TUARASCÁIL ón gComhchoiste Fiosrúcháin i dtaobh na Géarchéime Baincéireachta

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

REPORT of the Joint Committee of Inquiry into the Banking Crisis

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

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

Central Bank
CB: Core Book 4

January 2016

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C1c: Role, responsibilities and objectives of DSG

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Email and Memo to Tanaiste re update on issues Oct 2007	DOF01950 [001-007]	99-105
Memorandum for the Information of Government	DOF01980 [001-003]	106-108
Minutes between CBFSAI for crisis management initial meeting of DSG 6 March 2007	DOF01989 [001-004]	109-112

C1d: Adequacy of the DSG process, including considering bank resolution legislation

Description	Bates Number [Relevant Pages]	Page
Extract of Occasional Papers 76, Feb 2011 from Directorate-General for Economic and Financial Affair (Extract)	DOF05089 [001, 016-017]	114-116
Review of National Organisation Capability for the Management and Resolution of Systemic Financial Crises	DOF06142 [001-013]	117-129
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THEME: B2

Effectiveness of banks' credit strategies and risk management

LINE OF INQUIRY: B2b

Appropriateness of credit policies, delegated authorities and exception management

Irish Nationwide Building Society

Press Statement 22 December 2004

In 2003, the Financial Regulator received complaints from members of the Irish Nationwide Building Society, relating to the conduct of the Society's 2003 annual general meeting. The Financial Regulator commenced an investigation into these complaints and that investigation has now been completed.

The investigation related to the provisions governing the conduct of annual general meetings as provided for in Section 72(7) of the Building Societies Act, 1989. Specifically it focused on the issuance of proxy voting forms to members.

The investigation found, and Irish Nationwide has accepted, that preparations for the 2003 annual general meeting did not comply fully with the legislation. In contravention of the legislation, the Society issued separate proxy forms to some members, which were not appended to a notice of the AGM and were issued in the absence of any written request for these forms. This breach did not invalidate the exercise of proxies in any way. No such issue arose in relation to the 2004 annual general meeting.

Liam O'Reilly, Chief Executive of the Financial Regulator, stated that strict compliance is necessary to ensure that mutual societies retain the confidence of their members. "Regardless of the technical nature of this issue, it is clear that the actions of Irish Nationwide in this case were in contravention of the legislation governing building societies. It is a cause for some concern that this breach was permitted to occur", he said.

"It is important to stress that the new sanctions powers of the Financial Regulator will be available where contraventions of requirements occur in the future. We will continue to monitor compliance with the requirements of the legislation", he added.

http://www.centralbank.ie/press-area/press-releases/Pages/IrishNationwideBuildingSociety.aspx

THEME: C1

Effectiveness of the ECOFIN and Domestic Standing Group (DSG) (Central Bank, Financial Regulator and Department of Finance)

LINE OF INQUIRY: C1a

Inter-departmental contact and the Memorandum of Understandings with other EU states on the issue of banking

12C

Lonergan, Ciara

From: Beausang, William
Sent: 16 November 2007 11:01
To: Manley, Michael
Cc: Nolan, Kevin; Lonergan, Ciara
Subject: Agenda for today's DSG meeting

Could you compile something to the effect

- FSR - update on response / any follow up issues
- update on financial market environment and situation of Irish banks
- update on planning for simulation exercise
- update on contingency planning

F...9/105/pm/003

(6)

Confidential

1. Beausang (To see)
2. Tánaiste

CBFSAI Assessment of Financial Market Developments
16 November 2007

The attached report sets out the most recent assessment of the Central Bank and Financial Services Authority of the current situation presented at the Domestic Standing Group meeting on 16th November. The main points arising were as follows:

- Funding availability for Irish banks is tight. This situation is likely to be exacerbated by:
    - End-of –year pressures as banks seek to close off positions.
    - A number of Irish financial institutions have significant 'roll-over' funding requirements arising from the beginning of next year. **If the present market conditions persist, as expected, into 2008 there is an increased risk of liquidity issues arising for Irish banks.** The Irish banks are therefore engaged in contingency planning (incl. restructuring assets to provide collateral, restricting lending growth) to meet future funding needs.

- While Irish banks have, to date, absorbed the increased cost of funding there are already indications they are tightening credit standards, potentially impacting on economic performance.

- There is anecdotal evidence that the change in the financing environment and restriction of lending is impacting on the property development sector.

- Irish banks share prices have continued to fall and have lost between 30% and 50% of their value since the start of 2007 because of negative investor sentiment regarding Irish banks and their exposure to the Irish property market.

- Speculation against Irish financial institutions is an important element of the overall financial landscape, underlining the importance of **highlighting the inherent strengths of the Irish financial system and economy.**

The Department will continue to liaise with the CBFSAI, which in turn maintains high level links to the Irish banks and are monitoring the position very closely.

Michael Manley
28 November 2007

Confidential

CBFSAI Assessment of Financial Market Developments 16 November 2007

The level of activity in the interbank lending market remains low

In the euro area, the level of lending activity in the interbank market remains low by normal standards. There is good availability of funds at short maturity (1 month), but very limited at longer maturities, e.g. 3 month. While Irish banks are continuing to meet their funding needs in a difficult market environment in November, there are recent indications that the funding environment has deteriorated in particular in the unsecured interbank market. A covered bond issue by one of the major banks week commencing 19 November will be important in testing the appetite for Irish-economy based risk in the international marketplace.

Interbank rates remains high

Interest rates remain above the target 4% rate, particularly in the 3 month market, standing at 4.584% [Friday, 16 November rate], down from a peak of 4.795%. at 2 Oct. The 3 month rate is an important determinant of retail lending rates for the Irish banks – to date the banks have absorbed the increased cost of funding, but as this higher cost continues it puts upward pressure on lending rates charged to individuals and business. There are already indications that Irish financial institutions are tightening credit standards on account of the higher funding costs. This 'credit rationing' has the potential to impact on economic performance owing to the reduced availability of finance for investment and consumption.

"End-of year premium" will increase costs of accessing liquidity in the interbank market but ECB can inject liquidity into the market if required

At end-year there is usually a premium for cash as credit institutions close off their positions. In the current disrupted financial market conditions this "end-of-year premium" adds to the premium already present. Available liquidity in the market place is being reduced as major international banks hoard liquidity to meet their own requirements including to meet losses on sub-prime investments and to take on balance sheets exposures in conduits and SIV that were previously off balance sheet. In view of the scale of expected sub-prime losses against those currently disclosed, uncertainty remains in the market in relation to where losses are located – hedge funds are a source of concern in this respect.

In such circumstances second-tier banks (such the main banks in Ireland) are subject to greater pressure to secure funding. This is creating increased pressures on domestic financing institutions to restrict their lending activities or offering finance on stricter terms in order to support their liquidity position.

The ECB is continuing to prepare to intervene as required to provide liquidity to the market. However, this funding is provided at above market rates and is less attractive to banks which have mange their liquidity while minimising the cost of funds. Where banks have good quality assets as lending collateral, they are using it to access market funding at more competitive rates. This suggests that any increased access to ECB liquidity is evidence of increased financial stress.

Irish banks are managing their funding requirements with increasing difficulty

Banks are reporting to the CBFSAI that they are managing their liquidity, but that this is increasingly difficult given the tightness of liquidity in the money markets and the price of funds. As available funding is increasingly shorter term, this is compressing the maturity profile of the banks' funding. In circumstance of continuing credit market difficulties, this increases funding pressures in Irish banks. There are some indications that Irish banks are being subject to more refusals in the unsecured interbank market on account of negative international sentiment regarding the Irish banking sector and the Irish property market generally and events such as the high-profile solicitor cases and the recent difficulties in ISTC. As a small economy with a peripheral presence in international financial markets, large institutional investors may be inclined to by-pass the Irish market in a situation where market sentiment regarding the financial sector and the property market has been negative.

2008 will present particular challenges. Banks are currently executing contingency funding arrangements

A number of Irish financial institutions have significant funding requirements arising from the beginning of next year. In advance of this they are taking a number of steps to prepare for an eventuality that this funding rollover takes place against the backdrop of a resurgence of difficulties in international credit markets. These include steps to build up collateral requirements through, for example, securitisation transactions that will facilitate borrowing from the ECB if they are not able to access liquidity from the usual channels in those circumstances. Other measures that are available to Irish banks to prepare for this eventuality is to restrict lending growth. According to the FR there is anecdotal evidence that the change in the financing environment is impacting on the property development sector as projects are postponed (which for major projects alleviates somewhat funding pressures on the banks). The quality of assets secured on speculative development land is a particular focus of attention for financial institutions at this time.

Internationally, on a day-to-day basis longer term (i.e. 6 month and 12 month) funding is being rolled over into shorter-term (i.e. 3 month) debt. This process gives rise to a heightened risk of a major demand-supply balance on an ongoing basis. **Therefore, notwithstanding contingency measures adopted by banks to enhance their access to liquidity if the present market conditions persist, as expected, into 2008 there is an increased risk of liquidity issues arising for Irish banks.**

International investor views and the share price of Irish banks have continued to fall

Irish bank share prices have continued to fall and have lost between 30% and 50% of their value since the start of 2007. Notwithstanding the posting of good results by Bank of Ireland on Wed. 14 November, its share price fell a further 6% that day, at one point falling by 8%, perilously close to the 9% figure at which trading in a share is temporarily suspended. The decrease in value of Irish banks shares has been greater than in other countries. There is a general discount in the value of Irish banks as there is a perception internationally that they are exposed to the property market – reinforced in a 7 November report from Merrill Lynch setting out a negative perspective on the Irish banking sector because of property exposures. Possible hedging Intense speculation against Irish financial institution is an important element of the overall financial landscape including the activities of hedge funds and the possible hedging of exposures of commercial property bonds issued by Irish property developers through short-selling of Irish bank stocks. In the present uncertain climate, any negative event/comment is subject to amplification in international markets impacting on the share price of banks and the availability of funding. **Taking-up appropriate opportunities to highlight the inherent strengths of the Irish financial system and economy are therefore considered to be very important.**

Timeframe for normalisation of market situation

The view is increasingly being expressed by commentators, analysts and individual financial institutions that the current market disruption will take an extended period (i.e. up to 2 years) to resolve. At the same time there is continued uncertainty regarding the scale of losses on investments associated with US subprime mortgages with some estimates now a multiple of initial forecasts of €100bn. Developments in the US property market are expected to influence strongly the future direction of these estimates

The major risks for financial markets are a US recession impacting in particular in the US property market which leads to a degrading of assets backed by non-subprime mortgages or large losses by a major hedge fund leading to a forced sales sub-prime backed assets.

Contingency Planning Arrangements

The Central Bank and Financial Regulator continue to liaise with the Irish banks closely at CEO level and are monitoring the position very closely. The banks in turn are working intensively to implement contingency arrangements to meet their liquidity requirements.

FO09/145/10/003

(9)

Report of DSG meeting of 8 February 2007

Present:

Dept of Finance: W. Beausang (Chair), M. Manley, C. Lonergan
Central Bank: Brian Halpin, Tom O'Connell, Jane Kelly, Eoin O'Brien
Financial Regulator: Con Horan

1. Update on the financial market environment and situation of Irish banks.
Please see attached CBFSAI assessment as prepared for the Tánaiste for use at Government meetings.

2. Follow-up to scoping paper – overview of resolution issues
M Manley presented the Department's overview of Financial Stability resolution issues to the meeting (see attached presentation). The CBFSAI made a number of initial comments:

- Focus should be on facilitating 'non-public' market based solutions.
- Important to clarify whether examinership would allow certain normal banking activities to continue which might allow depositors to be paid on request.
- Examination of the insolvency regime for banks may need to be undertaken

3. Next Steps for Review of Deposit Guarantee Scheme
Key discussion points:

- Questions about the DGS scheme will continue to be asked (PQs, etc) and it is important that we are in a position to, at a minimum, state that the issues raised are being examined
- Important to distinguish between possible role of DGS in maintaining financial stability and in relieving social distress if bank were to go into liquidation – is a prudential role for the DGS viable. A DGS in itself is not sufficient to maintain financial stability.
- The current DGS meets EU minimum requirement but may require some work to ensure that it would function effectively in practice.
- Rough figures regarding the level of deposits protected at the current threshold suggest that approximately 90% of the number of depositors, and less than 50% of the actual value of deposits would be protected.

4. Action Points

- Department to prepare memorandum based on the AG's advice for the CBFSAI to disseminate back to their legal advisors.
- CBFSAI to present paper on DSG review to its Financial Stability Committee (FSC) on Wednesday 13 February 2008
- CBFSAI to keep Department informed of progress on DSG review.

CBFSAI assessment of financial market developments
8 February 2008

Markets

Despite remaining uncertainty in the inter bank markets Irish banks are still able to access the liquidity they require. The difference between the ECB base rate and the interbank 3 month rate has continued to improve and currently is about 0.3%. The ECB's decision to hold interest rates at 4% was in line with market expectations. However, the asset-backed securities and the asset-backed commercial paper markets remain effectively shut, and the spread between the three month swap rate and the ordinary three month rate for interbank lending is about 0.25%, indicating that uncertainty in the market remains.

Irish banks

The Irish banks are still able to access their required liquidity. However, recent negative assessment of the Irish banks by international investment banks has not helped sentiment in the market and their share prices remain low and volatile. Retail lending for 2008 is expected to be very flat with greater conservatism in lending as the banks become more risk averse in their lending choices. Also the margin for lending is poor at the moment as funds costs are still relatively high. The reduction in lending is helping the banks' liquidity position.

Residential and Commercial Property

On the residential property side there is not much evidence of increasing defaults – even as the value of property declines, once the borrowers continue to repay this should not cause major problems for the banks. The strength of the economy going forward will be the key factor, as it will impact on people's ability to services their loans. The CBFSAI have completed some stress testing mortgages, including a reduction in value of property of 20% and no major issues were highlighted. The repossessions that have taken place are generally in the subprime sector which will be covered by the Consumer Protection Code which requires lenders to explore fully all options for a resolution. Banks have traditionally been reluctant to repossess property.

The problems in the commercial property sector in the US and the UK are likely to have an impact on Ireland where difficulties in the commercial property sector are likely to arise during 2007this year. However, the current position is relatively strong as take-up and rents are high and vacancies are low and this should help reduce the impact of any future problems.

There are concerns about defaults in the commercial property sector that may arise in loans with moratorium or bullet repayments, where no payments are made until developments are completed. If the value of the completed development turns out at less than the required repayment, this may lead to defaults.

The Irish banks are generally happy with the 'big players' in property developments. There are some concerns about the next tier of developers – eg small builders who have completed a development and cannot sell it – and the banks are watching these types of customers closely.

Other developments

German exports growth remained flat for the first times in 4 years in 2007. This could have important implications for the world economy as German exports are the main driver of eurozone growth and Germany is the world's biggest exporter.

(A)

Meeting of 26 September 2008

Merrill Lynch presented a number of options – see document of 26 September 2008

Attendance:

ML X3 = Prasath, Baldock, Andreas Orcelli
Bob O'Hara
Con Horan
K Cardiff
D Doyle
Minister

ML points

- Worst credit crisis ever
- Need break a bad cycle
- French Government has indicated it will guarantee deposits
- However, number of situations where blanket guarantee may not add up having regard to numbers
- Liquidity is moving very very quickly
- Ireland is not an isolated case – other Governments also seeking ML advice, for example
- Management teams tend to try to play out to the end, because Government intervention tends to change the team, the advisers etc – their incentive therefore is to be over optimistic
- But it can create difficulties to go in without being asked in.

Presented a central scenario as follows

(a) provide liquidity on 'penal' terms – must not be easy money
(b) intervention

Difficulties – scale of intervention required.

Dangers with blanket guarantee – credibility and prolonging of weak institutions

Question of who should be protected in interventions – at least depositors in serious debt – possibly dated subordinate debt.

Big question is how to navigate between intervening early to protect deposits and minimise costs and giving time to markets and management to realise there is a problem and adjust to that reality (can happen in days). But corporate deposits can exit very quickly in the meantime.

On a blanket guarantee for all banks – ML felt could be a mistake and hit national rating and allow poorer banks to continue.

Liquidation – ML said this was the worst thing that could be done – accelerating trouble for all other institutions.

More generally, institutions should be encouraged to sell assets and get equity.

Next week is likely to be a very bad one in markets: Fortis, B&B, Dexia all having difficulties – EU will have to look at some more generalised action.

Minister asked that the options be articulated clearly over weekend so as to be ready to present to Government.

The Minister left and there was a discussion on allocation of work. To recommence at NTMA Sunday morning.

Different meeting

The issue and options outlined at the previous meeting were presented by KC who underlined the urgency of the situation. It was agreed that work would continue on the intervention possibilities outlined, and on preparing the relevant legislation.

Meeting of 26/9/08

Merrill Lynch presented a number of options – see document of 26/9/08

attendees: ML x3 = Prasad, Baldock, Andrews Ordillo
Bob [illegible]
Con Horan
K Cardiff
D. Doyle
Minister

ML points – worst credit crisis ever
– need to reach a [illegible] cycle
– French Govt has indicated it will guarantee deposits
– however, no. of situations where blanket guarantee may not add up having regard to numbers
– liquidity is moving very very quickly
– Ireland is not an isolated case – other Govts also seeking ML advice, for example

– Management teams tend to try to play out to the end, because Govt. Intervention tends to change the team, the advisers etc.
– their indication therefore is to be overoptimistic
– But it can create difficulties to go in without being asked in

Presented a [illegible] scenario as follows
a) provide liquidity a 'good' team – must not be easy [illegible]
b) intervention

difficulties – scale of intervention required
deposits with blanket guarantee – credibility and problems of weak institutions

question of who should be protected in resolution
- at least depositors + senior debt
- possibly dated subordinated debt.

Big question is how to [illegible] between intervening early to protect deposits + minimise costs and giving time for markets and everyone to realise there is a problem and adjust to that reality (can happen in days)
But corporate deposits can exit very quickly in the meantime

On a blanket guarantee for all banks — MC feel could be a mistake — could hit sovereign rating + allow poorer banks to continue. ~~[illegible]~~

Liquidity — MF said this was the worst thing that could be done — accelerate transfer for all other institutions

Consequently, institutions should be encouraged to sell assets + get equity

Next week is likely to be a very bad one in markets: Fortis, B&B, Dexia all having difficulties — EU will have to look at some more [illegible] action.

Minister asked that the options be articulated clearly / are assessed so as to be ready to present to Government

The Minister left and there was a discussion on allocation of work

To reconvene @ NTMA Sunday morning

THEME: C1

Effectiveness of the ECOFIN and Domestic Standing Group (DSG) (Central Bank, Financial Regulator and Department of Finance)

LINE OF INQUIRY: C1b

Formulation and reaction to crisis simulation exercises

Council Logo

COUNCIL OF
THE EUROPEAN UNION

Brussels, 5 April 2001

6168/01

LIMITE

PV/CONS 5
ECOFIN 31

DRAFT MINUTES[1]

Subject :	**2329th** meeting of the Council (**ECONOMIC AND FINANCIAL QUESTIONS**), held in Brussels on 12 February 2001

1 Information relating to the final adoption of Council acts which may be released to the public is contained in Addendum 1 to these minutes.

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ANNEX 2

<u>Concerning item 8 of the agenda</u>

COUNCIL OPINION

On the 2000 update of Ireland's Stability Programme, 2001-2003

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[1] , and in particular Article 5-(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On 12 February 2001 the Council examined the 2000 update of Ireland's Stability Programme, which covers the period 2001-2003.

The Council notes that the Irish economy continues to grow rapidly in 2000, with real GDP growth of 10.7% expected in the 2000 update. Employment growth in 2000 is estimated at 4.5%, with the unemployment rate declining further to 4.1% on average. Inflationary pressures have intensified. Average HICP inflation rose to -5.3% in 2000. While this upsurge in price inflation is partly due to external and temporary factors, which are expected to gradually fall out of the consumer price index, domestically-generated inflation has increased too, house price inflation remains very high and wages are rising rapidly.

[1] OJ L209, 02.08.1997

As a result of strong economic growth, the projections in the 1999 update of the Stability Programme for the improvement in the budgetary situation were exceeded by a large margin. The Council welcomes the fact that the general government balance for 2000 remains in substantial surplus, estimated to be around 4.7% of GDP, and that another sharp reduction in the general government debt ratio was achieved.

Projections for the period 2001 to 2003 show an average surplus ratio of 4.2%, with the debt ratio declining further to less than one quarter of GDP by 2003. The Council welcomes the fact that, as in the original programme and its 1999 update, Ireland fully and comfortably fulfils the Stability and Growth Pact obligations throughout the period covered. The projected general government surplus is clearly sufficient in each year to provide a safety margin against breaching the 3% of GDP reference value in the event of normal cyclical fluctuations.

The macroeconomic scenario underlying these projections assumes a gentle decline in real GDP growth and in inflation over the period. The positive output gap, after an estimated 4.5% of trend GDP in 2000, is expected to peak in 2001 at 5.4% and to gradually decline thereafter. In this context, the Council considers that the stimulatory nature of the budget for 2001 poses a considerable risk to the benign outlook in terms of growth and inflation portrayed in the 2000 update. The Council considers that this budget - the main measures of which are indirect and direct tax cuts and substantial increases in current and capital expenditure – is pro-cyclical. The Council finds that it will give a boost to demand of at least 0.5% of GDP and that its possible supply effects are likely to be small in the short term, thereby aggravating overheating and inflationary pressures and widening the positive output gap.

In particular, the strategy of inducing labour force increases through an alleviation of the direct tax burden, which was recommended in the 2000 BEPG with respect to the labour market,- may have become less effective than in the past because it took place in the context of an expansionary budgetary policy, and the tightness of the labour market could well hamper further attempts at encouraging wage moderation with direct tax cuts. Further, while indirect tax cuts have a once-and-for-all effect on the price level, they probably have no lasting effects on the rate of inflation but clearly further stimulate demand.

Given that the monetary policy is now set for the Euro area as a whole and no longer available as an instrument at national level, other policies, including budgetary policies, must be used more actively. Against this background, the Council finds that the planned contribution of fiscal policy to the macroeconomic policy mix in Ireland is inappropriate. The Council recalls that it has repeatedly urged the Irish authorities, most recently in its 2000 broad guidelines of the economic policies, to ensure economic stability by means of fiscal policy. The Council regrets that this advice was not reflected in the budget for 2001, despite developments in the course of 2000 indicating an increasing extent of overheating. The Council considers that Irish fiscal policy in 2001 is not consistent with the broad guidelines of the economic policies as regards budgetary policy. [The Council has therefore decided, together with this Opinion, to make a recommendation under Article 99(4) of the Treaty establishing the European Community with a view to ending this inconsistency.]

The Council welcomes the fact that the 2000 update addresses the issue of structural reform. In particular, the Council notes with satisfaction the progress made in the area of long-term sustainability of the public finances with the creation of a National Pensions Reserve Fund, which at end-2000 already amounts to about 6.3% of GDP. The Council also welcomes continued efforts to enhance the quality of public finances through reform of the tax/benefit system and an increased focus on capital expenditure in response to Ireland's infrastructural needs.

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Lonergan, Ciara

From: Beausang, William
Sent: 19 December 2007 11:44
To: gordon.barham@centralbank.ie
Cc: Manley, Michael; Lonergan, Ciara; Nolan, Kevin
Subject: FW: Gentle reminder - Crisis simulation exercise feedback form

Attachments: CS Feedback form wb.pdf; CS Feedback form.pdf

CS Feedback form wb.pdf (63 KB...

From: Lonergan, Ciara
Sent: 18 December 2007 18:56
To: Cardiff, Kevin; Beausang, William; Conlon, John
Cc: Manley, Michael; Nolan, Kevin
Subject: Gentle reminder - Crisis simulation exercise feedback form

A gentle reminder to complete a feedback form (attached) and send it to Gordon.barham@centralbank.ie by COB Wednesday 19 December

Thanks
Ciara

CS Feedback form.pdf (52 KB)

FEEDBACK FORM

Name:

Please give your overall opinion of the Crisis Simulation

Did the Crisis Simulation achieve its objectives?

Were there any parts that were not of relevance or benefit?

Please comment on the format, organisation and handouts :

What parts of the "Red Book" were actively used in the Crisis Simulation (before or during)

What areas should be concentrated on for subsequent Crisis Simulations?

What are the key priorities for future Crisis Management work?

Any other comments :

Please return to Gordon.barham@centralbank.ie

FEEDBACK FORM

Name: William Beausang

Please give your overall opinion of the Crisis Simulation

The 'playing' of the exercise clearly identified a number of very important areas that require strengthening in the context of national contingency planning arrangements:

- availability / 'flow' of information between public authorities
- communication / level of contact between authorities
- assessment / analysis of options from an early stage
- extent to which "CB" represents "FR" position in a crisis and vice versa, risk of second-guessing by Department of 'political' objectives and potential for conflict of objectives that would arise between all parties
- utility / benefit of pre-prepared material
- role / effectiveness of MoU for DSG
- slow responsiveness to need for public communication

Did the Crisis Simulation achieve its objectives?

Yes, insofar as it demonstrated that a lot of work is required by all parties both individually and collectively (in the context of the work of the DSG) to increase preparedness to an appropriate level for responding to a financial stability event.

Were there any parts that were not of relevance or benefit?

In planning the next exercise a particular concern should be to test the central elements of the national response to a financial stability event (i.e. financial analysis of an individual institution in difficulty, liquidity / solvency assessment, ELA procedures, Eurosystem / ECB aspects, systemic analysis, interacting with media / political level, communications between national authorities, resolution issues etc.) rather than areas which are, while still important, more peripheral

Please comment on the format, organisation and handouts :

Was planned, organised and executed effectively and efficiently.

What parts of the "Red Book" were actively used in the Crisis Simulation (before or during)

None

What areas should be concentrated on for subsequent Crisis Simulations?

See above – the main priority should be to test rigorously the financial, legal and policy assessments that underpin our 'model' of crisis management and also drawing out the possible conflicts of objectives that may emerge in the course of the management of an event in order to pre-empt the risk that these may arise in practice.

What are the key priorities for future Crisis Management work?

See above

Any other comments :

It should be a priority to establish on an agreed basis a targeted focused list of actions as an urgent follow-up to the exercise.

Please return to Gordon.barham@centralbank.ie

Conventional wisdom on crisis management

- Process viewed in a 'linear' way
  - Request to CBFSAI for Emergency Liquidity Assistance (ELA) provision from financial institution
  - Lead responsibility for crisis management during that phase residing with CBFSAI
  - Department's direct involvement predicated on the emergence of 'solvency' as opposed to 'liquidity' issues (i.e. need for public funds)

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Lessons learnt

- If confidence fragile then small institution could trigger systemic difficulties
- 'Market discipline' not a useful tool in current context
- Emergency Liquidity Assistance likely to trigger requirement for open ended State guarantees and possibly wider systemic problem
- Liquidity problem can quickly trigger solvency concerns

Framework for crisis resolution

- Key Principles:-
  - Earliest possible identification and communication to Department of possible threats to financial stability
  - Need to maximise options for early intervention to pre-empt requirement for ELA (by which time banks' financial position is unlikely to be retrievable)
  - Swift resolution presented as *fait-accompli* critical[1]
  - Open-ended State guarantees exposing the Exchequer to the significant fiscal risk are not regarded as part of the toolkit for successful crisis management and resolution
  - There are circumstances where such guarantees may be unavoidable to maintain confidence in the overall financial system

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

Main resolution options

- Market-based solution preferred option - depending on scale may require involve Irish banks, international banks, outside investors
- Nationalisation is sub-optimal, but may need to be considered as a last resort to pre-empt requirement for extended period of ELA support and attempted public <u>'market'</u> rescue <u>carried out in the public domain</u>
- Examinership is a legal option under insolvency law but in present climate would be seen to reflect very negatively on entire banking system

Legal assessment

- Legal advice obtained from the Office of the Attorney General on key aspects of the proposed framework
- In overall terms legal assessment is enabling, but will require a number of participants (outside the Dept's control) to agree/approve the resolution

Market Abuse Directive/Takeover Rules/Nationalisation/Guarantees

- A financial institution could postpone disclosing to the market information that prompts a negotiation for ELA, provided that:-
  - The institution had a legitimate interest, not be likely to mislead the public (OAG) and able to ensure the confidentiality of the information
- Public authorities could facilitate the non-public takeover of a distressed financial institution **<u>if</u>** the Takeover Panel granted a derogation from its Rules given the exceptional circumstances
- CBFSAI itself has express statutory power to purchase shares in a credit institution with the approval of the Minister for Finance
- Statutory authority to issue a Ministerial guarantee would need to be examined.

State Aid

- CBFSAI Liquidity support on commercial terms probably not a State Aid
- Other financial assistance, including guarantees <u>not</u> provided on commercial terms prima face likely constitute State Aid
- October 2007 Ecofin conclusions invite the Commission to clarify when a major banking crisis might be considered by the Commission as falling within Article 87(3)(b) 9 (“a serious disturbance of the economy”)

State Aid Cntd.

- EU Commission view of State aid control
  - Pursue a legitimate public interest
  - Well designed to deliver on the objective of common interest
  - Distortion of competition is limited
- Rescue and Restructuring Guidelines Article 87(3)(c)
  - Emergency liquidity (Normally Loan guarantees/loans), limited time period (6 months)
  - Restore long term viability, Avoid undue distortion of competition, limited to the minimum
- Article 87(3)(b) Crisis affecting the economy as a whole "…banking crisis will normally not be found compatible on the basis of Article 87(3)(b)

Conclusions

- Primary objective is to safeguard public / international confidence in stability of Irish financial system
- It is in the interests of the public that the situation is solved before it enters the public domain in order to prevent contagion
- Legal advice confirms that proposed framework for crisis resolution should be broadly legally feasible

European Union
Financial Services Committee

Brussels, 8 February 2006

NON PAPER for discussion

from :	Chairman
to :	Members of the FSC
Subject :	Update of the FSC Survey on national arrangements for Financial Stability and Crisis Management – Assessment and policy issues

1. Background

1. The EFC Report to the Scheveningen 2004 Informal ECOFIN on "Next Steps in developing the EU framework for financial stability and crisis management"[1] set out priorities for 2005-2006 at both EU and national levels in the follow up of the Brouwer reports. The Report drew on extensive work carried out by the FSC, in particular the May 2004 outcome of the Survey on national financial crisis management procedures and the subsequent operational conclusions in the July 2004 Report by the FSC Vice-Chairman[2].

2. At the national level, the recommendations in the EFC Report were the following:

[1] ECFIN/CEFCPE (2004) REP/50244 FINAL
[2] "Developing a framework for managing financial stability problems in the EU"- 30.06.2004 (not published)

- "*The EFC urged all Member States to review their national arrangements and to enhance them where needed, e.g. by creating domestic standing groups* (composed of all relevant authorities, including Ministries of Finance), *and, in this context, to develop contingency plans*".
- "*supervisors and central banks are invited to further develop stress tests and share the aggregate results with finance ministries on a periodic basis*".
- "*The effectiveness of national and EU level crisis management arrangements should be tested by crisis simulation exercises…*"

The FSC was invited to monitor progress in this area and report back to the EFC.

3. In October 2005, the FSC members were invited to update their answers to the first FSC survey on national arrangements for financial stability and crisis management, indicating those that had been changed since November 2003, taking into account the conclusions of the 2003-survey and the new MoU on co-operation between the Central Banks, Banking Supervisors and Finance Ministries of the European Union in Financial Crisis Situations.

4. The synoptic analysis of the responses to the update of the survey is presented to the FSC in a separate non-paper. On the basis of that analysis, the present non-paper has been elaborated for the attention of FSC members. Following the examination in the FSC, a revised non-paper setting out the position of the Committee will be transmitted to the EFC

2. Assessment

5. The EFC Report put forward a comprehensive and ambitious programme of action with the aim of setting up adequate mechanisms for financial stability and crisis management to deal with a more integrated and complex financial system. In short, what was decided was to build an EU framework with the involvement of all relevant authorities through an MoU, contingency planning and crisis simulation exercises, and to complement this with national systems along the same lines, even if the detailed set-up of national arrangements is left to the discretion of Member States.

6. Progress has proceeded rapidly at the EU level, with the signature of the MoU in July 2005 and the preparations for the April Crisis Simulation Exercise well advanced. At the national level, however, the results of the Updated Survey show that **progress is uneven and from an overall perspective, unsatisfactory**.

7. First of all, the degree of compliance with the request of the FSC to update the 2003-2004 survey has been disappointing, considering that two months were given for completing the work. On the expiry of the set deadline (16 Dec.2005), only 9 Member States had responded on time. To date, only another 10 Member States have provided responses, while the answers from 6 Member States are still missing. Insofar as this stock-taking survey is concerned, this situation has made it more difficult to come up with a complete and accurate picture of the state of, and the progress in, national systems for crisis management. Furthermore, it may illustrate an insufficient level of commitment and a delay in the underlying implementation work following the aforementioned EFC recommendations in a number of Member States.

8. The analysis of the responses to the Updated Survey received to date shows that progress has been uneven. In several Member States national systems have been revised and work has been carried out to comply with the recommendations in the EFC Report, starting in many cases with the creation of domestic standing groups with the participation of Ministries of Finance. Yet, there are also some Member States where the absence of any significant change or initiative leads to the reasonable presumption that the revision has not taken place.

9. Even after taking progress into account, national systems in a large majority of Member States are still quite far away from the standards set in the EFC Report. With the information available at this stage, **only four Member States (DK, FIN, SE and UK) have systems that can be reasonably considered to comply fully with all the standards**[3].

10. Given the political priority conferred by ECOFIN to crisis management, the FSC should recognise that **progress is unsatisfactory and much remains to be done**. The discussion should hence focus on **how to give momentum to bringing national systems in line with the recommendations**.

3. Policy issues

Agreeing on realistic deadlines with clearly defined objectives

11. Putting in place an effective system to deal with financial stability and crisis management is a challenging task for Finance Ministries. It demands an intensive use of time and human resources; it is technically complex and it entails a substantial effort of co-ordination with

[3] Consider the first three columns in the overview table provided in Annex 1 to the Non-paper providing a synoptic analysis of the responses to the update of the 2004 Survey.

central banks and supervisors. Furthermore, **as the 2004 Survey showed, in a majority of Member States the involvement of Finance Ministries in these issues was limited or non-existent**, which raises the cost of building a system along the lines recommended in September 2004. The conclusion is that **fulfilling the goal set in the EFC Report will take time**.

12. The build-up of an effective national system has a **logical sequence**, starting with the creation of a domestic standing group, which is undoubtedly the cornerstone of the whole framework[4]. The group then develops national contingency plans and regularly examines the aggregate results of stress tests[5]. The functioning of the system is then tested periodically by crisis simulation exercises arranged both at national and EU levels. This sequence could be used to **set deadlines** for complying with the main standards in the EFC Report in the following way:

- [**By July 2007**]. Creation of a **domestic standing group** and development of **national contingency plans**. It should be clear that the groups should comprise the Ministry of Finance and that the plans should cover all participating authorities and not just central banks and/or supervisors.

- [**By January 2008**]. **Crisis simulation exercise** and **sharing of aggregate results of stress tests with Finance Ministries**. The exercise should involve at least those authorities belonging to the standing group.

Do Members agree that pragmatic deadlines will help to give momentum to the process? Do Members consider the proposed course of action and deadlines appropriate?

Developing a positive peer pressure mechanism

13. The only tool to promote compliance with the EFC Report recommendations is **peer pressure**. Regular assessments of Member States systems, with a possible scoreboard for consideration by EFC-FST, are supposed to provide sufficient incentives for Member States to fulfil these recommendations. Yet, the risk of relying exclusively on this approach is that the focus would

[4] Paragraph viii of the Executive Summary of the Vice-Chairman Report reads "The report recommends that each Member State should, as a matter of priority, create standing domestic groups of all sector supervisors, the national central bank and the Ministry of Finance (or other relevant Ministry) for information exchange and for preventing, evaluating and managing potential systemic problems".

[5] As proposed in the Vice-Chairman Report, the stress tests could in the future be based on shared assumptions among authorities from Members States such as specific features to be tested and a common set of macro- and microeconomic assumptions.

tend to be more on the score in a table that on the real improvements in the components of the crisis management system.

14. Giving a clear picture of progress in each Member State will of course be a necessary feature of the process. But there could be merit in **complementing this traditional peer pressure** mechanism with a more positive side, **by making the FSC discuss on the specific problems**, **practices and experiences** in developing each of the elements of the crisis management system. For instance, a specific point on domestic standing groups could be included in one of the **2006** FSC meetings; one or two Member States (preferably in different stages of compliance with the standards) could be invited to present their experience. This kind of discussion and best practice-sharing could help FSC members to speed progress as well as to make their systems more effective. **At a later stage**, discussion could also cover experience drawn from the practical set up of national contingency plans and step up to good practice in preparation for the national crisis simulation exercises. The **EU-wide crisis simulation exercise** (April 2006) could also be a complementary source of inspiration for initial discussions on this latter topic.

Do Members see merit in developing this positive peer pressure mechanism? Do members consider that examining, in the FSC, experiences in creating effective domestic standing groups and in developing contingency plans, stress tests and simulation exercises could be useful?

A lighter monitoring process

15. The FSC survey on national arrangements for financial stability and crisis management has been an extremely useful tool to get a comprehensive view of the state of national systems and to base the recommendations to improve them. Yet, keeping the survey to monitor progress from now on could be unnecessarily burdensome, as evidenced by the outcome of the Update. If the **deadlines proposed** above are retained by the FSC, the Secretariat would suggest that, unless there is any objection to this new approach, **Member States should just be asked to give a short account of the compliance with the corresponding element some time before the deadline expires**. This simplified mechanism would avoid having to rely on supervisors and central banks to report the progress, which may otherwise significantly complicate the task for FSC members.

Do Members agree that the monitoring process should be streamlined?

29 April, 2005

MEMORANDUM OF UNDERSTANDING ON CO-OPERATION BETWEEN THE BANKING SUPERVISORS, CENTRAL BANKS AND FINANCE MINISTRIES OF THE EUROPEAN UNION IN FINANCIAL CRISIS SITUATIONS

Introduction

The agreement of the Parties leading to this Memorandum is based on the following considerations:

(1) The integration of financial markets and market infrastructures in the European Union (EU), together with the growing number of large and complex financial institutions, increases the scope for cross-border contagion and thus the likelihood of a systemic crisis affecting more than one Member State. In this context, it is important to have in place practical arrangements concerning co-operation in cross-border crisis situations at the EU level among the authorities potentially involved in preserving financial stability.

(2) The framework defined in this Memorandum will apply to crises which may have a potential for both cross-border and systemic impact affecting individual credit institutions, banking groups or banking components of financial groups, as well as to other possible systemic disturbances with cross-border implications, including those affecting payment systems or other market infrastructures.

(3) Co-operation between banking supervisors, central banks and Finance Ministries will take place in accordance with, and without prejudice to, their responsibilities under national and Community legislation, as well as the Treaty. In particular, in the context of this Memorandum, supervisory responsibilities should be interpreted in accordance with the applicable Community directives, including the role of consolidated supervision. Central banks' responsibilities should be interpreted with regard to their capacity as monetary authorities and overseers of payment systems, as well as their overall responsibility for contributing to the stability of the financial system as a whole. Finance Ministries' responsibilities should be interpreted with regard to their public accountability for the management and resolution of systemic crises.

(4) The Parties emphasise that this Memorandum is designed to facilitate the management of cross-border systemic crises with a view to safeguarding the functions of the financial system. The potential systemic implications of a crisis affecting a financial institution may require the involvement of banking supervisors, central banks and, in certain circumstances, of Finance Ministries. Such involvement should not be construed as representing an exception to (i) the principle of the firm's owners'/shareholders' primary financial responsibility, (ii) the need for creditor vigilance, as well as to (iii) possible market-led solutions to solve a crisis situation in individual institutions.

(5) Information-sharing between banking supervisors, central banks and Finance Ministries, will take place in the context of this Memorandum, on the basis of existing practices and arrangements and subject to the applicable conditions for the transmission of confidential information set out in national and Community legislation. In particular, information-sharing is limited to those authorities whose policy-making functions may be affected by the crisis situation.

(6) This Memorandum is seen by the Parties as an appropriate instrument for setting forth arrangements aimed at promoting co-operation between them in crisis or potential crisis situations without overriding their respective institutional responsibilities or restricting their capacity for independent and timely decision-making in their respective fields of competence, notably with regard to the conduct of day-to-day central banking and supervisory tasks. In particular, the evaluation of the possible systemic importance of a crisis situation, which may be required to be transmitted to Finance Ministries in accordance with this Memorandum, remains within the scope of the autonomy of banking supervisors and central banks.

(7) The Parties acknowledge that crisis situations may in practice involve a wider range of authorities and respective functions, including other financial supervisory authorities, deposit insurance schemes and competition policy authorities. This Memorandum is without prejudice to further co-operation arrangements involving a wider range of authorities and may be reviewed accordingly. The Parties also acknowledge that certain crises may require international co-operation with authorities whose jurisdiction lies outside the EU. However, such co-operation is beyond the scope of this Memorandum.

(8) This Memorandum complements, and is without prejudice to, other present and future arrangements on co-operation between responsible authorities, particularly banking supervisors and central banks. In this context, the Parties will aim to ensure that co-operation and information-sharing in crisis situations take place in a manner consistent with the provisions and objectives of any other existing arrangements.

THE PARTIES TO THIS MEMORANDUM OF UNDERSTANDING AGREE TO THE FOLLOWING:

1. Objective of the Memorandum

The objective of the Memorandum is, building on the existing national and EU arrangements, to support and promote co-operation in crisis situations between banking supervisors, central banks and Finance Ministries through appropriate procedures for sharing information, views and assessments, in order to facilitate the pursuance of their respective policy functions and preserve the overall stability of the financial system of individual Member States and of the EU as a whole. In particular, these authorities should be in a position, if needed, to engage in informed discussions amongst themselves at the cross-border level in the case of crisis situations affecting the financial system of more than one Member State or the EU as a whole.

2. The scope of co-operation in crisis situations

2.1 Banking supervisors, central banks and Finance Ministries will co-operate at the national and cross-border levels in accordance with the framework set out in this Memorandum. Co-operation will primarily involve the exchange of information, views and assessments among the Parties.

2.2 This Memorandum shall apply to crises with both potential cross-border and systemic implications. In particular, the reference to "crisis" throughout this Memorandum shall include the following features of potential cross-border and systemic shocks:

(i) Crises affecting individual credit institutions;

(ii) Crises affecting banking groups or the banking components of financial groups; or

(iii) Other systemic disturbances, including those affecting payment systems, other market infrastructures or financial markets;

which may warrant the involvement of Finance Ministries.

2.3 The co-operation procedures specified in this Memorandum may also be activated, at the discretion of the Parties involved, to exceptional events likely to lead to public concern and seriously affect the financial systems of more than one Member State.

3. Responsibilities in crisis situations

3.1 Efficient co-operation among authorities is expected to take place on the basis of the existing institutional and legal framework for financial stability in Member States, as well as the applicable Community legislation, fully respecting the roles and responsibilities of banking supervisors, central banks and Finance Ministries.

3.2 The co-operation between banking supervisors, central banks and Finance Ministries will be intended to enable each authority to fulfil their respective tasks and responsibilities, in accordance with Community and national legislation.

4. Activation of co-operation procedures

4.1 A crisis situation referred to in this document is not definable ex ante. It remains within the discretion of the responsible banking supervisors and/or the central banks to determine whether a crisis is emerging or developing for the purposes of this Memorandum. In the case of a potential crisis situation, co-operation procedures are expected to be activated in a timely manner.

4.2 Any of the Parties may transmit or request relevant information if a potential crisis situation appears to be developing, and joint discussions may be initiated at the request of any of the Parties.

5. Procedures for the sharing of information

5.1 Subject to the conditions set out in this Memorandum, the banking supervisors or the central banks that have access to information related to a potential crisis situation will provide their respective Finance Ministries with information regarding material developments or concerns including where possible, an assessment of potential systemic and cross-border implications, which may require their involvement.

5.2 Subject to the conditions set out in this Memorandum, the Finance Ministry of each Member State will provide the respective banking supervisor and central bank with any relevant information on the potential crisis situations that may be received from other entities, particularly Finance Ministries from other Member States.

5.3 The concrete items of information to be shared between the Parties may include views and qualitative assessments and, where relevant, specific information on, such as:

(i) Potential systemic implications for the domestic financial system; where possible, consideration should also be given to the systemic impact on other Member States' financial systems as well as on the EU's financial markets as a whole;

(ii) Where possible, on specific channels of contagion of the crisis to institutions, markets and market infrastructures;

(iii) Where possible, consideration of other relevant economic implications of the crisis situation;

(iv) Where possible, any constraints to the implementation of policy measures;

(v) Updates of relevant developments and related information.

5.4 The specific information needs, and the authorities to be contacted, shall be determined by the Parties in light of the particular features of the potential crisis. In particular, information shall only be shared among those Parties of each Member State whose policy-making functions may be affected by the crisis situation in view of the likely effects of the crisis on institutions, markets or market infrastructures within the competence of those authorities.

5.5 The Parties undertake to provide each other, where relevant and subject to Community and national law, and in accordance with the procedure set out in Section 7.1, with advance notice of any policy measures that may be undertaken in the context of the crisis situation, without prejudice to urgent decision-making by the responsible Parties.

5.6 The Parties involved in a crisis situation will, to the extent possible, co-ordinate jointly any statement to the public by discussing the appropriate content of such communication beforehand.

6. Co-operation at the national level

6.1 At the national level, the Parties will co-operate and share information in accordance with existing laws, institutional arrangements and procedures.

6.2 In order to cope with the situations described under Section 2, it is desirable that appropriate arrangements and procedures exist at the national level on mutual co-operation and exchange of information on common general issues related to financial stability among at least banking supervisors, central banks and Finance Ministries. Although the details of such arrangements are at the discretion of the Member States the arrangements should contribute to facilitating the operation of this Memorandum as well as setting out contingency plans in case of a potential national or cross border systemic crisis.

7. Co-operation at the cross-border level

7.1 At the cross-border level, banking supervisors, central banks and Finance Ministries, as a rule, will correspond with their respective counterparts in other Member States. At the discretion of any of the Parties, information may however be transmitted directly at the cross-border level between different types of authorities with concurrent transmission to the relevant counterpart authorities of the relevant Member State(s).

7.2 A crisis affecting more than one Member State may warrant multilateral co-operation among the Parties involved. In particular, measures in potential systemic and cross-border crises may need to be based on a common understanding as well as on assessments of the situation shared among the relevant authorities in several Member States. In such situations, those authorities involved or likely to be involved will decide on the most appropriate means for communication, information-sharing and co-operation among them.

7.3 In cases where wider multilateral co-operation among the Parties needs to be activated, such as in major disturbances that may affect the EU as a whole or several Member States, existing EU-committees may provide a platform for exchange of information, views and assessments.

8. Confidentiality

8.1 Any information exchanged and received by virtue of the application of the provisions of this Memorandum is subject to conditions of confidentiality and professional secrecy as provided in Community and national legislation.

8.2 The Parties will maintain, vis-à-vis third parties, the confidentiality of any request for information made under this Memorandum, the contents of such requests, the information received, and the matters arising in the course of co-operation without prejudice to relevant Community and national provisions.

8.3 The Parties will ensure that all persons dealing with, or having access to, such information are bound by the obligation of professional secrecy.

9. Crisis arrangements and contingency planning

9.1 The Parties will endeavour to develop, as well as to test and update on a regular basis, at the national and EU levels, contingency arrangements for managing crisis situations as well as conduct stress-testing and simulation exercises. The primary goal of such exercises would be to enhance the preparedness of authorities for handling potential crisis situations with cross-border systemic implications. The Parties may wish to share, utilising the existing EU committees, the methods and assumptions used in organising and conducting such stress-testing at national level.

9.2 As part of contingency arrangements, the Parties will organise emergency contacts lists at the national and EU levels including the indication of contact points, other public and private bodies that could be involved in a crisis situation, relevant sources of information, as well as all other means which could be regarded as necessary for the effective management of a crisis.

10. Further development of co-operation arrangements

10.1 The principles of co-operation provided in this Memorandum may also be implemented on a domestic or bilateral/multilateral basis by the Parties in accordance with their specific needs involving individual institutions, specific banking groups or the banking components of financial groups.

10.2 The Parties may, by common consent, invite other sectoral supervisory authorities and deposit insurance schemes of the Member States as well as Central Banks, supervisory authorities and Finance Ministries of the Contracting Parties of the European Economic Area to become parties to this Memorandum.

10.3 The Parties to this Memorandum will review this Memorandum periodically and consider necessary amendments within three years, if warranted in the light of experience or relevant developments – of its entry into effect.

11. Nature of the Memorandum

11.1 As the provisions of this Memorandum are not legally binding on the Parties, they may not give rise to any legal claim on behalf of any Party or third parties in the course of their practical implementation.

11.2 The provisions of the MoU do not prejudge or assume any particular decisions or remedies to be taken in crisis situations nor do they imply any change to or commitment to change existing national legislation.

12. Entry into effect

This Memorandum shall enter into effect on 1 July 2005.

Annexes:

1. Description of the roles and tasks of the Economic and Financial Committee (Financial Stability Table), the ESCB Banking Supervision Committee, Committee of European Banking Supervisors and Financial Services Committee.
2. List of signatories.

Annex 1

ECONOMIC AND FINANCIAL COMMITTEE

(FINANCIAL STABILITY TABLE)

The Economic and Financial Committee shall carry out the tasks described in Paragraphs 2 and 4 of Article 114 of the Treaty establishing the European Community. In accordance with Treaty Article 114(2), the EFC is the Ecofin Council's primary source of advice on issues concerning economic and financial developments, including on financial stability. According to its working methods, the EFC, as a rule, convenes about one week ahead of Ecofin Council meetings. Committee meetings, in full and restricted composition as well as in any of the three specific formats, are clustered in one- or two-day meetings per month in Brussels. Meetings are confidential.

The EFC meets at least semi-annually in its Financial Stability Table (FST) format and prepares the discussions on financial stability for the informal meetings of Ministers and Governors. When meeting as FST, the Committee may invite relevant non-members to attend as appropriate. The FST convenes at least twice a year. The FST brings together high-level representatives of finance ministries, the Commission, the European Central Bank, national central banks and supervisors[1], each contributing to the discussion by producing assessments from different angles. The EFC President determines the most efficient means of preparation according to the topics under consideration; for instance, by forming small ad-hoc working groups, or by asking relevant committees for contributions in their fields of competence.

The main aim of the FST is to develop well-informed assessments of financial conditions and risks within and across sectors for the purpose of informing Ministers and Governors and for sharing up-to-date information on EU-level developments between those responsible for preparing policy actions across the EU. As a result, EFC members should be in a better position to alert Ministers and Governors to potential problems relating to the stability of the EU's financial markets. The FST should ideally identify needs for policy actions. The FST format supports the information-sharing and economic policy-making in exceptional situations by providing a platform for communication between finance ministries and central banks and representatives of European supervisory authorities.

The EFC is assisted by secretariat acting on the instructions of the Committee when carrying out its responsibilities. The Secretariat is equipped with means of communication ensuring quick and confidential contacts with its members.

[1] Supervisory authorities are as a rule represented by the Chairmen of the Committee of European Banking Supervisors (CEBS), the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and the Committee of European Securities Regulators (CESR).

BANKING SUPERVISION COMMITTEE

OF THE EUROPEAN SYSTEM OF CENTRAL BANKS

The Banking Supervision Committee (BSC) is an ESCB committee which assists the ESCB in the fulfilment of its statutory tasks in the field of prudential supervision of credit institutions and the stability of the financial system. The BSC is composed of members from national central banks, banking supervisory authorities and the ECB which also provides the Secretariat.

The BSC has three main tasks:

- monitoring and assessing developments in the euro area/EU banking and other financial sectors from a financial stability perspective. In this context, the BSC also contributes to the production of regular reviews of financial stability conditions and prospects within the euro area/EU;
- analysing the impact of regulatory and supervisory requirements on financial system stability and structure, and financing conditions in the economy. In this context, the BSC also assists, where appropriate, in the preparation of the ECB's advice on draft Community and national legislation on prudential supervision of credit institutions and the stability of the financial system;
- promoting co-operation and exchange of information between central banks and supervisory authorities on issues of common interest. This includes devising and maintaining arrangements for co-operation and exchange of information relevant for the smooth conduct of their respective tasks and the prevention and effective handling of financial crises. At its own discretion, the BSC can also exchange information on supervisory issues not related to the statutory tasks of the ESCB.

In the context of its third task, the BSC has prepared in 2003 the Memorandum of Understanding (MoU) on high-level principles of co-operation between the EU banking supervisors and central banks in crisis management situations. As part of this MoU, the BSC is expected to support multilateral information-sharing in crisis situations by providing a platform for communication between banking supervisors and central banks. This BSC function would be assisted by the infrastructure of the ECB.

COMMITTEE OF EUROPEAN BANKING SUPERVISORS

The Commission Decision[2] establishing the Committee of European Banking Supervisors (CEBS) defines the main tasks of the Committee. The CEBS should provide advice to the Commission on implementing European legislation and contribute to consistent application of Community legislation, convergence of supervisory practice and co-operation between supervisors.

The Council[3] has furthermore stressed that the emphasis should be on convergence of supervision and implementation. Supervisory convergence, co-operation and information exchange is also called for from a financial stability perspective. CEBS' own Charter also notes that it will develop effective operational network mechanisms to facilitate the exchange of information in normal times and at times of stress.

CEBS members are high level representatives from the banking supervisory authorities and central banks of the European Union, including the European Central Bank.

The Committee was set up as a follow-up to the Lamfalussy report[4] which highlighted the need for faster and more flexible legislation, broad implementing powers for new committees and enhanced cooperation between regulators to ensure consistent implementation and application in Member States and stronger enforcement.

Open and public consultation is a central part of the Committee's accountability. The Committee is promoting open and transparent dialogue, interaction and co-operation with all market participants and end-users in its consultations. The Committee submits an annual report to the Commission and makes its work programme public. The Annual Report will also be sent to the European Parliament and the Council.

The Chair of the Committee reports periodically to the European Parliament, and when requested to the Council, and maintains strong links with the European Banking Committee. CEBS also participates as an observer on the Financial Services Committee (FSC), also preparing reports on supervisory convergence issues, and similarly highlights more general strategically important supervisory issues to the Economic and Financial Committee (EFC).

Publication of the work programme and other documents related to CEBS role and tasks on CEBS website should also allow European institutions, market participants and end-users to form a view on the way in which the Lamfalussy framework is being operationally implemented in the banking sector.

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[2] Commission Decision of 5 November 2003, establishing the Committee of European Banking Supervisors (2004/5/EC)

[3] Council Conclusions of 2 June 2004 and of 16 November 2004.

[4] Final report of the committee of wise men on the regulation of European securities markets, Brussels, 15 February 2001.

FINANCIAL SERVICES COMMITTEE

The Financial Services Committee (FSC) was set up on 18 February 2003 by the Ecofin Council with a mandate to provide for cross-sectoral strategic reflection separate from the legislative process; to help to define the medium- and long-term strategy for financial services issues; to consider sensitive short-term issues; to assess progress and implementation; and to provide political advice and oversight on both internal issues (e.g. single market, including implementation of the Financial Services Action Plan) and external issues (e.g. WTO).

The FSC is composed of high-level representatives of the Member States (Ministries of Finance) and the European Commission (DGMarkt). The European Central Bank, and the CESR, CEBS and CEIOPS have observer status. The Committee meets in Brussels.

The secretariat of the FSC is provided by the General Secretariat of the Council. The Committee may entrust the study of specific questions to its alternate members and/or to subcommittees. Furthermore, the Committee may call upon experts to assist in its work.

The Committee reports to the Economic and Financial Committee in order to prepare advice to the Council (EcoFin), taking into account the established role of Coreper. The Chairman of the FSC is available for a regular exchange of views on strategic developments related to financial markets with the Committee on Economic and Monetary Affairs of the European Parliament.

(o)

Manley, Michael 31

From:	Beausang, William
Sent:	08 May 2008 09:35
To:	Manley, Michael
Cc:	Lonergan, Ciara; Nolan, Kevin
Subject:	Version submitted to KC - no changes other than key points added
Attachments:	revised Briefing for Minister for Finance May 2008 rev1 (2).doc

revised Briefing for Minister ...

Briefing on Financial Stability Issues
7 May, 2008

This note sets out the Irish position and concerns in relation to current financial stability issues. Attached as appendices are notes dealing with: responsibilities in relation to financial stability and origins of current international financial stability.

The key points are as follows:-

International Position

- Since last August, as a result of the "credit crunch" normal wholesale inter-bank lending and funding activities (e.g. securitisation) have at an international level seized up; in essence bank funding is either much more expensive or unavailable at the longer-term maturities that banks need

- While there have been some recent assessments suggesting the environment is set to improve, there are no clear indications that current difficulties will ease significantly for some time.

- Any further marked deterioration in economic conditions in the US or the EU will lead to a worsening of credit conditions.

- An extensive programme of actions is being put in place at EU level to improve financial market conditions and prepare for any risk to financial stability in the EU.

- International central banks, the US Federal Reserve and the ECB / Eurosystem have been very active in seeking to stabilise market conditions.

Situation in Ireland

- The Irish banking system is sound and robust based on all key indicators of financial health (i.e. solvency, liquidity, asset quality, profitability)

- Irish banks have no meaningful exposure to the sub-prime securities which are at the root of the international liquidity crisis overall.

- International sentiment towards the Irish banks is very negative on account of the assessment that the pronounced downturn in the Irish market will undermine their financial position.

- Irish banks are therefore experiencing significant challenges in rolling-over their funding sources.

- In addition there has been intense speculation by hedge funds against specific Irish banks (i.e. Anglo-Irish and Irish Life and Permanent) which on occasion has put very serious downward pressure on their share price which has increased the risk of a run on deposits on those banks.

- Irish banks have been working intensively to exploit any funding opportunities available internationally; as relatively small financial institutions by international standards they have not extensive options

- The Irish banks have build up large reserves of assets that are eligible to be used as collateral against lending by the ECB in circumstances that other funding sources are not available.

- In general, Irish banks are reluctant to access this funding owing to the risk that this will send a negative signal to the market and lead to the shutting down of other credit lines.

- A domestic shock (e.g. failure of a major property developer or very sharp further falls in property prices) would have a major negative effect on the financial position of the Irish banks on a systemic basis.

Contingency Planning

- The Financial Regulator and the Central Bank have been working very closely with the banks to monitor their liquidity position on an ongoing basis and seek to identify risks to their sustainability at the earliest possible stage.

- The Department of Finance, Central Bank and Financial Regulator are in very close contact to exchange information on developments and advance contingency planning arrangements for dealing with the emergence of serious difficulties in any specific institutions or the banking system as a whole.

Primacy of market solutions

- Responsibility for managing current issues affecting individual institutions and developing strategic options for responding to the market environment rests with the boards and senior managers of the institutions concerned.

- The CEO of the FR has been meeting with the boards / top management of some financial institutions to impress upon them the need to be prepared to examine all options to pre-empt the emergence of any difficulties.

- State intervention is only appropriate in circumstances that problems in an individual institution run the risk of creating systemic difficulties in the national financial system as a whole.

Detailed information note attached.

Irish Financial System

Irish banks currently meet all the conventional measures of financial health - solvency, liquidity, profitability, asset quality. Their strong performance over recent years provides a good cushion to deal with the current financial market environment.

However, Irish banks cannot remain immune indefinitely to the virtual closure of money markets and are subject to specific pressures and stresses – over and above those applying more generally internationally - owing to wide-spread international concern regarding the exposure of Irish banks to the property market and in particular commercial lending. This has been demonstrated by heavy and intense speculation against Irish banks by hedge funds at times over recent months – share prices of individual banks had declined by 40-50% over the past twelve months and have been subject to particular volatility at times (e.g. share price of Irish banks fell between 5% and 15 % immediately after the announcement (17 March) of the collapse of Bear Stearns), while the share prices have recovered somewhat since, they remain significantly below their 2007 highs.

In the money markets, the price of 3 month money rose 34 basis points in March and a further 13 bp in April, such that funding is now significantly above its 'normal' price. Against a background of continuing tightening in money markets and particular concerns by international investors, the funding environment for Irish banks has disimproved further in recent weeks and there is evidence that some previously established credit lines in the US are being restricted. Notwithstanding the continuing positive statements by Government and the CBFSAI vouching for the strength of the Irish banking system, international investors are being influenced by the views expressed by some domestic commentators.

Prognosis for the International Financial Situation

Financial market conditions remain very difficult, the international financial sector remains under considerable stress and there is no reliable indicator that any sustained improvement will be achieved for some time. Reports are now occasionally appearing in the media of the 'bottom having being reached' in the present credit crunch, but these tend to be triggered by publication of economic statistics that are less bad than expected or unexpectedly good results (again less bad than expected) from individual financial institutions.

An example of such reports arose in the context of the publication of the UK's Financial Stability Report. The Bank of England, at the publication of the FSR, pointed out raising US sub-prime defaults had triggered a broad-based repricing of risk and deleveraging in credit markets. It pointed out that the adjustment to credit markets had proved more prolonged and difficult than anticipated, such that prices in some credit markets are now likely to overstate the losses that will ultimately be felt by the financial system and the economy as a whole. The Bank stated conditions should improve as market participants recognise that some assets look cheap relative to credit fundamentals. However, having made this point, the Bank of England noted sentiment remained weak[1], which had caused it to announce a special scheme to

[1] In the near term, tight funding conditions mean banks are vulnerable to adverse news and rumours, as highlighted by the run on Bear Stearns in mid-March, tight credit conditions can be expected to lead to a pickup in defaults among vulnerable borrowers, including some households/ parts of the commercial

improve the liquidity position of the banking system and to increase confidence in financial markets.

Notwithstanding occasional positive reports, overall, share prices in the financial sector remain volatile, wholesale inter-bank lending is only taking place over short time horizons, and financial institutions are experiencing major difficulties in securing funding for longer time periods. A high degree of caution and conservatism and hoarding of cash is evident across the whole of the international financial sector. A number of major international financial institutions have had to rebuild their capital position owing to the scale of losses they have experienced.

In Summary:

- The concerns that initially led to credit markets seizing up last August are persisting.
- Major financial institutions continue to disclose major write downs.
- Estimates of the total losses by authoritative international bodies continue to increase.
- International initiatives and in particular the activities of the Federal Reserve and the ECB / Eurosystem have helped in important respects to stabilise financial market conditions at particular times.
- International efforts to resolve the root causes of the crisis for example by promoting increased transparency or new valuation approaches are yet to bear fruit.

Funding Position of Irish Banks

As a member of the euro area, access to normal ECB funding is a major benefit for Irish banks owing to the wide range of eligible collateral against which they can borrow funds from the Eurosystem. Irish banks have over recent months built up large reserves of ECB eligible collateral. In general, however, they have been slow to access funds from the ECB owing to the view that this would contribute to negative investor sentiment but this buffer is available to them if credit market conditions were to deteriorate further.

In circumstances that the financial system cannot access funds from the wholesale market, the only viable commercial strategy is to significantly restrict their lending activities. This is already apparent in terms of the withdrawal of particular lending products (e.g. 100% mortgages) from the market and the introduction of much tighter lending criteria. A sharp retrenchment in lending has the obvious potential to impact adversely on the economy and increases the risk of loan defaults.

The Central Bank and Financial Regulator are working closely with the domestic financial institutions to monitor their liquidity position on a weekly basis, identifying where significant funding pressures may emerge in the future.

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property sector, and financing difficulties could emerge in some emerging markets, including countries in Central and Eastern Europe with large current account deficits

The following points set out, in summary form, information regarding domestic financial stability planning arrangements:-

- The Central Bank is liaising with the major domestic banks at CEO level to explore the options that may be available for mutual support between the Irish banks in a crisis situation and to respond to any problem in small institutions in a collaborative fashion.

- The CEO of the Financial Regulator is meeting with the top management / boards of institutions to discuss business strategies and market-based options for dealing with difficulties that may arise in meeting funding requirements.

- The NTMA has placed some deposits with most of the main financial institutions. They are keeping this under review and will liaise with the Department and the CB/Financial Regulator as necessary.

- The NTMA is also exploring engaging in secured lending on the basis of non-ECB eligible collateral.

- The Central Bank is examining on an ongoing basis the options available to it in providing funding to Irish financial institutions.

- A standing group is in place composed of senior representatives of the Department of Finance, the Central Bank and the Financial Regulator to consider any domestic financial market issues.

EU Actions
A broad programme of actions (set out in a 'Roadmap' agreed by EU Finance Ministers in October, 2007) is being undertaken at EU level in response to financial market conditions. This includes work on improving transparency of complex financial instruments, valuation standards, the prudential framework, risk management, supervision and market functioning, including the role of credit agencies. A Memorandum of Understanding has recently been agreed at EU level dealing with the principles and arrangements for dealing with a crisis affecting any major EU cross-border bank.

7 May, 2008

Appendix 1

Background on

Responsibilities in relation to financial stability

The Minister for Finance's overall responsibilities relate to policies for maintaining macroeconomic stability, the adoption of fiscal strategies that support long term budget sustainability, and promoting a competitive and efficient market in financial services with a strong focus on the consumer.

The **Central Bank and Financial Services Authority of Ireland** is the institution charged with contributing to financial stability in Ireland, under both domestic and EU legislation. The organisation consists of two component entities: the Central Bank and the Financial Regulator, each with its own responsibilities. The roles are complementary and there is close co-operation in relation to financial stability issues:

- The **Central Bank's** statutory[2] duty specifies that "the Bank has ... the objective of contributing to the stability of the financial system" [3] Its responsibilities for financial stability relate to the surveillance of the strength and vulnerability of the overall economy and financial system (i.e. its focus is at the overall macro level).
- The **Financial Regulator's** remit includes the authorisation, prudential supervision and surveillance of the financial soundness of individual institutions (i.e. it is focused at the more micro level of individual institutions).

[2] Central Bank Act, 1942 (as amended), Section 6A(2)(a)

[3] The Central Bank is also covered by the mandate of the ESCB, which requires the European Central Bank and national central banks to contribute to financial stability in the euro area. This, therefore, requires that the Bank contributes to financial stability, both in Ireland and, as far as is practicable, elsewhere in the euro area, through its involvement in international fora.

Appendix 2

Background note on origins of current financial stability concerns

Financial markets have been in turmoil since August 2007, amid a sharp decline in investors' appetite for credit risk. The turmoil was triggered by financial losses due to defaults in the US market for sub-prime (i.e. low credit-quality) mortgages. These losses have been transmitted rapidly across the global financial system via the markets for complex financial instruments. The opacity of these instruments, combined with credit risk dispersion, made it difficult to identify the exact size and location of losses, thereby undermining investor confidence in financial markets more generally. Losses to-date by major financial institutions has been estimated at circa $300 million, with estimates of eventual losses put in a range of $500 million, to (increasingly) $1billlion. Major US and EU financial firms (E.g., Citigroup, UBS, Bear Stearns) have had major write-offs, resulting in a need for these firms to raise fresh capital form investors and Sovereign Wealth Funds, or in the case of Bear Stearns, rescue by the US Federal Authorities.

The major consequence for the Irish banking system has been the profound disruption of money markets. This has made access to funds very much more difficult, increased in the cost of funds and 'shortening' of the funding periods (i.e. funding is increasingly available only on a weekly/monthly basis as compared to previous periods of three or six months or longer). Because of the difficulties in money markets, there have been considerable interventions by major central banks into the interbank markets to restore orderly conditions by providing liquidity.

INFORMAL ECOFIN 13-14 May 2005

Stability of EU Financial Systems

SPEAKING NOTE

Financial System Stability and Financial conditions in the EU.

- The Irish banking sector is currently in a strong position, with good profitability and reserves well above minimum requirements
- The concentration of risk exposures in the residential mortgage sector is being closely monitored by the supervisory authorities. However, with good economic growth and low employment, there is no real concern at present
- In the corporate sector, a proxy for risk is the rate of closure among firms. The overall corporate liquidations rate last year was at its long run average of, so there is no particular concern there.

Crisis Simulation Exercise (Only if necessary)

- I note with satisfaction the progress of the preparations for the crisis simulation exercise.
- The competent authorities in Ireland will be pleased to cooperate fully with the development of the arrangements for the exercise.
- I would like to thank all concerned for their efforts in advancing the exercise.

- I am looking forward to reviewing the outcome of the exercise when Mr. Koch-Weser reports on the first results in May 2006.

Supervision of Offshore Financial Centres (OFCs)

- Ireland operates to the highest EU and international standards of financial regulation.
- Ireland is an onshore financial centre, just like the other main European international financial centres such as Paris, Frankfurt, London and Luxembourg.
- We support the view that offshore financial centres must observe and enforce proper standards of financial regulation, corporate governance and so on.

How to organise the assessment on cross-sector and cross-border risks in the FST in a more systematic way.

- The views of the EFC are noted and we can revisit this topic when there is more to report.

INFORMAL ECOFIN 13-14 May 2005

Stability of EU Financial Systems

STEERING NOTE

Financial System Stability and Financial conditions in the EU.

What will happen today?
Cion and ECB may offer some comments on the current situation and other delegates may then be invited to contribute.

Irish concerns/issues
No specific Irish concerns. A background note setting out some recent trends and developments in the Irish financial system is attached.

Crisis Simulation Exercise

What will happen today?

In his letter to Mr Jean-Claude JUNCKER, President of the Ecofin Council, Mr. Caio Koch-Weser States that

> "The EFC also discussed the preparations for a **crisis simulation exercise** which aims at testing the current framework for managing financial crisis situations in practical terms. The EFC suggests arranging an exercise in April 2006, instead of November this year, to ensure thorough planning and efficient management of the exercise. I should be in a position to report on the first results in May 2006 at the latest"

It is understood that the Council will be asked to note progress being made on the arrangements for the Crisis Simulation Exercise.

Ireland's Position

Ireland is completely satisfied with the proposed arrangements for the simulation exercise and the competent authorities here are committed to cooperating and participating fully in the exercise.

Position of other Member States

All other Member States are fully supportive of the EFC proposals.

Supervision of Offshore Financial Centres (OFCs)

What will happen today?
Cion and ECB may offer some comments on the current situation and other delegates may then be invited to contribute.

Irish concerns/issues
Because the term "offshore" often has negative connotations in the context of financial services (tax haven status, secrecy/anonymity for clients, light financial regulation), we are anxious not to be associated with the "OFC" label.

Ireland is a financial centre of international repute. We follow the highest standards of financial supervision. Our authorisation and supervisory rules and procedures derive from EU and Irish law. We adhere to best practice guidelines established by international organisations such as the Basel Committee. We do not differentiate, in their application, between international and domestic business. We have participated in the IMF's Financial Sector Assessment Programme (FSAP) which assesses the level of supervision of the financial services sector and, in Ireland's case, the results were very satisfactory. In short, we supervise banking and other financial activities to the highest European and international standards.

How to organise the assessment on cross-sector and cross-border risks in the FST in a more systematic way.

What will happen today?
The Chair of the EFC may report on the recent EFC discussion on this topic. There may then be an exchange of views on this item, with most contributions coming from the Central Bank side.

Irish views
No Irish intervention is necessary.

Cross-sector issues are obviously best discussed in a cross-sector group. At Level 2, there is the Financial Conglomerates Committee, with Finance Ministry members. There is no specific Level 3 group but what happens is that the Chairmen of the 3 Level 3 Committees meet to discuss cross-sectoral issues. This informal grouping would seem to be well placed to look at cross-sector and cross-border risks and to report back to the FST. We would, of course be open to other suggestions.

Contact details
The contact details for the relevant Department of Finance officials are as follows:

Name	Grade	Office:	Mobile:
Colm Breslin	PO	6045556	
Finbarr Kelly	AP	6045833	

INFORMAL ECOFIN 13-14 May 2005

Stability of EU Financial Systems

BACKGROUND NOTE

Financial System Stability and Financial conditions in the EU.

Background Note on Irish Financial Sector Issues

Banking
The available information suggests that the banking system remains in robust health. Irish banks are comfortably profitable and remain well capitalised, with solvency ratios significantly in excess of the regulatory minimum.

Notwithstanding the significant slowdown in economic growth that occurred during 2003, aggregate data on asset quality suggest that non-performing assets stood at approximately 0.89 per cent of the value of outstanding loans as of end-2004. The low levels of interest rates and the strength of the labour market are key factors in keeping arrears at their historically low levels.

Mortgage Lending
Increasing house prices have contributed to strong mortgage lending growth. Strong house price inflation also increases the equity in existing loans thereby reducing the risk of loss-given-default for credit institutions. The share of credit institutions' aggregate loan book in property-related lending has increased persistently in recent years and is now approximately half of the resident loan book.

Households
With respect to households, personal-sector indebtedness continues to increase strongly, more than doubling in the past decade to approximately 110 per cent of disposable income by end-2004. This ratio will continue to grow strongly in 2005. The growth of personal-sector credit reflects the growth in residential mortgages, which account for approximately 80 per cent of personal-sector credit. However, personal-sector indebtedness is unevenly distributed across households. The latest census results suggest that 62 per cent of households have no mortgage debt. Of those with mortgages, household-level data would suggest that there is a small subset of households, most likely the group of new borrowers, with significant repayment burdens.

Labour market developments, an important determinant of credit risk arising from the household sector, continue to be positive. The unemployment rate was close to 4.5 per cent during 2004. The relatively strong performance by the construction and services sectors contributed significantly to this outcome. The economy is close to full employment. Despite the continued escalation of household indebtedness and property prices, the prospects for the financial health of the Irish household sector appear to be quite favourable.

Corporates
With respect to corporates, the annual nominal rate of credit growth to non-financial corporates in the year to September 2004 was approximately 28 per cent in comparison to approximately 17 per cent for the same period in 2003.

Crisis Simulation Exercise

It will be noted that the financial crisis being simulated with have *EU wide systemic and cross-border implications.* It does not cut across arrangements being made nationally to deal with domestic financial crises with no EU wide systemic implications or cross border effects. The competent authorities in Ireland (The Central Bank and Financial Services Authority of Ireland, IFSRA and the Department of Finance) will be pleased to cooperate fully with the development of the arrangements for the exercise. The staff of the Central Bank and Financial Services Authority of Ireland are already participating in the design of the simulation exercise.

EFC Report

The EFC Report to the Council outlines, as follows, how the arrangements for the Financial Crisis Simulation Exercise should proceed.

1. Following signing of the MoU, in line with the September 2004 'roadmap' on developing the framework for financial stability with the EU, the preparations of the technical work on a crisis simulation exercise should commence without delay.
2. The EFC stresses that, considering that this is a priority area of work towards spring 2006, adequate **resources, infrastructures,** and involvement of all **relevant parties** should be ensured. It expresses its full support to this work by recalling the following key priorities to be considered in preparations:
   - The need to overcome the practical and operational challenges of crisis management aimed at testing the arrangement foreseen in the new MoU; and possible causes for conflicts of interest between relevant parties (e.g. cost-sharing);
   - As a minimum, the preparations should include the three key areas:
     1. **constructing a crisis scenario**;
     2. preparing **'user's instructions'** for the crisis simulation exercise including relevant background information useful in managing financial crisis situations (e.g. procedures, regulations, tools and practical details such as contact lists); and
     3. **practical arrangements** for the running of the exercise (participation, logistics, venue, infrastructure, platform, financing, organisation considering keeping in mind the necessary requisites e.g. confidentiality aspects, network, taping);
   - The need to involve **the relevant committees** (FSC, CEBS, BSC and EFC), which will also be mentioned in the annex of the MoU, ensuring

involvement of all relevant parties e.g. through their secretariats in a balanced way;

– The Financial Stability Table should also discuss the **participation** in the exercise bearing in mind the need to involve observers from CEIOPS, CESR and the Commission, with a view to facilitate observations from important cross-sector and regulatory angles.

Developments at Home – Briefing Note

Side by side with developments at European Union level, Banking Finance and International Division is conducting a Review of National Organisational Capability for the management and resolution of any potential Financial Crisis in Ireland. This Review is being progressed in-house at the moment with a view to seeking formal Management approval for its recommendations by the end of May. It is proposed that the Review when approved will form the basis of a series of proposals that will be developed with the Central Bank and Financial Services Authority of Ireland and possibly other parties to strengthen and enhance the national organisational capability to manage and respond to any potential financial crisis.

Proposals already developed by the CBFSAI (referred to as the Black Book) are being assessed as part of the Review. The Black Book proposals can only be considered embryonic at this stage. The major drawback of the Black Book is that it is mainly focussed on the decision-making procedures and devotes no time to the optimum *structures and systems* that should be put in place to deal successfully with a financial crisis. Furthermore *strategy* as to how the crisis might be managed and resolved is compressed into one recommendation. This is that the State should provide a blanket guarantee to allow the rescue to be effected. The manner in which other key players in the financial system could share in the cost of and the management and resolution of the crisis in not elaborated. The issue of Financial Services Sector Restructuring is not dealt with in the Black Book.

For these reasons BFI Division decided to conduct a review of national organisational capability for the management and resolution of a financial crisis. Joint development of the proposals with the CBFSAI is envisaged once senior management give the imprimatur to the *structural, system and strategic issues* contained in the Review.

Financial Crisis Simulation Exercises at Home

Side by side with the arrangements for the financial crisis simulation exercise at EU Level, preparations are being made here to conduct a simulation exercise to test the efficacy of national organisational capability to manage and resolve any potential financial crisis in Ireland. At present, the CBFSAI is carrying out preliminary in-house financial simulation exercises with a view to refining its proposals in the Black Book.

It is proposed that once the strategic decisions are taken by the Department on Review of National Organisational Capability, discussions will take place with the CBFSAI and any other relevant parties with a view to combining the Review and the Black Book into one National Financial Crisis Management and Resolution Framework.

A further intention is to stress test the proposed National Financial Crisis Management and Resolution Framework by the end of the Year by conducting a simulation exercise of a domestic financial crisis in Ireland.

Both simulation exercises will provide critical insights into how purely national and EU wide systemic and cross border financial crises can be effectively managed and responded to.

The staff of the Central Bank and Financial Services Authority of Ireland are already participating in the design of the simulation exercise.

INFORMAL ECOFIN 13-14 May 2005

EU CRISIS SIMULATION EXERCISE

DRAFT PRESS POINTS

(Only if necessary)

- It will be noted that the financial crisis being simulated with have *EU wide systemic and cross-border implications.*

- I note with satisfaction the progress of the preparations for the crisis simulation exercise.

- The competent authorities in Ireland (The Central Bank and Financial Services Authority of Ireland, IFSRA and the Department of Finance) will be pleased to cooperate fully with the development of the arrangements for the exercise. The staff of the Central Bank and Financial Services Authority of Ireland are already participating in the design of the simulation exercise.

- I am looking forward to reviewing the outcome of the exercise when Mr. Koch-Weser of the EFC reports on the first results in May 2006.

QUESTIONS AND ANSWERS' ON THE MOU, PREPARED BY THE CHAIRMAN OF THE HIGH LEVEL WORKING GROUP.

- Please also find attached, a background document with 'questions and answers' on the MoU, prepared by the Chairman of the High

Level Working Group. The object of the background document is to help Ministers, Governors and Regulators to respond 'in a common language' to possible enquiries by the press and the public.

- The Secretariat of the Economic and Financial Committee has requested that the document be placed in the briefing files of Ministers, Governors; and the Heads of Banking supervisory authorities.

- The EFC Secretariat has also advised that the publication of the press release is scheduled for Saturday 14 May

Simulation of Domestic Financial Crisis in Ireland

- There is no perceived national advantage to discussing domestic arrangements with the Press at this stage. If pressed the Minister could say:

  - The national authorities in Ireland, The Department of Finance, the CBFSAI and IFSRA are currently actively cooperating to put in place appropriate procedures and arrangements to ensure that the Irish authorities can respond speedily and effectively to any emerging or actual financial crisis in Ireland.

  - Stress testing and simulation exercises are envisaged. A simulation exercise involving all of the above parties will be undertaken before the end of the year.

Informal Ecofin 7-8 April 2006.

Financial Market Stability

Suggested Speaking Points:*(if required)*

Supervisory Convergence & Stability, and Crisis Management

Housing

- I am aware that rising house prices in Ireland have been highlighted as a potential source of instability, due to the possible over-exposure of banks in this sector.
- This issue is being addressed. Last Friday the Irish Financial Regulator increased the risk weighting of certain types of residential mortgages, thus requiring banks to set aside a higher level of capital for loans which exceed 80% of the value of the property.
- The factors driving Irish house prices are structural rather than speculative. These include:
  - Strong economic growth
  - A rapid increase in population, primarily fuelled by high immigration
  - High employment levels and income increases
  - Low interest rates

- I might mention that in the 1970's, one third of all household income was used to service mortgage repayments. Today, even with the high housing costs, this ratio remains at a similar level.

Other issues (if appropriate)

- I would now like to address some of the other issues that have been raised.

Possible – Conglomerates – co-operation between supervisors

- We welcome the Memorandum of Understanding signed by the three Regulators' Committees in November as being a constructive approach to dealing with cross-sectoral issues, particularly with respect to financial conglomerates

Possible – Single European Regulator for Financial Services

- We are opposed to the idea of a Single European Regulator.
- We don't see any evidence of a need to go down this road and indeed it wasn't even highlighted as an issue in the Commission's recent 2005-2010 White Paper.
- All existing legislation is predicated on each Member State having its own competent authority.

- Most recent legislation, such as the Markets in Financial Instrument Directive, is based on appropriate exchange of information between competent authorities.
- We would be concerned if efforts to create a shared database for such exchanges of information, were to be used as an excuse for creating a pan-European Regulator.

Possible - Hedge funds.

- I recognise the importance that hedge funds play in the current market-place. The risk diversification they provide is important.
- In Ireland, hedge funds are restricted to high net worth investors, although retail investors are permitted to invest in "funds of hedge funds"
- I welcome the calls for an enhancement of measures to ensure market integrity by monitoring the activities of large hedge funds and their counterparties.

Informal Ecofin 7-8 April 2006.

Financial Market Stability

Steering Note

Supervisory Convergence & Stability, and Crisis Management

What will happen today?
The Chair of the EFC will provide Ministers with an oral report on the current state of play. This oral report will be based on the EFC's examination of the Financial Services Committee (FSC) paper of 23rd February 2006. The paper is not being circulated to Ministers.

The main points are expected to be:
- The need for swift implementation of the measures set down in the FSC paper.
- Issue an invitation to the FSC to look at the Commission's 5 year plan (2005-2010) and to set down priorities.
- Call on Member States to ensure Directives are transposed in a timely fashion
- Call for the 3 sectoral regulators (i.e. Lamfalussy Level 3 Committees) to work more closely together in the area of financial conglomerates.

A short update on the crisis management exercise on 6 April is also expected – this will be discussed in more depth at a later Ecofin.

Irish position
The FSC report received wide support. Ireland expressed concerns about the level of detail and suggested that a more concise version be produced. This, presumably, is one of the reasons why a written copy of the report is not being circulated to Ministers at this stage. We have no particular difficulties with regard to the supervisory convergence issues raised, although some of the measures seem a bit premature to us.

However, there was a comment at the EFC regarding the dangers to financial stability posed by the Irish and Spanish housing markets and a draft speaking note is included if an intervention is thought necessary.

There were also some comments at the EFC regarding co-operation between regulators regarding financial conglomerates, the possibility of a single European financial services regulator and on the need to monitor hedge funds more closely. Short speaking notes are provided if required.

Informal Ecofin 7-8 April 2006.

Financial Market Stability

Background Note

Supervisory Convergence & Stability and Crisis Management

Background Note
This issue has been around for some time. It stems, principally, from complaints by major financial institutions about the divergent implementation in Member States of the measures contained in the Financial Services Action Plan. Such divergences were thought to be harmful to a true internal market. Some Member States were also concerned at the lack of consistency across the EU and called for greater harmonisation.

This issue has already been discussed at Ecofin on 7 December 2004. Those Ecofin conclusions invited the FSC to provide a strategic overview of how the existing framework for financial regulation and supervision should be developed over the next few years. The FSC report to the EFC, dated 23 February 2006, is its formal response to the Ecofin invitation.

Some issues arising.
Crisis Management Exercise – 6 April 2006.
The EFC Financial Crisis Management (FCM) exercise was based on an EU which consists of 5 hypothetical countries. The same exercise was run 3 times simultaneously on 6 April and participants from Member States were divided into 3 teams. Participants were allocated roles which represented their roles in Finance Ministries, Central Banks, or as Banking Supervisors of one of the hypothetical States.

Supervision of Financial Conglomerates
In paragraph 18 of the revised EFC paper of 31 March, a call is made for an "urgent establishment the level 3 co-operation on conglomerates between supervisors". While such co-operation is indeed important, the paper does not take note of the fact that, last November, the 3 Committees did in fact sign an MOU specifically for this purpose. A short reference to this point is included in the Speaking Note, if required.

Single European Regulator
This issue was raised at last week's EFC. We, like many other MS see no justification for a single regulator. A short speaking note is provided, in case the matter is raised at Ecofin.

Hedge Funds
Financial Stability concerns were raised in relation to hedge funds, particularly in respect of banks' exposures. The paper calls for closer monitoring of such funds. We agree with this and a short speaking note is provided, if required.

Informal Ecofin 7-8 April 2006.

Financial Market Stability

Press Points

Supervisory Convergence & Stability, and Crisis Management

- The President of the Economic and Financial Committee (EFC) gave an oral presentation to Ministers on progress being made with regard to cross-sector supervision in the area of financial services.
- The Financial Services Committee was invited by Ecofin in December 2004 to examine this issue and their report forms the basis for today's presentation.
- The EFC's presentation noted that stability in the banking, insurance and securities sectors remain solid.
- The EFC highlighted the need to enhance measures to ensure market integrity and stability in the area of hedge funds.

Informal Ecofin 7-8 April 2006.

Financial Market Stability

Composite Introductory Note

Supervisory Convergence & Stability, and Crisis Management

The Chair of the EFC will provide Ministers with an oral report on the current state of play. This oral report will be based on the EFC's examination of the Financial Services Committee (FSC) paper of 23rd February 2006. The paper is not being circulated to Ministers.

Irish Position
We have no particular difficulties with regard to the supervisory convergence issues raised, although some of the measures seem a bit premature to us.

However, there was a comment at the EFC regarding the dangers to financial stability posed by the Irish and Spanish housing markets and a draft speaking note is included if an intervention is thought necessary.

ECOFIN 11 July 2006

Public Finances in EMU 2006 – The first year of the revised SGP.

SPEAKING NOTE (if required)

- I welcome the message in the report that experience of the first year of the reformed Stability and Growth Pact has been broadly positive.

- I also welcome the Commission's assessment that Ireland's public finances remain strong and that the Government's fiscal targets are achievable.

- The Irish Government remains committed to sound public finances. The fiscal stance reflects the implementation of the Government's key economic and social programmes and the major infrastructural investment programme which is essential to tackle Ireland's infrastructure deficit and sustain the growth potential of the Irish economy.

- Our ***public investment***, whose rate is already amongst the highest in the EU, has now been placed on a multi-annual basis and includes a major programme of capital spending on transport and communications.

- We are also very conscious of the need to meet anticipated fiscal pressures over the long term. The National Pensions Reserve Fund now stands at almost 10% of GDP, having grown in 2005 by nearly 20%. We have initiated reforms in several pension aspects and, since the Stability Programme Update was published, we have introduced further measures to incentivise pension provision by those who need it most.

ECOFIN 11 July 2006

Public Finances in EMU 2006

STEERING NOTE

What will happen today?
The Council will consider the Commission communication on "Public Finances in EMU 2006 - the first year of the revised Stability and Growth Pact".

Public Finances in EMU 2006 presents an overview of recent budgetary developments and focuses on the first year of the reformed SGP. Two analytical sections deal with (i) the role of national fiscal rules and institutions to help Member States run sound public finances and (ii) fiscal policy in "good times" which deals with the scope for member states to step up budgetary consolidation during the current economic recovery. The issue of national fiscal rules and institutions is due to be discussed by the Council later in the year.

Commission's position
The assessment of the first year of the revised Pact is broadly positive. Reforms have improved implementation of the Excess Deficit Procedure (EDP). Country specific medium-term objectives (MTOs) have been set in line with the Pact with some more ambitious than required. Budget updates have been based on realistic forecasts. There has however been a deterioration in the structural balances of some MS. The Commission is critical of the tendency in Stability and Convergence Programme updates of back-loading of adjustment and a lack of specification of budgetary measures in certain cases. Overall, the Commission call for greater fiscal consolidation during the current "good times", as envisaged in the SGP.

Ireland's Position
We can generally support the Commission's call for a greater fiscal effort in all countries in the light of the current economic recovery in the EU as a whole. We have no objections to the draft Council conclusions (Appendix 1).

The *Ireland fiche* is broadly positive. The Commission expect Ireland's public finances to remain strong over the forecast period and our Stability Programme targets are regarded as achievable. The spring forecast was that Ireland would record a surplus of 0.1% of GDP for 2006. Recent data has resulted in the Commission revising the projected surplus to 0.5% of GDP, due to buoyant domestic demand and solid revenue growth. The structural balance is forecast to deteriorate by about ¾% in 2006 reflecting what the Commission see as an expansionary fiscal stance in the current year. For 2007, the Commission's Spring forecast is a deficit of 0.4% which is broadly in line with our SPU. The debt level is projected to remain on a modest downward trend to 27.0% of GDP. The Ireland fiche acknowledges that debt reduction would be even more significant but for the acquisition of assets by the National Pension Reserve Fund.

[redacted]

ECOFIN 11 July 2006

Public Finances in EMU 2006

BACKGROUND NOTE

1. Recent budgetary developments and prospects

In 2005, the nominal deficit in the EU was reduced to 2.3% of GDP, down from 2.6% of GDP in 2004. The structural balance improved by about 0.75% of GDP, the largest improvement since 1997. In the euro area, the deficit fell by 0.4% to 2.4% of GDP.

The deficit reduction is attributed to higher than expected growth, better revenues and strengthened policy implementation. The better than expected outturn was relatively broadly based although more pronounced in Germany, Spain, the Netherlands and Ireland.

In the spring forecasts the general government deficit is forecast to remain relatively unchanged in 2006. In 2007, the euro area deficit is expected to improve slightly to 2.3% mainly due to budgetary consolidation plans in Germany. The outlook for the general government balance in the EU as a whole is broadly similar. The up to date position on each of the countries in excess deficit is provided in Appendix 2.

After increasing in 2005 for a second consecutive year, the debt ratio in the EU is forecast to fall from 63.4% of GDP in 2005 to below 63% in 2007 due to a combination of stronger economic growth and a stable primary surplus.

EU-25

	2004	**2005**	**2006**	**2007**
GDP (%)	2.4	1.6	2.3	2.2
GGB (% of GDP)	-2.6	-2.3	-2.3	-2.2
Debt (% of GDP)	62.4	63.4	63.2	62.9

Euro area

	2004	**2005**	**2006**	**2007**
GDP (%)	2.0	1.3	2.1	1.8
GGB (% of GDP)	-2.8	-2.4	-2.4	-2.3
Debt (% of GDP)	69.8	70.8	70.5	70.1

Source: Commission Spring Forecasts 2006.

2. Commission's assessment of implementation of SGP reform

Overall, the 2005 reform strengthened the role of the SGP in the budgetary co-ordination process in promoting a high degree of macroeconomic stability, an essential condition for sustained economic and employment growth, as reflected in the Lisbon Integrated Guidelines for Growth and Jobs.

The Commission consider that the increased focus on *long-term sustainability* issues envisaged in the SGP reform has been reflected in the 2005 Stability and Convergence Programmes.

The assessment of the functioning of *the preventive arm* of the pact is mixed. On the positive side

- o Differentiated medium-term objectives (MTOs) have been set with a clear link to sustainability and country specific circumstances.
- o There is a greater commitment to realistic macroeconomic assumptions.
- o There is a reduction in the use of one-off measures.

On the negative side,

- o The structural fiscal adjustment planned for 2006 by MS not yet at their MTO falls short of the agreed 0.5% GDP
- o It is not yet clear whether fiscal consolidation will be stepped up in line with the improving growth prospects.
- o In some MS, the projected adjustment is back-loaded and not underpinned by concrete measures.
- o According to the spring forecasts, on average the structural balance for the EU will not improve and for some MS will deteriorate, turning the fiscal stance expansionary and pro-cyclical. Rigorous budgetary implementation and, if necessary, additional consolidation measures in 2006 together with ambitious fiscal policy plans for 2007 are needed in order to reduce the gap between actual efforts and requirements under the SGP.

The experience with *the excess deficit procedure* is regarded as generally positive,

- o An increased focus on structural fiscal consolidation efforts rather than just short-term nominal results.
- o Increased emphasis on the need to reduce debt
- o Consideration by the Commission of all relevant developments
- o The increased room for judgement has been used to set realistic deadlines while ensuring that significant fiscal efforts are made
- o The SGP reform has stimulated a constructive and transparent policy dialogue at EU level on the individual country cases.

A summary of the main features of the SGP reform is at Appendix 2.

3. Assessment of Ireland's Performance

The Ireland fiche is broadly positive. Overall, the public finances remain strong notwithstanding macroeconomic risks notably related to the housing sector and sensitivities to changes in the global economic environment which, if realised, would result in a larger than forecast deficit.

2005:

The general government balance posted a surplus of 1% of GDP in 2005 compared with the targeted deficit of 0.8% of GDP. This better-than-expected outturn was due to an increase in tax revenues, notably driven by buoyant capital taxes and stamp duties.

2006:

On the revenue side, the main Budget measures included a widening of the standard rate band and an increase in employee and personal tax credits (-0.5% of GDP) and the termination of some (in particular property based) tax reliefs (0.1% of GDP approx.). On the expenditure side, there were notable increases in social welfare benefit rates (0.7% of GDP) and a significant rise in capital spending especially on transport infrastructure (0.2% of GDP) and a five-year childcare package (0.2% of GDP approx.)

A deficit of 0.6% of GDP was projected at Budget time, and this was updated to 0.3% in the April EDP notifications to take account of increasing revenues. Commission projects a surplus of 0.1% in 2006 in line with its forecast of buoyant domestic demand and revenue growth.

The Commission forecast a deterioration of around 0.75% of GDP in the structural balance in 2006 indicating an expansionary fiscal stance.

2007:
The Commission forecast a deficit of 0.4% of GDP in 2007 which is broadly in line with the Stability Programme projections.

Debt:
The government debt ratio is projected to remain broadly stable in 2006-2007 at around 27% of GDP. In the absence of the National Pensions Reserve Fund the gross debt ratio would be falling over the period to end 2007 as the accumulation of outside financial assets by the Fund prevents a quicker fall in the debt.

	Spring Forecast		**Stability Programme**	
	2006	2007	2006	2007
GDP (%)	4.9	5.1	4.8	5.0
GGB	0.1	-0.4	-0.6	-0.8
Structural balance	1.1	0.8	0.2	0.1
Debt	27.2	27.0	28.0	28.2

4. Developments in EU budgetary surveillance
The Commission has responded to the discrepancy between budgetary plans and outcomes by increasingly focusing its assessment on the credibility of the budgetary adjustment path, and by assessing Member States' fiscal policies more comprehensively over time, thereby taking greater account of aspects relating to the long-term sustainability and quality of public finances.

The Commission's assessment of the 2005 stability and convergence programmes, focused on the structural balance as the yardstick of fiscal adjustment. It is particularly critical of the back-loading of fiscal adjustment and the fact that the corrective measures are not specified in many cases. The Commission consider that member states have not been taking advantage of the current recovery to tighten the fiscal stance.

The reference to the fiscal effort required of MS which have not yet achieved their MTO is to Belgium, Luxembourg and Austria[1]. The 2006 fiscal targets are also considered at risk, to varying degrees, in Greece, France, Italy and Portugal (i.e the eurozone countries in EDP other than Germany). In each case, the Commission

[1] Budgetary Developments in 2006 and Prospects for 2007 in the euro area. ECFIN(2006) REP/52855, 17 May 2006 - table 4.2, page 16.

consider that the 2007 target is achievable but only with a (very) significant adjustment effort. For this reason, they are focusing now on member states' budgetary proposals for 2007.

5. Ireland's position

Ireland has consistently supported the operation of the Stability and Growth Pact. The formulation of medium-term budgetary policy in accordance with the SGP is in line with the Government objectives for employment, prosperity and balanced economic development.

Ireland's budgetary policy is well aligned with the SGP and the Commission's Integrated Guidelines for Growth and Jobs - as evidenced by

- The move back towards a sustainable level of annual growth as reflected in the projected average growth rates of 4.9% and 4.6% in GDP and GNP terms over 2006-2008.
- The prioritisation of productive investment through the multi-annual capital envelopes, with the objective of maintaining capital investment at almost 5% of GNP (almost twice the EU average);
- Timely anticipation of the costs of ageing by the setting aside of 1% of GNP each year for the National Pensions Reserve Fund;
- A modest debt-to-GDP ratio which is being maintained at the second lowest in the euro area – around 27% for the period 2006-2008
- Meaningful social partnership – Government has successfully promoted appropriate wage developments and consensus on economic and social priorities.

Ireland's Stability Programme Update for 2005 received a favourable Council Opinion –"a good example of fiscal policies in compliance with the Stability and Growth Pact".

6. Appendices

1. Draft Council Conclusions

2. Summary of SGP reforms

3. Note on analytical sections of Public Finances Report – fiscal rules and fiscal councils.

4. Update on EDP countries.

ECOFIN 11 July 2006

Public Finances in EMU 2006

DRAFT PRESS POINTS

- Ministers discussed the budgetary developments in the EU in light of the revised Stability and Growth Pact.

- Ministers were satisfied that the revised SGP has had broadly positive results. There was a larger than expected deficit reduction in the EU as a whole in 2005.

- However, it was recognised that budgetary plans in some Member States need to be implemented with rigour, to ensure that a satisfactory pace of budgetary consolidation is achieved especially in light of the favourable economic environment.

- Ministers also emphasised the importance of the sustainability of public finances in the face of ageing populations and called on Member States to put this issue at the heart of fiscal policy making.

ECOFIN 11 July 2006

Public Finances in EMU 2006

COMPOSITE INTRODUCTORY NOTE

The Council will discuss the Commission Communication on “Public Finances in the EMU 2006 – the first year of the revised Stability and Growth Pact”. This report presents an overview of recent budgetary developments in the EU in light of the revised SGP. The report also focuses on possible challenges facing Member States including the sustainability of public finances, the avoidance of pro-cyclical policies and the importance of national fiscal rules and institutions.

APPENDIX 1

The first year of the revised Stability and Growth Pact

Draft Council Conclusions

One year after the reform of the Stability and Growth Pact (SGP), and on the basis of the Commission's Communication on Public Finances in EMU, the Council discussed the implementation of the revised SGP. Ministers also exchanged views on the execution of the 2006 budgets and preparations of budgetary plans for 2007. They agreed to come back later this year to the role national fiscal rules and institutions can play to facilitate budgetary consolidation strategies as well as to help avoid pro-cyclical policies.

Overall, the first-year's experience with the revised SGP can be judged as positive. While remaining a rules-based system, the reformed SGP has stimulated a constructive and transparent economic policy dialogue at EU level on the individual country cases, allowing the Council to reach unanimous agreement on all proposals put forward by the Commission under the revised rules of the Pact.

Budgetary adjustment in the EU has resumed and budgetary positions in 2005 have improved in structural terms by 0.8% of GDP, both in the EU and in the euro area. Medium-term budgetary objectives (MTO) have been differentiated for individual Member States in line with the agreed principles; in some cases, MTOs are more ambitious than required by the SGP. However, some Member States must pursue and step up efforts to reach their medium-term budgetary objectives. In many cases, the adjustment needs to be more frontloaded and underpinned by concrete measures

In 2006, the economic situation is improving. It is essential to take advantage of this benign economic environment to pursue and step up fiscal consolidation efforts. The long-term fiscal sustainability challenges stemming from ageing populations should be at the heart of policy making. Against this background, Member States should implement 2006 budgets with rigour and, when preparing their 2007 budgets, maintain or speed up the pace of deficit and debt reduction and avoid pro-cyclical fiscal policies. Member States in excessive deficit procedure are committed to put an end to the excessive deficit, fully complying with the Council recommendations. Member States of the euro area and of the ERM II that have not yet reached their MTO reaffirm their commitment to achieve, as a benchmark, an annual structural adjustment of 0.5% of GDP net of one-off measures.

APPENDIX 2

The Stability and Growth Pact (SGP) Reform – March 2005

The European Council endorsed changes to improve the operation of the Pact in March 2005 which impacted on both the preventive and corrective arms and made recommendations for improving fiscal and statistical governance at both the EU and the national level. Overall, there is now more room for economic judgement in the fiscal surveillance procedure and in the assessment of individual country cases. The basic requirement to comply with the reference values of 3% of GDP for the general government deficit and 60% of GDP for gross government debt continues to apply.

- The Medium Term Objective of budgetary policy of "close to balance or in surplus" is now differentiated to take account of the varied economic and budgetary circumstances across Member States.
- More flexibility allowed for countries experiencing prolonged economic downturns to consolidate their budgets over a longer timeframe, with a presumption of consolidating public finances during favourable economic periods.
- Includes incentives for Member States to carry out structural reforms, in line with the Lisbon strategy to promote jobs and growth.
- Permits a more comprehensive economic assessment of budgetary developments in the implementation of the EDP.
- Allows for the extension of the one-year deadline for the correction of an excessive deficit by an additional year and certain steps in the EDP to be repeated.

Structural reforms (eg pensions/healthcare reform or labour and product market reforms) can substantially improve government accounts in the medium to long term. The 2005 SGP reform package includes provisions aimed at ensuring that the budgetary objectives of the EU fiscal framework do not clash with such structural reforms.

APPENDIX 3

Analytical sections of "Public Finances in EMU 2006"

National fiscal rules and institutions

In the discussions on the 2005 reform of the SGP, the Council emphasised the importance of strengthening fiscal governance in the Member States. It advocated that national budgetary rules should be complementary to the Member States' commitments under the SGP. The Council also underlined that domestic governance arrangements should complement the EU framework, and that national institutions could play a more prominent role in budgetary surveillance. A discussion on this topic is planned for later in the year.

The Commission paper suggests that institutional settings at national level can play an important role in containing spending and deficit biases. These settings include in particular (i) the procedural rules of the budgetary processes (ii) the numerical fiscal rules which guide or impose restraints on policy makers and (iii) the independent bodies or institutions which provide forecasts, analysis and recommendations in the area of fiscal policy.

The Commission undertook a survey of the fiscal rules and institutions in the EU 25 in the period 1990-2005. While most of the rules applied to regional and local governments are statutorily based, rules applying to the whole of the general government sector tend to be based on political agreements and commitments. The survey concluded that numerical expenditure rules lead to lower deficits. Strong fiscal rules with automatic enforcement mechanisms seem to have a larger influence on budgetary outcomes.

The Commission's survey found no significant evidence of the development of "fiscal councils" in the member states. It distinguished existing institutions which (i) provide forecasts and analysis of fiscal policy issues and (ii) institutes issuing statements and recommendations on fiscal policy. The survey concluded that delegation of the forecasting activity could address biases in macroeconomic projections. The existing institutions appear to influence public debate and policy formation. There also seems to be a perception that independent fiscal institutions have contributed to fiscal discipline.

Fiscal policy in good times

The Commission's analysis is that pro-cyclical fiscal policies have been frequent in euro-area countries in the past decades. Since the completion of EMU, budgetary correction in bad times has become less common, but there is a greater incidence of pro-cyclicality in good times and it is mainly related to expenditure. The survey acknowledges that technical issues such as the calculation of the output gap and measurement of the economic cycle are possible mitigating factors. The Commission conclude that a possible response to the pro-cyclical issue is setting up national-level rules and institutions "that permit governments to credibly commit not to surrender to the pressures to increase spending or cut taxes in good times."

The Commission consider that independent "fiscal councils" which produce macroeconomic forecasts and budgetary impact assessments could assist in the operation of medium-term expenditure and revenue rules (with particular reference to the use of revenue windfalls or the establishment of rainy-day funds). This would support the objective under the reformed SGP of better fiscal consolidation in good times.

Comments on Analytical Sections
Ireland would be in a relatively strong position in terms of the institutional framework for fiscal policy. Budgetary policy is formulated in accordance with the SGP and a commitment to sustainable public finances. The arrangements for the control and monitoring of expenditure have been consistently updated in the context of public service modernisation. “Fiscal rules” include for example a medium-term expenditure framework and multi-annual capital budgets. Additional revenues are generally applied to improve the government balance. In relation to the fiscal council aspect, the ESRI like its European counterparts has a significant role in providing independent analysis on fiscal policy.

The findings of the Commission’s survey are not surprising. As it states, ultimately all fiscal policy has a redistributive aspect and nowhere has fiscal policy been delegated.

APPENDIX 4

Budgetary Surveillance for countries under EDP

Since spring 2005, the Commission and the Council took action on six Member States subject to an EDP. The EDP for the Netherlands was abrogated in June 2005. Article 104(7) recommendations were issued for Italy in June 2005, for Portugal in September 2005 and for the UK in January 2006. In March 2006, the Council addressed a notice to Germany under Article 104(9), which has to correct its excess deficit in 2007. The Commission and the Council also decided that Hungary has not respected the recommendations which it received under Article 104(7). Since January 2006, twelve EU countries are subject to the EDP: five euro area countries (Italy, Germany, France, Greece and Portugal), the UK and six new Member States. The up to date position on each of the EDPs is set out below.

2005 Correction Deadline

FRANCE: (in EDP since January 2003; to correct excessive deficit by 2005).
Deficit of 2.9% of GDP recorded in 2005, but is forecast to increase to 3.0% and 3.1% (on a no-policy-change basis) of GDP in 2006 and 2007 respectively.
Conclusion: Although the deficit has been corrected, abrogation at this point is not an option since there is no clear evidence of a substantial correction and there are risks attached to the forecasts. The matter should be reviewed following the autumn 2006 notifications.

CYPRUS: (in EDP since July 2004; to correct excessive deficit by 2006)
Deficit of 2.4% of GDP recorded for 2005 with projections that this will fall to 2.1% in 2006.
Conclusion: The excessive deficit has been clearly corrected. The Commission is expected to adopt a recommendation with a view to a Council decision on 11 July 2006 to abrogate the July 2004 decision.

2006 Correction Deadline (financial year 2006/2007 for UK)

GREECE: (in EDP since July 2004; to correct excessive deficit by 2006)
Deficit for 2005 was 4.5% of GDP and is projected to fall to 3.0% of GDP in 2006. The structural improvement is in line with the Council notice, but the deficit falls to 3% of GDP only because of significant one-offs (0.6% of GDP). In 2007, unless further consolidation measures are introduced, the deficit is forecast to rise to 3.6%.
Conclusion: There is no reason to act now. If the autumn 2006 forecast shows a deficit above 3% of GDP in 2006 and/or 2007, a repetition of the Council notice might be considered provided that the improvement in the structural balance required in the notice for 2006 (of at least 0.6% of GDP) is secured.

MALTA: (in EDP since July 2004; to correct excessive deficit by 2006)
Recorded a deficit of 3.3% of GDP in 2005 and this is set to fall to 2.9% in 2006.
Conclusion: While **Malta** seems to be on track to correct the excessive deficit in 2006, the spring forecasts envisage it increasing to 3.2% in 2007.

UK: (in EDP since January 2006; to correct excessive deficit by March 2007)
EDP was initiated by the Council in January following deficit figures of 3.3% of GDP for the financial year 04/05. The Commission forecast that this will fall to 3.0% in

06/07 and the structural improvement appears to be in line with the Council recommendation.
Conclusions: Action taken so far seems sufficient to ensure "adequate progress" overall towards the correction of the excessive deficit. However, there is zero margin below the reference value in financial year 2006/07 and there are several risks to achieving the budgetary targets. A further Commission assessment is due after the 24 July 2006 deadline for taking effective action.

2007 Correction Deadline
GERMANY: (in EDP since January 2003; to correct excessive deficit by 2007)
Following non-compliance with the 2005 correction of the excessive deficit, and taking account of the policy proposals of the new government, the Council agreed in March of this year that the deadline should be extended to 2007.
Germany recorded a deficit of 3.3% of GDP in 2005. Deficit forecast to fall to 3.1% in 2006 and 2.5% of GDP in 2007. However, the structural improvement falls short of the 1% of GDP recommended by the Council.
Conclusion: On the basis of currently available information, action taken so far seems sufficient to ensure "adequate progress" towards the correction of the excessive deficit according to the Council recommendations. A further assessment is due after Germany submit an update report on 14 July 2006.

ITALY: (in EDP since July 2005; to correct excessive deficit by 2007)
Italy recorded a deficit of 4.1% of GDP in 2005. The Commission's spring forecasts put the deficit at 4.1% of GDP in 2006 followed by an increase to 4.5% in 2007. **Conclusion:** The forecast confirms the significant uncertainties surrounding the correction of the excessive deficit by 2007 highlighted in the March 2006 Commission communication. In the coming months, close monitoring by the Commission and Council will be necessary to decide whether a stepping up of the procedure (leading to a Council notice under Article 104(9)) may be required.

POLAND: (in EDP since July 2004; to correct excessive deficit by 2007)
Deficit of 2.5% of GDP recorded in 2005 but the Commission forecast that this will rise to 3.0% of GDP in 2006 and 2007. However, after the implementation of the Eurostat decision (by spring 2007) on the classification of funded pension schemes, the deficit figures will be revised upwards by 2% of GDP.
Conclusion: As it is unlikely that Poland will correct the deficit by the Council deadline, it is likely that the Commission will review the matter later in the year and may propose further measures under the EDP.

SLOVAKIA: (in EDP since July 2004; to correct excessive deficit by 2007)
Recorded a deficit of 2.9% of GDP in 2005 which is projected to fall further to 2.7% and 2.1% of GDP in 2006 and 2007 respectively. However, after the implementation of the Eurostat decision (by spring 2007) on the classification of funded pension schemes, the deficit figures will be revised upwards by 1.25% of GDP.
Conclusion: No steps under the EDP required for this year however a stronger fiscal effort will be needed in 2007.

2008 Correction Deadline
CZECH REPUBLIC: (in EDP since July 2004; to correct excessive deficit by 2008)

Kevin

I wd favour a much more summary formal minute as a record of the meeting. Cld you revise on that and have draft pl. We do need more detailed draft notes for our own follow-up etc.

Report of DSG meeting of 30 July 2007

Present:

Dept of Finance:	W. Beausang (Chair), P. Ryan, K. Nolan
Central Bank:	Tom O'Connell, Anne Marie McKiernan
Financial Regulator:	Con Horan

1. FOI and information exchange in the context of the DSG A DoF paper outlined advice received from the AG's Office in relation to the implications of FOI for information exchange in the context of the DSG. The advice indicated that information coming within the scope of the professional secrecy provisions of the Supervisory Directives would be protected by the secrecy provisions of the FOI Act. It was further noted that information on general financial stability issues that might not come within the scope of the Supervisory Directives would be likely to secure exemption from release under one or more of the exemption provisions in the FOI Act.

Action points arising:

- Con Horan undertook to consult the FR's legal side to confirm that general financial stability issues would not be comprehended by the Supervisory Directives.
- DoF to respond to FSC request for details of any obstacles to information exchange in national laws/frameworks by 4 September 2007 (item is on FSC agenda for 18 September).

2. Business Continuity Planning It was noted that work in the area of BCP has been underway internally in the CB and in groups such as the IBF's Systemic Risk Forum which has sub-groups dealing with Payments Systems, Liquidity/Funding and [A-MMcK to provide 3rd sub-group's title]. At the invitation of the IBF, the CB and FR have been represented on the SRF. DoF had also recently begun attending the SRF [at the IBF's invitation ??].

The SRF is preparing to conduct a simulation exercise based on a business continuity scenario as opposed to a financial crisis issue. The latter will be the basis for the DSG's planned simulation exercise which is to take place before January 2008. The CB's current BCP focus is on its own internal operational preparedness. Above this the CB and FR monitor private sector business continuity issues through a joint committee. [A-M McK to provide title of this committee]

Anne Marie McKiernan will meet shortly with the Michael Maher from the CB's financial operations side to examine the degree of overlap if any that exists in the various groups' work on BCP. With this information it will be possible for the DSG to consider whether it needs to establish its own sub-group on BCP or if it would be sufficient for it to receive regular reports on the work of the various groups mentioned.

The meeting had an update paper from the Dept of Finance on developments with the EU programme for critical infrastructure protection which noted inter alia the UK Treasury's case for exclusion of financial services from the scope of the proposed

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Directive and summarised the ECB's formal opinion on it. DoF will continue to update the DSG on this item.

Action points arising:

- Outcome of CB's assessment of possible overlap of BCP efforts to be reported on at next DSG meeting.
- BCP to be a standing item on the DSG agenda.
- DoF to keep DSG up-to-date on EU CIP proposals.

3. DSG work programme A discussion document for the meeting outlined priority work items for the remainder of 2007. Discussion focussed on the conduct of a crisis simulation exercise and the development of national contingency plans. The EFC timetable for delivery of both these items is January 2008.

CB is currently working on an outline scenario for the simulation. To provide an effective exercise in a short period, the plot needs to involve a sudden and significant shock to the financial system. As the simulation is meant to test DSG members' preparedness, the plot will need to encompass elements of active involvement by DoF and provide robust testing of cooperation and information sharing procedures. For these reasons scenario definition requires careful consideration and planning. For obvious reasons it is essential that players in the simulation are not involved in its design. For this reason, Anne Marie McKiernan will liaise with Ciara Lonergan in DoF in relation to plot modelling issues.

It was noted that the outcomes of the domestic simulation conducted by the CB/FR and more recent EU level exercise of April 2006 should assist in the development of a working document for the proposed DSG exercise.

Ideally finalising of a national contingency plan would follow completion of the simulation exercise. However in light of the common EU deadline for these items, it was agreed that the procedures to be followed in the simulation would be reviewed as part of the post-simulation assessment. The revised procedures, which would in effect be the national contingency plan, would then feed into the more detailed crisis management manuals for each of the DSG parties. The inter-linkages between the DSG members' manuals, for example in relation to informational requirements, will need to be identified and fully addressed.

Action points arising:

- CB will continue to refine the simulation scenario in August/September with a view to issuing documentation to the players in October. This timetable will enable the simulation exercise to be undertaken in December 2007. A pre-simulation trial would be held about three weeks before the actual simulation.
- Anne Marie McKiernan will liaise with Ciara Lonergan in DoF regarding scenario modelling for the crisis simulation exercise.

4. Update on financial stability A number of issues around vulnerabilities and risks to financial stability were discussed. Some of these have been addressed in the first iteration of the 2007 FSR which will be presented to the CB Board shortly{?}. The final iteration, to be presented to the Board in September, will take account of more

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recent issues and developments [including for example sub-prime mortgage developments in the US.]

5. Update on developments at EU FSC and EFC The FSC has been monitoring MS's compliance with the timetable set out in the EFC *"Next Steps"* document in relation to the establishment of Domestic Standing Groups, putting in place of national contingency plans and carrying out of crisis simulation exercises. A comprehensive assessment of the position in MSs was presented to the July 2007 FSC meeting. The FSC will report formally on the position to the EFC meeting of 4-5 September 2007 as part of the Financial Stability Table agenda items. The FSC assessment indicated unevenness in progress with some MSs in danger of missing targets.

At its 18 September 2007 meeting the FSC will discuss the way forward in putting into effect the conclusions of the final report of the ad-hoc working group on developing EU financial stability arrangements. This is with a view to providing advice to the EFC/ECOFIN. (The ad hoc group's final report will be presented to the EFC at its 4/5 September 2007 meeting).

Action point arising:

- DoF to furnish Con Horan with a copy of the FSC July 2007 updated assessment of national arrangements for financial stability and crisis management.

6. AOB Con Horan raised the issue of Level 3 Committees and progress in supervisory convergence. Mr. Beausang reported that at the June 2007 FSC meeting there was general agreement that L3 committees had achieved a lot in a short period but that there were limits to what they could accomplish. There was a feeling that the tools now available to promote supervisory convergence should be utilised by supervisors. Clarification was necessary as to the limits of the L3 committees' mandates.

7. Next Meeting A date in early October was preferred as by then the final draft of the 2007 FSR will have been presented to the CB Board which should provide further analysis of some of the issues discussed under item 4.

Action point arising:

- Agree date in early October for next DSG meeting.

F007/145/10/003

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Report of DSG meeting of 30 July 2007

Attendance:

Dept of Finance:	W. Beausang (Chair), P. Ryan, K. Nolan
Central Bank:	Tom O'Connell, Anne Marie McKiernan
Financial Regulator:	Con Horan

1. FOI and information exchange in the context of the DSG

The Department updated the Group on the advice received by the Department from the Office of the Attorney General on this issue. The Financial Regulator undertook to provide further information to the DSG on the application of the secrecy provisions of the EU Supervisory Directives in respect of financial stability issues.

Item (2)

2. Business Continuity Planning (BCP)

It was agreed that this should be a standing item on the DSG's agenda. The Group noted progress in this area in the CBFSAI. It was agreed that the Group will need to consider in due course how best to ensure that its work is informed over time by the work of the IBF's Systemic Risk Forum as appropriate.

Item (3)

3. DSG work programme

The Group noted that the CB was working on an outline scenario for the proposed simulation exercise. This is intended to encompass elements of active involvement by DoF and provide robust testing of cooperation and information sharing procedures. An update on this project will be provided at the Group's meeting in October.

4. Update on financial stability

The DSG noted and discussed the main issues emerging in the context of the CBFSAI's ongoing work on the preparation of its annual Financial Stability Report.

5. Update on developments at EU FSC and EFC

DSG noted the FSC's assessment of MSs' state compliance with the timetable set out in the EFC *"Next Steps"* document for financial stability planning arrangements.

6. Next Meeting October 2007 on a date to be agreed

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Report of DSG meeting of 30 July 2007

Attendance:

Dept of Finance:	W. Beausang (Chair), P. Ryan, K. Nolan
Central Bank:	Tom O'Connell, Anne Marie McKiernan
Financial Regulator:	Con Horan

1. FOI and information exchange in the context of the DSG DSG noted AG's Office advice that information coming within the scope of the professional secrecy provisions of the Supervisory Directives would be protected by the secrecy provisions of the FOI Act. It was further noted that information on general financial stability issues that might not come within the scope of the Supervisory Directives would be likely to secure exemption from release under one or more of the exemption provisions in the FOI Act. FR's legal side is to be consulted to confirm that general financial stability issues would not be comprehended by the Supervisory Directives.

2. Business Continuity Planning DSG noted that work in the area of BCP has been underway internally in the CB and in the IBF's Systemic Risk Forum and its sub-groups dealing with Payments Systems, Liquidity/Funding and [A-MMcK to provide 3rd sub-group's title]. CB will consider the degree of overlap if any that exists in the various groups' work and report to next DSG meeting. BCP will be a standing item on the DSG agenda.

3. DSG work programme DSG noted that the CB was working on an outline scenario for the crisis simulation exercise. To provide an effective exercise in a short period, the plot needs to involve a sudden and significant shock to the financial system and, as the simulation is meant to test DSG members' preparedness, the plot will also need to encompass elements of active involvement by DoF and provide robust testing of cooperation and information sharing procedures.

CB will continue to refine the simulation scenario in August/September with a view to issuing documentation to the players in October. A pre-simulation trial would be held about three weeks before the actual simulation.

4. Update on financial stability A number of issues around vulnerabilities and risks to financial stability were discussed. Some of these have been addressed in the first iteration of the 2007 FSR which will be presented to the CB Board shortly{?}. The final iteration, to be presented to the Board in September, will take account of more recent issues and developments [including for example sub-prime mortgage developments in the US.]

5. Update on developments at EU FSC and EFC DSG noted that an FSC assessment of MS's state compliance with the timetable set out in the EFC *"Next Steps"* document for the establishment of Domestic Standing Groups, putting in place of national contingency plans and carrying out of crisis simulation exercise indicated unevenness in progress with some MSs in danger of missing targets.

6. AOB DSG noted that at the June 2007 FSC meeting there was general acknowledgement that Level 3 committees had achieved some progress on supervisory convergence in a short period but that there were limits to what they

Record 10

could accomplish. There was a feeling that the tools now available to promote supervisory convergence should be utilised fully by supervisors.

7. Next Meeting October 2007 on a date to be agreed

Action points arising:

- Con Horan to consult FR's legal side to confirm that general financial stability issues would not be comprehended by the Supervisory Directives.
- Outcome of CB's assessment of possible overlap of BCP efforts to be reported on at next DSG meeting.
- CB will continue to refine the simulation scenario in August/September with a view to issuing documentation to the players in October.
- Anne Marie McKiernan will liaise with Ciara Lonergan in DoF regarding scenario modelling for the crisis simulation exercise.
- Agree date in early October for next DSG meeting.

THEME: C1

Effectiveness of the ECOFIN and Domestic Standing Group (DSG) (Central Bank, Financial Regulator and Department of Finance)

LINE OF INQUIRY: C1c

Role, responsibilities and objectives of the Domestic Standing Group (DSG)

(439)

Lonergan, Ciara

From:	Lonergan, Ciara
Sent:	08 October 2007 14:40
To:	'con.horan@financialregulator.ie'; 'tom.oconnell@centralbank.ie'; McKiernan AnneMarie
Cc:	Manley, Michael; Beausang, William
Subject:	Summary of CBFSAI assessment of financial market developments from DSG meeting 3 October
Attachments:	DSG 3 October - CBFSAI assesment of financial market developments.doc

Dear all

The attached summary of the current market situation, as discussed at the DSG meeting 3 October is intended to be submitted to the Tánaiste for this weeks' Government meeting - we'd be glad of clearance at your earliest convenience.

DSG 3 October - CBFSAI assesme...

Thanks very much

Ciara Lonergan

Taxation and Financial Services Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2
Telephone: (01) 6045677

F047/145/10/08 (4)

1. Mr Beausang - to see please
2. Tánaiste – from Michael Manley

Confidential

Subject: Update on Financial Issues - Government Meeting 9 October 2007

CBFSAI report on the Financial Sector

Please find attached most recent CBFSAI report on the financial situation. In summary:

- There are continuing signs of a return to more normal financial market conditions but wholesale lending rates remain high particularly in the eurozone
- The recent disclosures by major investment bank on sub-prime write-downs have improved market sentiment
- Lenders are differentiating between financial institutions on the basis of their potential sub-prime exposure.
- Irish banks currently have a "good-name" in the market on account of their low sub-prime exposure and low dependence on short-term funding
- Retail lending rates in Ireland will remain under upward pressure for as long as disturbed credit market conditions persist
- Even with recent improvements in liquidity conditions, there is a general tightening of lending behaviour which is likely to persist.
- There have been significant losses incurred by high net worth individuals in relation to Contracts for Differences (CFD)

Deposit Protection Issues

On 1 October last an increase in UK deposition protection scheme to a guaranteed 100% of deposits up from £31,700 to £35,000 (euro equivalent €50,500) was announced along with a review of the need for further changes. In your speech for the 2nd Stage of the MiFID Bill on 2 October you signalled the need to review deposit guarantees arrangements in light of developments in the UK. It is now expected that the Commission and the EU Financial Services Committee (FSC) are to be given a mandate by Ecofin on 9 October to review possible enhancements of Deposit Guarantee Schemes in the EU and report by mid – 2008. This will provide the context for a review of the Irish scheme, including the maximum guarantee level and the operation and funding of the scheme.

Department and CBFSAI interaction regarding financial issues

The Department, together with the Central Bank and Financial Regulator is working through the Standing Group on Financial stability (DSG) to continue to monitor the developments in financial markets, any regulatory issues arising for Ireland and domestic financial stability arrangements.

8 October 2007

cc Secretary-General, Mr Cardiff, Mr Steadman

10/WB/16
(4)

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2. Tánaiste – from Michael Manley

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8 October 2007

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CBFSAI assessment of financial market developments – 2 November 2007

The level of activity in the interbank lending market remains low

In the eurozone area, the level of lending activity in the interbank market remains low by normal standards although there are signs of some improvement. The 1 month market has improved significantly but the 3 month market is still very inactive.

The interbank interest rate remains high

The interbank lending interest rate remains higher than the base interest rate of 4%, particularly in the 3 month market. The spread has narrowed from a peak of 4.795% on 2nd October to 4.589% [Tuesday 6 November rate] at the present time. However the market is quite volatile as demonstrated by the response of 3 month money on 1 November to the larges losses disclosed by Merrill Lynch as well as the perception in the markets that there are institutions that have a significant, as yet undisclosed, subprime exposure. The 3 month rate is an important determinant of retail lending rates for the Irish banks - its continuing high level maintains upward pressure on lending rates charged to individuals and business.

"End-of year premium" will increase costs of accessing liquidity in the interbank market but ECB can inject liquidity into the market if required.

At the end of the year there is usually a premium for cash as credit institutions close off their positions. In the current market conditions this "end-of-year premium" will be adding to the risk premium already present, which is causing the high interest rates in the interbank market. This could cause further problems for credit institutions who want to access liquidity during Quarter 4. The ECB is very conscious of the prospect of an upward spike in wholesale interest rates and is likely to intervene as required to provide liquidity to the market. An increased level of adverse disclosures by financial institutions in the end-year reporting season could exacerbate market conditions.

Irish banks are generally able to access their funding requirements with undue difficulty though the funding available is quite short.

They are reporting to the CBFSAI that they are not having any significant difficulties in meeting any funding requirements through the interbank market but the funding available is increasingly shorter term. This is compressing the maturity profile of the banks' funding which in circumstances that there were a resurgence in credit market difficulties would increase funding pressures in Irish banks. Given the general nervousness of international financial markets, Irish banks are also concerned about the potential impact any negative domestic event could have on their access to funding.

A number of Irish banks will be looking to rollover their longer term funding arrangements in early 2008. Banks are currently developing contingency arrangements for this rollover in case the wholesale liquidity market difficulties continue.

A number of Irish financial institutions have significant funding requirements in the course of Q1 of 2008. In advance of this they are taking a number of steps to prepare for an eventuality that this funding rollover takes place against the backdrop of a resurgence of difficulties in international credit markets. These include steps to build up collateral requirements through, for example, securitisation transactions that will facilitate borrowing from the ECB if they are not able to access liquidity from the usual channels in those circumstances.

The share price of Irish banks has continued to fall.

Irish bank share prices have continued to fall and have lost between 30% and 40% of their value since the start of 2007. The decrease in value of Irish banks shares has been greater than in other countries. (There is a general discount in the value of Irish banks as there is a perception internationally that they are exposed to the property market). It is also understood that some international hedge funds may be targeting the share price of at least one Irish bank. There is continuing speculation that major Irish banks may become very attractive for takeover bids if their share price continues to fall.

The recent press coverage of the problems of two Irish solicitors has been noted internationally

The Irish banks report that there was an international reaction to the media coverage of the exposure of Irish banks to potential losses due to the property market speculation of two Irish solicitors. This sensitivity in the markets underlines the possibility for reputational damage for Ireland which could have a far greater effect than any losses suffered by individual institutions due to the solicitors' actions. The weaknesses in some banks' lending practices disclosed by the abuse of solicitors' undertakings are being addressed. However, the scale of the potential losses do not give rise to any significant prudential concerns.

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10/WB/18

November, 2007

Oifig an Aire Airgeadis

Memorandum for the Information of Government

Financial Markets Developments

1. Matter-Issue for Information

The Tánaiste is submitting this Aide Memoire, in accordance with his commitment, to keep the Government informed of ongoing developments in the financial markets and their possible impact on Ireland. The Aide Memoire is based on the attached report of the Central Bank and Financial Services Authority of Ireland (CBFSAI) agreed following the recent meeting of the Domestic Standing Group on Financial Stabiltiy composed of the Department of Finance, the Central Bank and the Financial Regulator.

2. Background-Reason for Aide Memoire

There have been some improvements in credit market conditions. The actions of international central banks over recent months in providing liquidity to the marketplace and in cutting interest rates (Federal Reserve) or holding bank on interest rates increases (ECB) and have supported)confidence. Disclosures by major financial institutions of their losses have reduced uncertainty. However, confidence remains fragile, financial market conditions remain volatile and the expected normalisation of wholesale lending market conditions has not taken place to date.

At an international level, there are continuing concerns regarding such issues undisclosed losses and incomplete information (exacerbated by losses of almost $8bn written by Merril Lynch in its Q3 results, the CEO having previously announced losses of ?), the state of the US property market and the lack of a policy response to its deterioration) and the slow progress achieved by initiatives to restore confidence (e.g. Superfund proposal by some major investment banks to buy up CDO assets and repackage them for sale to investors).

3. Interbank market

The level of activity on the wholesale interbank lending market remains low and wholesale interest rates that banks rely on significantly to fund their activities remain high. Accessing funding through this market is difficult and the approach of year end will introduce a premium for cash as banks look to close their positions, increasing the cost of liquidity above its already high level.

4. Irish Impacts

To date, these developments have not has any serious affects the Irish domestic financial system over and above their international impact but a number of areas remain a focus of attention.

Domestic Irish institutions are financially sound with good quality assets and are well regulated. However, the general tightening of access to credit has required careful attention to liquidity management and work on contingency planning is being undertaken by financial institutions (e.g. seeking to restructure asset holdings to ensure these can be used as collateral for credit). At various times of the year, banks 'roll over' their credit positions, leading to a certain 'lumpiness' (i.e. periods when relatively significant portions of debt have to be rolled over). Irish banks face such a period early in the New Year, which may coincide with what some expected to be a 'second-round' of serious funding difficulties in international markets.

Irish banks have a good name internationally and have an asset base that that can be used as collateral to access liquidity within the Eurosystem. However, more generalised concerns about the Irish economy and the exposure of banks to the property sector has resulted in Irish banks having to pay a premium in accessing liquidity, and share prices have been depressed (making them increasingly attractive for takeover). In this context and the current heightened sensitivity of the international financial system, recent reports of wrongdoing by lawyers in relation to borrowing, though the amounts are small in the overall context, have been unhelpful but are of a scale that there is no potential for any prudential concerns..

The domestic financial institutions do not have significant direct exposure to sup-prime lending, though a number of SPVs are registered in Ireland. While the resolution of any difficulties these encounter is a matter for their parent organisations and the supervisory authorities, reputational risks for Ireland remain.

On the longer term economic situation; there has been recognition that global credit difficulties will have an effect beyond the purely financial realm, though it is too early yet to determine the full extent. Increasingly international commentators are factoring in that the increased cost and reduced availability of finance will spillover into lower economic growth internationally in 2008.

5. The Central Bank's Financial Stability Report

The Central Bank's annual Financial Stability Report will be published on Wednesday 14 November 2007 (check). This report is a comprehensive and authoritative assessment of the state of financial stability in Ireland and is likely to give rise to significant public and media attention. The key messages from the report are expected to be as follows:

[Reproduce material included in the CBFSAI report when we have it]

6. Contingency Planning

The DSG is continuing its work in line with EU requirements to strengthen financial stability planning arrangments in Ireland. This comprises part of the Government's Emergency Planning Arrangements generally. The DSG is also examining the lessons for Ireland from developments in Northern Rock in the UK including in relation to the powers available to the CBFSAI and the Minister for Finance to respond to any such situation arising in Ireland as well as the issues for Ireland arising from the EU review of Deposit Guarantee arrangments.

7. Conclusion

It is important to emphasis that the Irish banking system is strong, liquid and well capitalised. However, should current market conditions continue Irish banks could have difficulties in accessing funding and may even be subject to a hostile takeover bid. It is important to continue to monitor the situation and the Financial Regulator has increased the frequency of its liquidity reporting requirement. In addition the FR will meet with the Treasury Departments of the major banks in Ireland to discuss possible pressure points for funding as well as contingency plans should the interbank market remain tight..

(4)

WPR

1. Mr Ryan to see

2. Ms Lonergan

To:

1. Mr. K Nolan
2. Mr. P ~~Ryan~~ WPR
3. Mr. W Beausang ✓ WB 19.3

Can you email to CB IFR perhaps for any final changes. Ths

WB 21.3

cc: Kevin Cardiff

Re: Initiating Domestic Standing Group for crisis management / financial stability – meeting 6 March 2007

Please see attached note which outlines the main points arising at a meeting between Department of Finance, Central Bank and Financial Services Authority of Ireland and the Financial Regulator, where the establishment of a Domestic Standing Group was discussed.

Ciara Lonergan

Ciara Lonergan
19th March 2007

Note of Meeting between Department of Finance, Central Bank and Financial Services Authority of Ireland (CBFSAI) and Financial Regulator re initiating Domestic Standing Group for crisis management/financial stability 6 March 2007

Attendance:	CBFSAI:	Tom O'Connell Tony Grimes Ann Marie McKiernan
	Financial Regulator:	Con Horan
	Department of Finance:	William Beausang Phil Ryan Ciara Lonergan

This note records the main points arising

1. **Role of DSG**
It was agreed that the role of the DSG is to co-ordinate information sharing between the CBFSAI, the Financial Regulator and the Department of Finance within the framework of the current legal powers of each authority. The existing roles and responsibilities of all three authorities will remain unchanged. The DSG will gather together information and will be briefed on work on financial stability issues being undertaken in the three authorities. The DSG will operate at a macro level overseeing the financial stability environment generally and appropriate planning arrangements. The DSG will also plan and manage crisis simulation exercises. It may be appropriate for the DSG to set up working groups examining for example in more detail relevant BCP/critical infrastructure issues (see point 3 below)

2. **Interaction of DSG with the existing financial stability framework**
The DSG should dovetail with the existing stability framework, without overlapping with current arrangements. The Financial Stability Committee of the CBFSAI and the Financial Regulator examines financial stability at a macro level. There may be "added value" by the inclusion of the Department of Finance perspective, for example the economic and tax side may have useful information to input into the assessment of the DSG. The meetings of the DSG could align with FSC meetings to facilitate the information sharing role of the DSG.

3. **Business Continuity Planning (BCP)/Critical infrastructure Protection (CIP)**
The CBFSAI's current work on BCP has two strands. The first strand is internal BCP for the CBFSAI's operations. This is currently being developed with the aim of having all systems replicated in the Sandyford Currency Centre. The second strand involves dialogue with industry in relation to BCP in the financial sector. The CBFSAI is currently talking to the IBF, who have been working on BCP issues independently. The CBFSAI does not become engaged at a detailed level with this type of BCP but needs to be assured that appropriate BCP is in place in the industry. Discussions carried out with the IBF have looked at the main issues: liquidity, payments system and broader "cash" issues.

The EU proposals for CI protection relate to European Critical Infrastructure (ECI) which is "those infrastructures, the destruction or disruption of which would ***affect two or more member states*** or a single Member State if the critical infrastructure is located in another Member State." In relation to the financial infrastructure in Ireland the key ECI is the Target payment system
With respect to the DSG, the DSG's role in BCP/CIP needs to be explored in detail. The extent to which a problem with the financial infrastructure is an issue for the DSG will need to be scoped out – the key issue is whether an infrastructural problem will lead to systemic problems. It will be important in examining this issue to also look at the probabilities of different scenarios and their impact on the financial system overall.

4. **Crisis Vs Non-Crisis role of DSG**
It is important to distinguish between the appropriate role of the DSG during a time of crisis and during non-crisis times. Generally its role will be as described in point 1 above. In a crisis situation the DSG's role will be to advise the principals in each authority. As in a non-crisis situation, the roles and responsibilities of each authority are without prejudice to the exercise of statutory responsibilities by the constituent authorities. The majority of work required for any support operation would take place within each authority with the DSG facilitating information sharing and co-operation between the organisations.
The benefit of the DSG in a crisis situation is that its members will have developed their familiarity with the procedures and issues arising in such a situation, through briefing and simulation exercises. These simulation exercises will help clarify the role of the DSG in a crisis situation. Some further examination of the DSG's specific role in a crisis may be required.

5. **Membership of DSG**
The general business of DSG will be undertaken at the level currently attending these preliminary meetings, with representatives from the CBFSAI, the Financial Regulator and the Department of Finance.
In addition to the three organisations who make up the DSG, in times of crisis the DSG may need the assistance of other public authorities (e.g. the Office of the Attorney General, the Department of Enterprise, Trade and Employment and the NTMA). The DSG may have to ensure that there is a contact point in each organisation available as required. This may be included as part of the three authorities' operational manuals rather than outlined in the MoU governing the DSG.

6. **Public disclosure/confidentiality**
The European Central Bank has tended to say very little about financial stability planning/financial crisis management arrangements. The MoU on crisis management and the tripartite cross border MoU between Ministries of Finance, Central Banks and Authorities are not published. The CBFSAI has tended to follow the ECB's example and has not published material on financial crisis management.
Practice on whether DSG and financial crisis arrangements are publicised varies from country to country in the EU. Those that have published information (e.g. UK, Sweden) have tended not to be in the Euro system

although the Benelux countries, particularly Belgium, have a significant amount of information in the public domain.

7. **Future EU Developments**
The work of the EFC Ad hoc Working Group on financial crisis management may lead to further requirements for Member States in this area. The Group's interim report is to be presented at the EFC meeting in March.
Financial stability/financial crisis management requirements may be raised at the EFC Financial Stability Table in April and September.

8. **Next Steps: Memorandum of Understanding**
A key priority for the DSG is the preparation of a draft MoU outlining the composition of and role of the DSG and the member's roles and responsibilities, highlighting the fact that the establishment of the DSG does not affect the existing legal framework. The Department of Finance will draft a preliminary MoU to be circulated to all parties and arrange bilateral meetings as required. The agreed draft would then be discussed at a meeting after Easter and the preliminary agreed draft could then be submitted for approval in the Department of Finance, the CBFSAI and the Financial Regulator.

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Ciara Lonergan

THEME: C1

Effectiveness of the ECOFIN and Domestic Standing Group (DSG) (Central Bank, Financial Regulator and Department of Finance)

LINE OF INQUIRY: C1d

Adequacy of the DSG process, including a consideration of the bank resolution legislation

EUROPEAN ECONOMY

Occasional Papers 76 | February 2011

The Economic Adjustment Programme for Ireland

Directorate-General for Economic and Financial Affairs

Economic
and Financial Affairs
DIRECTORATE-GENERAL

EUROPEAN COMMISSION

deposits with a maturity of post-September 2010[10]. While the guarantees have provided some relief to banks, they have not allowed them to restore their access to term market funding. The ELG Scheme has been prolonged to 31 December 2011 for all liabilities under the Scheme, subject to continuing EU Commission state aid approval at six-monthly intervals.

14. **The government also took action to strengthen banks' capital.** Given banks' difficulties to find a private solution to their capital needs, the government provided additional capital in cash or through promissory notes[11] to five domestic institutions, Irish Life and Permanent being the exception. A second measure the government took with a view to providing impaired assets relief to banks was the establishment of the National Asset Management Agency (NAMA, see Box 1). In total, some €46 billion (29% of GDP) has been injected in domestic banks over the period 2009-2010 (see Table 2). This amount does not include additional recapitalisations which will be identified under the EU/ECB/IMF Programme and injected over its course.

Table 2: Capital injections into Irish banks during the crisis (as of 28 January 2011)

Anglo Irish Bank ***(Nationalised in January 2009)***	**Total**: **€29.3bn** (18 1/3 % of GDP), including o €4 bn (June 2009) o €8.3 bn in form of a promissory note (March 2010), increased to 10.3 bn (May 2010). o €8.6 bn through a promissory note (notified June 2010, approved by the Commission on 10 August). o €6.4bn (of which €1.5bn already approved in August 2010) through a promissory note (December 2010),
Allied Irish Bank (AIB)	**Total: €7.2bn** (4½% of GDP), including o €3.5 bn (2¼% of GDP) in preference shares, via the National Pension Reserve Fund (NPRF) (February 2009) (*As part of the capital injection approved by the Commission in December 2010, all preference shares were converted into ordinary shares to increase the equity in the bank*) o €3.7bn cash investment by the NPRF in equity (December 2010)
Bank of Ireland (BoI)	**Total: €3.5 bn** (2¼% of GDP) in preference shares, via the NPRF (February 2009) of which €1.7 billion were converted into equity as part of BoI's capital raise in April 2010
Irish Nationwide Building Society	**Total: €5.4bn** (3½% of GDP), including o €0.1bn through special investment shares (March 2010) o €2.6bn in form of a promissory note (March 2010) o €2.7bn in form of a promissory note (December 2010)
EBS Building Society	**Total: €0.9bn** (½% of GDP) o €0.1bn through special investment shares (March 2010) o €0.25bn in form of a promissory note (June 2010) o €0.525bn in form of special investment shares (December 2010)
TOTAL	**€46.3bn (29% of GDP)**

Note: In addition, covered institutions benefit from the *bank guarantees* granted by the Irish authorities and have *transferred impaired property-related assets* to the bad bank "NAMA".
Source: Commission services

[10] The liabilities covered include: all deposits (to the extent not covered by deposit guarantee schemes in the State (other than the Credit Institutions Financial Support Scheme) or any other jurisdiction); senior unsecured certificates of deposit; senior unsecured commercial paper; other senior unsecured bonds and notes. In addition, a blanket guarantee will apply to all relevant deposits incurred or rolled-over by a participating institution from the time such participating institution avails of a guarantee under the ELG Scheme for the first time, regardless of type, nature or the identity of the depositor.

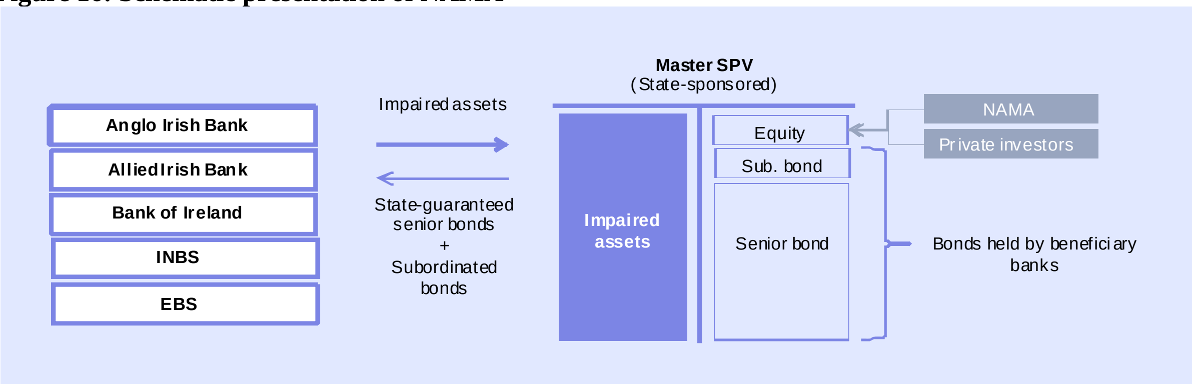
[11] Debt securities issued by the Irish State which qualify as core Tier 1 capital for the purpose of the calculation of Irish banks' regulatory capital adequacy ratio. The nominal amount of these securities is not disbursed immediately but over a 14 year period. The holder of these securities is also entitled to receive a coupon from the Irish State.

Box 1: The National Asset Management Agency (NAMA)

In December 2009, the Irish authorities established the National Asset Management Agency (NAMA), in order to arrange and supervise the purchase (as initially estimated) of approximately €82.5 billion worth of land, development property and associated commercial loans (together with associated derivatives). There are five financial institutions participating in the scheme: Anglo Irish Bank, Allied Irish Bank, Bank of Ireland, Irish National Building Society, and Educational Building Society. The minimum threshold for assets to be transferred to NAMA was initially set to €5 million for AIB, Anglo Irish Bank and Bank of Ireland. This threshold was raised to €20 million for AIB and Bank of Ireland in September 2010.. However, the minimum threshold will be removed for BoI and AIB as envisaged by the EU/ECB/IMF financial assistance programme.

NAMA is not directly involved in acquiring impaired assets and issuing bonds (see Figure 16) In order to achieve its objectives, NAMA established a special purpose vehicle (SPV), which is responsible for the purchase, management and disposal of loan assets from participating institutions and financing such purchases through the issuance of debt securities. The SPV is owned jointly by private investors (51%) and NAMA (49%). The purchase price of assets is paid through the issuance by the SPV of State-guaranteed senior debt securities (essentially IOUs) for 95% of the purchase price and the issuance of (non State-guaranteed) subordinated debt securities for 5%. The issued securities are held by the participating credit institutions pro rata their share in the assets transferred to NAMA. Table 3 presents a breakdown of assets transfers to NAMA by institution. The State-guaranteed debt securities could then be used by the participating credit institutions as collateral to receive financing from the European Central Bank, helping to improve the liquidity position of these banks.

Figure 16: Schematic presentation of NAMA



Source: Commission services

This institutional set-up implies that while NAMA is classified as part of the government, the SPV (as a company in which NAMA holds only a minority stake) is not.

The first two tranches of assets were respectively transferred in May and in August 2010, representing a total amount of respectively € 15.4 and € 11.9 billion. The assets were transferred to NAMA with an average haircut of respectively 50.2% and 55.7%. In September 2010, the Irish authorities announced that the remaining (NAMA eligible) assets (amounting to €46 billion) would be transferred in a single tranche to NAMA by the end of 2010 / early 2011. As of mid-January 2011, €71.3 billion had been transferred with an average discount of 58%. The transfer of the remaining €3.7 billion was expected to be completed by Q1 2011.

Table 3: Estimated NAMA Transfers (as at 20 January 2010)

	AIB	BoI	Anglo	INBS	EBS	Total
Loans > Eur 20 mn						
Loan Nominal (Eur bn)	18.5	9.4	34.0	8.5	0.8	71.3
Consideration (Eur bn)	8.5	5.5	13.0	3.0	0.3	30.3
Discount	54%	42%	62%	64%	60%	58%
Loss	10.0	3.9	21.0	5.5	0.5	41.0
Loans < Eur 20 mn (Expected) *						
Loan Nominal (Eur bn)	4.40	2.10				6.50
Consideration (Eur bn)	1.94	1.26	Not applicable			3.20
Discount	56%	40%				51%
Loss	2.46	0.84				3.30

(* Initial information as of September 2010)

Source: Commission services

REVIEW OF NATIONAL ORGANISATIONAL CAPABILITY FOR THE MANAGEMENT AND RESOLUTION OF SYSTEMIC FINANCIAL CRISES

"It is important to have a framework for crisis management in place before you need to use it. This …can help make any future crisis less painful. Having a framework in place requires the authorities to be aware of the complexity of the process, to have authority established to make decisions, and to delegate responsibility once the broad principles have been determined at the political level".[1]

[1] Remarks by Stanley Fischer First Deputy Managing Director International Monetary Fund Seminar on Policy Challenges for the Financial Sector in the Context of Globalization Sponsored by the World Bank, IMF, and the Board of Governors of the U.S. Federal Reserve System Washington, D.C., June 14, 2001

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Part VI: Recommendations

INTRODUCTION

"We believe that financial crises can be foreseen, their magnitude can be estimated, precautionary steps can be taken to prevent crises, strategic options can be devised and implemented and corrective measures can be taken to lessen the storm's ultimate impact. Leaders with the foresight to observe and react effectively can manage a crisis strategically before, as well as after, a crisis hits."[2]

This Review has its origin in the work going on at European Union level in regard to the prevention, management and resolution of financial crises in the Member States of the European Union. Specifically all member States have been enjoined by the Economic and Financial Committee to put arrangements in place to prevent, manage and resolve financial crises. Secondly member States have been requested to conduct financial crisis simulation exercise to assess the organisational response capability of national competent authorities to any future financial crises that has systemic implications.

This imperative resulted in the preparation of a Black Book by the CBFSAI setting out their views on the arrangements that should be put in place to manage and resolve any systemic financial crisis that may arise in Ireland. Issues in relation to the prevention of financial crises are being dealt with separately mainly in the context of the development of the regulatory and supervisory regime for financial services at European Union level. Lesser financial crises where there are no systemic implications or where the entity is not deemed too big to fail (TBTF) will be the subject of a further exercise. Many of the recommendations made here, will however, have relevance to those situations also. The Black Book exercise is to be welcomed even in its incomplete form. It provides an excellent starting point from which to devise an optimum strategy for dealing with management and resolution of systemic financial crises in Ireland.

The Black Book makes certain tentative suggestions about the role and function which the Department of Finance and the Minister should play in the resolution of a major financial crisis. The Black Book is still being developed so cannot in any sense be regarded as a complete or final work. The major drawback of the Black Book is that it is mainly focussed on the decision-making procedures and devotes no time to the optimum structures and systems that should be put in place to deal successfully with a financial crisis. Furthermore strategy as to how the crisis might be managed and resolved is compressed into one recommendation that the State provide a blanket guarantee to allow the rescue to be effected. The manner in which other key players in the financial system could share in the cost of and the management and resolution of the crisis in not elaborated. For these reasons BFI Division decided to conduct a review of national organisational capability for the management and resolution of a financial crisis.

[2] Dangerous Markets - Managing in Financial Crises. Dominic Barton, Roberto Newell, Gregory Wilson.

Objective of Review

The objective of the Review is to ensure that the Department of Finance and its related bodies are properly prepared to deal efficiently and effectively with any future financial crisis of systemic proportions. Its primary value at this stage is to highlight lacunae in the preparedness of the Irish regulatory, monetary and administrative Systems to deal with a financial crisis. While the focus of the Review is on TBTF failures or systemic failures, many of the recommended changes are applicable also to less systemically relevant crises. The Review will

- Present senior management with a comprehensive overview of the structures, systems, powers and procedures currently available to deal with the management and resolution of a systemic financial crisis;
- Examine the strength and weaknesses of existing arrangements;
- Make recommendations to facilitate optimum decision-making, management and resolution of a financial crisis.
- Recommend that the necessary steps be taken now to put in place the legislation that will allow the Minister and other key actors to take the appropriate decisions in a crisis situation without fear of litigation or of acting ultra vires Ministerial powers or Constitutional provisions.

Rationale for Recommendations

This Review is prepared on the basis that any legal ambiguities arising in the role, function, powers, responsibilities and accountabilities of the key actors should be put beyond doubt before any possibility of a financial crisis arises. It is suggested that the Financial Services Legislation Consolidation / Modernisation exercise be availed of make the necessary legislative change. Rather that adopting a irrationally exuberant view on the possibilities offered by the use of existing powers from a diverse range of sources, a constructively critical stance is taken in relation to identifying fault-lines in the existing structures, systems and processes. In essence the focus is on finding the structural, systemic and procedural weaknesses. To do otherwise would be to expose the Minister and the Secretary General to an unacceptably high risk level of risk in regard to the general discharge of their macro-economic management responsibilities and accountabilities.

Methodology

Our choice of methodology for the Review was motivated firstly by a desire to move away from precedent-based or perceived self evident 'We know best' decision-making approaches. A second emphasis is to provide evidence-based solutions and to identify and introduce internationally accepted analytical frameworks and best practice.

The Review takes an organisational development approach to crisis management and resolution and adopts two principle tools from the organisation development repertoire. These are a vertical role analysis and a horizontal 'process engineering' look at the decision-making process.

Vertical Role Analysis

The vertical Role Analysis looks at the Role, Functions, Powers of each key player in the management and resolution process. It aims to identify any gaps in the statutory roles, functions and powers of the key players. It also examines what role the private sector can play in the resolution and management process. A subsidiary aim is to identify the strategies, structures and systems that would be necessary to lock the private sector into the response mechanism in advance of any major financial crisis happening. Burden sharing in relation to the cost of resolving a financial crisis is also considered.

Horizontal examination of decision-making process

A process analysis has been undertaken in regard to each step in the decision-making process. The analysis is designed to

- establish the critical steps in the decision-making process;
- test for any weaknesses in the perceived role, function, powers and responsibilities of key actors;
- identify the essential variables at each decision-making step;
- identify the analytical decision-making frameworks that would summarise in readily assimilable form the main features of the financial crisis and its wider economic and social impacts; and
- ensure that the decision-making procedure observes the fundamental principles of the separation of powers set out in national legislation.

Structure of Review

The report comes in thee parts as follows.

Part 1: This is the main body of the report entitle *'Review of* National Organisational Capability for the Management and Resolution of Systemic Financial Crises' in Ireland. This Part at the structures, systems, procedures and analytical tools that should be available to the Minister to respond to a systemic financial crisis. It examines the following major themes in detail:

Section I: deals with a number of thematic considerations under the heading**:** Theoretical, Conceptual and EU Competition Considerations. It considers what is meant by financial stability, examines the stages in a financial crisis and provides a summary of EU Competition law applicable to rescue operations launched by Member States to resolve financial crises. It also examines the utility of the moral hazard and constructive ambiguity in the preparation of in the preparation of a financial crisis management and resolution framework;

Section II: looks at financial crisis resolution precedents from at home and abroad. In particular it will examine the lessons arising from the management and resolution of the financial crisis arising from collapse of the Insurance Corporation of Ireland in 1985. An alternative scenario is presented by examining the macroprudential structures and systems in place for the management and resolution of financial crises in the United States of America.

Section III: considers contextual and situational issues including the Characteristic of the Irish Financial System and the changes in the System Architecture. It looks at the changes to the overall governance and accountability structures that have been put in place since the last major financial crisis in Ireland. It suggests that a paradigm shift has occurred in the accountability framework. The contextual backdrop therefore provides the appropriate scenery against which the role, responsibilities, duties and accountabilities of the key actors can be analysed.

Section IV: examines the role, functions of, powers and accountabilities of key players with particular emphasis on the identification and amelioration of any gaps. It also discusses the principles that should inform the Government's involvement in the management and resolution of financial crises.

Section V: highlights a number of issues in which the Department of Finance will play a critical role and the preparations necessary to enhance its effectiveness in discharging those responsibilities.

Section VI: sets out the recommendations for future action arising from the Review. They include a wide range of legislative change to allow maximum flexibility and an appropriate mix of interventions to be taken in relation to

Single events threatening financial stability i.e. the collapse of a single financial institution;

More *generalised systemic problems* where interventions may be required across the system.

Part 2: Analyses the inter-institutional procedures for cooperation and decision making in the management and resolution of a financial crisis as they currently stand and makes a series of recommendations for the future.

This Part describes in broad terms the parameters of the existing decision-making process in relation to the management and resolution of financial crises. It goes on to envision what elements an optimum financial crisis resolution decision-making process might look like.

It then undertakes a forensic examination of each node of the proposed new financial crisis management and resolution process under six generic headings:

- Objective
- Key Player
- Clarity of Role and Function of Key Player
- Efficacy of Systems and Processes
- Action Necessary to Remedy Perceived Deficiencies
- Action by Department of Finance

The examination of the decision-making process follows the strategic framework for financial management and resolution identified by Stanley Fischer of the IMF but ahs been adapted to Irish circumstances. The rest of this Chapter is accordingly structured on the following basis.

Stages of Financial Crisis Management and Resolution	***No. of Discrete Decision Points at each Stage***
Financial Crisis Identification and Confirmation Stage	6
Stabilisation Stage: Developing the Financial Stability Programme – Tier One Decisions	11
Confidence Building Stage: Public Relations and Communication Strategy	7
Restructuring Implementation Stage – Tier Two Decisions	10
Final Recovery Stage	5
Total Number of Critical Decision Points	39

The focus is on building pre-programmed supports to support optimum decision-making at the time of crisis. The Review therefore will be precise and specific about what structures, systems and processes should be in place but will simultaneously preserve maximum flexibility in relation to the response mechanisms chosen at the time of financial crisis.

This Part concludes that the work to date also suggests that

- certain administrative arrangements and decision-making structures should now be put in place;
- legislative powers should be clarified in order to facilitate the optimum decision-making;
- necessary powers to allow the Minister to act should be put beyond doubt in the form of specific legislation to allow the Minister or his agents to provide liquidity, grants; guarantees; take equity participations or to acquire an insolvent banking institution where the threat to financial stability would warrant such action;

- National strategy should be informed by the developments at European Union Level.

Part 3: Contains a series of appendices containing extracts from the extensive research material and background data consulted as part of the Review.

Cultural and Strategic Considerations

It is not surprising that a review of this nature should throw up some issue where tradition, precedents and culturally-driven attitudes may seek single purpose solutions to multidimensional problems. A number of such issues have arisen in this Review and are discussed briefly in the following paragraphs. A more thorough-going analysis of the value of certain constructs is provided in the body of the Review itself. Our view is that the nature of the game has changed profoundly and multifaceted and complex responses will be required for the future.

Secondly, the evolution and development of the financial services legislation in Ireland has only in recent years been subject to sustained and strategic reform. This review identifies a further need to clarity in legislation the boundary of the role, responsibilities and accountability of the Minister for Finance in the financial services sector.

A number of brief observations are provided on such topics in the following paragraphs

1. Underlying Assumptions in Black Book

- A number of underlying assumptions in the Black Book are worthy of note. These are;

    i. The time constraints placed on the key decisions makers in the Department are set in terms of hours not days or weeks! This is a function of the rate of technological development in the markets.

    ii. The Black Book is based on the assumption that, at least the two major players in the Irish retail banking market are too big to fail. Other second tier organisations will be stress tested by the CBFSAI to determine whether they are too big to fail.

    iii. The expectation on the part of the CBFSAI is that the Minister for Finance will commit substantial (but unquantified) funding to the ailing enterprise on the basis of incomplete information (also perhaps presented in a self-serving way) presented by the Chairman and CEO of the ailing bank.

iv. CBFSAI envisage that an immediate commitment of public money will be made in the form of a letter of comfort or State guarantee issued by the Minster for Finance within hours of the alert of the impending crisis. At which point no clear analysis of the situation is available.

v. There are no suggestions as to how and to what degree the private sector should be involved in funding the resolution of any financial crisis.

- The Review examines the relevance and sustainability of these assumptions in the light of prevailing regulatory, prudential, governance, accountability and parliamentary practices in the course of its analysis of optimum response mechanisms. A number of preliminary comments are however appropriate

    i. If the underlying assumption is that the two big players in the Irish market are TBTF is left unchallenged it will mean that over 80% of the Irish Bank Sector is deemed to big to fail. Ab initio, this raises issues of concentration and fundamental questions about the efficacy of competition policy as it applies to the Banking sector. Issues of equity also arise as to why 'uninsured depositors' with smaller entities not of systemic importance should not be protected.

    ii. As CBFSAI is statutorily responsible for the maintenance of the payments system, the health of which would be a critical part of any decision matrix, it would be critical to ensure that the CBFSAI and IFSRA are put into the position of having to take the lead role in regard to advising the Minister in regard to the crisis and to clearly recommend a way out of the impasse.

2. ***Constructive Ambiguity***

Considerable time and attention is devoted in the Review to the concept of constructive ambiguity, mainly because, it is not a readily understood concept. Intuitively, ambiguity on its own could hardly be described as being constructive. Secondly, constructive ambiguity is a bedrock concept, the acceptance or rejection of which has profound implications for the direction of policy. Thirdly, on forensic examination, the concept has been found to have two apparently contradictory effects. It may be relevant in the context of the CBFSAI's posture in regard to the provision of liquidity assistance in any set of prevailing circumstances. The Review, however, demonstrates that its application to the question of establishing structures, systems and procedures to deal with any future financial crisis may be contrary to the national interest and damaging to the long-term health of the banking system.

3. *Clarity of Strategic Role of Minister in relation to Financial Services*

- An unanticipated outcome of the Review is that there is no specific role specified in the financial services legislation for the Minster for Finance in regard to financial stability. The Ministers and Secretaries Act, 1924, is also silent on the issue. This Review will recommend that this deficiency be made good.

- What is even more curious is that neither the legislative codes for financial services or the Ministers nor Secretaries Acts *specifies the role of the Minister for Finance in relation to financial services generally*. It is not apparent that any other body or code of legislation does either.

- A part explanation for this state of affairs may be found in the legislative drafting conventions that have to date tended only to specify the Minister's role, functions, powers and responsibility within the confines of specific pieces of legislation. The strategic and general role, function and powers of the Minister in relation to financial services overall seem to have got lost in the specificity of industry and sectoral codes of legislation.

- It is suggested that the point is of some significance and that his responsibilities in relation to domestic and international financial services be unambiguously established.

Stress Test / Pilot Project

As indicated earlier, the European Union requires member State governments to undertake a pilot study to stress test the ebullience of their financial crisis management and resolution systems. In exercise of this requirement, the BFI approach was to conduct a review of the structures, systems and procedures that can currently be relied upon for this purpose. At an early stage it became apparent that a number of shortcomings were evident at the structural, systemic and decision-making levels. These lacunae have now been confirmed to be of such significance as to render any procedural pilot exercise of dubious value. It is recommended that the pilot exercise would have much more meaning and relevance when policy decisions have been taken in relation to the structural, systemic and procedural issues identified in this Review. It may be purely coincidence that the date for the EU pilot test has also been deferred until spring 2006.

Motivation

The particular in-depth approach to this project was motivated by a number of primary influences. The first was the statement by the former Secretary General of the Department of Enterprise Trade and Employment at the Departmental Conference on the importance of using the Regulatory Regime as a means of improving competitiveness. Second was the endorsement of this concept by the Senior Management Team at the Departmental Conference. Thirdly the Secretary General at the Division's meeting with the MAC stressed, in particular, the importance of the competitiveness indicator as we embarked on modernising the regulatory regime for financial services. Furthermore the Secretary General has repeatedly stressed the need to conduct and assessments of the major risks facing the Department.

The Recommendations

The recommendations in this Review if implemented are consistent with the advancement of Ireland further up the International Capital Market Development Indices. Secondly they will help minimise the financial costs of managing and resolving financial crises to the private and the public sector. They will finally help ameliorate the potential economic fallout from such an event.

Mr. Paul O'Brien, now with OPW and Mr. Declan Cahill provided valuable assistance in completing this project.

____

Finbarr Kelly,
BFI Division,
20 May, 2005

Follow up to Crisis Simulation Exercise 2007[1]

Introduction

The following note represents a summary of the feedback from the players of the Crisis Simulation Exercise (CSE) held on the 17th of December. The exercise consisted of representatives from both the CBFSAI and the Department of Finance.

Plot Outline

The plot for the crisis simulation was based round the likely default of a large commercial property loan in Ireland. The default of the commercial property loan would have implications for Alpha bank both in terms of the quality of the loan book but also the future income stream of Alpha bank. Alpha bank was modelled on an existing Irish credit institution.

While the plot, the characters and the institutions were contrived the exercise was designed to reflect one possible scenario which could develop. The fictional financial institution and system was designed to reflect the features of the Irish financial system

Purpose of the Crisis Simulation Exercise

The aim of the exercise was to test the procedures put in place by both the CBFSAI and the Department of Finance. These included an assessment of our crisis management procedures, especially:

1. The co-ordination between the three parties
2. The Functioning of the CSG in terms of an advisory forum on crisis management and the roles assigned to CSG members
3. Adequacy of, and assessment of, information that is critical to crisis management
4. Testing the use of materials in the new Black Book e.g., Crisis Management Procedures, System Impact Assessment and the communications Strategy

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[1] Compiled by Gordon Barham, FSD

Lessons learned from the Crisis simulation Exercise

Based on the criteria listed above, the following section summarises the general points offered in the feedback forms. An annex at the end of this note provides further information on the feedback broken down into CB, FR and DoF Responses.

1. **Communications channels** were highlighted as an area that requires future work. The concern surrounds the communication between DSG members as well as the role of press offices in communicating with the public.

   The DoF was concerned about the extent to which "CB" represented "FR" position in a crisis and vice versa, risk of second guessing by Department of 'political' objectives and potential for conflict of objectives that would arise between all parties

   Feedback from both the CB and FR also highlighted a need for increased communication and flow of information with the DoF

In order to ensure a balanced view it was suggested that a representative from both the CB and FR be present during meetings with the DoF.

The flow of information could also be enhanced if key information that the DoF would require was identified in advance insofar as possible. This could include information on the breakdown of deposits. It may be necessary to nominate a member of the CSG to be responsible for collating this information. However, it is worth considering the logistics of this step in light of any confidentially agreements held between the CBFSAI and regulated institutions

Focusing on the role of outside communication it might be useful to prepare templates of press releases that the DSG members could call upon in a crisis situation

2. The number of participants involved in the CSG presented **logistical issues** such as the sharing of information among the members. This led to a situation where individuals were talking among themselves rather than the CSG interacting as a single group. This led to information asymmetries and hampered the ability of the group to form a coherent view.

The suggestion is to streamline the CSG with a structure similar to the CBFSAI organisation. Each area – Prudential, Operations, Financial Stability/Economics etc. would take responsibility for their area of analysis. Each area would be *responsible for offering their view of the systemic nature of the affected institution(s). The head of Financial Stability would be responsible for collating these high level views only.*

3. **Prioritisation of Information** It was felt that the members of the Crisis Steering Group (CSG) were required to process too much information in a relatively short period of time. Given the flow of information, participants found it difficult to assimilate information and in turn it was difficult to form an overall picture of the situation.

   More attention needs to be paid to operational deadlines that would be faced during an actual crisis. These include deadlines for the Stock Exchange, payments system and Collateral transfer.

   A combination of the above points meant that it was not possible to carryout a systemic impact assessment

It may be useful to prepare a list of key data sets that participants feel are important for evaluating a crisis. This list could also include a template of how this material should be presented to the relevant decision makers. This would allow decision makers to be more aware of what material is readily available, if available at all.

It might be useful to draw up a short (one-page) template in relation to the systemic impact assessment which would cover the key areas of concern. Each area would take responsibility for there own section of the systemic impact assessment. In this way the relevant sub-groups of the CSG could focus their analysis and briefing on the required assessment.

The above recommendations should reduce the issues of "too many voices" and allow the CSG to focus on the pertinent issues. The Red book should be revised in light of these concerns.

4. Based on the feedback provided by the players almost all indicated that they had read the **Red Book** prior to the crisis exercise. However, few indicated actually using the book during the course of the exercise. The most relevant parts indicated by the feedback forms were the contact lists, and the first three chapters (procedures for crisis management – summary, Systemic Impact Assessment – procedures and ELA procedures and Collateral Transfer Documentation)

Question: Were participants happy with the role of the Red Book in the exercise? In light of the feedback from the exercise does the DSG feel there are areas of the Red Book that need improving/reviewing?

5. The role of the **Deposit Guarantee Schemes** (DGS) needs to be looked at in more detail. It was felt that the decision to advise the DoF to guarantee all deposits was reached too quickly without looking at intermediate options and without sufficient thought given to the ultimate burden of responsibility.

There is ongoing work examining the policy issues surrounding DGS

Future Work on Crisis Management

Arsing from the exercise a number of areas have been highlighted by participants. These include:

- Further analysis into the interlinkages – interbank borrowing and lending positions – between institutions.
- Further analysis on the overseas operations of Irish banks and how they might be dealt with in a crisis. For example, would deposit assurance have to be extended to deposits at foreign branches of Irish banks – as in the Northern Rock case?
- Improve information and identify the key data required for dealing with a crisis
- Further work into the area of deposit guarantee schemes and deposit insurance.
- Examine the role of communication both internal and external further

Areas of Focus for Subsequent Crisis Simulations

Participants were asked to comment on areas of interest for future simulations. All three authorities highlighted the area of media relations and communication with the public. As already stated previously, further consideration is the need to coordinate a response and ensure that the correct message is conveyed to the public.

In addition to media relations some other areas suggested included:

- Circumstances when assurances, guarantees, commitments should be extended
- Examine if the necessary administrative arrangements/parameters including legal issues are in place. This may require advanced planning for each bank in advance
- More focus on specific roles played by individuals. Possible mini-exercises based on testing key aspects of certain roles.

In addition to the areas that need to be concentrated on in future exercises, participants offered feedback on the logistics of exercise. In general most consider that the CSE was conducted over too short a period and that future exercises should be conducted over a minimum of one day. This would allow participants to process the material more thoroughly. Based on the feedback it was felt that an actual crisis is unlikely to play out over the course of an afternoon.

A number of responses suggested a movement away from the paper-based format of this exercise, as it was too cumbersome. It has also been suggested that there should be greater involvement from the staff of relevant departments/authorities.

An exercise that is held over a longer period would greatly increase the workload required to prepare the necessary background material. However, the involvement of staff from the relevant department/authority would allow for a more realistic exercise. A dedicated person or team from each of the relevant departments/authorities could be involved throughout the planning process and implementation of the exercise would allow the material to be presented in a more realistic manner. The designated person(s) could also act as a point of contact in dealing with "players" queries during a CSE and allow for more interaction. This could help reduce/replace the paper-based format of the last game. However, it is worth considering, in reality, what level of involvement ordinary staff would have in a crisis.

The DSG is asked to review and discuss the feedback from the participants. From the discussion the follow-up steps can be agreed and crisis management procedures revised accordingly.

Annex: Extended Summary of CSE Feedback

Central Bank Feedback

General Comments

Overall, participants found the exercise to be worthwhile. In general the players found the plot to be realistic and found it topical. The main points of the Central Bank feed back are outlined below:

- A number of players indicated that the exercise was run over too short a period.
- The number of participants involved in the CSG presented logistical issues such as the sharing of information among the members. This led to a situation where individuals were talking among themselves rather than the CSG as a single group. This led to information asymmetries and hampered the ability of the group to form a coherent view.
- It was felt that the members of the Crisis Steering Group (CSG) were required to process too much information in a relatively short period of time. Given the flow of information, participants found it difficult to assimilate information and in turn it was difficult to form an overall picture of the situation.
- A combination of the above points meant that it was not possible to carryout a systemic impact assessment.
- The role of the Deposit Guarantee schemes needs to be looked at in more detail. It was felt that the decision to advise the DoF to guarantee all deposits was reached too quickly without looking at intermediate options and without sufficient thought given to the ultimate burden of responsibility.

Specific Comments

In terms of the comments based on how the exercise was played the following are points expressed by the Central Bank participants:

- An area which may not have received sufficient attention are timing issues through the course of the day such as closing time of payments and deadlines relating to the Stock Exchange.
- There is a need to separate theoretical/conceptual issues from operational issues. During a crisis the issues should relate to operational issues in light of informed discussion on the theoretical issues. Theoretical issues, such as moral hazard and deposit protection should be dealt with prior to a crisis.
- It was felt that there should have been greater communication with the DoF. It appeared that at certain stages Finance were out of the picture. The apparent lack of contact and up-to-date information may have hampered the ability of the DoF to come to a clear decision in light of the available information.
- When initially briefing the DoF it was felt there was a need to have a representative from both the CB and FR. This is in order to be able to answer any bank specific question Finance may have as well as to represent the views of the FR and support the view of the CB where necessary.
- The role of the press office was highlighted as an area where careful work needs to be conducted. Specifically, the role of press releases from the relevant public authorities.

Role of the Red Book

In terms of the usefulness of the Red Book most participants glanced at it prior to the exercise. The most useful part related to the logistics of the CSG such as organisation and contacts list. Participants indicated that in general they did not use the Red Book during the exercise.

Future work on Crisis Management

Arsing from the exercise a number of areas have been highlighted by the participants. These include:

- Further analysis into the interlinkages – interbank borrowing and lending positions – between institutions.

- Improve information and identify the key data required for dealing with a crisis
- Further work into the area of deposit guarantee schemes and deposit insurance.
- Further analysis on the overseas operations of Irish banks and how they might be dealt with in a crisis. For example, would deposit assurance have to be extended to deposits at foreign branches of Irish banks?
- In relation to preventive measures, should there be greater analysis of the sustainability of banks' business models. Should the risk weightings of different asset classes be reviewed more frequently?
- Clarify precise requirements from various areas during the course of a crisis e.g., 15/30 minute updates of payments balances/queues and movements in collateral.

Areas of Focus for subsequent Crisis Simulations

Areas identified by CB participants for greater focus in future exercises include:

- Circumstances when assurances, guarantees, commitments should be extended
- Content of any press statement
- Ensure administrative arrangements/parameters including legal issues are in place; this will not be properly done without planning for each bank in advance
- More focus on specific roles played by individuals

Financial Regulator Feedback

General Comments

The participants of the Financial Regulator found the exercise to be constructive, relevant and timely. The case study dealt with the important issues such as solvency and liquidity. It raised certain issues that need to be addressed and highlighted the pressure situation that participants would find themselves in a real crisis. The main points of the Financial Regulator feed back are outlined below:

- The number of participants involved in the CSG presented logistical issues such as the sharing of information among the members.
- The length of the exercise was too short. The decision process would have benefited had the exercise been played over a longer period.
- The assessment of the crisis was unclear as there was no systemic impact assessment carried out
- Insufficient contact between the Regulator and the Department of Finance

Specific Comments

- There may have been too much communication and information sharing at the expense of identifying the information critical for crisis management
- There was no apparent conflict of interest between the CB and FR although the reasons for this may need to be examined further to ensure it was not just a function of this being an exercise only
- The roles of particular individuals, as outlined in the Red Book, need to be clearly explained to ensure everyone is aware of their responsibilities and the responsibilities of others.
- There may be some value in having a whiteboard or similar device in the CSG's meeting room to record key information and have it visible to all participants
- Would be useful to look at final decision again in the cold light of day – check validity

Role of the Red Book

In general people looked at the Red Book prior to the exercise, specifically the first three chapters, but did not consult the Red Book during the exercise.

Future work on Crisis Management

- The co-ordination of decision making seemed to work well at senior CB&FR levels but we should consider the potential impact if the Board and Authority members were to become involved
- As outlined in Annex 2 of the Red Book, the Task Force on Crisis Management has identified key information required to perform an assessment of the systemic impact of a crisis. Some of this information is already gathered but may not be readily available or sufficiently up-to-date when a crisis occurs. One priority should be to review these information requirements and decide if institutions (or a small number of them) should be required to provide additional information on a regular basis or to be able to produce such information at short notice.
- The need for a set of predefined templates for information and a central repository for recording new information as it arrives.
- Agreement is needed on how the Deposit Guarantee Scheme will operate in a crisis and what communication should be provided to the public. This is already being examined in the Sub-Group.
- Our role in relation to crisis management for Irish branches and subsidiaries of foreign banks and foreign branches and subsidiaries of Irish banks needs to be clarified.
- We need to explore what measures/options are available to handle a crisis apart from ELA or Government guarantees.
- Focus on the channel of communications. What are we saying publicly, especially in the early stages when we are unsure about the state of the ailing bank and any Government guarantee. Secondly who will be saying it - Minister/CEO/Governor etc.?

Areas of Focus for subsequent Crisis Simulations

- Consider a change in the format of the exercise. Move away from a paper based approach. Consider other channels of communication. In a real crisis the most immediate information would be communicated by telephone, face-to-face meetings and email
- In reply to: future simulation exercises there needs to be involvement of the staff of the CSG in seeking out and distributing information.
- Ensure that, whatever format future exercises may take, there are sufficient handouts and information for all participants.
- Examine the role of communication both internal and external further

Department of Finance Feedback

General Comments & Future Work in Crisis Management

The exercise was very useful in highlighting the range of issues that can arise in the context of a crisis. It demonstrated that a lot of work is required by all parties both individually and collectively (in the context of the work of the DSG) to increase preparedness to an appropriate level for responding to a financial instability event. The areas require further work include:

- Availability/'flow' of information between public authorities
- Communication/level of contact between authorities
- Assessment/analysis of options from an early stage
- Extent to which "CB" represents "FR" position in a crisis and vice versa, risk of second guessing by Department of 'political' objectives and potential for conflict of objectives that would arise between all parties
- Utility/benefit of pre-prepared material
- Role/effectiveness of MoU for DSG
- Slow responsiveness to need for public communication

Role of the Red Book

The Red book was not used much but was essential to know it is there.

Areas of Focus for subsequent Crisis Simulations

In planning the next exercise, a particular concern should be to test the central elements of the national response to a financial stability event (i.e. financial analysis of an individual institution in difficulty, liquidity / solvency assessment, ELA procedures, Eurosystem / ECB aspects, systemic analysis, interacting with media / political level, communications between national authorities, resolution issues etc.) rather than areas which are, while still important, more peripheral

The main priority should be to test rigorously the financial, legal and policy assessments that underpin our 'model' of crisis management and also drawing out the possible conflicts of objectives that may emerge in the course of the management of an event in order to pre-empt the risk that these may arise in practice.