules. The new governance arrangements for all eurozone member states help deal with some of the major problems that faced the euro area in the past and they will help avoid such problems emerging in the future. These new governance arrangements provide reassurance to the markets. They provide an early warning system if problems begin to emerge, they reduce the risk of contagion spreading from one Member State to another, and they increase peer review pressure to help ensure responsible policies are pursued by all Member States in the euro area.

These new governance arrangements are important for small Member States with very open economies such as Ireland as it ensures that large member states are pursuing policies that are in the interests of the Euro. Of course, it works both ways and we must act responsibly too and the post-programme surveillance arrangements must be seen in that context.

Both the IMF and the EU conduct post programme monitoring following completion of a programme. This provides for regular missions and reports on a bi-annual basis.

- For the IMF, monitoring focuses on a reduced range of indicators: balance of payments, public finances, debt sustainability and macroeconomic performance, essentially assessing Ireland's continued ability to pay.
- For the EU, the arrangements for post programme surveillance are set out in the enhanced surveillance regulation of the 'Two Pack'. This also provides for regular reports and missions which would be expected to be twice yearly. It is important to

note that, on exiting the programme all the provisions of the EU's expanded economic policy coordination arrangements as set out, for example in the "Six Pack", the European Semester and the previously mentioned "Two Pack" will become effective. This would be in addition to the fiscal constraints already applying, in terms of complying with the Commission's recommendation under the Excessive Deficit Procedure, and also the provisions of the Stability Treaty.

In this context, it is worth noting that the normal regime for countries outside a programme is to have annual visits from the EU Commission's country desks and from the IMF for its Article IV review. Surveillance will move to the bi-annual post programme arrangements – essentially adding one additional mission to the usual annual visits from the EU and the IMF.

8. Loan Disbursements

As of end-October 2013, just over €63½ billion (or around 94%) of the external funding available under the EU/IMF Programme had been drawn down. On 7 November, the final instalments – €150 million and €100 million respectively – of the Swedish and Danish bilateral loans were drawn down. Some €2.9 billion is due from the EFSF and IMF in December and the final EFSM disbursement of €0.8 billion is due in February 2014. The receipt in 2014 is for technical reasons and does not affect the Programme end date.

In view of its relatively strong funding position the NTMA announced, on 1 October, a suspension of its monthly Treasury Bill auctions for the final quarter of 2013. The NTMA also decided to defer consideration of any further medium/long term bond issuance until early 2014.

On the basis of the successful market operations during the early part of the year, together with the remaining EU/IMF Programme disbursements, Ireland is well placed to have 12-15 months of advance Exchequer funding in place at year-end, as the Programme ends.

Looking ahead to 2014, the NTMA is targeting in the range of €6 - €10 billion market issuance next year.

9. Observations Returned

No observations supplied



National Treasury Management Agency

Mr Brian Lenihan TD
Minister for Finance
Government Buildings
Upper Merrion Street
Dublin 2

28 November 2010

Dear Minister

I refer to my letter of 27 November 2010 regarding the proposed programme of external financial assistance and the subsequent discussion on it at last night's Government meeting at which I was in attendance. I am writing, as requested, to elaborate on a number of issues which arose.

I learnt during the course of the discussion that the external authorities and the European Central Bank (at board or equivalent level) had taken the view that burden sharing with unguaranteed bank senior bond holders was "not on the table". It is unfortunate that, notwithstanding the fast moving pace of recent events, I was not made aware of this outcome.

Recognising that burden sharing involving unguaranteed bank senior bond holders is no longer a potential cost mitigant, it is all the more important that the costs to the State of recapitalising the banks are kept to the minimum consistent with restoring a viable banking system. In this context I referred last night to the need to manage carefully the pace of deleveraging the banks' balance sheets so as to limit drawings on the €35 billion bank capital contingency.

As indicated in my letter, the NTMA is of the view that the estimated average cost of the facility, at 5.8%, is not unreasonable. The rates underlying that average are based on long standing IMF formulae and precedent lending. The estimated average rate is comparable with the 6.02% paid on Ireland's most recent Government bond auction (September 2010) which was for an 8 year maturity. Our credit rating has, of course, moved down sharply since that auction.

As I also indicated in my letter, the NTMA accepts that the adoption of the programme is the best course of action. I would, however, emphasise again the immediate need for a clear statement from the ECB underpinning ongoing liquidity support for the Irish banks if the programme is to succeed.

Yours sincerely

A handwritten signature in black ink that reads "John C. Corrigan". The signature is written in a cursive, slightly slanted style.

John C. Corrigan
Chief Executive

ECB - SECRET

CONFIDENTIEL UE/
EU CONFIDENTIAL



ESRB
European Systemic Risk Board
European System of Financial Supervision

Jean-Claude Trichet
ESRB Chair

Frankfurt, 22 September 2011
ESRB/2011/0097

An Taoiseach
Enda Kenny

Ireland

Dear Taoiseach,

I am transmitting herewith for your attention a copy of the confidential Warning ESRB/2011/WNP2 approved on 21 September 2011 by the ESRB General Board, in accordance with the Regulation (EU) No 1092/2010.

This Warning is issued on a confidential basis in accordance with Article 18(4) of the above mentioned Regulation.

Yours sincerely,

The Chair of the European Systemic Risk Board

ECB-CONFIDENTIAL



ESRB
European Systemic Risk Board
European System of Financial Supervision

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EU CONFIDENTIAL

Jean-Claude Trichet
ESRB Chair

Frankfurt, 21st September 2011
ESRB/2011/WNP2

Mr. Herman Van Rompuy
President of the European Council

Mr. Donald Tusk
Prime Minister of Poland

Mr. Jan Vincent-Rostowski
Minister of Finance of Poland

Cc/ Mr. Olli Rehn
Member of the European Commission

Cc/ Mr. Vittorio Grilli
Chairman of the Economic and Financial Committee

Cc/ Mr. Uwe Corsepius
Secretary-General of the Council of the European Union

Confidential Warning under Article 3 (2) (c) and 16 of Regulation (EU) No. 1092/2010

Dear President Van Rompuy, Dear Prime Minister Tusk, Dear Minister Vincent-Rostowski,

In my previous warning of 1 July, on behalf of the ESRB General Board I made you aware of potential threats to the financial stability of the EU related to the absence of private or public backstop measures for the recapitalisation of banks which had either not passed the EU-wide stress test or were perceived by markets to be at risk.

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At its third regular meeting of 21 September, the ESRB General Board has identified a number of further key intertwined vulnerabilities in the EU financial system, namely:

- High sovereign indebtedness
- Funding vulnerabilities within the EU banking sector

Reflecting these vulnerabilities, turbulence in markets has escalated over the summer and has spread much more widely across Member States. It has been aggravated by the deteriorating global economic growth outlook and manifested in various financial market segments. The intertwined difficulties faced by sovereigns, banks, and the real economy mean that even small negative shocks have the potential to trigger adverse feedbacks and potentially generate a systemic shock to the EU financial system and the real economy. Moreover negative feedbacks have been compounded by a growing lack of confidence in policy makers' ability to address the underlying sources of the instability comprehensively and in a timely manner.

Signs of severe stress are observed in some government bond markets as well as other market segments which are important for bank funding such as unsecured inter-bank markets, primary unsecured debt markets and securitisation markets. In parallel, high volatility in equity markets has indicated that tensions have spread across capital markets, i.e. from government bond markets to stock markets. Hence, the overall ability of the EU financial system to provide comprehensive funding to the real economy remains very fragile.

The conditions described in Article 18 of the Regulations 1093/2010, 1094/2010 and 1095/2010 ("Adverse developments which may seriously jeopardise the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union") have in part already materialised. Further aggravation might trigger a threat to general liquidity and solvency conditions of the financial sector, in forms similar to the abrupt crisis in 2008. Contrary to 2008, however, monetary and fiscal policies now have limited room in several EU economies.

Overall, the ESRB General Board would like to communicate to the authorities of the EU and its Member States that the nature of the crisis has changed over the course of the summer when it moved beyond smaller economies to large European countries, with the potential to affect – albeit differently – all countries of the Union. Hence, Europe as a whole no longer faces a localised but rather a systemic crisis.

Macro-financial conditions are extremely challenging and all existing instruments should be activated, at the European and national level, to avoid a systemic shock to the EU financial system and the real economy. The ESRB stands ready at any time to activate the mechanisms of the EU Regulation 1092/2010 to request the Council to determine the existence of an emergency situation.

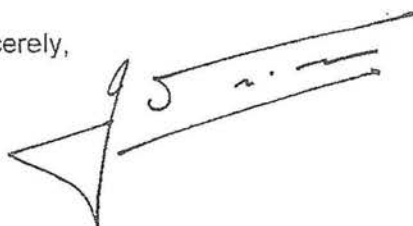
Warning

In line with Regulation (EU) No. 1092/2010 (Articles 3(2) (c) and 16), and in light of the gravity of current adverse developments which may seriously jeopardise the stability of the whole financial system in the Union and adversely impact the real economy, the ESRB General Board warns the addressees of this letter, as representatives of the European Union as a whole and of the EU Member States, that without:

- (i) a pro-active adoption and implementation of credible sustainability-oriented fiscal programmes and policies,*
- (ii) coordinated action by EU supervisors to strengthen bank capital, including by having recourse to backstop facilities, recognising the need for transparent and consistent valuation of sovereign exposures,*
- (iii) a full and speedy implementation of the measures announced at the 21 July meeting of the Head of State or Government of the euro area to address the risks of contagion,*
- (iv) standing ready to cope with unexpected events, associated with the acceleration of the unfolding of the crisis, and*
- (v) coordinated and consistent communication by all policy-makers,*

critical downside risks for the financial system and, as a consequence, for the EU real economy might materialise.

Yours sincerely,



The Chair of the European Systemic Risk Board

Address by an Taoiseach, Brian Cowen, T.D., to EU Heads of Mission,

9 December 2010

Ladies and Gentlemen,

Can I begin by thanking Ambassador Robert Devriese for hosting today's lunch. It is a great pleasure to be here and I look forward to our discussions.

I would also like take the opportunity to pay tribute to Belgium, and to Spain before it, for the effective and efficient way in which you have run your Presidencies. For any Member State, big or small, the undertaking is a demanding one at the best of times. Both countries have more than risen to the challenge in 2010.

As I don't get to meet with this group very often, I thought the best use of our time together would be for me to make some introductory remarks and then to take a few questions.

2010 – An Exceptionally Difficult Year

There is no escaping it, 2010 has been an exceptionally difficult year for Ireland.

In the past three years, like the rest of the developed world, we have had to come to terms with new economic realities. For a number of reasons, this has been a more difficult journey for Ireland than for most.

We are a small open trading economy, with all the vulnerabilities that brings. When the world experiences an economic shock, Ireland cannot avoid feeling the brunt of it. This is evident in our employment levels, our tax receipts and our welfare costs.

Also, when global credit began to dry up, Ireland was left with a banking system that had grown to disproportionate size, based on a toxic combination of cheap credit and reckless lending practices. The scale of the problems in the sector has only come to reveal itself fully over time.

Ireland could probably have handled the consequences of either one of these challenges on our own.

While we have a serious and significant imbalance in our public spending, we have been taking strong and deep measures in order to bring income and expenditure into line, and into keeping with the strictures of the Stability and Growth Pact.

We have also dedicated huge resources and time to seeking to resolve the enormous difficulties in the banking sector.

In the end, however, tackling both sets of difficulties together became a challenge too big for us to manage on our own, under current market conditions.

We are, therefore, very appreciative of the support of our partners in the EU – Member States and institutions – and the IMF for the significant assistance that they have made available to Ireland, particularly in recent weeks.

The phrase ‘we are where we are’ has become something of a cliché in public discussions in Ireland in recent times. But let me be clear, where we are in Ireland today is not where any Government or people would wish to find themselves.

We are a proud and independent people and it is not easy for us to find ourselves relying on the support of others, albeit on our good friends in the EU.

I therefore want to reassure you today that we are utterly determined to get back to standing on our own feet as quickly as we possibly can.

The Road to Recovery

In late November we published a National Recovery Plan covering the period from now until 2014. Shortly afterwards, we agreed a programme of action with the EU institutions and the IMF. On Tuesday, we brought forward the budget for 2011.

All three pull in the same direction.

Taken together, they chart the way forward towards sustainable growth and recovery.

Ireland is determined to reach the deficit target of 3% of GDP as rapidly as we can. We have already made adjustments of €14.5 billion in the last two years, and will take out another €15 billion in the period between now and 2014. Under the Programme agreed with our EU partners, we have been given more room for manoeuvre – until 2015 – in case growth prospects don't turn out to be as positive as has been predicted.

The adjustment of €15 billion is broken down into €10 billion in spending reductions - €7 billion on the current side and €3 billion on capital side - and €5 billion in revenue raising measures.

To make our seriousness of intent plain, and to get ourselves into a better position as rapidly as possible, €6 billion of this adjustment will be made in 2011.

As this week's budget demonstrates, this will require a contribution from all sections of society.

I appreciate fully that the impact of the budget will be difficult for many of our citizens. But we carefully considered all the options and possibilities available to us. We have taken very tough decisions in order to balance protecting the most vulnerable in our society, with the need to meet our international obligations, and the need to promote economic growth and employment.

We have brought forward a budget that we believe bears evenly on people and shares the burden fairly.

Getting the economy back on track is not just a story of cutting spending and raising revenues, vital as these steps are. It is also about continuing to put in place strategies and measures to improve competitiveness, foster growth and create employment.

Specifically, we have decided to reduce the minimum wage by €1 per hour and to reform the welfare system to remove unemployment traps and to provide incentives to get more people back to work. We are also putting reinvigorated activation policies in place, to help unemployed people make as swift a return to employment as possible.

We will bring real competition to bear in the professions, including measures to reduce legal costs.

We will aim to reduce waste and energy costs faced by business and to enhance availability of technological infrastructure, especially next generation broadband.

We are also determined to increase efficiency in the public sector and to reduce costs for the private sector. This will be tough.

We are committed to reducing the cost of public sector pay and pensions. We will implement overall payroll adjustments of €1.2 billion by 2014. Public service staff numbers will be cut by 24,750 from end-2008 levels. There will be a reformed pension

scheme for new entrants to the public service and they will enter on pay 10% below those already serving.

We will make more efficient use of staffing resources, with redeployment of staff within and across sectors of the public service to meet priority needs.

Reform of the Banking Sector

We have also charted the way forward on reforming our banking sector.

Of course, a great deal has already been done to manage difficulties in this sector. We have transferred the banks' riskiest loans to NAMA, and a detailed capital adequacy assessment made in the summer has been followed up with significant capitalisation measures.

But it was clear that markets did not yet have sufficient confidence.

Therefore, the Programme agreed with our international partners builds on the measures already taken, providing for a fundamental downsizing and reorganisation of the banking sector.

This will lead to a smaller banking system, more proportionate to the size of the economy, capitalised to the highest economic standards, with renewed access to normal market sources of funding and focused on strongly supporting the recovery of the economy.

Much of the funding for the banks in the external assistance programme will be provided on a contingency basis, to be drawn down only if required, helping to hasten a reformed banking system and rendering it better placed to serve the needs of the economy.

The Prospects for Recovery are Good

Taken together, this represents a reasonable, if challenging, programme for moving forward again. And I believe that the prospects for recovery are better than many would allow.

We are now seeing a stabilisation of our public finances and renewed export-drive growth. From a drop of 7.6% in 2009, we expect modest growth of 0.3% in GDP this year and average annual growth of 2.75% per annum between now and 2014.

Recovery is gaining pace due to increased competitiveness combined with increasing international demand for our goods and services – a virtuous circle. Exports increased by nearly 7% in the first half of this year. Manufacturing is up by 12% in the third quarter. The labour market has stabilised.

We are moving towards a positive balance of payments in 2011, meaning that the economy as a whole is paying down external debt.

We have a strong and diversified economy. Good infrastructure. High quality human capital – the youngest best educated population. A strong multi-national sector and vibrant native industrial base. We have tax policies that favour entrepreneurship, investment and work.

Not least, we are a resilient and capable people.

The European Dimension

Ladies and Gentlemen,

I am conscious that so far I have spoken about Ireland and its difficulties. But I am acutely

aware that they must be seen alongside the difficulties being experienced by the European Union and the eurozone in particular.

As a member of the European Council I have seen how economic and currency issues have dominated our agenda this year.

The economic crisis has stress-tested our arrangements for economic governance and found them wanting. There is, however, consensus in favour of taking the steps necessary to improve them.

Thanks to the work of the Task Force chaired by European Council President Van Rompuy we now have a template for increased fiscal discipline, broadened economic surveillance with a stronger focus on debt sustainability, and deepened economic coordination. We are establishing a more robust framework for crisis management. Preparation of the legislation to give effect to the Task Force Report is being fast-tracked through the system.

When we meet next week, the European Council will take further decisions, including on the wording of a limited Treaty change necessary to establish a permanent crisis mechanism to safeguard the financial stability of the euro area as a whole.

Eurogroup Ministers have set out some detail of what this mechanism should look like and I expect that will be reflected in what President Van Rompuy brings to next week's Council meeting.

I firmly hope that, with these measures, we will see confidence restored to the markets as soon as possible.

We have recently seen all sorts of wild speculation as to the future of the euro and even of the European Union itself. And, while I believe that much of this speculation has been

enormously wide of the mark, I do share Chancellor Merkel's view that the health of the euro and the health of the Union are inextricably linked.

I also strongly share the view of the President of the European Central Bank, Jean Claude Trichet, that observers tend to underestimate the determination of decision-makers in Europe to do what is necessary to protect our interests.

This is a testing time. To some extent we are collectively on a war-footing. As President Trichet has said, it is a time for careful and precise communication – for clarity and for discipline in what we say.

Yes we need to consider our options for the future. But we need to do so in a careful, reflective and considered way.

We cannot create policy from soundbites. We have to be thorough, strategic and long-term in our thinking, not just driven by day-to-day movements in the markets.

Confidence is something that you grow and nurture carefully. It doesn't just spring up overnight. It is built through actions more than through words.

Conclusion

Finally, I would like to take this opportunity to thank you all for the work that you do in communicating developments in Ireland to your respective capitals. It has, I imagine, been a busy year for you all. I hope that the holiday season will give you and your families a chance to wind down and to reflect on the most important things in life – health, happiness and hope for the future.

Thank you.

ENDS

Term Sheet on the ESM

The European Council has agreed on the need for euro-area Member States to establish a permanent stability mechanism: the European Stability Mechanism (ESM). The ESM will be activated by mutual agreement¹, if indispensable to safeguarding the financial stability of the euro area as a whole. The ESM will assume the role of the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM) in providing external financial assistance to euro-area Member States after June 2013.

Access to ESM financial assistance will be provided on the basis of strict policy conditionality under a macro-economic adjustment programme and a rigorous analysis of public-debt sustainability, which will be conducted by the Commission together with the IMF and in liaison with the ECB. The beneficiary Member State will be required to put in place an appropriate form of private-sector involvement, according to the specific circumstances and in a manner fully consistent with IMF practices.

The ESM will have an effective lending capacity of €500 billion². The adequacy of the lending capacity will be reviewed on a regular basis and at least every five years. The ESM will seek to supplement its lending capacity through the participation of the IMF in financial assistance operations, while non-euro area Member States may also participate on an ad hoc basis.

The remainder of this term sheet sets out the key structural features of the ESM:

Institutional form

The ESM will be established by a treaty among the euro-area Member States as an intergovernmental organisation under public international law and will be located in Luxembourg. The statute of the ESM will be set out in an annex to the treaty.

Function and funding strategy

The function of the ESM will be to mobilise funding and provide financial assistance, under strict conditionality, to the benefit of euro-area Member States,

¹ A decision taken by mutual agreement is a decision taken by unanimity of the Member States participating to the vote, i.e. abstentions do not prevent the decision from being adopted.

² During the transition from EFSF to ESM, the combined lending capacity will not exceed this amount.

which are experiencing or are threatened by severe financing problems, in order to safeguard the financial stability of the euro area as a whole.

The Member States of the euro area will give to the ESM the financial sanctions received under the Stability and Growth Pact and the Macroeconomic Imbalances procedures³. Such sanctions will form part of the paid-in capital.

The ESM will use an appropriate funding strategy so as to ensure access to broad funding sources and enable it to extend financial assistance packages to Member States under all market conditions. Any associated risk will be contained through adequate asset and liability management.

Governance

The ESM will have a Board of Governors consisting of the Ministers of Finance of the euro-area Member States (as voting members), with the European Commissioner for Economic and Monetary Affairs and the President of the ECB as observers. The Board of Governors will elect a Chairperson from among its voting members.

The Board of Governors will be the highest decision-making body of the ESM and will take the following major decisions by mutual agreement:

- the granting of financial assistance;
- the terms and conditions of financial assistance;
- the lending capacity of the ESM;
- changes to the menu of instruments.

All other decisions by the Board of Governors will be taken by qualified majority, unless stated otherwise.

The ESM will have a Board of Directors, which will carry out specific tasks as delegated by the Board of Governors. Each euro-area Member state will appoint one Director and one alternate Director. In addition, the Commission and the ECB will each nominate an observer and an alternate to the Board of Directors. All decisions by the Board of Directors will be taken by qualified majority, unless otherwise stated.

Voting weights within the Board of Governors and the Board of Directors will be proportional to the Member States' respective subscriptions to the capital of the ESM. A qualified majority is defined as 80 percent of the votes.

³ Subject to a final agreement at political level.

The Board of Governors will appoint a Managing Director responsible for the day-to-day management of the ESM. The Managing Director will chair the Board of Directors.

Capital structure

The ESM will aim to obtain and maintain the highest credit rating from the major credit rating agencies.

The ESM will have a total subscribed capital of €700 billion. Of this amount, €80 billion will be in the form of paid-in capital provided by the euro-area Member States, of which €40 billion will be available from July 2013 with the remaining share being phased in over the three following years. In addition, the ESM will also dispose of a combination of committed callable capital and of guarantees from euro area Member States to a total amount of €620 billion.

The contribution key of each Member State in the total subscribed capital of the ESM will be based on the paid-in capital key of the ECB as annexed. By ratifying the Treaty establishing the ESM, Member States legally commit to provide their contribution to the total subscribed capital.

The Board of Governors will decide by mutual agreement when adapting the amount of total subscribed capital or when calling capital, except in the specific cases described below. First, the Board of Directors can decide, by simple majority, to restore -by calling in capital- the level of paid-in capital in the event that the amount of paid-in capital is reduced by the absorption of losses⁴. Second, an on-demand guarantee procedure will be put in place that allows calling in capital automatically from the shareholders of the ESM if needed to avoid a payment shortfall to the creditors of the ESM. The liability of each shareholder will in all circumstances be limited to its share in the subscribed capital.

Any contribution to subscribed capital by a Member State⁵ joining the ESM after July 2013 will be made according to the same terms applied for the original contributions. The practical implications for the overall amount of subscribed capital and the distribution of capital among the Member States will be decided by the Board of Governors by mutual agreement.

As long as the ESM has not been activated and provided that the effective lending capacity is not less than 500 billion, the proceeds from the investment of the ESM paid-in capital will be returned to the Member States, after deductions

⁴ The vote of the Member State whose default is at the origin of the loss to be covered is suspended for this decision.

⁵ As a consequence of joining the euro area, a Member State shall become a member of the ESM with full rights and obligations.

for operational costs. Following the first activation of the ESM, the proceeds from the investment of ESM capital and financial assistance activity will be retained within the ESM. However, in the event that paid-in capital exceeds the level required to maintain the lending capacity of the ESM, the Board of Directors can decide, by simple majority to distribute a dividend to the euro-area Member States based on the contribution key.

Instruments

The ESM will provide financial assistance subject to strict conditionality under a macro-economic adjustment programme, commensurate with the severity of the imbalances of the Member State. It will be provided through loans.

However, it may intervene, as an exception, in debt primary markets on the basis of a macro-economic adjustment programme with strict conditionality and if agreed by the Board of Governors by mutual agreement.

- ESM stability support (ESS)

The ESM can grant short-term or medium term stability support to a euro-area Member State, which is experiencing severe financing problems. Access to an ESS will imply a macroeconomic adjustment programme with adequate policy conditionality commensurate with the severity of the underlying imbalances in the beneficiary Member State. The length of the programme and maturity of the loans will depend on the nature of the imbalances and the prospects of the beneficiary Member States regaining access to financial markets within the time that ESM resources are available.

- Primary market support facility

The ESM can purchase the bonds of a Member State, which is experiencing severe financing problems, on the primary market, with the objective of maximizing the cost efficiency of the support. Conditions and modalities under which bond purchasing would be conducted will be specified in the Decision on the terms and conditions of financial assistance.

The Board of Governors may review the instruments at the ESM's disposal and may decide to make changes to the menu of instruments.

IMF involvement

The ESM will cooperate very closely with the IMF in providing financial assistance⁶. In all circumstances, active participation of the IMF will be sought, both on the technical and the financial level. The debt sustainability analysis will be jointly conducted by the Commission and the IMF, in liaison with the ECB. The policy conditions attached to a joint ESM/IMF assistance will be negotiated jointly by the Commission and the IMF, in liaison with the ECB.

Activation of financial assistance, programme monitoring and follow-up

Financial assistance from the ESM will in all cases be activated on a request from a Member State to the other Members States of the euro area. The Eurogroup will inform the Council that a request for activation of support has been made. On receipt of such a request, the Board of Governors will ask the Commission to assess, in liaison with the ECB, the existence of a risk to the financial stability of the euro area as a whole and to undertake a rigorous analysis of the sustainability of the public debt of the Member State concerned, together with the IMF and in liaison with the ECB. The subsequent steps in the activation of ESM financial assistance will be as follows:

- If an ESS is requested, the Commission, together with the IMF and in liaison with the ECB, will assess the actual financing needs of the beneficiary Member State and the nature of the required private sector involvement, which should be consistent with IMF practices.
- On the basis of this assessment, the Board of Governors will mandate the Commission to negotiate, together with the IMF and in liaison with the ECB, a macro-economic adjustment programme with the Member State concerned, detailed in a MoU.
- The Commission will propose to the Council a decision endorsing the macro-economic adjustment programme. The Board of Governors will decide on the granting of financial assistance and the terms and conditions under which assistance is provided. When the programme has been adopted by the Council, the Commission will sign the MoU on behalf of the euro area Member States subject to prior mutual agreement by the Board of Governors. The Board of Directors will then approve the

⁶ It is however understood that any IMF involvement will be consistent with its mandate under the Articles of Agreement and by applicable decision and policies of the IMF Board.

financial assistance agreement which would contain the technical aspects of the financial assistance to be provided.

- The Commission, together with the IMF and in liaison with the ECB, will be responsible for monitoring compliance with the policy conditionality required by a macroeconomic adjustment programme. It will report to the Council and to the Board of Directors. On the basis of this report, the Board of Directors will decide by mutual agreement on the disbursement of the new tranches of the loan.
- After discussion in the Board of Governors, the Council can decide, on a proposal by the Commission, to implement post-programme surveillance, which can be maintained for as long as a specified amount of the financial assistance has not been repaid.

Consistency with the EU multilateral surveillance framework

Approval by the EU Member States will be sought to allow the euro-area Member States to task the Commission, together with the IMF and in liaison with the ECB, the analysis of the debt sustainability of the Member State requesting financial support, the preparation of the adjustment programme accompanying the financial assistance, as well as with the monitoring of its implementation.

While the Board of Governors has the autonomy to decide on the existence and modalities of financial assistance under an intergovernmental framework, the policy conditionality established under an enhanced surveillance or a macroeconomic adjustment programme should be consistent with the EU surveillance framework and must guarantee the respect of EU procedures. To this end, the Commission intends to propose a Regulation clarifying the necessary procedural steps under Article 136 of the Treaty in order to enshrine the policy conditionality in Council decisions and ensure consistency with the EU multilateral surveillance framework. The Council and the Commission will inform the European Parliament on a regular basis about the establishment and the operations of the ESM.

Pricing

The Board of Governors will decide on the pricing structure for financial assistance to a beneficiary Member State.

The ESM will be able to lend at a fixed or variable rate. The pricing of the ESM will be in line with IMF pricing principles and, while remaining above the funding costs of ESM, will include an adequate mark up for risks.

The following pricing structure will apply to ESM loans:

- 1) ESM funding cost
- 2) A charge of 200 bps applied on the entire loans
- 3) A surcharge of 100 bps for loan amounts outstanding after 3 years

For fixed rate loans with maturities above 3 years, the margin will be a weighted average of the charge of 200 bps for the first 3 years and 200 bps plus 100 bps for the following years.

The pricing structure will be defined in the pricing policy of the ESM, which will be reviewed periodically.

Private sector involvement

1. Modalities for involving the private sector

An adequate and proportionate form of private-sector involvement will be expected in all cases where financial assistance is received by the beneficiary State. The nature and extent of this involvement will be determined on a case-by-case basis and will depend on the outcome of a debt sustainability analysis, in line with IMF practice⁷, and on potential implications for euro-area financial stability.

(a) If, on the basis of a sustainability analysis, it is concluded that a macro-economic adjustment programme can realistically restore the public debt to a sustainable path, the beneficiary Member State will take initiatives aimed at encouraging the main private investors to maintain their exposures (e.g. a "Vienna Initiative" approach). The Commission, the IMF, the ECB and the EBA will be closely involved in monitoring the implementation of such initiatives.

(b) If, on the basis of a sustainability analysis, it is concluded that a macro-economic programme cannot realistically restore the public debt to a sustainable path, the beneficiary Member State will be required to engage in active negotiations in good faith with its creditors to secure their direct involvement in restoring debt sustainability. The granting of the financial assistance will be contingent on the Member State having a credible plan and demonstrating sufficient commitment to ensure adequate and proportionate

⁷ In line with the IMF, debt is considered sustainable when a borrower is expected to be able to continue servicing its debts without an unrealistically large correction to its income and expenditure. This judgement determines the availability and the appropriate scale of financing.

private sector involvement. Progress in the implementation of the plan will be monitored under the programme and will be taken into account in the decision on disbursements.

In negotiating with creditors, the beneficiary Member State will adhere to the following principles:

- *Proportionality*: the Member State will seek solutions proportionate to its debt sustainability problem.
- *Transparency*: the Member State concerned will engage in an open dialogue with creditors and share relevant information with them on a timely basis.
- *Fairness*: the Member State will consult creditors on the design of any rescheduling or restructuring of public debt with a view to reaching negotiated solutions. Measures reducing the net present value of the debt will be considered only when other options are unlikely to deliver the expected results.
- *Cross-border co-ordination*: the risk of contagion and potential spill over effects on other Member States and third countries will be duly taken into account in the design of measures to involve the private sector. The measures taken will be accompanied with a proper communication by the Member State concerned aimed at preserving the financial stability of the Euro Area as a whole.

2. Collective Action Clauses

Collective Action Clauses (CACs) will be included in all new euro area government securities, with maturity above one year, from July 2013. The objective of such CACs will be to facilitate agreement between the sovereign and its private-sector creditors in the context of private sector involvement. The inclusion of CACs in a bond will not imply a higher probability of default or of debt restructuring relating to that bond. Accordingly, the creditor status of sovereign debt will not be affected by the inclusion of CACs.

The main features of the CACs will be consistent with those commonly used in the US and the UK markets since the G10 report on CACs. CACs will be introduced in a way which preserves a level playing field among euro area Member States. This implies the use of **identical and standardized clauses** for all euro area Member States, harmonized in the terms and conditions of securities issued by the Members States. Their basis will be **consistent with the CACs that are common in New York and English law**.

CACs will include an **aggregation clause**, enabling a super majority of bondholders across multiple bond issues subject to such a clause and subject to the law of a single jurisdiction to include a majority action clause where the needed majority of creditors for the restructuring would not be attained within a single bond issue. **Appropriate representation** will be put in place. Most important issues – the reserve matters – (e.g. key payment terms, conversion or exchange of bonds) will be decided with a larger **majority** than non-reserve matters. Appropriate **quorum** requirements will apply. Changes agreed by the relevant majorities are binding on all bondholders.

An appropriate **disenfranchisement** clause will apply to ensure a proper voting process. Appropriate clauses to prevent disruptive legal action will be considered.

CACs will be introduced in a standardized manner, which ensures that their legal impact is identical in all euro-area jurisdictions and so preserves a level playing field among euro-area Member States. The euro area Member States will adopt the necessary measures to give effect to the CACs.

Euro area Member States will be allowed to continue to “tap” outstanding debt without CACs under pre-determined conditions after June 2013 in order to preserve the necessary liquidity of old bonds and to give sufficient time to euro area Member States to create, in an orderly fashion, new bonds on all benchmark maturities. The detailed legal arrangements for including CACs in euro-area government securities will be decided on the basis of work to be undertaken by the EFC Sub-Committee on EU Sovereign Debt Markets, following appropriate consultation with market participants and other stakeholders, and be finalised by the end of 2011.

3. Preferred Creditor Status of the ESM

Like the IMF, the ESM will provide financial assistance to a Member State when its regular access to market financing is impaired. Reflecting this, Heads of State or Government have stated that the ESM will enjoy preferred creditor status in a similar fashion to the IMF, while accepting preferred creditor status of IMF over ESM.

This shall be effective as of 1 July 2013 without prejudice to the terms and conditions of any other agreement provided under the EFSF and the Greek facility.

Transitional arrangements between EFSF and ESM

As originally foreseen, the EFSF will remain in place after June 2013 so as to administer the outstanding bonds. It will remain operational until it has received full payment of the financing granted to the Member States and has repaid its liabilities under the financial instruments issued and any obligations to reimburse guarantors. Undisbursed and unfunded portions of existing loan facilities should be transferred to the ESM (e.g. payment and financing of instalments that would become due only after the entry into force of ESM). The consolidated EFSF and ESM lending shall not exceed €500 bn.

To ensure a smooth transition from the EFSF to the ESM, the CEO of the EFSF will be tasked with the practical preparation of the establishment of the ESM. He will regularly report on the progress made to the Eurogroup Working Group.

Participation of the non euro area Member States

Non euro area Member States can participate on an *ad hoc* basis alongside the ESM in financial assistance operations for euro area Member States. If non-euro area Member States participate in such operations, they will be represented in the relevant meetings of the ESM boards that will decide on the granting and the monitoring of the assistance. They will have access to all relevant information in a timely manner and be appropriately consulted. The euro area Member States will support equivalent creditor status of the ESM and that of other Member States lending bilaterally alongside the ESM.

Dispute settlement

If a dispute arises between a euro area Member State and the ESM in connection with the interpretation and application of the treaty establishing the ESM, the Board of Governors will decide on this dispute. If the Member State contests this decision, such dispute shall be submitted to the European Court of Justice in accordance with Art. 273 TFEU.

With regard to the relationship between the ESM and third parties, the applicable governing law and jurisdiction will be dealt with by the legal and contractual documentation which will then be put in place between the ESM and those third parties.

Annex: ESM contribution key based on the ECB key

ESM contribution key

Country	ISO	ESM key
Austria	AT	2.783
Belgium	BE	3.477
Cyprus	CY	0.196
Estonia	EE	0.186
Finland	FI	1.797
France	FR	20.386
Germany	DE	27.146
Greece	EL	2.817
Ireland	IE	1.592
Italy	IT	17.914
Luxembourg	LU	0.250
Malta	MT	0.073
Netherlands	NL	5.717
Portugal	PT	2.509
Slovakia	SK	0.824
Slovenia	SI	0.428
Spain	ES	11.904
Total	EA17	100.0

Notes: The ESM key is based on the ECB capital contribution key.

Member States with a GDP per capita of less than 75% of the EU average will benefit from a temporary correction for a period of 12 years after their entry in the euro area.

This temporary correction will be three quarters of the difference between GNI and ECB capital shares (effectively comprising of 75% of GNI share and 25% of ECB capital share) as follows: $ESM\ share = ECB\ key\ share - 0,75*(ECB\ key\ share - GNI\ share)$

The downwards compensation on those countries is redistributed among all the other countries according to their ECB key share.

GNI and GDP per capita in 2010.

Sources: ECB, Ameco and DG ECFIN calculations.



19.

Urgent and Confidential

11 July 2011

Mr John Callinan
Assistant Secretary
Department of the Taoiseach
Dublin

[Handwritten signature]
13/7/11

Dear John

I enclose for onward transmission to the Taoiseach a letter from Jean-Claude Trichet, in his capacity as Chair of the European Systemic Risk Board, attaching a copy of a warning issued on 30 June 2011 by the ESRB General Board. The letter was received here on Friday last.

NB

You will note that it is necessary for the Taoiseach to confirm receipt of the document.

A letter in identical terms is being forwarded to the Minister for Finance.

Yours sincerely

[Handwritten signature of Rory Montgomery]

Rory Montgomery
Permanent Representative

*Mrs Blake
for transmission to PST
& copy to Sec Gen's
asap please*

*Jim O'Brien DfM
NB need to acknowledge*

[Handwritten signature]
13/7

ECB-CONFIDENTIAL

**CONFIDENTIEL UE/
EU CONFIDENTIAL**



ESRB
European Systemic Risk Board
European System of Financial Supervision

Jean-Claude Trichet
ESRB Chair

Frankfurt, 1 July 2011
ESRB/2011/052

An Taoiseach
Enda Kenny

Dear Taoiseach,

I am transmitting herewith for your attention a copy of the Warning ESRB/2011/WNP1 approved on 30 June 2011 by the ESRB General Board, in accordance with the EU Regulation No. 1092/2010.

This Warning is issued on a confidential basis in accordance with Article 18(4) of the above mentioned Regulation.

Yours sincerely,

A handwritten signature in black ink, consisting of a stylized 'J' and 'C' followed by a horizontal line and a small flourish.

The Chair of the European Systemic Risk Board

Encl.



**COUNCIL OF
THE EUROPEAN UNION**

Brussels, 6 July 2011

12488/11

**CONFIDENTIEL UE/
EU CONFIDENTIAL**

**ECOFIN 502
UEM 241**

NOTE

From: General Secretariat of the Council
To: Members of the European Council
Subject: European Systemic Risk Board letter

The Council Secretariat was asked by the ESRB to distribute the letter attached in view of the Council Secretariat's robust procedures for handling classified information.

ECB-CONFIDENTIAL

CONFIDENTIEL UE/
EU CONFIDENTIAL



ESRB

European Systemic Risk Board

European System of Financial Supervisors

Jean-Claude Trichet
ESRB Chair

Frankfurt, 1 July 2011

ESRB/2011/WNP1

Mr. Herman Van Rompuy
President of the European Council

Mr. Donald Tusk
Prime Minister of Poland

Mr. Jan Vincent-Rostowski
Minister of Finance of Poland

Cc: Mr. Olli Rehn
Member of the European Commission

Cc: Mr. Vittorio Grilli
Chairman of the Economic and Financial Committee

Cc: Mr. Uwe Corsepius
Secretary-General of the Council of the European Union

Confidential Warning under Articles 3(2)(c) and 16 of Regulation (EU) No. 1092/2010

Dear President Van Rompuy, Dear Prime Minister Tusk, Dear Minister Vincent-Rostowski,

At its second regular meeting of 22 June 2011, the General Board of the ESRB, in reviewing the macro-prudential aspects of the current economic and financial situation in the EU, has identified potential threats to the financial stability of the EU overall, namely:

- (a) possible EU-wide contagion from sovereign shocks, combined with
- (b) possible adverse market movements at the time of the publication of the results of the banking sector stress test exercise, and

|1



- (c) possibly insufficient plans in some EU Member States to ensure both comprehensive and timely private plans and, where necessary, public backstops at national level to address any weaknesses identified¹.

These adverse developments could be expected to have widespread ramifications throughout the EU financial system, in particular in view of the extent of its interconnectedness. The General Board highlights:

- (i.) extensive links within the banking sector. As experienced in the aftermath of the 2007-08 disruption, concerns about the creditworthiness of major financial counterparties would mean that it is likely that even core financial markets would be threatened, for example inter-bank, bond and associated derivatives markets;
- (ii.) close links between the banking sector and other sectors and markets, given the propensity for asset fire sales due to credit ratings downgrades, or collateral margining;
- (iii.) the potential for significant destabilising feedback loops to take hold within the financial system and between it and the real economy. These can be driven by close links between the assessments of creditworthiness of sovereign and financial debtors and the possibility for contagion both among sovereigns as well as between financial institutions.

Hence, the General Board considers it critical that public policy efforts should focus on ensuring that the EU financial system – in all its components – can continue to recover towards a self-sustaining position. To support this objective, in the near term, and to limit potential adverse spillovers within the European Union overall, the ESRB stresses the crucial importance of the commitments already agreed by the competent authorities in the EU and its Member States, when the Council of the European Union published a two-page official statement on “Backstop mechanisms in the context of the 2011 EU-wide stress test exercise” on 17 May this year.

Introducing that statement in its own conclusions, the Ecofin Council of that day wrote:

The Council “agreed that all member states would have in place credible backstop mechanisms at the time of the publication of the [stress test] results (...) and set deadlines for addressing any vulnerability revealed by the stress tests, with a stated preference for private sector solutions.”

Previously, the European Council had already concluded on 25 March that:

“Member States will prepare, ahead of the publication of the [stress test] results, specific and ambitious strategies for the restructuring of vulnerable institutions,

¹ An ad-hoc Assessment Team under the aegis of the Advisory Technical Committee of the ESRB has assessed the macro-prudential risks deriving from a possible shortage of private and public backstop measures. An interim report was presented to the General Board of the ESRB on 22 June.



including private sector solutions (direct financing from the market or asset sales) but also a solid framework in line with State aid rules for the provision of government support in case of need."

In addition, the European Council later on concluded on 24 June:

"Stress tests are being conducted in the banking sector. It is of key importance that they are fully credible and transparent and concluded in full compliance with the methodology and guidelines issued by the European Banking Authority and that all participants ensure the highest quality of the outcome. All necessary measures fully consistent with international standards must be rapidly taken to address any possible banking vulnerabilities brought to light by these stress tests."

The General Board is of the view that were the above-mentioned adverse developments to materialise in the prevailing environment, they could pose a significant systemic threat to the EU financial system overall and, consequently, to the achievement of the ESRB's own objectives as outlined in Article 3 of Regulation (EU) No. 1092/2010. As a result, the General Board attaches the utmost priority to the prevention and mitigation of these risks, which, in its view, could likely result in widespread financial distress and a likely disruption in the provision of financial services to the real economy.

Warning

In line with Regulation (EU) No. 1092/2010 (Articles 3(2)(c) and 16), the ESRB warns the addressees of this letter, as representatives of the European Union as a whole and of the EU Member States, that without

- (i) concrete private sector measures to address, when required, the need to strengthen capital positions, and
- (ii) supporting actions by Member States to establish credible public backstops against the potential for the deterioration of assets of financial institutions,

under worsening market conditions, risks of a systemic nature might materialise at the level of the EU Member States and the EU as a whole, leading to a likely disruption in the provision of financial services to the real economy.

The ESRB urges in particular the EU Member States to ensure that - where this has not yet been the case - these public backstops are finalised ahead of the forthcoming publication of the EU stress test results on banks and announced simultaneously to that publication.

The necessary private sector measures and supporting public actions, as intended in the warning above, would include, in particular, that:



- all relevant financial institutions across the EU commit to the identification of any weaknesses, and thereby contribute to deliver the 2011 EU-wide stress test in a rigorous and consistent way. The stress test – and its accompanying additional disclosure – should provide a clear and rigorous assessment of the resilience of institutions under an adverse scenario and reassure that EU banks can withstand a possible deterioration of their assets;
- all competent authorities cooperate effectively with the European Banking Authority, in particular to ensure full implementation of its recent recommendations and guidance to the credit institutions participating in the stress test (as part of the agreed process of quality assurance and peer review);
- governments ensure that private-sector plans are in place to strengthen capital positions, so as to ensure that EU banks can withstand a possible deterioration of their assets. Any such plans need to be supported by public backstops at national level to ensure that any weaknesses identified are promptly addressed. In this regard, the ESRB considers of the utmost importance that remedial measures be applied not only to the financial institutions which will formally fail the stress test, but are also available to those which pass the test, but still are perceived by markets to be at risk. Member States should closely cooperate at the European level in the preparation of backstop measures for banking groups, which are present in different countries;
- all stakeholders involved communicate simultaneously and consistently on the existence of backstop measures, refraining from ex-ante announcements as well as ex post communication which might undermine the credibility of the exercise. Communication might need to take account of country specific issues.

In close cooperation with the other authorities of the European System of Financial Supervision, the ESRB will monitor, very closely, developments going forward and take further actions within the remit of its mandate as necessary – including issuance of formal recommendations – consistent with the prevention and mitigation of systemic risks to the financial stability of the Union.

Yours sincerely,

The Chair of the European Systemic Risk Board



EUROPEAN CENTRAL BANK

EUROSYSTEM

Strictly Confidential

Jean-Claude TRICHET
President

Mr Brian Lenihan
Tánaiste and
Minister for Finance
Government Buildings
Upper Merrion Street
Dublin 2
Ireland

COPY

Frankfurt, 15 October 2010
L/JCT/10/1280

Dear Minister,

I refer to our last phone conversation. As you know the ECB greatly appreciates the recent commitment of the Irish government to develop, in close cooperation with the Commission in liaison with the ECB, a multi-annual economic and fiscal adjustment strategy. Given Ireland's convincing track-record in fiscal adjustment, I am confident that your medium-term strategy will be successful in restoring fiscal sustainability and financial sector soundness.

In this context, I would like to draw your attention to a number of issues arising from the *extraordinarily large provision of liquidity by the Eurosystem to Irish banks* in recent weeks. The participation in Eurosystem credit operations is subject to rules. These include the requirement for the Eurosystem to base its lending operations with market participants on adequate collateral. Moreover, the General Documentation on Eurosystem monetary policy instruments and procedures requires our counterparties to be financially sound. In this context, the Eurosystem may limit, exclude or suspend counterparties' access to monetary policy instruments on the grounds of prudence and may reject or limit the use of assets in the Eurosystem credit operations by specific counterparties. The Governing Council indeed carefully monitors the Eurosystem credit granted to the banking system, in the Irish as well as in all other cases, and in particular the size of Eurosystem exposures to individual banks, the financial soundness of these banks, and the collateral they provide to the Eurosystem. The assessment by the Governing Council of the appropriateness of its exposures to Irish banks depends very much on progress in economic policy adjustment, enhancing financial sector capital and bank restructuring.

Moreover, the provision of *Emergency Liquidity Assistance (ELA)* by the Central Bank of Ireland, as by any other National Central Bank of the Eurosystem, is closely monitored by the ECB's Governing Council as it may interfere with the objectives and tasks of the Eurosystem and the prohibition of monetary financing under the Treaties. Therefore, if ELA is provided in significant amounts, the Governing Council will assess whether there is a need to impose specific conditions in order to protect the integrity of our monetary policy. In addition, in order to ensure compliance with the monetary financing prohibition, it is essential to ensure that the ELA recipient institution continues to be solvent.

Against the background of these principles, I would like to re-emphasize that the current *large provision of liquidity by the Eurosystem and the Central Bank of Ireland to entities such as Anglo Irish Bank should not be taken for granted as a long-term solution*. Given these principles, the Governing Council cannot commit to maintaining the size of its funding to these institutions on a permanent basis.

As I told you, a key element of the monitoring by the Governing Council of Eurosystem exposure to the Irish banking system, and the related decisions the Governing Council may take, will be its assessment of *progress in implementing the four-year economic strategy* that the Irish government envisages to announce in early November. This is not only because significant parts of the Irish banking systems are partially or fully Government owned, but also because an important share of the Eurosystem exposure to Irish credit institutions is collateralised with securities issued or guaranteed by the Irish Government. I trust that the four-year strategy will target a fiscal deficit of below 3% in 2014 and a decline in the public debt-to-GDP ratio from 2012/13 onward, based on cautious real growth forecasts, as well as a strong structural reform programme. Future decisions by the Governing Council of the ECB regarding the terms of liquidity provision to Irish banks will thus need to take into account appropriate progress in the areas of fiscal consolidation, structural reforms and financial sector restructuring.

With my best regards,



Cc.: Mr Olli Rehn, EU Commissioner for Economic and Monetary Affairs
Mr Joaquín Almunia, EU Commissioner for Competition



EUROPEAN CENTRAL BANK
EUROSYSTEM

Secret

Jean-Claude TRICHET
President

Reclassified for publication on 6 November 2014

Mr Brian Lenihan
Tánaiste and
Minister of Finance
Government Buildings
Upper Merrion Street
Dublin 2
Ireland

Frankfurt, 19 November 2010

L/JCT/10/1444

Dear Minister,

As you are aware from my previous letter dated 15 October, the provision of *Emergency Liquidity Assistance (ELA)* by the Central Bank of Ireland, as by any other national central bank of the Eurosystem, is closely monitored by the Governing Council of the European Central Bank (ECB) as it may interfere with the objectives and tasks of the Eurosystem and may contravene the prohibition of monetary financing. Therefore, whenever ELA is provided in significant amounts, the Governing Council needs to assess whether it is appropriate to impose specific conditions in order to protect the integrity of our monetary policy. In addition, in order to ensure compliance with the prohibition of monetary financing, it is essential to ensure that ELA recipient institutions continue to be solvent.

As I indicated at the recent Eurogroup meeting, the exposure of the Eurosystem and of the Central Bank of Ireland vis-à-vis Irish financial institutions has risen significantly over the past few months to levels that we consider with great concern. Recent developments can only add to these concerns. As Patrick Honohan knows, the Governing Council has been asked yesterday to authorise new liquidity assistance which it did.

But all these considerations have implications for the assessment of the solvency of the institutions which are currently receiving ELA. It is the position of the Governing Council that it is only if we receive in writing a commitment from the Irish Government vis-à-vis the Eurosystem on the four following points that we can authorise further provisions of ELA to Irish financial institutions:

- 1) The Irish government shall send a request for financial support to the Eurogroup;
- 2) The request shall include the commitment to undertake decisive actions in the areas of fiscal consolidation, structural reforms and financial sector restructuring, in agreement with the European Commission, the International Monetary Fund and the ECB;

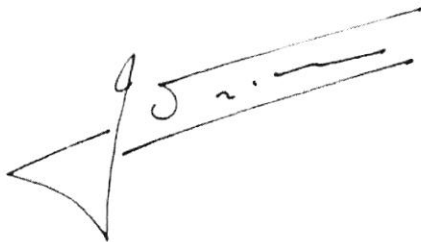
3) The plan for the restructuring of the Irish financial sector shall include the provision of the necessary capital to those Irish banks needing it and will be funded by the financial resources provided at the European and international level to the Irish government as well as by financial means currently available to the Irish government, including existing cash reserves of the Irish government;

4) The repayment of the funds provided in the form of ELA shall be fully guaranteed by the Irish Government, which would ensure the payment of immediate compensation to the Central Bank of Ireland in the event of missed payments on the side of the recipient institutions.

I am sure that you are aware that a swift response is needed before markets open next week, as evidenced by recent market tensions which may further escalate, possibly in a disruptive way, if no concrete action is taken by the Irish government on the points I mention above.

Besides the issue of the provision of ELA, the Governing Council of the ECB is extremely concerned about the very large overall credit exposure of the Eurosystem towards the Irish banking system. The Governing Council constantly monitors the credit granted to the banking system not only in Ireland but in all euro area countries, and in particular the size of Eurosystem exposures to individual banks, the financial soundness of these banks and the collateral they provide to the Eurosystem. The assessment of the Governing Council on the appropriateness of the Eurosystem's exposure to Irish banks will essentially depend on rapid and decisive progress in the formulation of a concrete action plan in the areas which have been mentioned in this letter and in its subsequent implementation.

With kind regards



Cc.: Mr Brian Cowen, Prime Minister

"The more you talk about restructuring debt, the harder it is to obtain debt," Irish Finance Minister Brian Lenihan said in an interview with Dublin-based RTE television yesterday. "That is the reality."

Merkel's stance echoes her approach to Greece earlier this year when she initially refused to rush to its aid, sparking speculation about the euro region's ability to handle the worst crisis in its history. While billionaire George Soros at the time said her strategy risked pushing Greece into a "death circle," Merkel said the "tough" terms of the country's eventual bailout vindicated her policy.

The new push comes as her Christian Democrat party loses support to the Social Democrats, with an Oct. 27 Forsa poll putting the opposition 12 percentage points ahead of her CDU-Free Democrat government. The government also faces regional elections from March that involve 25 percent of the population.

Time Bomb?

Leaving taxpayers to shoulder the burden of bailouts may set off "a dangerous social time bomb" of popular dissatisfaction, Finance Minister Wolfgang Schaeuble said in a speech late yesterday. "The currency union was never designed as a model for the enrichment of financial speculators."

Merkel's government was the biggest contributor to April's Greek bailout and would also shoulder the lion's share of any rescue under the current temporary backstop.

"These things are more about politics than economics," said Paul Lambert, head of the global macro team at Polar Capital Holdings Plc in London. "It's clear that for some economies in Europe it's going to be incredibly difficult to make the fiscal adjustments needed on their own. It's either going to mean Germany picking up the tab, or countries in Europe being cut loose."

~~the German~~ proposals are hurting Portuguese debt even after the nation's government and biggest opposition party reached an agreement Oct. 29 on next year's budget. The country's bonds are the third-worst performing government debt securities this year, down 5.7 percent, according to indexes compiled by Bloomberg and the European Federation of Financial Analysts Societies.

Irish Spread

Only Greece, with a 16 percent decline, and Ireland, with a 6.9 percent drop, fared worse. German bonds earned more than 8.2 percent this year.

The spread on Irish bonds has doubled in the past three months as the government tries to cut its deficit in the face of bank-bailout costs that may reach 50 billion euros. The country's 10-year bond yesterday yielded 7.304 percent, the most since 1996.

"The German government is following what the market is telling it," said Nicola Marinelli, a portfolio manager at

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BN Merkel Debt Plan Provokes Selloff Trichet Foresaw: Euro Credit
 Nov 3 2010 0:01:00

Glendevon King Ltd. in London, which oversees \$200 million in assts. "The Greek government, and probably the Irish and Portuguese, will need to be bailed out. If you sense that it's inevitable then it's better to have something to manage than complete chaos."

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Independent.ie

Investors' fear sends yield on Irish bonds to new 7.45pc high

By Donal O'Donovan
Wednesday November 03 2010

The spiralling cost of Government borrowing hit a fresh high of 7.45pc yesterday as the European Central Bank (ECB) stepped in to calm the markets.

Germany's plan to get tough with bondholders, the failure to sell AIB's UK arm and fears that too much austerity could stifle the economy all added to the pressure on the bonds.

"The amount of selling has been relatively small, but the market is all sellers and no buyers, which drives up the yield. The ECB has come in to prevent this becoming a rout," said Padhraic Garvey, Head of Developed Markets Debt at ING Bank in Amsterdam.

Value

Yields of more than 7.4pc mean Irish 10-year bonds that pay 5pc in interest per year are being bought for a little more than 83pc of face value. Irish yields have now risen for six days in a row.

Bondholders have been selling Irish and other higher risk sovereign bonds since Germany proposed tough new bailout rules last week.

Under German Chancellor Angela Merkel's plan, lenders to sovereigns that are bailed out by the EU would take a haircut on their debt. If approved by EU members the proposals would come into force in 2013.

The EU needs a mechanism to manage defaults but holding discussions about the plan at a time when the market is so vulnerable has mystified many observers.

Yesterday Ms Merkel said that for rules to have "more bite" to protect the euro, along with steps to prevent EU nations running up excessive debt, a crisis mechanism enshrined in the bloc's treaties is necessary for the longer term.

"We will set it up in such a way that European taxpayers will no longer be on the hook for possible new mistakes and turmoil on the financial markets," Ms Merkel said.

Fears that Ireland's austerity plans could hurt the economy are also turning some bondholders off Irish bonds. "With austerity measures you're damned if you do and damned if you don't. The market wants to see the cuts but at the same time fears they will hurt the economy," said Mr Garvey.

That adds to pressure on Finance Minister Brian Lenihan to produce a four-year plan that convinces investors who are now abandoning Irish debt to buy back in.

If the cuts he proposes are too deep, investors fear there will not be enough growth in the economy to revive the banks. If cuts are too shallow, investors won't believe the deficit can be brought under control.

The cost of insuring Irish bonds against default also hit a new high yesterday.

Credit Default Swaps (CDS) that insure bondholders against a default in the next five years cost 5.3pc early yesterday. This means a bondholder has to pay €530,000 to insure €10m of bonds against default. Bad news from AIB was one factor in the rising cost of insuring Irish bonds, which rose more sharply than Greek or Portuguese CDS, said Gavan Nolan, credit analyst at research firm Markit.

"The banking situation is an extra factor in Irish risk.

"On Tuesday Ireland underperformed the other peripherals after AIB said it could not sell its UK assets.

"That adds to the cost of the bank bailout for Ireland at a time when the sovereign debt market was already very nervy," Mr Nolan said.

- *Donal O'Donovan*

Financial Times

Debt costs jump for Dublin and Lisbon

By Richard Milne in London and Ralph Atkins in Frankfurt
Published: November 1 2010 19:41 | Last updated: November 1 2010 19:41

Borrowing costs for Ireland and Portugal shot up as investors took fright at European proposals to force them to take a greater share of losses in future state bail-outs.

The moves in the bond markets on Monday follow agreement at last week's European Union summit on a Franco-German proposal on a mechanism to resolve future Greek-style sovereign debt crises.

Ireland saw the premium it pays over German benchmark interest rates rise to 4.67 percentage points, while the yield on its 10-year bonds reached 7.14 per cent, up 0.22 percentage points. Both the premium and the yield set new records since the introduction of the euro.

Meanwhile, Portugal's yield rose 0.16 percentage points to 6.11 per cent, while Greece and Spain saw smaller rises and European banking shares fell sharply in a broadly flat market.

"People do seem shocked about the idea of a future eurozone debt restructuring – but this should not have been a surprise unless you really believed that the German taxpayer would always underwrite everything," said Erik Nielsen, Goldman Sachs European economist.

The rise in the yields of the so-called peripheral nations in the eurozone appears to fulfil the forecast of Jean-Claude Trichet, European Central Bank president, who warned European heads of state last week that the proposed rescue system would increase borrowing costs.

Gary Jenkins, head of fixed income at Evolution Securities, said the danger was that by talking about debt restructuring "it could become a self-fulfilling prophecy". Markets are particularly worried that borrowing costs for Ireland and Portugal could become so high that they are forced to tap the eurozone's bail-out fund, a potentially destabilising move.

Exacerbating the discord among Europe's leaders, a top ECB official on Monday sharply criticised Germany's plan to allow a debt rescheduling by a member state. "Calling for an orderly debt restructuring mechanism sounds nice and is costless. Designing and implementing it is somewhat different," Lorenzo Bini Smaghi, an ECB executive board member, said in a speech in Abu Dhabi.

Despite the soaring cost of borrowing – Greece's yields have risen by more than 1 percentage point in a week – the ECB made no purchases in its government bond-buying programme for the third week.

Separately, credit rating agency Moody's said Greece, Portugal and Ireland were likely to avoid sovereign bond defaults because of a strong domestic investor base of local banks and pension funds that would buy their government's debt even in times of stress.

Many investors, however, remain convinced that one or more countries, most likely Greece, will restructure. "You can't get away from the fact that there will be some kind of restructuring in the eurozone periphery," said Rod Davidson, head of fixed income at Alliance Trust Asset Management.

Additional reporting by David Oakley

Extracts from Embassy Summary of French Press Coverage

Paris Press summary, 3 November 2010

Foreign news stories, including the mid-term elections in the US, the Chinese State visit to France and continuing terrorist threats, make the headlines in Paris this morning.

1. Eurozone – Ireland

Le Figaro Economie reports on German Finance Minister Wolfgang Schaeuble's visit to Paris yesterday. "Eurozone: Berlin wants to make the private sector pay up; the German Finance Minister revealed.....his vision of the future mechanism for crisis resolution". The report describes Schaeuble as "an ardent defender of orthodoxy and a convinced partisan of tough measures to heal the ills of Euroland (sic)". Schaeuble set out his vision of the mechanism to resolve crises agreed last week by the European Council. The 27 agreed on the principles but gave themselves two months to work out the details, something that has not failed to cause concern on the markets. Unsurprisingly, Schaeuble defends a strict interpretation of the rescue mechanism. Besides financial sanctions, he is favourable to taking voting rights in the Council away from countries which are not respecting the budgetary discipline agreed by their peers. He calls for a restructuring mechanism for public debt involving private sector participation. "Countries in financial difficulties can't expect that the Community will assist them unconditionally.....Participation by the private sector should be a central element of the Mechanism". Schaeuble: "monetary union was never conceived as a means of enriching financial speculators; neither is it a system for financial transfers from the richer to the poorer countries". In the context of revising the Treaty, the report says that Berlin wants to attach to "the no bail out clause" – the English expression is used – a mechanism for restructuring which would not leave the holders of private bonds, notably banks and insurance companies, indemnified. Schaeuble apparently also availed of the opportunity offered by his visit to Paris to sing the praises of "the German economic model".

<http://www.lefigaro.fr/conjoncture/2010/11/02/04016-20101102ARTFIG00659-zone-euro-berlin-veut-faire-payer-le-prive.php>

A separate article in Le Figaro Economie is headed "Ireland, Portugal, Greece: costs of borrowing take off". The report says that Trichet's fears are being realised. Gilles Moec, an economist at Deutsche Bank, says "the market is thinking like Trichet: it hates uncertainty". Ireland's ten year bonds yesterday reached 7.22%, the highest level since it joined the Eurozone. "Even if Ireland and Portugal were already worrying the markets for the past two months because of their dangerous budgetary situation, investors were reacting in particular to the risk of debt restructuring in the countries of the Eurozone". Another article in Le Figaro reports on a study by Markit on growth rates in Europe. "The diagnosis is nuanced. It reveals in effect a Europe of different speeds, with important disparities depending on the particular country. Growth rates in manufacturing are improving in Germany, in Italy, in Spain, in the Netherlands, in Austria and in Ireland.

Weblinks not available

Paris Press summary, 1st November

1. Outcome of European Council

On Saturday, Le Figaro's headline was "*Economic Governance: Merkel and Sarkozy relaunch Europe*". The report says that the 27 are agreed on "*a limited revision of the*

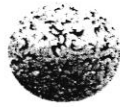
Lisbon Treaty”.....and “*Pandora's box risks being re-opened*”. In a separate report on prospects for the EU budget, Le Figaro writes that “*Paris, Rome and Berlin had rejected the idea of suppressing direct aids to farmers in the framework of the CAP*”. The editorial in Saturday's Figaro sees the Eurozone as going in the right direction but anticipates difficulties when it come to revising the Lisbon Treaty: “*it's hard to see the Irish — already quite suspicious — putting their heads on the block in ratifying a text of which they could be among the first victims*”. Liberation (Jean Quatremer in Brussels) heads its report “*the 27 swallow the Deauville deal*” (i.e. the outcome of the recent Sarkozy-Merkel meeting). The report says that Merkel explained that she was forced by her country's Constitutional Court to insist on a revision of the Treaty. Le Parisien talks of re-opening Pandora's box.

Le Figaro Economie (Jacques Mével in Brussels) this morning says that ECB President Trichet is concerned about plans to revise the Lisbon Treaty and fears a negative reaction from the markets for sovereign debt. “*The devil is in the detail and after the agreement in principle arrived at with some difficulty in Brussels last Friday, the 27 are faced with a choice which is already causing division: what's the place of the law of the market in the new rescue mechanism for Eurozone countries threatened with bankruptcy?*”. Merkel and Trichet are in opposing camps. What was agreed for Athens can't become the practice. Merkel's tough line was supported by France and Netherlands. Trichet's tough line caused surprise. What's the explanation? “*Announcing that restructuring is just around the corner could dissuade private investors, set off interest rates and worsen the burden of countries like Greece and Ireland*”. The report concludes “*just as the ECB is trying to disengage from buying up government bonds, Trichet's problems are increasing*”.

SPREADS FOR PERIPHERALS

Spread	4.45pm	11.45am	10am	03-Nov	02-Nov	01-Nov	29-Oct	28-Oct	27-Oct
Greece	899	865	852	851	843	833	821	794	794
Portugal	434	416	411	396	386	372	348	345	340
Ireland	546	532	526	512	492	477	447	436	429
Spain	195	191	186	186	182	177	170	164	161
Italy	154	147	145	147	144	141	136	133	133
Bund yield	238	248	248	243	247	248	253	257	257

10/0063/MF
M. X. Cardiff
Secretary General



Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Referred pl

R. Kearney

29/11/10

Brian Lenihan, TD,
Minister for Finance,
Government Buildings,
Dublin 2.



November 21, 2010

COPY

Dear Minister,

You have asked us to report to you briefly on our overall impression of the discussions so far in relation to a possible EFSM/EFSF/IMF programme for Ireland, with a view to informing the Government on the question of making a formal application for such a programme.

It is not necessary for us to summarize the content or shape of what is being envisaged for such a programme, as we understand that this will be presented in a Memorandum to Government. We believe that proceeding now to a formal application is likely to lead to a good programme design and we recommend that the Government should make such an application immediately. There are remaining uncertainties and concerns, but to hold back now would not help resolve these uncertainties, and to the extent that the concerns can be dealt with, this will only be possible in the context of formal negotiations.

Our main concerns are threefold.

First, the cost of the funds to be borrowed looks like being higher than we expected when the discussions began. As late as yesterday, a figure of approximately 5-5 ½ per cent interest was being mentioned by the funders, but this has since jumped by over a percentage point. Depending on how much of the available funds will be drawn down, servicing this debt will worsen the debt dynamics and could threaten the sustainability of the programme. This will need to be scrutinized further to ensure that the final agreement is not only clearly sustainable, but that it is likely to be seen as sustainable by the markets. If the programme does not restore market confidence, it will fail to stabilize the situation, though without such a programme it is hard to see how stability could be achieved. Further consideration needs to be given to the question of the overall level of debt likely to result and its sustainability.

Second, while the programme envisages providing ready access to funds that can be used to boost bank capital thereby reassuring depositors, and thereby reduces the overall risk of a bank run, the programme design does not yet go as far as it might in insulating the economy as a whole from the tail risk of extremely adverse events. Thus, although the bank depositors would be insulated from extreme loan losses, that risk is, in effect, shifted to the State, and not to the funders. Further discussions on insurance-type mechanisms, perhaps to be introduced in subsequent years, that could

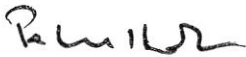
A. Nolan
- for Ch. pl.
11/11/10

transfer tail risk away from Ireland would be desirable, though the existing legal basis for the EFSF does not explicitly provide for such an arrangement.

Third, the Government should be aware that the actual level of future draw down on the envisaged contingent capital facility (CCF) is inevitably the subject of continuing uncertainty. While the preliminary assessment by the external authorities has been that our prudential capital assessment methodology has been robust, the actual development of loan losses will only become clear over time and in the event that tail risks do materialise then further draw downs can be anticipated. Similarly, a key component of the programme is a restructuring of the banking system in order to shrink the size of the banks' balance sheets to improve their structural funding position. This too raises the prospect of further draw downs on the CCF.

Finally, we are acutely aware that market and depositor confidence in the banks depends not only on the banks' access to capital, but more immediately on their access to liquidity. This is a matter for the central bank and we will be doing everything in our power to maintain financial stability. We believe that our efforts in this regard would be undermined by any delay in applying for a programme.

Yours sincerely



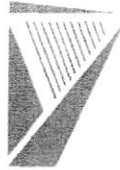
Patrick Honohan, Governor



Tony Grimes, Director General



Matthew Elderfield, Head of Financial Regulation



National Treasury Management Agency

Mr. Brian Lenihan TD
Minister for Finance
Government Buildings
Upper Merrion Street
Dublin 2

21st November 2010

Dear Minister

I refer to the ongoing discussions with the IMF, the European Commission and the ECB regarding the stressed liquidity conditions affecting Ireland. The NTMA recognises that the liquidity conditions of the banking system are now so stressed that there is a serious risk of a collapse of the system. Given the close links between the State and its banking system the financial stability of the State itself is now in question.

To address these issues and, based on the information available to us, the NTMA recommends that an application be made to the external authorities for appropriate financial assistance. It is envisaged that such assistance will provide for a capital strengthening of the banking system and, although likely to be expensive, will also provide for a sizeable funding facility to the State. Appropriate support from the ECB would be a necessary complement to a decision to apply to the external authorities.

Yours sincerely

John C Corrigan

Chief Executive 



An Roinn Airgeadais
Department of Finance

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21 November 2010

Mr Olli Rehn
Commissioner on Economic and Monetary Affairs
European Commission

Mr Dominique Strauss-Kahn
Managing Director
IMF

Mr Jean-Claude Trichet
President
European Central Bank

Dear Sirs,

On behalf of the Irish Authorities, I am writing to formally apply for financial assistance in the context of a joint EU-IMF programme. The external assistance sought is made under the terms of the European Financial Stabilisation Mechanism, the European Financial Stability Facility and the IMF assistance programme.

I welcome the statement by the Eurogroup and ECOFIN Ministers which concurred with the EU Commission and the ECB that providing assistance to Ireland is warranted to safeguard financial stability in the EU and in the euro area.

The Irish Authorities will cooperate fully in the preparation of the joint EU-IMF programme of assistance to the Irish State that will now be required to be developed.

Yours faithfully,

Brian Lenihan TD
Minister for Finance

cc Mr Jean-Claude Juncker, Eurogroup President
Mr Didier Reynders, European Union Presidency

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21 November 2010

Mr Jean-Claude Juncker
Eurogroup President

Mr Didier Reynders
European Union Presidency

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Yours faithfully,

Brian Lenihan TD
Minister for Finance

cc Mr Olli Rehn, Commissioner on Economic and Monetary Affairs, European Commission
Mr Dominique Strauss-Kahn, Managing Director, IMF
Mr Jean-Claude Trichet, President, European Central Bank



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21 November 2010

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

Dear Jean-Claude

I refer to your letter of 19 November 2010.

First, let me say that I fully understand your concerns and that of the Governing Council in regard to the implications of the current situation of the Irish banking system. As you know, Ireland has worked very aggressively, and to the limits of our fiscal capacity, to protect and repair the banking system in the light of the dangers to financial stability both in Ireland and Europe.

For example, in September 2008 the Government introduced an extensive Bank Guarantee to seek to bolster the funding difficulties of the banks by providing a Sovereign guarantee of bank liabilities. This was quickly followed by a bank recapitalisation programme announced in December 2008 and nationalisation of Anglo Irish Bank in January 2009. The establishment of NAMA was announced in April 2009 to remove the riskiest land and property development loans from the banks' balance sheets. At this stage, Ireland has provided or pledged some €32 billion of capital to the banking system.

These extensive set of measures have been taken in tandem with a most extensive programme of fiscal adjustment, amounting to some €15 billion of discretionary fiscal consolidation in 2009 and 2010 so far, with a further adjustment of another €15 billion planned by 2014. Measures for 2011 alone will amount to over €6 billion. Thus, Ireland has proved so far to be flexible and aggressive in dealing with its problems and will continue to be so.



These assertive measures, contributed to a substantial improvement in international sentiment towards Ireland and a partial recovery in the banks' funding position in the first quarter of 2010. The new Financial Regulator announced the results of his PCAR exercise and required the banks to meet it by the end of the year. The banks successfully commenced the process of accessing longer-term funding to manage the large redemptions cliff due in September. Reliance on bank funding from the Eurosystem was reduced. In addition, Bank of Ireland initiated and ultimately successfully completed its private capital raising exercise.

However it was not possible to sustain the improvement in the banking environment. As the year progressed there were a number of developments which led to a sharp reversal in financial conditions, of which the following are just some.

- Following the onset of the Greek debt crisis during April, international markets became increasingly concerned regarding Ireland's fiscal position, the strength of the Bank Guarantee and the fiscal capacity of the State to stand behind the banks.
- There was a slowdown in the pace of economic recovery nationally and increasing concern regarding the speed of recovery in the international economy particularly in the USA.
- Credit rating actions and negative market sentiment exacerbated the situation
- Uncertainty about the status of bondholders in the event of access to external support added to instability
- These events led to a crisis of confidence in both the Irish banking system and increasingly the Irish Sovereign. As a result, our banks, as you know so well, have had to turn to ECB/Central Bank funding to replace their market funding especially in September when a large number of bonds which matured under the two year Credit Institutions Financial Support (CIFS) Guarantee became due.

In order to seek to reverse these trends, I made a further comprehensive and detailed further Statement on Banking at the end of September and outlined the actions being taken to provide certainty to the international markets on the scale of bank losses. The Statement covered changes to NAMA to accelerate loan transfers and provide visibility on the final discounts expected to arise, the revised assessment of the capital positions of the banks on the basis of final expected NAMA discounts and the projected maximum capital requirements for Anglo Irish Bank.

While initially this information was initially well received, the credibility of projected bank loan losses was increasingly called into question by analysts and investors – there comes a point at which negative sentiment starts to feed on itself, even independently of underlying realities, and we are clearly at that point.

In relation to points (1) to (4) of your letter, I would like to inform you that the Irish Government has decided today to seek access to external support from the European and international support mechanisms. This grave and serious decision has been taken in the light of the developments I have outlined above and informed by your recent communications, and the advice you have conveyed to me personally and courteously in recent days.

The Government is clear, in the light of the very intensive and productive work done by Irish, European Commission, IMF and of course ECB officials, in recent days, that there is a potential programme which will be both workable and effective and which will incorporate real and significant restructuring measures in relation to the financial sector, structural reforms and fiscal consolidation, and the Government is committed to this. Indeed, your officials in Dublin have had the opportunity to see a draft of our proposed four year plan, so you may be aware that our fiscal and economic programme is in fact very extensive, and forms an appropriate basis for programme discussions.

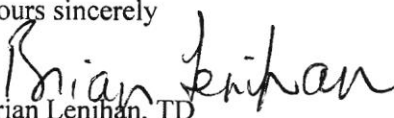
It is also clear from the discussions over recent days that any programme will include provision for further capitalisation on a scale which should convince markets that capital is not a problem. I was very pleased to note that the intensive examination of the Irish authorities' work on capital requirements has not indicated any new and unanticipated 'hole' in the banks' capital position, and it would be helpful if this is made clear in internal and external communications. However, the fact is that the market has not accepted the current capital levels as adequate, so more must be done.

In relation to your fourth point, there are already such arrangements in place in respect of each bank in receipt of ELA which provide the assurances that you call for.

I hope that this will provide some reassurance to the Governing Council and that you will be able to reiterate in a public way the continuing practical support of the ECB for the liquidity position of the Irish banks, to help to reassure the market on this crucial point.

You know that we here will not be lacking in the will to do all that is necessary on our part to protect our economy and people and to play our role in the Eurosystem.

Yours sincerely


Brian Lenihan, TD
Minister for Finance

IMF Reaches Staff-level Agreement with Ireland on €22.5 Billion Extended Fund Facility Arrangement

Press Release No. 10/462
November 28, 2010

Mr. Dominique Strauss-Kahn, Managing Director of the International Monetary Fund (IMF), issued the following statement today on Ireland: "The Irish authorities have today proposed a clear and realistic package of policies to restore Ireland's banking system to health and put its public finances on a sound footing. Immediate actions to tackle vulnerabilities in the banks and continued strong fiscal adjustment are set in a multi-year policy framework for sustained growth and job creation.

"In recent years, Ireland has resolutely carried out bold policies in a very challenging environment, and I have confidence in its ability to implement this new program. Supported by substantial financing, this program can underpin market confidence and bring Ireland's economy back on track. "The strategy for the financial system rests on twin pillars: deleveraging and reorganization; and ample capitalization. A fundamental downsizing and reorganization to restore the viability of the system will commence immediately.

"At the end of this process, a smaller, more robust, and better capitalized banking system will emerge to effectively serve the needs of the Irish economy. The transition to this goal will be buttressed by substantial recapitalization based on higher capital standards and stringent stress tests and asset valuation to accurately determine the quality of banks' loan portfolios. In addition, structural measures—a special resolution scheme for deposit-taking institutions and a further strengthening of the supervisory system—will impart greater stability.

"On the fiscal side, the program incorporates a comprehensive National Recovery Plan that covers a period of four years. The plan will form the basis for the 2011 budget and also details fiscal consolidation measures through 2014. The process of budget formation will be reformed to safeguard these gains and bring greater sustainability to public finances.

"The fiscal plan strikes an appropriate balance between revenue and spending measures, and maintains Ireland's due regard to a social safety net.

"To restore strong sustainable growth the program includes a strategy to remove potential structural impediments to enhancing competitiveness and creating new employment opportunities. It also details appropriate sectoral policies to encourage exports and a recovery of domestic demand, thereby supporting growth and reducing long-term unemployment.

"A financing package of €85 billion (about US\$113 billion) will support Ireland's effort to get its economy back on track. Of this, the European Union and bilateral European lenders have pledged a total of €45.0 billion (about US\$60 billion). The Irish authorities have decided to contribute €17.5 billion to this effort from the nation's cash reserves and other liquid assets. The Fund's contribution would be through a three-year SDR 19.5 billion (about €22.5 billion; or US\$30 billion) loan, representing about 2,320 percent of quota, under the Extended Fund Facility (EFF). The IMF has activated its fast-track procedures for consideration of Ireland's funding request, and I expect the EFF will go to the IMF Executive Board for approval in December."

The choice of an EFF offers Ireland a facility with a longer repayment period, with repayments to the Fund starting after four and a half years and ending after 10 years. The IMF charges member countries a uniform interest rate on nonconcessional loans, which is a floating rate based on the SDR interest rate, which is updated weekly. (The SDR interest rate is a weighted average of yields on three-month Treasury bills for the United States, Japan, and the United Kingdom, and the three-month Europe rate.) For amounts up to 300 percent of quota, the lending interest rate is currently 1.38 percent, while the lending rate on amounts over 300 percent of quota includes a surcharge that is initially 200 basis points and rises to 300 basis points after three years. At the current SDR interest rate, the average lending interest rate at the peak level of access under the arrangement (2,320 percent of quota) would be 3.12 percent during the first three years, and just under 4 percent after three years.

Ends

Government Statement

Announcement of joint EU - IMF Programme for Ireland

The Government today agreed in principle to the provision of €85 billion of financial support to Ireland by Member States of the European Union through the European Financial Stability Fund (EFSF) and the European Financial Stability Mechanism; bilateral loans from the UK, Sweden and Denmark; and the International Monetary Fund's (IMF) Extended Fund Facility (EFF) on the basis of specified conditions.

The State's contribution to the €85 billion facility will be €17½ billion, which will come from the National Pension Reserve Fund (NPRF) and other domestic cash resources. This means that the extent of the external assistance will be reduced to €67½ billion.

The purpose of the external financial support is to return our economy to sustainable growth and to ensure that we have a properly functioning healthy banking system.

The external support will be broken down as follows: €22½ billion from the European Financial Stability Mechanism (EFSM); €22½ billion from the International Monetary Fund (IMF); and €22½ billion from the European Financial Stability Fund (EFSF) and bilateral loans. The bilateral loans will be subject to the same conditionality as provided by the programme.

The facility will include up to €35 billion to support the banking system; €10 billion for the immediate recapitalisation and the remaining €25 billion will be provided on a contingency basis. Up to €50 billion to cover the financing of the State. The funds in the facility will be drawn down as necessary, although the amount will depend on the capital requirements of the financial system and NTMA bond issuances during the programme period.

If drawn down in total today, the combined annual average interest rate would be of the order of 5.8% per annum. The rate will vary according to the timing of the drawdown and market conditions.

The assistance of our EU partners and the IMF has been required because of the present high yields on Irish bonds, which have curtailed the State's ability to borrow. Without this external support, the State would not be able to raise the funds required to pay for key public services for our citizens and to provide a functioning banking system to support economic activity. This support is also needed to safeguard financial stability in the euro area and the EU as a whole.

Programme for Support

The Programme for Support has been agreed with the EU Commission and the International Monetary Fund, in liaison with the European Central Bank. The Programme builds on the bank rescue policies that have been implemented by the Irish Government over the past two and a half years and on the recently announced National Recovery Plan. Details of the measures are set out in the accompanying Notes for Editors.

The Programme lays out a detailed timetable for the implementation of the measures contained in the National Recovery Plan.

The conditions governing the Programme will be set out in the Memorandum of Understanding and the Government will work closely with the various bodies to ensure that these conditions are met. The funding will be provided in quarterly tranches on the achievement of agreed quarterly targets.

The Programme has two parts – the first part deals with bank restructuring and reorganisation and the second part deals with fiscal policy and structural reform. The requirement for quarterly progress reports covers both parts of the programme. When the documentation on the Programme is finalised, it will be laid before the Houses of the Oireachtas.

Bank Restructuring and Reorganisation

The Programme for the Recovery of the Banking System will be an intensification of the measures already adopted by the Government. The programme provides for a fundamental downsizing and reorganisation of the banking sector so it is proportionate to the size of the economy. It will be capitalised to the highest international standards, and in a position to return to normal market sources of funding.

Fiscal Policy and Structural Reform

The Ecofin has acknowledged the EU Commission's analysis that a further year may be required to achieve the 3% deficit target. This analysis is based on a more cautious growth outlook in 2011 and 2012 and the need to service the cost of additional bank recapitalisations envisaged under the programme. The Council has today extended the time frame by 1 year to 2015.

The Programme endorses the Irish Government's budgetary adjustment Plan of €15 billion over the next four years, and the commitment for a substantial €6 billion frontloading of this plan in 2011. The details of the Programme closely reflects the key objectives set out in the National Recovery Plan published last week. The adjustment will be made up of €10 billion in expenditure savings and €5 billion in taxes.

The Programme endorses the structural reforms contained in the Plan which will underpin a return to sustainable economic growth over the coming years.

The Government welcomes the support shown to Ireland by our Eurozone partners and in particular by the United Kingdom, Sweden and Denmark who have expressed their willingness to offer bilateral assistance. The Government also welcomes the assistance of the IMF.

As part of the Programme, Ireland will discontinue its financial assistance to the Loan Facility to Greece. This commitment would have amounted to approximately €1 billion up to the period to mid-2013.

28th November 2010

**Statement by An Taoiseach, Mr Brian Cowen TD on Provision of
International Financial Support for Ireland**

Dublin, 28 November 2010

I can confirm that the Government has concluded negotiations with our European partners and international institutions, including the European Commission, the European Central Bank and the International Monetary Fund.

We have reached agreement on a programme for the provision of significant international financial support for Ireland.

A programme of assistance for Ireland totalling 85 billion euro has been agreed.

This includes external assistance of 67.5 billion euro, comprising 45 billion euro from the EU and bilateral loans from the UK, Sweden and Denmark and 22.5 billion euro from the IMF.

The estimated average interest rate on the loans is in the order of 5.83% per annum, based on current market conditions.

The duration of the programme is 3 years, while the average length of loan is up to 7.5 years.

The remaining 17.5 billion euro in the programme will be funded from Ireland's own resources – 5 billion from our cash reserves and 12.5 billion from the pension reserve fund.

This approach is reasonable in the context of such large loans from other countries and as a means of reducing the total amount of debt involved.

Crucially for Irish jobs, the agreed programme does not involve any change to our Corporation Tax rate of 12.5%.

In addition, we have obtained more room for manoeuvre by agreeing with the European Commission that the timeframe for reducing the deficit below 3% of GDP can be extended to 2015, if the four-year adjustment of 15 billion euro proves insufficient.

This programme is absolutely essential for our country.

The Government's agreement to it follows very tough negotiations over recent days.

Those negotiations, and the agreed programme, have been informed by the most robust consideration of our national interest and the broader interests of the eurozone.

We have carefully considered all available policy options.

In reaching this agreement, the Government has accepted the recommendations of the Minister for Finance, the Governor of the

Central Bank and the Chief Executive of the National Treasury Management Agency.

While the agreement has important implications for the European Union as a whole, I wish to address my remarks this evening to the people of Ireland.

The first point that people should know is that the significant loans being provided to Ireland are necessary to allow us to fund our budgets over the coming years.

These loans will provide money that we had already planned to borrow on the international markets.

That funding will now be available to Ireland at a cheaper interest rate than if we borrowed on the markets.

Without these loans, the necessary tax increases and spending cuts would be far more severe, and they would be imposed far more quickly, than is proposed in the Government's National Recovery Plan.

A large portion of the loans – some 50 billion euro - will be used to fund the Exchequer.

This will be used to help to pay for social welfare payments, pensions, health, education and other public services over the coming years, as we manage the transition to a sustainable deficit and debt position.

The remaining portion of the facility being put in place will be devoted to support for the banking system.

This will be drawn down as required while the necessary reform and restructuring of the Irish banks is brought to a conclusion, and in a manner that facilitates the continued effective provision of credit to Irish businesses.

This support will also include the funds drawn from our own reserves.

10 billion euro will be drawn down immediately for the purposes of bank capitalisation, with the remaining 25 billion available on a contingency basis.

Compared to the National Recovery Plan projections, the programme involves an increase in the national debt.

The precise extent of that increase depends on how much additional funding for the banking system is drawn down, as well as on future economic growth.

The Government estimates that the debt ratio will stabilise in 2013 and that interest payments would represent over 20% of tax revenue in 2014.

It is worth recalling that in 1985 interest payment costs reached close to 35% of tax revenue

This represents a very large increase in our national debt over the course of this unprecedented economic crisis and this must be addressed over time.

Nevertheless, it is sustainable if we fully implement the National Recovery Plan.

The second important issue is that people understand that what has been agreed today is broadly consistent with policies already set out in the National Recovery Plan.

It endorses the proposed adjustment of 6 billion euro next year and 15 billion euro over the next four years.

It does, however, recognise that because of a more cautious outlook for economic growth and additional debt service costs, the timeframe for reducing the budget deficit to 3% of GDP should be extended to 2015.

While this does not alter the existing targeted adjustment of 15 billion euro up to 2014, it does mean that we have further room for manoeuvre if economic growth is lower than expected.

As with the National Recovery Plan, the agreed programme sets out the actions to be undertaken by Ireland to deliver on the structural reforms that are necessary to meet our budgetary targets and to promote economic growth and job creation.

Progress on all the actions set out in the programme will be reviewed on a quarterly basis, while the National Recovery Plan will be reviewed on an annual basis as already announced.

The next step in the implementation of the National Recovery Plan and the programme of international assistance is the passing of the Budget for 2011.

As you are aware, this will be presented to Dáil Eireann on December 7th.

The third important issue agreed today concerns the reform and restructuring of the Irish banking system.

The agreed programme sets out a detailed set of actions in that regard.

This will involve an intensification of the measures already adopted by the Government.

The programme provides for a fundamental downsizing and reorganisation of the banking sector

This will lead to a smaller banking system, more proportionate to the size of the economy, capitalised to the highest international standards, with renewed access to normal market sources of funding and focused on strongly supporting the recovery of the economy.

The Government Statement includes an information note that sets out the key measures within the Programme in relation to the bank restructuring and reorganisation.

In conclusion, I want to reiterate that this agreement is necessary for our country and our society.

It is in the best interests of Ireland and of the European economy on which our future prosperity depends.

In particular, I want to make it very clear that all of the options for reducing the cost to Ireland of the resolution of our banking difficulties – including the importance of requiring subordinated bondholders to share the burden of bank losses - were fully explored by the Government during the negotiations.

The proposed programme has been developed with the assistance of, and is endorsed by, our international partners.

The final agreed programme represents the best available deal for Ireland.

It allows us to move forward with secure funding for our essential public services, our welfare state and for the most vulnerable members of our society who depend on them.

It provides Ireland with vital time and space to successfully and conclusively address the unprecedented problems that we have been dealing with since this global economic crisis began.

ENDS

Statement by Minister for Finance, Brian Lenihan T.D. on the
EU/IMF Programme for Ireland and the National Recovery Plan
2011 to 2014

A Cheann Comhairle, amid the sometimes hysterical and contradictory reaction to the external assistance programme on which the Government concluded agreement last weekend, one quintessential point has been overlooked. It is this: without this Programme, our ability to fund the payments to social welfare recipients, the salaries of our nurses, our doctors, our teachers, our Gardai, would have been extraordinarily limited and highly uncertain.

Fifty billion of the €67.5 billion we are receiving from our European partners and from the IMF will go to fund those vital public services over the next three years. In those circumstances, the only responsible course of action for any government was to accept the EU/IMF financial assistance fund.

Nonetheless, we enter this Programme not as a delinquent State that has lost fiscal control. We enter it as a country that is funded until the middle of next year; as a State whose citizens have shown remarkable resilience and flexibility over the last two years in facing head on, an economic and financial crisis the severity of which has few modern parallels internationally.

The team with whom we have negotiated has acknowledged our success in stabilising our public finances and they have endorsed our banking

strategy. They have also accepted our four year Plan for National Recovery and have built their prescribed Programme around that Plan.

This needs to be emphasised because it shows that we do have the capacity to get out of our difficulties and that we have already made considerable progress in that respect. The fact is our economy is showing signs of recovery. As I have already reminded this house last week

- GDP will record a very small increase this year based on strong export growth.
- Exports are expected to grow by about 6% in real terms this year, driven by improvements in competitiveness and a strengthening of international markets.
- Conditions in the labour market are also beginning to stabilise.

The outlook for next year is much improved. As forecast in the Plan growth is expected to be around 1 $\frac{3}{4}$ per cent next year again driven by a remarkably robust export performance.

The Fine Gael leader referred to the European Commission's less optimistic forecasts in the Dail yesterday which he suggested had undermined our Four Year Plan. He ignored the substantial upward revision of the Commission's forecast on international trade which will benefit a small open economy like ours in which growth, by common consent, will be export led.

It is also the case that, under the Programme, we have been given an extra year to reach the deficit target of 3% of GDP precisely to take account of the Commission's lower growth forecast. I welcome this step but it does

not alter our budgetary plans as set out in the Plan. In other words the target of €15 billion of adjustments by 2014, remains but there is further room for manoeuvre in the event that growth is lower than expected. In the later years, the Commission's growth forecasts are similar to my Department's. It is also the case that others - such as the ESRI for example - believe that the Department of Finance forecast is too pessimistic.

The Programme has adopted in its entirety the measures set out in the National Recovery Plan as a roadmap to return our economy to sustainable growth. The adjustment of €15 billion by 2014 has been accepted as has the breakdown of €10 billion in spending reductions and €5 billion in revenue raising measures. The details of the first €6 billion of this adjustment will be contained in the budget which I will present to the House next Tuesday.

The programme of structural and labour market reform aimed at improving our competitiveness has also been endorsed by the Programme. It set out a detailed quarterly schedule for the achievement of the agreed measures.

The negotiations on the Programme which took place over a ten day period were intense and at times difficult. They were conducted under my direction and that of the Governor of the Central Bank by the most senior

officials from my Department, the Central Bank and the Financial Regulator, the National Treasury Management Agency and the Office of the Attorney General.

There has been the usual barrage of criticism of the outcome accompanied by the personal abuse of those involved that has become common place in our debased public discourse. But none of the critics explains how we could have secured the funds we require at less cost to the State.

Indeed the arguments put forward have been patently wrong. For example, it has been claimed that we are paying a higher interest rate than Greece even though Greece is now seeking our terms. The interest on Greek loans is 5.2% for 3 year loans. Ireland's interest rate will be 5.8% for loans that are on average for 7½ years. A basic fact of sovereign borrowing is that the longer a country borrows money, the higher the interest rate paid.

Germany can borrow at 2½% but the remainder of the EU member states are borrowing at either far closer to 5% or higher than 5% and they must cover their costs.

Of course, if at any time during the three years of the Programme, it emerges that we could borrow at a lower rate in the markets, there is nothing to stop us from doing so.

I want to clarify the position of the €85 billion funding package and its impact on our debt levels. Of the total, €50 billion is to provide the normal budget financing: in other words, it is money we would have had

to borrow over the next three years in any event. The Programme provides these funds at a much lower rate than currently available to us in the market. This level of funding is already included in the plan. Of the remaining €35 billion - €10 billion is for immediate additional bank recapitalisation and the remaining €25 billion is to be used as a contingency fund, only to be drawn down if required

Furthermore, the State is in the happy position of being able to contribute €17.5 billion towards the €85 billion from its own resources, including the National Pension Reserve Fund. It can do this without prejudicing the commitments in the four year plan to use funds from the NPRF for projects such as the water metering programme and retrofitting.

This use of the NPRF has provoked the most bewildering criticism of all from parties who, having for years fundamentally disagreed with the very existence of the Fund, have now become its most ardent protectors. And on this point the arguments make absolutely no sense. Why would we borrow expensively to invest in our banks when we have money in a cash deposit earning a low rate of interest? And how on earth can we ask tax payers in other countries to contribute to a financial support package while we hold a sovereign wealth fund? We have a large problem with our banks which has forced us to seek this external assistance. In these circumstances, it is surely appropriate that our cash reserves should be deployed to help solve that problem.

The reason we had to seek external assistance is because the problems in our banking system simply became too big for this State to handle on its

own. Our public finance problems are serious but we were well on the way to solving them. The combination of the two sets of difficulties in circumstances where the entire Eurozone was under pressure was beyond our capacity.

So the primary aim of the Programme agreed last weekend is to support the recovery and restructuring of our banking system.

It has been clear for some time that our banks were facing serious challenges in terms of their liquidity position. Lingering concerns in the market regarding their capital position led to negative market sentiment.

This was despite the substantial transfer of the banks' riskiest loans to NAMA and the detailed capital adequacy assessment made by the Financial Regulator in the summer as well as the significant recapitalisation measures that flowed from that.

But the Programme does not propose any departure from existing policy: its prescription is an intensification and acceleration of the restructuring process already being undertaken for the Irish banks. A key objective is to ensure that the size of the domestic banking system is proportionate to the size of the economy and is appropriately aligned with the funding capacity of the banks overall taking into account stable sources of deposit and wholesale funding.

The programme also seeks to demonstrate the capacity of the banks to accommodate very significant further deterioration in asset quality so as

to rebuild market confidence in the robustness and financial resilience of the banking system overall.

The Central Bank is requiring the banks to meet a Core Tier 1 capital ratio of 12% - a key measure of capital strength. If the banks cannot source it themselves, the State will inject the necessary capital. For that purpose, €10bn can be drawn down immediately from the overall Programme fund. A further remaining 25 billion euro will be available on a contingency basis.

The Central Bank will also carry out an updated capital assessment exercise or PCAR review of the capital position of the banks in early 2011 based on stringent stress testing and detailed reviews of asset quality and valuation. This exercise will ensure that over the coming years, the banks' capital ratio do not fall below 10.5% - this is a high standard in international terms and should give significant confidence to the market that our banks will be in a strong financial position. This in turn will provide the necessary reassurance to allow the banks to attract greater market funding in due course.

The Government will also undertake a process of significant restructuring and right-sizing of the banks to reduce their balance sheets. In this context, all land and development loans below €20m in Bank of Ireland and AIB will be transferred to NAMA.

Further work will be undertaken in the short-term with the banks to identify how the sector can be reorganised to ensure that we have a viable and financially strong banking system which meets the needs of the real economy and has the confidence of international markets. This strategy, developed in collaboration with the various international organisations

and endorsed by them, builds on the measures adopted by the Government over the past two years to resolve our serious banking difficulties.

The Programme allows for an integrated approach to the restructuring of Anglo Irish bank and Irish Nationwide Building Society, building on the proposed Asset Recovery Bank structure to seek to maximise value from their loan books.

Revised restructuring plans for the two institutions will be submitted to the European Commission in early 2011 detailing the resolution of the institutions, in particular the arrangements for working out of assets over an extended period of time

I would like to reiterate that all deposits held with the domestic banking system are safe and covered by the Deposit Protection Scheme for sums up to €100,000. In addition, deposits are covered under the Eligible Liabilities Guarantee Scheme for sums over €100,000 for the full term of the deposit up to five years providing they are made prior to 30 June 2011.

There has been much commentary about the need for senior bondholders to accept their share of the burden of this crisis. I certainly raised this matter in the course of the negotiations and the unanimous view of the ECB and the Commission was and is that no Programme would be possible if it were intended by us to dishonour senior debt. The strongly held belief among our European partners is that any move to impose burden sharing on this group of investors would have an enormous ripple effect throughout the Euro system. That was confirmed by Professor

Honohan in an interview last Monday when he said there was no enthusiasm in Europe for this course of action.

There is simply no way that this country, whose banks are so dependent on international investors, can unilaterally renege on senior bondholders against the wishes of the ECB. Those who think we could do so are living in fantasy land. Worse still, those who know we cannot do so but who nonetheless persist with the line are damaging this country and its financial system: and all for the sake of a cheap headline. It is a case of politics as usual even at this most difficult time.

It is estimated that around 84% of Ireland's bonds are held by international investors. Whether guaranteed by the State or not, a decision to default on these bond obligations would seriously compromise the standing of the whole of the Irish financial system. That is the advice of the Governor of the Central Bank; that is the advice of the National Treasury Management Agency; that is the advice of the Attorney General.

The idea that is out there that somehow there are no costs associated with default is entirely incorrect. Ireland is hugely dependent on Foreign Direct Investment. These companies have large funds and investments in Ireland and directly and indirectly employ a quarter of million people in this economy. Any default on senior debt and the uncertainty that would cause would undoubtedly impact on the future investment decisions of these companies.

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Subordinate Bonds

Subordinated debt holders are in a different position. As I said in my statement on the 30th of September last, there will be significant burden sharing by junior debt holders in Irish Nationwide and Anglo Irish Bank. These two institutions had received very substantial amounts of State assistance and it was only right that this should be done.

My Department has been working with the Office of the Attorney General to draft appropriate legislation to achieve this and this is near finalisation. Parallel to this Anglo Irish Bank has run a buyback operation which will offer these bondholders an exchange of new debt for old but at a discount of 80%. This process is still underway and will be concluded shortly.

Obviously this approach will also have to be considered in other situations where an institution receives substantial and significant State assistance in terms of capital provided to maintain their solvency ratios. I hope to be in a position soon to announce this legislation.

We need a properly functioning banking system for this country. As I have indicated in the past we need to shift to a banking system commensurate with the economy but one that is strong and capable of meeting our needs. That has been the overriding objective of all our efforts since this crisis began two years ago. I believe the considerable funds provided by this Programme, will enable us to bring this crisis to an

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end and to secure the future of the Irish banking system so that it can play its full role in supporting the development of this country.

Conclusion:

We have been through a traumatic two years. Of course, we would have preferred to avoid resort to external assistance. But we can emerge from it a stronger and fitter economy. The attributes that brought us the boom: the quality of our workers, our entrepreneurship, our pro-business environment; all of these remain in tact. During the boom we built a top class transport infrastructure, sport and cultural facilities and educational sector. Over the last two years, we have won back much of the competitiveness we lost during the boom.

This 3 year EU/IMF Programme will provide the basis for funding us through our current difficulties. It provides the funding to restructure and recapitalise our banking system. And it will guide us through the implementation of the necessary budgetary and reform strategies set out in the National Recovery Plan. A Cheann Comhairle, we have every reason to be confident about the future of this economy.



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Dublin, 3 December, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. Strauss-Kahn:

1. Ireland faces an economic crisis without parallel in its recent history. The problems of low growth, doubts about fiscal sustainability, and a fragile banking sector are now feeding on each other, undermining confidence. To break this vicious circle, we are proposing a strong, wide-ranging, reform programme, backed by a substantial international financing package, to restore confidence and return the economy to a path of sustained growth and job creation.
2. At the root of the problem is a domestic banking system, which at its peak was five times the size of the economy, and now is under severe pressure. The Irish owned banks were much larger than the size of the economy. The fragility of the banking sector is undermining Ireland's hard-earned economic credibility and adding a severe burden to acute public finance challenges. Decisive actions to restore the strength of the financial sector and re-establish fiscal credibility are needed now.
3. The Irish authorities have already undertaken major steps to address these challenges. For the financial sector, these include measures to facilitate funding of banks, separate good assets from bad, asset disposals, and bank recapitalisation. On the fiscal side, we have pursued a large consolidation programme since 2008 and have announced a National Recovery Plan that accelerates the process of putting public finances on a sound footing.
4. But we recognise that more needs to be done. A fundamental downsizing and reorganisation of our banking system is essential. We are immediately undertaking several bold measures to achieve a robust, smaller, and better capitalised banking system that will effectively serve the needs of the economy. Restoring the banks to viability will also help insulate public finances from further pressures. We are mindful that the transition to a healthy banking sector will need to be actively managed to avoid fire sales of assets and



reduce market uncertainty. We are, therefore, expeditiously raising capital standards, stepping up efforts that will ensure that banks' losses are promptly recognised, and creating a mechanism to inject needed capital into the banks. We are also strengthening the banking resolution framework to promote financial stability.

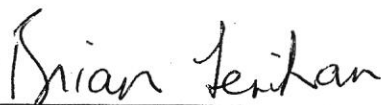
5. In addition, we are also pressing ahead with our commitment to achieving a sustainable budget position. The National Recovery Plan lays out our strategy for staying the course of needed reform in a way that is socially fair and protects the most vulnerable. Recognising that Ireland already has put in place a business-friendly environment, our Plan also lays out a range of structural reforms that will be implemented to underpin economic stability, and enhance growth and job creation.

6. We are turning to our international partners for support as we implement these far-reaching objectives. Our estimate is that the financing need would be up to €85 billion until the end of 2013. We therefore request that the Fund support our policy programme through an arrangement under the Extended Fund Facility which can be drawn over a period of 36 months in the amount of SDR 19.4658 billion (€22.5 billion). This arrangement, along with support of €45 billion from the European Financial Stability Mechanism/European Financial Stability Facility including bilateral loans from the United Kingdom, Sweden and Denmark, and the judicious use of our own resources (€17.5 billion), will help ensure financial stability as we restore market confidence and return to durable growth.

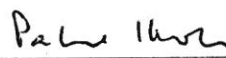
7. The attached Memorandum of Economic and Financial Policies outline the economic and financial policies that the Irish authorities will implement during the remainder of 2010 and the period 2011–13. We are confident that the policies set forth in this memorandum are adequate to achieve the objectives under the programme. We stand ready to take any corrective actions that may become appropriate for this purpose as circumstances change. As is standard under Fund-supported programmes, we will consult with the Fund on the adoption of such actions in advance of necessary revision of policies contained in this letter.

8. This letter is being copied to Messrs. Juncker, Reynders, Rehn, and Trichet.

Sincerely,



Brian Lenihan
Minister for Finance



Patrick Honohan
Governor of the Central Bank of Ireland



EUROPEAN COMMISSION

Brussels, xxx
SEC (2010) xxx

MEMORANDUM OF UNDERSTANDING

BETWEEN

THE EUROPEAN COMMISSION

AND

IRELAND

MEMORANDUM OF UNDERSTANDING

BETWEEN

THE EUROPEAN COMMISSION

AND

IRELAND

The present memorandum of understanding contains the following documents:

- (a) A memorandum of economic and financial policies
- (b) A memorandum on specific economic policy conditionality
- (c) A technical memorandum of understanding

The memorandum of understanding may be amended upon mutual agreement of the parties in the form of an Addendum. The Addendum will be an integrated part of this Memorandum and will become effective upon signature.


Done in Brussels on .../12/2010 ... and in Dublin on .../12/2010 in three originals, in the English language.

For Ireland

For the Central Bank of Ireland



Brian Lenihan
Minister for Finance



Patrick Honohan
Governor of the ~~Irish~~ Central Bank of Ireland

For the European Commission



Olli Rehn
Member of the European Commission

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

1. We have concluded that Ireland expeditiously requires a strong programme to restore domestic and external confidence and, thus, snap the pernicious feedback loops between the growth, fiscal, and financial crises.
2. We propose that such a programme comprise of four key elements:
 - A fundamental downsizing and reorganisation of the banking sector—complemented by the availability of capital to underpin solvency—is required to restore confidence. Addressing market perceptions of weak bank capitalisation, overhauling the banks’ funding structure, and immediately beginning a process of downsizing the banking system will be required.
 - An ambitious fiscal consolidation building, on the progress already made.
 - Renewing growth through a multi-pronged effort.
 - A substantial external financial assistance will support the achievement of our policy objectives.

Recent Economic Developments and Outlook

3. After two years of sharp declines in output, the Irish economy is expected to broadly stabilise this year before expanding during 2011–14. As domestic imbalances from the boom years are being repaired, the recovery will, at least initially, be primarily export-driven. We project that GDP growth will increase over time as export performance filters through to investment and consumption, consumer confidence returns, and labour market conditions improve. We recognise that the risks in the short term are tilted to the downside, and, in particular, the headwinds from fiscal consolidation on domestic demand could be larger than anticipated. Over the longer haul also, continued private and public sector balance sheet adjustments, coupled with a weak banking sector, could delay the recovery.
4. Inflation is expected to remain low, reflecting the large output gap and modest external price pressures. Although the inflation rate will likely increase over time, it is expected to remain lower than in trading partner countries. This will have the benefit of improving competitiveness but the low rates of inflation would unavoidably keep real debt burdens high and dampen domestic demand.
5. The current account balance is projected to continue to improve gradually over the medium term, reflecting export expansion and the contraction in domestic demand. However, profit repatriation from multinationals and large interest payments to foreign holders of Irish debt are expected to limit the improvement over the programme period.

Restoring Financial Sector Viability

6. With its large size relative to the economy, its heavy reliance on wholesale funding, and its large exposures to the real estate sector, much of the domestic Irish banking system is in a stressed state. The Government has intervened heavily to safeguard financial stability. In late 2009, we established the National Asset Management Agency (NAMA) to take over certain vulnerable commercial and property development assets of banks. In addition, major efforts have been made to boost banks' capital.

7. Although the Government has made strong efforts to contain the fallout from the sector's vulnerabilities, a continued lack of market access and the loss of deposits have created significant funding pressures, alleviated largely by an increase in recourse to Eurosystem financing facilities and Emergency Liquidity Assistance by the Central Bank. Moreover, capital injections in the banks have placed a heavy burden on public finances.

8. Our proposed programme will take decisive steps to ensure the viability and health of the financial system. We intend to lay the foundations of this process very quickly, if we are to reassure the markets that banks will return to viability and will have the ability to operate without further state support in a reasonable period of time.

9. The key component of our efforts is an overhaul of the financial sector with the objective of substantial downsizing, isolating the non-viable parts of the system and returning the sector to healthy functionality. It will be important to support this process through capital injections into viable financial institutions. In addition, structural measures—a special resolution scheme for deposit-taking institutions and a further strengthening of the supervisory system—will impart greater stability to the system. It is our goal that the leaner and more robust system that emerges from these efforts will not be dependent on state support, will have a more stable funding base, and will provide the credit required to foster growth.

10. The plan to overhaul the banking system has several elements. First, banks will be required to run down non-core assets. Second, land and development property loans that have not yet been transferred to NAMA will also be transferred. Third, banks will be required to promptly and fully provide for all non-performing assets as needed. Fourth, the banks will be required to securitise and/or sell asset portfolios or divisions with credit enhancement if needed, once the market normalises. And finally, swift and decisive action will be taken to resolve the position of Anglo Irish Bank (Anglo) and Irish Nationwide Building Society (INBS) in a way that protects depositors and strengthens the banking system. To this end, by end-January 2011, we will submit to the European Commission a revised proposal developed in collaboration with IMF, to resolve Anglo and INBS. Each of these initiatives will require technical or legislative measures, most of which we believe can be expeditiously instituted.

11. To achieve the above goals, banks will be required to submit deleveraging plans to the national authorities by end-February 2011. The plans will be prepared on the basis of clear periodic targets defined by the Central Bank, taking into consideration the Prudential Liquidity Assessment Review (PLAR) to be conducted in consultation with the EC, ECB and IMF. By end-March 2011, the Central Bank with assistance from an internationally recognised consulting firm, will complete the assessment of the banks' restructuring plans (structural benchmark). The deleveraging plans will be a component of the restructuring plans to be submitted to the European Commission for approval under EU competition rules.

12. This reorganisation and downsizing of the banks will be bolstered by raising capital standards. While we expect that, in a restructured system, banks will be able to raise capital in the market, we recognise that the higher standards may imply that, in the short run, public provision of capital will be needed for banks that are deemed to be viable. To support this process—and to render it credible—we will undertake a review of the capital needs of banks on the basis of a diagnostic of current asset valuations and stringent stress tests (PCAR 2011).

- As an immediate step, to enhance confidence in the solvency of the banking system, the Central Bank will direct Allied Irish Bank (AIB), Bank of Ireland (BoI) and EBS to achieve a capital ratio of 12 percent core tier 1 by end-February 2011 (structural benchmark) and Irish Life & Permanent (ILP) by end-May 2011 (structural benchmark). This would imply an injection of fresh equity capital of €7bn into these four banks and provide an additional buffer for a potential increase in expected losses. This action, along with early measures to support deleveraging and taking account of haircuts on the additional loans to be transferred to NAMA (see ¶10) would result in an injection of €10bn of fresh capital into the banking system, above and beyond the already committed capital injection of €6.6bn for AIB previously announced by the Irish authorities.
- By end-December 2010, in consultation with EC, ECB, and IMF staff, we will define the criteria to run stringent stress test scenarios (structural benchmark). We will also agree with EC, ECB, and IMF staff, by end-December 2010, on draft terms of reference for the due diligence of bank assets by internationally recognised consulting firms (structural benchmark). We intend to complete the diagnostic evaluation of banks' assets by end-March 2011 and the stress tests (PCAR 2011) by end-March 2011 (both structural benchmarks), and transparently communicate our findings.
- Based on these assessments, starting end-April 2011, banks will be required to maintain a core tier 1 capital ratio of 10.5 percent. Banks will report their capital adequacy ratios to the Central Bank on a quarterly basis. The Central Bank's assessment of banks' capital adequacy ratio will be made public at least semi-annually.

13. The question of whether burden should be imposed on bank sub debt is influenced by two factors: the quantum of capital the State has committed to support the institution and the perceived viability of the bank in the absence of receiving such capital. Forced burden sharing through legislation is possible and legislation is currently being prepared in this regard. Alternatively, in certain cases, a very deeply discounted liquidity management exercise might also be an appropriate option.

14. In addition, we will finalise proposals to strengthen the legal framework for dealing with distressed deposit-taking institutions in line with recent EU developments (including EU competition rules) and international sound practices. Such a special resolution regime will broaden the available resolution tools with the aim of promoting financial stability and protecting depositors. In particular, the draft legislation will (i) provide for the appointment of a special manager where, in the opinion of the Central Bank, an institution's financial condition has severely deteriorated; (ii) grant powers to the Central Bank for the transfer of assets and liabilities to other institutions; and (iii) create a framework for the establishment of bridge banks. We seek to submit draft legislation including the above-mentioned elements to Dáil Éireann by end-February 2011 (structural benchmark).

15. Moreover, we will continue the efforts to strengthen banking supervision by ensuring higher staffing levels and budget allocations in line with OECD best practices. We will enhance the risk assessment framework and raise the corporate governance standards. By end-September 2011, a report by an independent assessor on our compliance with Basel core principles for effective banking supervision will be made public.

16. We will also reform the personal insolvency regime for financially responsible individuals (including sole traders), which will balance the interests of both creditors and debtors. The objectives will be to lower the cost and increase the speed and efficiency of proceedings, while at the same time mitigating moral hazard and maintaining credit discipline. The new legal framework will include a non-judicial debt settlement and enforcement mechanism as an alternative to court-supervised proceedings.

17. We will continue to provide means-tested financial assistance to limit the economic and social fallout of the crisis. The existing mortgage interest supplement scheme is crucial for providing temporary assistance to distressed mortgage holders. The scheme's administration will be centralised to ensure a more consistent application focusing on households that are most in need, and further modification will be introduced in the 2011 Social Welfare Act.

18. Our strategy for the credit union sector is based on three components. First, we will complete a full assessment of their loan portfolios by end-April 2011 (structural benchmark). Second, by end-April 2011, we will have ready a comprehensive strategy to enhance the viability of the sector. And third, by end-December 2011 we will submit legislation to

Dáil Éireann to assist the credit unions with a strengthened regulatory framework including effective governance and stabilisation requirements.

19. We will continue efforts to ensure the flow of credit to viable businesses, building on actions already taken under previous recapitalisations and NAMA legislation. Allied Irish Bank and Bank of Ireland have agreed, in connection with recapitalisation last March, to make available not less than €3 billion each for targeted lending for new or increased credit facilities to small and medium-sized enterprises in both 2010 and 2011 as well as funds for seed and venture capital and for Environmental lending. The lending policies and decisions of both banks are subject to review by the Credit Review Office, which enables businesses who have had credit refused or withdrawn, to apply for an independent review of the bank's decision.

20. NAMA is subject to an extensive range of statutory Governance and Accountability arrangements and these will be fully adhered to. Members of the NAMA Board must have relevant experience and expertise, and the work of the Board is supported by audit and other sub-committees. NAMA operations are also subject to statutory codes of practice. NAMA is required to prepare various reports, including quarterly reports of its activities, and these are subject to scrutiny by Oireachtas committees. The Comptroller and Auditor General audit the annual accounts and prepare reports on NAMA for review by the Public Accounts committee.

Safeguarding Public Finances

21. To continue with the programme of fiscal consolidation, a comprehensive National Recovery Plan 2011-14 was approved by the Government and published on 24 November 2010. This Plan forms the basis for the 2011 budget consistent with fiscal consolidation measures amounting to €15 billion, a 9 percent of GDP budgetary correction over the period 2011–14. Having stabilised the deficit, albeit at a high level, the steps announced in the Plan will place the budget deficit-to-GDP ratio on a firm downward path. While the debt-to-GDP ratio will remain at high levels for the next few years, it is projected to decline thereafter, underpinning debt sustainability. We also propose to keep under review progress towards meeting the Stability and Growth Pact targets.

22. Budget 2011 which will include adjustment measures of €6 billion, will be submitted to Dáil Éireann for passage on 7 December (prior action). As set out in the National Recovery Plan, most of this adjustment will come from the expenditure side. The capital budget will be reduced, partly through greater value for money in our infrastructure procurements. On current expenditures, we are pursuing public service numbers reductions through natural attrition and voluntary schemes, adjustments in public service pensions, and further savings on social transfers (from reductions in working age payments, reductions in universal child benefit payments and other reforms). Protecting the socially vulnerable at a

time of difficult economic adjustment remains a central policy goal. Current savings will also be realised from streamlining government programmes and through administrative efficiencies. Should these savings or the expected numbers reductions not materialise, we reserve the option to take further measures.

23. An income tax-led revenue package—sized at over €2 billion in a full year—will supplement the above expenditure measures in 2011. Over the past decade, the proportion of citizens exempt from income tax has risen to 45 percent and tax credits have doubled, resulting in a comparatively low burden of tax on ordinary incomes. This is no longer sustainable. Accordingly, we are widening the tax base, by lowering income tax bands and credits by 10 percent, and by reducing various pension-related tax reliefs. We are also taking action on other tax expenditures, and distortions arising from the existence of multiple levies.

24. To secure our fiscal targets, a number of fiscal measures have been identified for 2012–14. We will continue to rely on expenditure savings (€6.1 billion), led by current spending (€4.9 billion), as outlined in the National Recovery Plan. We are targeting further reductions in public sector numbers, social benefits and programme spending, and have anchored the prospective savings by publishing multi-year expenditure ceilings by Vote Group through 2014. We are also planning to move towards full cost-recovery in the provision of water services and ensuring a greater student contribution towards tertiary education, while ensuring that lower-income groups remain supported. In addition, we will accelerate the process of placing the pension systems on a path consistent with long-term sustainability of public finances. On the tax side, we will build on the base-broadening measures outlined above and establish a sound basis for sub-national finances through a new residential-property based site value tax. The Finance Bill 2012 will contain necessary provisions to bring into effect the already signalled VAT increases in 2013 and 2014.

25. We are preparing institutional reform of the budget system taking into account anticipated reforms of economic governance at the EU level. A reformed Budget Formation Process will be put in place. Furthermore, we will introduce a Fiscal Responsibility Law which will include provision for a medium-term expenditure framework with binding multi-annual ceilings on expenditure in each area by end-July 2011 (structural benchmark). A Budget Advisory Council, to provide an independent assessment of the Government's budgetary position and forecasts will also be introduced by end-June 2011 (structural benchmark). These important reforms will enhance fiscal credibility and anchor long-term debt sustainability.

Raising the Growth Potential

26. We recognise the need to restore strong sustainable growth. The structural changes to the financial and fiscal sectors, described above, are critical for improving the prospects of economic recovery and raise the medium-term growth potential. Although, as is widely recognised, Ireland is a global leader in providing a business-friendly environment, the

Government's Negotiation of Programme of Assistance and Interest Rate Savings

- The Government has successfully negotiated several key changes to the programme of assistance in series of phases:
 1. The MoU was amended also to allow for the jobs initiative, the restoration of the minimum wage and also to provide that no further loans were transferred to NAMA.
 2. The Government has successfully renegotiated the interest rate which will give rise to significant savings for the state. This in turn will improve our debt sustainability and reduce the cost of the bailout to taxpayers. This is very welcome news.
- As pointed out by Minister Noonan in Poland we have achieved significant clarity in our favour on interest since July and over the last week.
- The annual saving based on the full drawdown of the €45 billion available from the EU and bilateral loans are set out in the tables below. They set out the calculation of the original estimates (from July) and the more recent estimates based on last week's discussions.

Initial Illustrative Calculation – based on initial illustrative assumptions of 2% reduction:

	Percentage reduction in the interest rate	Total available loans (€bn)	Annual Interest Savings in €m
EFSF	2.00%	17.7	354
EFSM	2.00%	22.5	450
Bilaterals	2.00%	4.8	96
Total		45	900 ¹

Updated NTMA estimates reflecting last week's announcements – EFSF rate reduction is approx. 2.6% and EFSM rate reduction is just under 3%

	Percentage reduction in the interest rate	Total available loans (€bn)	Annual Interest Savings in €m
EFSF	2.6%	17.7	450
EFSM	2.925%	22.5	650
Bilaterals	2.00% (not yet finalised)	4.8	100 (to be finalised)
Total		45	1,200 ²

¹ Figure only valid when all €45 billion has been drawn down and for as long as this amount remains outstanding.

² Figure only valid when all €45 billion has been drawn down and for as long as this amount remains outstanding.

- In addition, the cost of our IMF loans will reduce as a result of recent and forthcoming increases in our IMF quota. The NTMA has calculated the overall benefit of this interest rate reduction at some €1.9 billion. Some €30 million of this arises in 2012 and is included in the overall estimate of €900 million of interest savings for next year.
- Based on the above estimates for the changes to the EU and IMF elements of the loans, the overall saving based on the initial lifetime of the programme (which will be extended) would be over €10 billion.
- For 2012 the changes in the EU and bilateral loans combined with the impact of IMF quota changes amount to some €900 million.
- The average maturities of the loans will be extended – this has the effect, as pointed out by Commissioner Rehn on Friday of improving our debt sustainability and also of improving liquidity for Ireland.
- Furthermore Minister Noonan pointed out that it has been agreed at the weekend meeting that Ireland will get a prepaid margin of €600m on the EFSF returned in 2016. This had not been clear beforehand. While it is important to note that this margin return is already factored into the interest savings figures once all the programme funding is drawdown it does give rise to a €600m capital receipt in 2016 directly to the Exchequer.

Impact of interest rate reduction on adjustment for 2012

- These actions are very positive for Ireland and improve our debt sustainability but there is a need for us to be realistic as there are a lot of difficult decisions still to be made. Indeed, we only get the benefit of the interest rate reductions if we continue to meet our programme commitments. The Commission, when announcing the proposed change to our EFSM, rate cited the fact that Ireland is meeting its programme.
- This Government is committing to making these difficult decisions and restoring our sovereignty but we will continue to negotiate key elements of our programme, as appropriate.

Ireland's Economy Back from the Brink, But Continued Progress Needed

IMF Survey

December 19, 2013

- Signs of growth emerging and unemployment has started falling
- Considerable achievements, but strong policy efforts still needed
- Lessons from the Irish experience for global policymakers

The successful completion of Ireland's EU/IMF-supported program has left the country in a much stronger position than when its program began, say the IMF's Ajai Chopra and Craig Beaumont.

Ireland has pulled back from an exceptionally deep banking crisis, significantly improved its fiscal position, and regained its access to the international financial markets.

In an interview, former Ireland country reviewer Chopra and current Ireland mission chief Beaumont—who were involved with the program from start to finish—share their views on the main achievements and the road ahead. Ireland needs to persevere with steady fiscal consolidation and reforms to help an emerging economic recovery become strong and lasting, say Chopra and Beaumont, noting that the program's success owes much to the full commitment by the Irish authorities and its people—who persisted despite challenges and uncertainty during their program.

IMF Survey: Jai, you oversaw the Fund's work on Ireland—what do you see as major successes under the program and what is left to do?

Chopra: Ireland has achieved a tremendous amount in the three years since the EU/IMF-supported program began in December 2010. Remember that this period included threats to the very existence of the euro area, making Ireland's achievements all the more impressive.

The crisis in Ireland was first and foremost a banking crisis. Hence the immediate priority was to recapitalize and stabilize the banking system, which was achieved early in the program, stemming the outflow of deposits. Progress has also been made in reducing the size of the banking system, which had assets of almost 500 percent of GDP when the program started.

On the fiscal side, budget consolidation started even before the program. Over 2009–13, the structural primary deficit has been reduced by about 10 percentage points of GDP. This consolidation has been achieved in a pragmatic way with a good balance of spending and revenue measures and with due regard to fairness. As a result of this adjustment, Ireland should be able to achieve a primary balance in 2014 and government debt should soon be on a declining path.

We are also beginning to see signs of growth emerging and unemployment has been falling. Back in 2011, I had said that employment growth, which has been accelerating in recent quarters, would be the real test of whether the program is working.

Ireland has also implemented a range of institutional reforms to address weaknesses that led to the crisis. The medium-term fiscal framework has been strengthened and a credible and well-functioning fiscal council has been established. And on the financial side, regulation and supervision, which were deficient in the run-up to the crisis, have also been revamped.

But all that said, there is still much that needs to be done. This is not unusual—when problems are as severe as what Ireland faced, it is not possible to fix matters in three short years. This was recognized at the outset, and it does not detract from what has already been achieved.

Importantly, there's still a large overhang of debt that needs to be worked out. Households' debts amount to almost 200 percent of disposable income. Sovereign debt is also still high—we project it to peak at about 124 percent of GDP in 2013. So private balance sheet repair and fiscal consolidation both need to continue. Inevitably, these processes take time.

Despite the progress in recapitalizing and stabilizing the banking system, banks are not yet supporting the economy with adequate lending. Nonperforming loans are still high and progress in dealing with these impaired assets has been slow. And bank profitability remains weak. Work needs to continue to address these impediments to sustained recovery.

Looking forward, the critical objective is to generate higher growth based not only on exports, but also a revival of domestic consumption and investment. Such balanced growth is essential to create more jobs and make a bigger dent on unemployment.

The Irish authorities recognize that continued sound policies are needed to support Ireland's growth and they recently released a medium-term economic strategy to cover the period from 2014 to 2020. The determination to articulate and implement such a strategy is most encouraging.

IMF Survey: Thank you, Jai. And Craig, as mission chief, what do you think were the major steps that Ireland took to regain access to capital markets?

Beaumont: Ireland began to regain market access in the middle of 2012. It started by issuing Treasury bills, with the first issue happening to come immediately after the end-June Summit that called for banking union. Access continued to strengthen, especially after ECB President Draghi announced Outright Monetary Transactions.

Ireland was well placed to take advantage of improved market conditions in the euro area because its strong program implementation had addressed the acute uncertainties around public debt that prevailed at the end of 2010. The deficit target for 2011 was met and the budget for 2012 continued fiscal consolidation at a steady pace. As Jai mentioned, decisive actions on the banking sector during 2011 identified and met the banks' capital needs in a credible way, at an overall cost below expectations. Perhaps most importantly, markets gained confidence in Ireland's capacity to recover from the banking crisis as export-driven growth was quite strong in 2011 at 2.2 percent; investors we talked with considered that important.

So regaining market access reflected a combination of steadfast policy implementation, signals of Ireland's potential to recover economically from its deep banking crisis, and the significant steps forward in addressing the euro area crisis. Market access was confirmed through well subscribed bond issues in January and March this year, including a 10-year issue at a 4.15 percent yield, which is now trading at about 3.5 percent.

IMF Survey: How did the Fund and its European partners collaborate in support of Ireland during this period of turmoil and crisis?

Beaumont: Working with our EU Commission and European Central Bank counterparts was a very collaborative process, seeking a common position on all the key policies. This collaboration helped produce better policy proposals which were then very intensively discussed with the Irish authorities.

In advance of the missions in Dublin, we would coordinate on what the main policy issues were and alert the Irish authorities to those. During the missions we would learn a great deal from our discussions with the authorities, and also with private sector and academic economists, and need to adjust our views.

Typically during the weekend the troika teams would work together on drafts of the policy agreements (the Memorandum of Understanding and Memorandum of Economic and Financial Policies), which often required lengthy discussions among the experts on each issue—we would sometimes bet on when the meetings would finish!

The Irish authorities were the key party in developing and implementing the policies for the program supported by the EU and the IMF. This reflected Ireland's strong commitment to recover from the crisis, as seen in its significant contribution to program financing, with €17.5 billion of the total package of €85 billion coming from the Irish state.

IMF Survey: What was a broader social and political impact of the bailout?

Beaumont: The bailout was a dramatic shock for Irish society. The government that had negotiated the program soon resigned and elections were held in February 2011. The new coalition government formed in March had a strong mandate to implement its program for Ireland to recover from the crisis. It began by engaging with the troika on redesigning aspects of the program supported by the EU-IMF, including by revising the mix of budget measures to promote job creation.

The social impact of the bailout is hard to disentangle from the ongoing fallout from the banking crisis. Often the bailout is linked to difficult budget measures, though Ireland had been undertaking such measures for 2–3 years before the program, and in the absence of EU-IMF financing, even larger measures would have been required. There was also disappointment in Ireland that the program did not provide a more immediate turnaround in the economic situation. For example, unemployment kept on rising until it peaked in early 2012, though it has declined more recently. But the program did avert a sharper deterioration in the economy, which was likely given the deep loss of domestic and external confidence at the end of 2010, especially in the banking system.

Chopra: I would also add that the teams from the IMF, EC, and ECB made a concerted effort to have a dialogue with labor unions and with other organizations that had direct experience

in dealing with vulnerable parts of society. This dialogue was very useful. No doubt, our counterparts will consider that not enough was done to address their concerns and I can understand that perspective. But we encouraged the government to design its fiscal consolidation measures with fairness and equity very much in mind.

IMF Survey: How do you see the prospects for Ireland's economy going forward?

Beaumont: After relatively strong growth in 2011, growth was sluggish in 2012 and into this year owing to weak trading partner activity and a “patent cliff” shock to Ireland’s large pharmaceutical sector. But a range of indicators signal the economy is beginning to pick up in the second half of 2013.

We are projecting growth to rise to about 1¾ percent in 2014—a little below consensus estimates—and then to about 2½ percent in the medium term. Ireland’s economy is highly open so the main contributor to higher growth is the recovery expected in trading partners, especially the United States, the United Kingdom, and the euro area.

By contrast, we anticipate modest gains in domestic demand next year, with the revival of domestic demand expected to be a protracted process as strained private balance sheets gradually become more healthy and also as the pace of fiscal consolidation eases. Improving financial sector health will also help sustain recovery through renewed lending, although near-term contributions are not expected to be significant.

Chopra: Here I think it’s worthwhile to pick up on a point that Craig made, about the strength of trading partners. Ireland has grown faster than the eurozone average over the last three years. This is encouraging, but it should not obscure the fact that Ireland’s prospects are inextricably intertwined with those of the eurozone. Therefore, Ireland’s prospects will depend very much on the progress made to address demand and supply deficiencies in the eurozone, to achieve the ECB’s inflation target rather than undershoot it, to reduce fragmentation, and to make more meaningful progress in improving the architecture of the monetary union.

IMF Survey: What lessons does the Irish experience hold for global policymakers?

Chopra: IMF rules require an independent staff team to prepare an ex-post evaluation of the Ireland program before the end of 2014. That evaluation will provide a more definitive view, but for now I’ll offer five preliminary lessons.

The first is when the government is dealing with a systemic banking crisis it needs to come to grips with the situation quickly. It is essential to identify whether institutions are viable or not and then deal with them accordingly. Nonviable banks need to be resolved while viable ones need to be recapitalized, restructured and restored to healthy functionality.

Even though systemic banking problems in Ireland first blew up in 2008, confidence that these problems were being adequately tackled did not come till the publication of stress test results in March 2011, about three months into the program. These stress tests, together with the underlying asset quality diagnostics that were undertaken with the help of independent experts, have served as a model in other cases. The Irish also set a high bar for the transparency with which they communicated the results of the analysis underpinning banks’ capital needs.

But it is not just a matter of recapitalizing banks. The banks also need to improve their profitability and get back into the business of lending. And to do that they need to be forceful in dealing with the bad debts on their books. Ireland was quick to set up an asset management company, NAMA, to deal with the large problem loans, especially in the property sector. But it is also essential to deal with smaller distressed borrowers, a problem that became more acute with the rise in residential mortgages that are in arrears. On this front, it took some time to develop a political consensus and the necessary legal framework and banks' operational capacity to deal with mortgage arrears. In retrospect, more rapid progress in dealing with mortgage arrears would have been worthwhile.

The second lesson is that it is unfair to impose the burden of supporting banks primarily on domestic taxpayers while senior unguaranteed bank bond holders get paid out. This not only adds to sovereign debt, but it also creates political problems, making it harder to sustain fiscal adjustment. Eurozone partners precluded the Irish from imposing haircuts on senior creditors of insolvent banks. But subsequent developments in the principles of orderly resolution of banks, after Ireland had paid off these creditors at great cost, have shown that imposing losses on senior bank bond holders is now becoming more accepted.

Third, on the fiscal front, steady but gradually phased fiscal consolidation that is designed within a well-specified medium-term plan, and that allows for the free play of automatic stabilizers, can be consistent with the return of confidence. There are some who wanted Ireland to move even faster with fiscal consolidation. This would have been a grave mistake. Investors also care about growth.

The fourth lesson from the Irish case is that it demonstrates how pernicious feedback loops can be. Weak balance sheets of banks, of the government, of households, and of companies all interact with each other. These interactions cause economic activity to stagnate and increase deflationary tendencies, further worsening all these sectors' balance sheets all over again. These feedback loops need to be arrested.

Some of this requires a domestic effort, which the Irish have accomplished as has already been outlined, although much remains to be done to reduce over indebtedness. But in a monetary union support is also needed from partners in the union. No doubt eurozone and EU partners have been generous and supportive of Ireland's efforts through various initiatives. Nevertheless, there remains an excellent case for even greater eurozone solidarity to break these adverse feedback loops, especially between banks and sovereigns. Such additional support would have a positive payoff, making it an investment that is worth undertaking.

Finally, and perhaps most importantly, the government's design and ownership of the program is critical. The Irish authorities' excellent record of policy implementation and compliance with conditionality under the program owes much to the fact that key components of the program were designed by the Irish themselves, and adopted only after they had been debated intensively both internally and with external partners. Social and political cohesion was maintained. Only then do you get full commitment to the measures as in Ireland. Moreover, the Irish persisted despite uncertainty and some dark moments. This makes me more confident that they will continue to persevere to get the economy growing again and to improve people's lives.

IMF Survey: Finally, Jai, you are leaving the program and the Fund and many people in Ireland are interested to hear about your plans.

Chopra: My involvement with Ireland over the past few years has been the capstone of a three-decade career at the IMF. This experience, together with other stimulating work I've done over the years at the IMF, motivates me to stay engaged in economic policy analysis and advocacy, but in a different setting here in Washington, D.C. I am also interested in doing volunteer work on financial literacy with low-income families and students. The manipulation of borrowers leading up to the crisis demonstrates the need for improving such literacy.

Ref:

2/02/2010

Oifig an Aire Airgeadais
Memorandum for the Information of the Government

Delegation of Banking Functions to the National Treasury Management Agency

1. Matter/Issue for Information

The Minister for Finance would like to highlight to the Cabinet his intention to delegate extra functions in the banking area to the National Treasury Management Agency (NTMA).

2. Reason for the Change

As the banking crisis has evolved, the Minister has been considering the ordering of work between his Department and the National Treasury Management Agency. He considers that some of the extra functions which were taken on under the Credit Institutions (Financial Support) Act 2008 should now be transferred to the NTMA. At present the same covered institutions are dealing with the NTMA on some issues and the Department of Finance on others and the Minister does not consider that the current arrangement provides the optimum position for the State.

3. Functions to be Delegated

The main functions which the Minister wishes to delegate are as follows:

- a) All negotiations with the covered institutions on their capital needs in the context of NAMA, but also to ensure that the covered institutions meet appropriate regulatory capital requirements going forward.
 - The NTMA will lead the discussions with the covered credit institutions to determine their likely capital requirements; discussions will be carried out in conjunction with the Department of Finance and in consultation with the Central Bank and Financial Services Authority of Ireland. These discussions should determine the extent to which their likely capital requirements may be met by private capital raising, asset disposals or other means with a view to minimising the amount, if any, of additional capital required from the State.
 - The NTMA will negotiate with the covered credit institutions the terms and conditions on which any capital support provided by the State will be invested.

- b) All negotiations with all institutions on the realignment of the banking sector.
 - The NTMA will lead discussions, in conjunction with the Department of Finance, with all interested parties on the ultimate shape of the 'third force' and any other restructuring of the financial system.

- The NTMA will conduct discussions with other players in the market, both national and international, on the Minister's behalf, as necessary.
- c) The management of the States capital injections and the ownership of the credit institutions.
- d) The management of any relationship framework put in place with the institutions (to date only Anglo has a relationship framework).
- e) Some remaining functions under the guarantee schemes.
- f) Advise on banking matters generally including issues relating to crisis prevention, management and resolution.

4. Relationship with the Department of Finance

All of these functions will be carried out in conjunction with the Department of Finance and building on the existing excellent relationships between the two organisations. The NTMA will be required to co-ordinate closely with the relevant Department of Finance officials generally and keep me and the relevant Department of Finance officials informed on major or significant developments. The NTMA will, of course report back to me and seek my approval and direction prior to making any irrevocable commitment.

5. EU Matters.

The Department of Finance will continue to manage the EU and State Aid issues in the banking area and the NTMA will be required to cooperate fully with any requirements which arise in these areas.

6. Legal Issues and Next Steps.

A draft delegation order and a draft direction are currently being discussed with the Attorney General's Office. The actual transfer of work will happen on a phased basis to be agreed between the NTMA and my Department. The implementation of these arrangements will require some phasing period to allow NTMA to find appropriate staff.



BAIL-IN STRATEGY WITH HOLDERS OF SENIOR AND SUBORDINATED DEBT

NATIONAL TREASURY MANAGEMENT AGENCY

STRICTLY PRIVATE AND CONFIDENTIAL

28 MARCH 2011



Introduction

Due to the levels of support that have been provided to the Irish banking sector to date and the impending results of the current PCAR/PLAR exercise, the issue of burden sharing with senior as well as subordinated debt holders has been raised as a method to mitigate to the cost for the State of providing further capital support to the banking sector.

Burden sharing with debt holders either through debt write downs, the conversion of debt into equity or conversion of liabilities into contingent capital instruments will create capital gains for the Irish banks which, depending on the eventual level of haircut applied to the senior unsecured unguaranteed debt (senior debt) and subordinated debt, could give rise to a capital saving to the State of approximately €14.9¹ billion. While this amount would not be sufficient to fully offset the cost to the State of providing capital to the banks it would provide a significant contribution to the costs to the State of the capitalisation of the banks.

However, to take the approach of burden sharing with holders of senior debt appropriate legislation will need to be implemented and the support of the external authorities would, unless the Government decides to proceed without the support of the external authorities, be critical to any final position to be taken by the Government on this matter.

Debt Sustainability

Ireland is currently three notches above sub-investment grade with Moody's and Fitch and four notches above sub-investment grade with S&P. The rating agencies have stated that the maintenance of this rating will be contingent on (but not guaranteed by) the level of capital committed by the State following the announcement of the capital figures on 31 March 2011. A downgrade will almost inevitably follow if the capital cost to the State is over €10 billion, in the case of S&P and Fitch and €20 billion in the case of Moody's. If burden sharing keeps the cost under those respective limits prescribed by the rating agencies, there is a chance of avoiding a downgrade on that issue alone. But other issues such as the new ESM structure may cause a downgrade independent of the PCAR/ PLAR/ restructuring.

The primary impacts of a downgrade to sub-investment grade for the Irish State would be:

- significant adverse effects for the ability of the banks and the State to source funding,
- delay the eventual return of the State to the public bond markets,
- material impairment of the ability of the State to source foreign direct investment, and
- material impairment of the ability of the State to fund ongoing public infrastructure projects.

Each of these impacts would augment the financial difficulties of the State and the State's requirement for funding from the ECB and the other external authorities.

The markets have already priced in a possible restructuring of senior debt and there appears to be a greater number of hedge funds holding senior Irish bank debt. AIB senior bonds are trading at a level that shows a possible average 20% haircut, this is 15-20% in the case of Bank of Ireland and 40% in the case of Anglo.

¹ This figure is based on the assumed haircut levels contained in the below tables. The actual figure gained would depend on the actual haircuts negotiated with the debt holders.



Mitigation

Burden sharing across both senior and subordinated would increase the probability of preventing a Sovereign credit rating downgrade following the PCAR/ PLAR announcement. The rating agencies have publicly issued assumptions about the expected final cost to the State from the PCAR/PLAR. Burden sharing would help to keep the final cost to the State within the bounds outlined by the rating agencies. It would therefore be problematic for the rating Agencies to justify a downgrade on the PCAR/ PLAR issue alone. However, notwithstanding the rating issue, the possible return from this exercise would significantly mitigate the direct cost to the taxpayer of bank capitalisations following the announcements on 31 March 2011.

Proposed Approach

To enable a write down of senior debt it is imperative that there is an appropriate legislative structure in place to enable such an action to take place. The legislation currently in place provides the platform for the write down of subordinated debt only. Critical to any restructuring action would be the ability to rely on legislation to prevent the ability of the banks contractual counterparties to call events of default. Without this legislation in place the risks of events of default and other adverse actions being triggered by debt counterparties are materially heightened.

The Attorney General is examining the legal issues relating to the development of legislation to enable the implementation of burden sharing with senior debt.

The proposed approach involves a contemporaneous meeting with the senior and subordinated bondholders to determine the level of haircuts to be applied to the various classes of debt in the various institutions. Once agreed, the practical implementation (to respect legal issues relating to debt priorities) would, first involve a material write down of subordinated debt (this would not include debt held by the State or other Irish banks) followed by action to restructure senior debt.

It was proposed that legislation would be in place prior to any approach on this matter to the external authorities, however given the timing issues it is unlikely that this will now be the case. The case for burden sharing would be presented to the external authorities together with a statement of intent to introduce enabling legislation as soon as possible. Depending on the position of the external authorities the Government would then have three choices:

- (a) pursue a policy of burden sharing by senior debt holders with the approval of the external authorities,
- (b) the policy of burden sharing by holders of senior debt is abandoned and burden sharing is conducted solely with subordinated debt holders,
- (c) whether due to debt sustainability issues and other matters relevant to the State it is decided to progress with the broad burden sharing policy without the approval of the external authorities, or
- (d) the policy of burden sharing with holders of senior debt is only implemented with debt holders in Anglo and INBS.

The potential outcomes of each of these approaches can only determined following discussions with the external authorities.



If the decision is taken to progress with burden sharing by both senior and subordinated debt the State would need, with the legislative backdrop, to develop a strategy with the banks to implement a consistent approach for the sector. The banks would then engage with the creditors to negotiate the restructuring options, come to a final negotiated position and then implement the negotiated transaction to enable the return for the banks. In the case of AIB, Bank of Ireland, EBS and ILP (assuming following PCAR that it is decided not to immediately commence the wind down or transfer of ILP and EBS) it is assumed that this process would be completed by end September 2011. In the case of Anglo and INBS due to the fact that these entities are being wound down and as highlighted below, a different approach is being taken it is assumed that this process would be completed in July 2011.

Possible Gains

AIB/BOI/EBS/ILP

We have set out below a table of potential haircuts for senior and subordinated debt in each of AIB, Bank of Ireland, EBS and ILP. The haircuts to be applied are indicative only and are subject to negotiations with creditors. However if there is to be any burden sharing with the holders of senior debt, subordinated liabilities will need to be effectively wiped out in the first instance. In determining the approach to be taken with each of the institutions cognisance will need to be taken of the relative position of each institution and the level of State support provided. This is reflected in the below table.

Bank	Debt Eligible for Restructuring		Haircut Levels		Haircut Amounts		
	Senior Unsecured € m	Junior € m	% Senior	% Junior	Amount Senior € m	Amount Junior € m	Total Amount € m
AIB	5,864	2,600	60%	90%	3,518	2,340	5,858
BOI	5,198	2,581	45%	80%	2,339	2,065	4,404
EBS	520	150	60%	90%	312	135	447
ILP	1,156	1,203	60%	90%	694	1,083	1,777
Total	12,738	6,534			6,863	5,623	12,486

Source: AIB/BOI/EBS/ILP, Lazard Frères and Central bank of Ireland

Anglo/INBS

In respect of Anglo and INBS the approach will be different. There is approximately €3.6 billion of senior unsecured unguaranteed bonds and €0.1 billion of subordinated liabilities that would be targeted for burden sharing in these institutions. There may be further impairment charges on the loan portfolios of Anglo and INBS which would generate possible future capital shortfalls.

Due to the fact that the merged entity comprising Anglo and INBS is currently fully capitalised to meet any future contingent capital needs of the merged entity it is proposed to exchange senior debt instruments for contingent capital instruments at a discount. These contingent capital instruments would convert into equity should the merged entity have any additional capital requirements in the future. As part of this process it is proposed to extend the maturities (there is €15 billion falling due by 2013) of those instruments to improve



the merged entity’s liquidity position. If the contingent capital requirement never arises the additional capital raised will not impact the level of capital to be provided by the State following the 31 March 2011 announcement

Bank	Debt Eligible for Restructuring		Haircut Levels		Haircut Amounts		
	Senior Unsecured € m	Junior € m	% Senior	% Junior	Amount Senior € m	Amount Junior € m	Total Amount € m
Merged Anglo/INBS	3,629	141	63%	90%	2,286	127	2,413

Source: Anglo/INBS and Lazard Frères

AIB/BOI Views on Burden Sharing

Both AIB and Bank of Ireland were approached for their informal views on the merits of the burden sharing with holders of senior debt. Both were of the view that it would have material adverse implications for each bank. Both institutions were of the view that burden sharing with senior debt should only apply to the non-viable institutions.

The primary implications outlined were as follows:

- continued close out from the funding markets;
- triggering of credit default swaps;
- withdrawal of market counterparties (e.g. hedging and repo counterparties);
- events of default triggered.

Bank of Ireland also stated that they have been reviewing capital raising options and that they envisage that they could raise €1 billion through a liability management exercise on their subordinated debt and possibly raise €0.5 billion to €1 billion through private equity initiatives. Bank of Ireland stated options would be undermined by burden sharing with holders of senior debt and/or the elimination of subordinated debt

While the NTMA recognises these concerns, the NTMA is of the view that the highlighted adverse effects of a burden sharing strategy with senior debt would be ameliorated where burden sharing with senior debt was conducted system wide with the benefit of supporting legislation. In addition we are of the view that a more aggressive approach (as highlighted above) could be taken with the holders of subordinated debt to generate more than the €1 billion suggested by Bank of Ireland.

Risks

Taking the approach of burden sharing with holders of senior debt will have a number of risks the primary risks are as follows:

- there could be a wider negative European impact, including possible ratings downgrades and adverse funding issues for the European banks,
- counterparties prepared to engage in off balance sheet transaction are likely to withdraw their support. This would be likely to increase the cost of balance sheet management,



- if there is a successful constitutional challenge to any legislation implemented to enable burden sharing this could undermine the whole strategy for burden sharing with senior debt. However, until legislation has been drafted it is not possible to assess the likelihood of a successful challenge,
- the ability to legally differentiate the treatment of unsecured, unguaranteed bondholders from deposits and other categories of senior debt will be challenging,
- the ability to treat Irish institutions holding senior debt and subordinated debt in the covered institutions differently to other debt holders will be legally challenging, and
- it will be difficult to identify credit unions and other Irish institutions holding secondary market acquired debt. While we expect that the amount of debt held by credit unions and other Irish institutions to be immaterial relative to the overall level of debt the holdings could be material at an individual level for a particular credit union or institution.

Communications

It is imperative that any messaging in respect of burden sharing with senior debt makes it clear which classes of debt are included and which classes of debt are excluded, in particular depositors.

Recommendation

Given the:

- Unprecedented debt sustainability issues for the State;
- ability of the State to limit the cost to the taxpayer of the huge capital costs arising from the current PCAR/PLAR exercise;
- fact that the banks are currently unable to access market funding; and
- fact that the markets are expecting and have priced in burden sharing with subordinated and senior debt,

it is the recommendation of the NTMA that, subject to a view being taken by Government on the potential implications of an adverse reaction from the external authorities and the implementation of an appropriate legal framework, immediate steps should be taken following the announcement of the PCAR/PLAR results to enable burden sharing with both senior and subordinated debt.

The implementation of the burden sharing should be undertaken prior to the implementation of any other capital raising initiatives arising from the PCAR/PLAR results. The implementation of other capital raising initiatives prior to burden sharing with debt holders will reduce the cost mitigating benefits of such actions for the State.