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 6

January 2016

Table of contents – by line of inquiry

THEME: C4

Appropriateness and effectiveness of the domestic policy responses

LINE OF INQUIRY: C4a

Decision to nationalise Anglo in 2009 and a review of the alternatives available and/or considered

SECRET
Offig an Aire Airgeadais

Ref No **Date: 15 January 2009**

Decision Sought on the Nationalisation of Anglo Irish Bank

1. Decision Sought

The Minister for Finance asks the Government today to approve:

(a) That Anglo Irish bank should be nationalised and that this should be done by way of a Bill, the indicative text of which is attached; this will be subject to amendment to be agreed between the Minister for Finance and the Attorney General. The Bill, when finalised, is to be published.

(b) That the Houses of the Oireachtas be recalled with a view to sitting on Tuesday 20 January, with a view to taking all stages on Tuesday.

(c) That there be an early signature motion to incorporate the Bill.

(d) That the Government notes that it would be the intention of the Minister that the newly appointed Chairman and the public interest Directors would be reappointed after nationalisation and that the Minister would consider the position of the other Directors giving due regard to the need for continuity.

(e) That a statement will be issued this evening and the draft of the Bill will be made available publicly.

(f) Finally, the Minister will be informing the opposition spokespersons.

2. Background

Last night, the Central Bank, the Financial Regulator, the NTMA, and the Department of Finance recommended that nationalisation of Anglo Irish Bank provides the better prospect of stability in the Irish banking system and should be pursued in preference to the planned recapitalisation of Anglo on Friday.

This morning AIB and BOI gave their view that a nationalisation of Anglo should not de-stabilise their position, provided a clear distinction is made between their financial and market position, and that of Anglo, and each bank said that in their opinion, on balance, nationalisation was the best option available.

This advice was given because of a number of serious corporate governance concerns at Anglo, and because of Anglo's progressively deteriorating liquidity position.

3. **Corporate Governance**

There is continuing concern about governance issues including Directors loans, loans to buy Anglo shares and other financial arrangements in the Bank. The ODCE has commenced an investigation and it is possible that the ODCE would appoint a court inspector on these and other company law matters.

The Financial Regulator is concerned about all of the governance issues and is conducting a number of investigations. However, the disclosure of some or all of these issues would have the effect of further destabilising the position of Anglo Irish Bank. This is in a context where, following the resignations of the Chair and CEO, market confidence in Anglo is already extremely low, which has meant that Anglo is encountering increasing liquidity difficulties.

4. **Liquidity**

Anglo's liquidity has disimproved since early December, with the bank losing €3bn in corporate deposits. Anglo's liquidity position is now very fragile.

Fitch's are expected to downgrade Anglo's credit-rating today, leading to a potential further €1bn -€2bn outflow of corporate deposits. Downgrades from S&P are also expected to result in even greater corporate outflows. A total of €6bn or more could flow out from Anglo and it is clear that this flow is not being stemmed by our announcement on recapitalisation and government voting rights in Anglo.

Using Central Bank and NTMA options to replace this liquidity would put at risk a disproportionate amount of liquidity reserves to protect Anglo. It is considered unlikely that this public liquidity support could be repaid in the foreseeable future by the bank.

As a result of these new developments, it is necessary to re-evaluate the approach to be taken with Anglo. The alternative to the planned recapitalisation is nationalisation. While neither option can quickly resolve Anglo's difficulties, on balance nationalisation mitigates the risks that the Anglo now presents to the public finances and to financial stability.

5. **Pros and Cons of Nationalisation**

<u>Pros:</u>

- Should mitigate the risk of an S&P ratings downgrade
- Minimises deposit outflows
- Reduces risks of significant demands on the liquidity reserves available to the NTMA and the CBFSAI
- Introduces certainty in the market on Anglo
- €1.5bn can be used for liquidity funding, with a better chance of recovery
- Even with recapitalisation and liquidity support, continuing bad news could lead to a requirement to nationalise Anglo, but from a weaker position
- De-listing ends share speculation about the bank on the market
- Allows for orderly work-out of the loan book
- Allows Minister direct control to deal with the governance issues

Cons:

- Introduces perception of confused approach to Anglo problems
- Contagion risk to other banks
- Liquidity support likely to still be required
- May be perceived as a reaction to significant negative issues arising from the due diligence process
- Asset realisation values may be negatively impacted

6. Taking all of the above factors into account, I am therefore seeking your approval to nationalise Anglo Irish Bank.

THEME: C4

Appropriateness and effectiveness of the domestic policy responses

LINE OF INQUIRY: C4b

Establishment, operation and effectiveness of National Asset Management Agency (NAMA)

SECRET
Oifig an Aire Airgeadais

Ref No: F514/72/09 **Date: 3 September 2009**

Memorandum for Government

National Asset Management Agency Bill 2009

Decision Sought

1. The Minister for Finance requests Government to approve the NAMA Bill as presented for publication on Tuesday 8 September, or as soon as possible thereafter but no later than Thursday 10 September, subject to further drafting amendments to be made by the Minister in consultation with the Attorney General.

Amendments to Bill

2. The Bill as presented incorporates some changes from the Bill as circulated at the Government meeting on Tuesday 1 September. These changes are mainly of a minor technical nature. The Minister wishes to draw the Government's attention to two significant changes which have been introduced:

Risk Sharing Mechanism

3. The Minister has examined a number of measures on how a risk sharing mechanism could be included in the NAMA proposal. Any risk sharing proposal should take account of:

   i. The overriding objective of cleaning up the credit institution's balance sheets to enable lending back into the economy
   ii. The desire by the Government to ensure that the taxpayer does not take undue risks and that the institutions share a portion of the risk
   iii. The recommendation of the ECB that some element of risk sharing be considered

iv. The recommendation by all parties at the Oireachtas Committee on Finance & the Public Service on 1 September that some risk sharing be considered

4. The possibility of issuing equity in NAMA as part payment for the assets being acquired has been examined. However, this was rejected as the accounting treatment would mean that the equity asset would not be recognised on the bank's balance sheets and so would undermine the objective of cleaning up the bank's balance sheets.

5. An alternative option involves the issue to the banks of subordinated debt in NAMA. This is workable provided the total proportion of the payment is kept small (maximum 5%).

6. The NAMA Bill has been amended (Section 48) to provide that NAMA can pay partly (5%) in subordinated debt for loans to be acquired from an institution. This proposal would meet the objectives listed under paragraph 3. It would allow the NAMA Board the option not to pay the dividend/coupon on the debt if NAMA makes losses in a given year. Also on the wind up of NAMA, the subordinated debt would be wiped out if NAMA is in a loss making position.

7. It should be noted that all institutions will have to be treated equally in getting 5% of their assets paid for in subordinated debt. In addition, the payment or non-payment of the coupons and / or debt on the wind up of NAMA will be dependent on NAMA's overall performance. These features are necessary to ensure the desired accounting treatment and thereby meet the overriding objective at paragraph 3 above.

Transparency

8. A number of changes have been made to the NAMA Bill to improve its transparency of operation. Among these is an insertion in section 11 of a new overriding requirement that NAMA act in a transparent manner in order to achieve its purposes.

9. Other changes agreed for inclusion:

i. Laying details before the Oireachtas within 30 business days of any securities issued as consideration to purchase eligible bank assets

ii. Requiring NAMA to make half yearly reports to the Minister who shall pass these reports onto the relevant Oireachtas Committee

iii. Requiring the first comprehensive assessment of NAMA by the C & AG at 31/12/2012 and every 3 years thereafter while NAMA exists

Incentivisation

10. The management of incentives offered to the banks to manage loans on behalf of NAMA was raised at Tuesday's Government meeting. The position is as follows:

NAMA, under the Service Level Agreements with the financial institutions to service and administer the loans acquired by it, will define key performance indicators (KPI's) with the institutions which can be adapted from time to time. If institutions do not meet their KPI's, NAMA would have a right to withhold such fees and terminate the relationship if necessary. NAMA will also regularly benchmark performance against other market participants of such services. This would be line with financial services industry standards and the NTMA already have such service level agreements in place in the provision of services to the NPRF.

11. The part payment in subordinated debt by NAMA for loan assets now included in the Bill will provide further incentive to the banks to manage the loans efficiently. If NAMA makes a loss in a given year no coupon payments will be made on the debt and if NAMA makes a loss on winding up this debt could be wiped out.

Upper Limit on Bonds to be issued

12. An amended provision incorporating an upper limit on the issuance of bonds by NAMA is included in the Bill as presented. The provision allows the Minister to specify by Order the maximum amount of bonds to be issued.

13. The Minister has indicated he will announce on 16 September an estimate for the haircut on the aggregate NAMA portfolio. This will allow the provision limiting the

issuance of bonds to be revised at Committee Stage to ensure that the upper limit will be agreed by the Oireachtas and included in the primary legislation.

Next Steps

14. The Bill is targeted for formal publication on Tuesday 8 September or as soon as possible thereafter but no later than Thursday 10 September. The Valuation Regulations will be published in draft form on 16 September but the Minister will revert to Government with these Regulations before publication.

OIFIG AN AIRE AIRGEADAIS

Ref No: **1 April 2009**

SECRET

Memo for Government

Proposal for a National Asset Management Agency

1. Decision Sought

The Minister for Finance asks the Government to approve an announcement on Budget Day that he intends to set up a National Asset Management Agency (NAMA) under the auspices of the National Treasury Management Agency.

The NAMA will purchase the land and development books of the covered institutions and certain property investment loans associated with the largest 20 or so borrowers from these institutions.

This purchase, which will be funded by the issue of Government Bonds, will be at a discount to take account of the need for write downs by the banks. The total book value of the assets purchased will be likely to be of the order of €80bn.

2. Background

Concerns over asset quality in Irish banks relate to property based lending, generally land and development lending. The issue of how best to address this problem has been addressed in the context of the scheduled six month review of the Credit Institutions (Financial Support) Scheme, 2008.

The Minister for Finance appointed Mr Peter Bacon to work in conjunction with the NTMA to report and advise him on the best solutions in this area. His report assesses various options including risk insurance but recommends that an Asset Management Agency be established to purchase a portfolio of loans from the banks focusing on the riskiest loans. After the review of the various options in consultation with the NTMA, the Governor of the Central Bank, Financial Regulator, and taking account of the Bacon report the Minister has decided that a National Asset Management Agency to manage and work out these risky loans represents the best option.

3. Advantages of National Asset Management Agency

The aim of establishing an Asset Management Agency is to provide the banks with a clean bill of health, to strengthen their balance sheets, to considerably reduce uncertainty over bad debts and as a consequence ensure the flow of credit on a commercial basis to individuals and businesses in the real economy.

An asset management agency would

- Deal with the issue of impaired property loans more decisively and definitively, providing the banks with cleaner balance sheets and reducing the risk of further impact of impairments from property loans on the banks
- Improve the funding position of the banks by providing them with assets that can be used to access ECB funding
- Remove management of the problem loans from the banks, which should provide greater control of the work-out of the loans and deal with market concerns that the banks are not realistic about the extent of likely losses
- The asset manager should have limited regulatory capital requirements in respect of losses on impaired loans
- Should improve sentiment towards the banks and allow management time to be refocused on rebuilding strength particularly in core retail businesses and maintaining their deposit bases.

4. Assets to be included

The Minister has considered three possible approaches

i. Land and Development loans only, which is the riskiest part of the banks loan portfolio – these are currently valued at c€60bn

ii. Land and development loans plus the banks 20 or so largest commercial exposures– this portfolio would amount to circa €80bn.

iii. All land and development and property development loans, currently valued at c€160bn.

Taking account of the advice of the NTMA, the Central Bank, the Financial Regulator, the Department of Finance and legal and financial advisors the Minister has decided in favour of option ii, the land and development loans plus the banks 20 or so largest exposures (exact number to be decided based on assessment of exposures). In reaching this conclusion the Minister has taken account of the impact on the banks, on financial markets and on the national debt.

It is proposed that the assets would be purchased through the issue of government bonds to the banks. The Agency would then manage the loan assets over time to ensure the minimum loss for the State. The assets being considered for transfer currently have book value assessed at:

	Total €bn
Net Exposure to largest borrowers	17
Land & Development Book	64
Total exposure to top borrowers and L&D books	**81**

The Government should note that **this is not a final figure.** The loan books will have to be worked out and reviewed with each of the Banks to ensure that the appropriate loans are taken and that the banks are cleared of their identified riskiest loans. In view of the administration costs associated with management of small loans and the large number of such loans where the banks have very significant other relationships with the customers special arrangements will be put in place for such customers. A number of options are being considered, but all involve transferring the economic value of the loans to the State. The Minister will revert to Government with proposals for the management of such small loans.

5. Cost to the State

To ensure best value for money for the taxpayer the loans will be transferred to the NAMA at an appropriate written down value. All loans transferred will be classified as high risk, medium risk or low risk and the write down the bank will take on these loans will depend on how risky each category of asset is perceived (see appendix 1). Most of the land and development books will be categorised as high risk and will attract a higher rate of discount. The rates of discount are subject to EU state aid approval.

The annual interest charged to the State for bonds of this size is likely to be of the order of €1.2bn. The income accruing to the underlying asset book is also estimated to be of the order of €1.2bn. However, there will also be administrative costs for the agency and the bond interest and agency income may not match exactly leading to a net cost to the State over the initial running period of the agency (until assets are sold).

The main disadvantage of an Asset Management Agency is the upfront impact this will have on the national debt. The impact could raise the ratio of debt to GDP from 52% to approximately 85% (compared to an EU average of 60%). It is not clear whether this agency's assets will be on the States balance sheet and we are in discussions with the CSO to try and ensure that the scheme is designed to keep them off the balance sheet. In this context we note that similar UK Treasury Bills are off balance sheet.

6. The National Asset Management Agency

It is proposed to establish the National Asset Management Agency on a statutory basis, under the aegis of the National Treasury Management Agency. A central feature of the arrangement is that the banks will have to play their part in a practical and demonstrable manner – they will probably be charged with contributing to the agency by providing highly skilled staff. All income from the purchased loans will accrue to the NAMA as will proceeds from the eventual sale of the underlying assets. The Government will on the winding up of NAMA determine if it has made a profit or a loss in its lifetime. Any profits accrue to the State but any losses incurred by NAMA will be clawed back from the participating institutions by means of a levy over a number of years.

7. Participation

This initiative arises from the compulsory review of the Bank Guarantee Scheme. In keeping with the terms of the Scheme participation in the Asset Management Agency will be offered to all the covered institutions. Optional participation is proposed, but any bank that opts in would have to agree that all loans in particular portfolios have to be sold to NAMA at the discounted rate determined for that category of risk.

The legislation will also provide for a mandatory power to acquire assets so as to ensure against any recalcitrance on the part of institutions, or to overcome legal difficulties with the assignment of assets.

8. Bank Guarantee Extension

In addition to pursuing the NAMA option the Minister for Finance is also in discussions with the EU Commission on the possible extension of the Bank Guarantee beyond September 2010 for a more limited range of instruments.

Appendix 1

Agency Structure	Commercial Semi State entity, ideally structured to be off Balance Sheet [requires agreement of Eurostat]. Should be carried out under the governance, direction and management of the NTMA and be designated as, for example, the National Asset Management Agency (NAMA).
Institutions Covered	Those covered by the Government guarantee who are regarded by the Government as appropriate for inclusion having regard to the structure of their loan book, their access to support, their ownership structure and their relative importance to the national economy.
Assets Covered	All loans in respect of the purchase of land for development and associated work in progress arrangements. In addition, certain property investment loans, especially where associated with the largest 20 or so borrowers. Exact assets to be considered further.
Size of NAMA	Potentially €80bn to €90bn in assets
Timeframe	Budget day announcement with legislation enacted soon thereafter. Preparation of legislation and preparation of the management structures would be initiated in parallel.
Legislation	The NAMA initiative would require new legislation (the "NAMA Act") which would create NAMA under the umbrella of the NTMA.
Pricing	Portfolio pricing depending on the category of underlying security. Appropriate percentage discounts would be paid for Land & Development Loans and for property investment loans depending on the assessment of risks involved. The objective should be to break the link between banks and the property assets, at least at the outset. EU requirements may require a more disaggregated valuation of assets.
Participation	Optional participation proposed, but banks would have to agree that all loans in particular portfolios have to be sold to NAMA. The legislation should also provide for a mandatory power to acquire assets so as to ensure against any recalcitrance on the part of institutions, or to overcome legal difficulties with the assignment of assets.
Payment	Property loans sold to NAMA will be paid either in Government Bonds or in Government guaranteed bonds issued by NAMA.
Clawback	The government will on the winding up of NAMA determine if it has made a profit or a loss in its lifetime. Any profits accrue to the State but any losses incurred by NAMA will be clawed back from the participating institutions by means of a levy over a number of years.

Special Purpose Vehicles (SPV's)	In order to achieve the optimal return some property loans sold to NAMA will be capable of being transferred into NAMA SPV's which will be capable of being worked out and disposed of in an orderly manner with private equity partners.
NAMA	The Government will capitalise NAMA with sufficient equity so as to undertake its business in an optimal manner.

THEME: C4

Appropriateness and effectiveness of the domestic policy responses

LINE OF INQUIRY: C4c

Decision to recapitalise Anglo, Allied Irish Banks (AIB), Bank of Ireland (BoI), Educational Building Society (EBS), Permanent TSB (PTSB) and the alternatives available and/or considered

EUROPEAN COMMISSION

Brussels, 21.12.2010
C(2010) 9475 final

Subject: State aid N 553/2010 – Ireland
Second emergency recapitalisation in favour of Allied Irish Banks plc

Sir,

The Commission wishes to inform the Irish authorities that, having examined the information supplied by your authorities, it has decided to approve the measure referred to above for Allied Irish Banks plc ("AIB" or "the Bank").

1 PROCEDURE

(1) On 12 May 2009, the Commission approved a EUR 3.5 billion capital injection into the Bank in the form of Core Tier 1 New Preference Shares[1].

(2) Following this capital injection, the Bank submitted an initial restructuring plan on 13 November 2009 followed by a number of exchanges.

(3) On 30 March 2010, the results of the Prudential Capital Assessment Review (PCAR) were announced by the Irish financial regulator. These results highlighted the need for AIB to increase its capital, which led to changes to the restructuring plan.

(4) On 4 May 2010, AIB submitted a revised restructuring plan, which again was followed by a number of exchanges between the Commission and the Irish authorities.

(5) On 30 September 2010, the Irish Minister of Finance made a public statement on the situation of the Irish banking sector and announced that AIB needed additional capital of EUR 7.9 billion (taking into account the capital generated by the sale of its Polish subsidiary). The Minister also confirmed that in the current stressed market conditions, the Bank was unlikely to be able to conduct a traditional privately underwritten

[1] Commission Decision in Case N 241/2009, *Capital injection into Allied Irish Bank*, OJ C 223, 16.09.2009, p. 2

Mr Micheál MARTIN,
Minister for Foreign Affairs,
Department of Foreign Affairs
80, St. Stephen's Green,
Dublin 2,
Ireland

transaction as was originally contemplated in July 2010, announcing at the same time that in these circumstances the Irish State would underwrite the capital raise, thus effectively committing to provide a further State-funded recapitalization of the Bank.

(6) On 28 November 2010, the Irish Government announced that a Programme for Support (the "Programme for Support") has been agreed with the Commission and the International Monetary Fund ("IMF"), in liaison with the European Central Bank ("ECB"). As part of the Programme for Support, the Government has agreed to undertake certain bank recapitalisation and reorganisation measures under a Programme for the Recovery of the Banking System (the "Banking System Programme"). As part of the Banking System Programme, and building on the results of the Central Bank of Ireland's (the "Central Bank") PCAR carried out earlier in the year, the Central Bank has set new minimum and target capital requirements for AIB and other credit institutions in Ireland. The Central Bank publicly announced the new minimum and target capital requirements for Irish banks on 28 November 2010.

(7) On 2 December 2010, the Irish authorities notified to the Commission a second emergency recapitalisation in favour of AIB, for an additional net recapitalisation of up to EUR 9.8 billion, to be granted in 2 phases. In addition, all (minus one) the EUR 3.5 billion of Preference Shares will be converted into ordinary shares, as explained in paragraph (40).

2 DESCRIPTION OF THE MEASURE

2.1 The beneficiary

(8) A detailed description of AIB is provided in Section 2.1 of the Commission decision concerning the first recapitalisation of the Bank of 12 May 2009[2]. A short summary is provided below.

(9) AIB is with The Governor and Company of the Bank of Ireland ("Bank of Ireland") one of the two largest banks in Ireland. It is a diversified financial services group which offers a full range of personal and corporate banking services with an emphasis on the Irish retail banking market (in terms of market share in Ireland, the Bank has approximately: [30-40][*]% of personal current accounts, [10-20]% of mortgages, [30-40]% of savings and [40-50]% of SME current accounts). As of 8 December 2010, AIB remains a listed company and its shares are quoted on the Dublin, London and New York stock exchanges.

(10) Its main areas of operation outside Ireland are the UK, the US and Eastern Europe (Poland in particular), however the Bank has recently embarked on a far reaching divestment programme of its foreign operations.

(11) According to its annual report for the year ended 31 December 2009, AIB had total assets of EUR 174 billion and total deposits of approximately EUR 147.9 billion, which consisted of customer deposits (EUR 83.9 billion), deposits by banks (EUR 33.333 billion) and debt securities in issue (EUR 30.6 billion). As of the same date, AIB's total loan book was approximately EUR 131.5 billion. The loan to deposit ratio was 146% (123% excluding loans held for sale to NAMA). The level of deposits has

---

2 Commission Decision in Case N 241/2009, *Capital injection into Allied Irish Bank,*

* Confidential information

however been steadily decreasing from September 2010 and the amount of customer deposits is currently at EUR […] billion (as of 2 December 2010).

(12) AIB's current credit ratings are […] by Moody's, S&P and Fitch respectively (downgraded by S&P on 8 October 2010 and put on Credit Watch Negative by Moody's on 6 October 2010). The level of AIB's 5 year Senior CDS spread is approximately 1050 bps as of 8 December 2010. This compares to around 800 bps for Bank of Ireland and to approximately 150 bps for the 5 year senior financials ITRAXX index on the same day (vs. 244 bps 6 months ago on 10 May 2010). AIB's share price is EUR 0.51 at 8 December 2010 (vs. EUR 1.23 6 months ago on 18 May 2010).

(13) As of 12 November 2010, AIB had participated to the following sector wide State support measures:

(i) The Credit Institutions Financial support Scheme (CIFS) from 24 October 2008 to 29 September 2010[3];

(ii) The Eligible Liabilities Guarantee Scheme (ELG) from 21st January 2010. Amount of liabilities covered at 30 September 2010 is EUR […] billion[4];

(iii) An asset relief measure consisting of the transfer of commercial property and development loans to the National Asset Management Agency ("NAMA") from 12 February 2010[5]. As part of the first tranche of assets transferred to NAMA, AIB transferred bank assets with an aggregate loan balance of EUR 3.288 billion at an average discount of 42% (i.e. for a purchase price of EUR 1.905 billion). The second tranche of bank assets to NAMA contained assets with an aggregate loan balance of EUR 2.674 billion at an average discount of 48.5% (i.e. for a purchase price of EUR 1.403 billion). It is currently expected that the remaining AIB bank assets (EUR 13.5 billion) will begin to transfer to NAMA in November 2010 for completion by the end of the year at an average discount of 60%[6].

(14) In addition to the above, on 11 February 2009, the Government announced the decision to inject EUR 3.5 billion into AIB in the form of preference shares (the 2009 Preference Shares). The 2009 Preference Shares are Core Tier 1 non-cumulative perpetual preference shares in the Bank with a fixed annual dividend of 8% (or the right to shares in lieu) and with detachable warrants to acquire further ordinary shares in AIB (the "Warrants"). The 2009 State Investment was approved by the Commission under EU State aid rules on 12 May 2009[7].

---

3 See Commission Decision in Case NN48/2008, Guarantee Scheme for Banks in Ireland, OJ C 312, 06.12.2008, p. 2.

4 See Commission Decision in Case N349/2009, Credit Institutions Eligible Liability Guarantee Scheme, OJ C 72, 20.3.2010, p. 6, subsequently prolonged until 30.6.2010 through the Commission's Decision in Case N198/2010, Prolongation of the Eligible Liabilities Guarantee Scheme, OJ C 191, 15.7.2010, p. 1 and again extended until 31.12.2010 through the Commission Decision in Case N254/2010, Second Prolongation of the Eligible Liabilities Guarantee Scheme, OJ C 238, 03.09.2010, p. 2.

5 Commission Decision in Case N 725/2009, *Irish asset relief – NAMA*, OJ C 94, 14.4.2010, p. 10.

6 Under the terms of the support programme announced on 28 November 2010, loans with a nominal value of between EUR 0 to 20 million will also be transferred, corresponding to an additional loan nominal value of EUR […] billion. .

7 See Commission Decision in Case N241/2009, *Capital injection into Allied Irish Bank*, OJ C 223, 16.09.2009, p. 2.

(15) Following the Commission decision of May 2009, the Irish authorities submitted a restructuring plan for AIB on 13 November 2009. Central to this plan was AIB's intention to sell some its foreign subsidiaries. After a number of iterations and following the results of the PCAR exercise, AIB ultimately decided to engage in a more far-reaching divestment programme and to divest all its main foreign subsidiaries (Polish, UK and US). A revised restructuring plan was submitted on 4 May 2010.

(16) In the second half of 2010, AIB started the divestment programme. The sale of the Polish business to Santander was announced on 10 September 2010 for a total consideration of EUR 3.1 billion. The transaction will generate EUR 2.5 billion of equivalent equity tier 1 capital which is in line with July 2010 expectations (see Table 1). The divestment of the US business (M&T shares) was also completed on 4 November 2010, with a positive capital impact of EUR 900 million, slightly in excess of expectations. However, the sale of the UK business is proving more challenging. In November 2010, AIB announced its decision to halt the current sales process of AIB UK and to undertake instead a strategic review of its UK business. The above impacts of the Polish and the US divestments have been taken into account in the amount of recapitalisation necessary for AIB by the Irish financial regulator.

Table 1: Equity Tier 1 impact disposals AIB

Disposals	Equity Tier 1 Impact in EUR billion
BZWBK (Polish business)	+ 2.500
M&T (US business)	+ 0.900
Total capital impact from disposals	+ 3.400

2.2 The events triggering the measure

(17) AIB, like the main other Irish banks, was very exposed to its home market and in particular to the property market. From 2002 to 2008, AIB's exposure to the property market grew rapidly fuelled by the Bank's easy access to wholesale funding. This left the Bank in a very vulnerable position when the global financial crisis hit and the Irish real estate bubble burst.

(18) The subsequent material deterioration in the financial position of AIB led it to participate in all the sector-wide support measures put in place by the Irish State in order to safeguard the stability of the financial system in the State. […]

<u>The Central Bank's PCAR exercise</u>

(19) On 30 March 2010, the Irish Financial Regulator announced that it (together with the Central Bank) had carried out an exercise to determine the forward-looking prudential capital requirements of certain Irish credit institutions, covered by the CIFS Scheme and the ELG Scheme which included AIB ("the PCAR exercise"). The PCAR exercise was undertaken to determine the recapitalisation requirements (if any) of the participating credit institutions if they were to meet regulatory capital needs in both an expected (base case) and a stressed case scenario for the period 2010 to 2012.

(20) The PCAR was undertaken to determine the recapitalisation requirements of certain Irish credit institutions with reference to both a base case and a stressed case scenarios:

(i) Base case scenario: A target level of 8% Core Tier 1 Capital after taking account of the realisation of future expected losses and other financial developments under a base case scenario. As a further prudential requirement, the capital used to meet the base case target must be principally in the form of equity, the highest quality form of capital, with 7% equity as the target level.

(ii) Stressed case scenario: A target level of 4% Core Tier 1 Capital that should be maintained to meet a stress scenario for loan losses and other financial developments.

(21) The Financial Regulator required the credit institutions that had completed the exercise, including AIB, to prepare recapitalisation plans to comply with the additional capital specified by the PCAR. The Financial Regulator required that the amount of capital set by the PCAR process was to be in place by the end of 2010[8].

(22) Under the PCAR, the Financial Regulator determined AIB's additional capital requirements as:

(i) An additional EUR 7.396 billion of equity capital to meet the base case target of 7% equity, before taking account of projected asset disposals, and

(ii) EUR 4.865 billion of Core Tier 1 capital, less any equity generated under paragraph (i) above, excluding conversion of preference shares held by the Government, to meet the base case target of 8% Core Tier 1. This additional Core Tier 1 capital also satisfied AIB's stress case target of 4% Core Tier 1.

<u>The increase in the haircut for the transfer of loans to NAMA</u>

(23) The capital increases resulting from the PCAR exercise announced on 30 March 2010 were based on (i) the Central Bank's own assumptions regarding expected losses for non NAMA loans (including a buffer) and on (ii) the haircuts applied for the transfer of the first tranche of assets for NAMA assets, which was 42%. However, it later appeared that the required haircut for the transfer of the third tranche of NAMA was in fact greater than for the first tranche, namely 60% (and as such greater than the assumption used in the PCAR exercise). At the request of the Minister, NAMA has now provided an estimate of the NAMA haircuts on all remaining tranches.

(24) Following the higher haircut for the second tranche of NAMA, the Central Bank advised AIB that it will be required to raise an additional EUR 3 billion by 31 December 2010, on top of the EUR 7.4 billion additional equity and EUR 4.9 billion additional Core Tier 1 already announced under PCAR requirements.

<u>The Minister's 30 September 2010 announcement</u>

(25) The additional capital requirement for AIB following the higher NAMA haircut was announced by the Irish Minister for Finance on 30 September 2010. According to the announcement, AIB's new total capital requirement amounted to EUR 7.9 billion after deducting the capital generated by the sale of its Polish subsidiary[9]. As for core tier 1

[8] However the Financial Regulator has taken a more flexible approach with regard to the capital increase resulting from the sale of the Polish subsidiary BZWBK. The net proceeds will only impact the balance sheet of AIB when the sale process is completed (early 2011).

[9] Subsequently reduced to EUR 7.0 billion following the sale of the US business.

capital (also taking into account the sale of the Polish and US businesses) this meant a new core tier one requirement of EUR 4.5 billion.

(26) In his statement, the Minister announced that the new Core Tier 1 capital requirement would be met through an open offer and placement of shares to existing and new shareholders of AIB for an amount of EUR 5.4 billion that the Government would ultimately fully underwrite. It has since been decided that such open offer and placement operation will not proceed at this time given the current stressed market circumstances and the Programme for Support, and that the State will inject the capital needed in full following the adoption of a Special Resolution Regime for banks.

Announcement of the Programme for Support

(27) On 28 November 2010, the Irish Government announced that a EUR 85 billion Programme for Support had been agreed with the Commission and the IMF, in liaison with the ECB. The Irish State will contribute EUR 17.5 billion to the facility, which will come from the National Pensions Reserve Fund[10] ("NPRFC") and other domestic cash resources. This reduces the extent of external assistance under the facility to EUR 67.5 billion. The external support will be broken down as follows: EUR 22.5 billion from the European Financial Stability Mechanism ("EFSM"); EUR 22.5 billion from the European Financial Stability Fund ("EFSF") and bilateral loans from the UK, Sweden and Denmark; and EUR 22.5 billion from the IMF's Extended Fund Facility ("EFF").

(28) The Programme for Support has two parts. The first part deals with bank restructuring and reorganisation under a Banking System Programme (EUR 35 billion) and the second part deals with fiscal policy and structural reform (EUR 50 billion). The Banking System Programme provides for a recapitalisation, fundamental downsizing, restructuring and reorganisation of the banking sector.

(29) The recapitalisation needs resulting from the Programme for Support will build on the results of the 30 March 2010 PCAR, and will factor in a new minimum capital requirement target of 10.50% core tier 1 for AIB, Bank of Ireland, Irish Life and Permanent ("ILP") and Educational Building Society ("EBS"). Further, the Central Bank is requiring AIB, Bank of Ireland and EBS to raise sufficient capital to achieve a capital ratio of at least 12% Core Tier 1 by 28 February 2011 (May 2011 for ILP). The Central Bank requires this additional capital to be in the form of equity. The target of 10.5% minimum Core Tier 1 capital will become the ongoing minimum capital requirement for AIB, Bank of Ireland, EBS and ILP going forward.

(30) This increase in the target requirement from 7% equity/8% core tier 1 to 12% core tier 1 will generate an additional core Tier 1 capital need of EUR […] billion for AIB.

(31) Immediate further deleveraging of the banks will be achieved by the extension of the NAMA programme to include approximately EUR […] billion of land and development loans in AIB, which had previously been excluded as they were below a value threshold of EUR 20 million. It is expected that all loans will be transferred by end-March 2011. The additional capital requirement will be met by the Programme for Support. This measure will be notified to the European Commission in accordance

[10] The NPRFC is a statutory body whose sole purpose is to manage the assets of the National Pension Reserve Fund on behalf of the Irish finance Minister. The NPRF is a fund established in 2001 with the objective of meeting as much as possible of the costs of social and public service pensions from 2025. The assets of NPRFC are owned y the Minister. The NPFRC already holds the 2009 Preference Shares.

with EU State aid rules (in particular with regard to the assessment of the discounts to be applied to loans).

(32) The transfer of these smaller loans to NAMA will lead to an estimated additional Core Tier 1 capital need of EUR […] billion for AIB.

(33) As a result of the new target capital ratio under the base case of 12% and of the further transfer of assets to NAMA, the Central Bank estimates that AIB requires additional Core Tier 1 capital of approximately EUR 5.3 billion[11]. The core tier 1 capital requirement announced in September 2010 (and still to be met) was EUR 4.5 billion. This means that AIB is required to raise approximately EUR 9.8 billion of additional Core Tier 1 capital by end-February 2011.

Announcement on Special Resolution Regime and Recapitalisation Measures

(34) In the week 13-19 December 2010, the Irish [Government] announced the passing of the Credit Institutions (Stabilisation) Bill 2010. This Bill puts in place a special resolution regime aimed at providing the State with the proper powers and legislative tools necessary to complete the recapitalisation and restructuring measures spelled out in the Banking System Programme.

2.3 The measure

(35) The notified measure concerns: (i) the recapitalisation of AIB; and (ii) the conversion of preference shares into ordinary shares.

(36) The State will recapitalise AIB up to EUR 10.2 billion to first reach the capital requirements of the Irish financial regulator following from the PCAR as updated on 30 September 2010 and secondly the Core Tier 1 capital levels agreed upon in the Banking Support Programme ("the Recapitalisation Measures").

(37) The Recapitalisation Measures will take place in two phases:

(i) The Capital Contribution: a capital contribution by the Irish State of EUR 3.9[12] billion into AIB for new ordinary shares and common non voting shares ("CNV Shares") to be completed prior to end December 2010;

(ii) The Further Capital Contribution: a capital contribution by the Irish State of up to EUR 6.3 billion[13] into AIB for new ordinary shares and / or CNV Shares prior to end of February 2011.

(38) The net capital injection by the Irish State will be EUR 9.8 billion. EUR […] of fees will be paid by AIB to the State in relation to the Capital Contribution, the Further Capital Contribution, and the conversion of preference shares.

---

11 EUR […].

12 This amount covers the fees payable by AIB to the State in relation to the Capital Contribution, the conversion of Preference Shares and the cancellation of the warrants. The Capital Contribution will provide net proceeds to AIB of EUR 3.7 billion.

13 This amount covers the fees payable by AIB to the State in relation to the Further Capital Contribution. The Further Contribution will provide net proceeds to AIB of EUR 6.1 billion. AIB may generate additional core tier 1 capital through a liability management exercised and/or asset disposals prior to end of February 2011. The amount of Further Capital Contribution will be reduced accordingly.

(39) Both the Capital Contribution and the Further Capital Contribution will be in the form of a direct purchase by the State without offering an opportunity to participate in the capital injection to existing shareholders, as foreseen under the special resolution regime created by the Credit Institutions (Stabilisation) Bill. The Capital Contribution will be funded through existing cash reserves of the NPRFC. The Further Capital Contribution will be funded through the Programme for Support. The shares issued through both exercises will be held by the NPFRC on behalf of the Minister for Finance.

(40) The NPFRC also holds the existing EUR 3.5 billion of 2009 Preference Shares. To simplify the capital structure of AIB, and because investors have a lower perception of preference shares than ordinary shares when providing funding to banks, it is intended that the State will convert all the Preference Shares into ordinary shares […]. This conversion will have no impact on the core tier 1 ratio of the bank as the Preference Shares are already regarded as core tier 1 by the Financial Regulator. The NPFRC will keep one Preference Share to maintain certain specific rights attached to Preference Shares[14].

(41) The Capital Contribution and the conversion of Preference Shares will be done at a price set as the lower of (i) the closing price of AIB's ordinary stocks on 26 November 2010 (EUR 0.342 per share) which was the last trading day prior to the Central Bank of Ireland announcement on 28 November 2010; or (ii) the closing price of AIB's ordinary stocks on the last trading day prior to the Government's announcement of the AIB recapitalisation measures, which is anticipated to be made following the enactment of the legislation enabling the State to recapitalise the bank without market placement.

(42) The Further Capital Contribution will be done at a price that will be set at a later stage because the terms of the transaction are not exactly yet known. The price of AIB shares may further decline, and the size of the transaction may be affected by the success of potential liability management exercises. However the Irish authorities have committed that the Further Capital Contribution will be done at a price that will not exceed the price of the Capital Contribution.

(43) On this basis, NPFRC will hold on behalf of the Minister 95-[…] % of the entire issued ordinary share capital of AIB.

(44) Because of a technical regulatory issue arising from the change of control of AIB before the sale of the Polish subsidiary BZWBK to Santander is closed, the State intends to initially limit its voting rights and ordinary shareholding of AIB to a level below 50% for a period of time up to completion of the sale of BZW to Santander. This will be achieved by the NPFRC subscribing initially to ordinary shares for up to 49.9% of the bank ordinary shareholding and for the remainder of the recapitalisation in CNV Shares.

(45) The State will convert all the CNV shares into ordinary shares as soon as the sale of BZWBK has been completed if AIB is delisted. If AIB retains its existing listing, the State will convert a number of CNV shares so as its ordinary shareholding will remain below 75%.[15]

---

14 The specific rights attached to the preference shares are: (i) 25% of total ordinary share voting rights in respect of resolutions concerning change of control and board appointments; and (ii) the right to directly appoint up to 25% of the board of directors of AIB.

15 […] If not, the Irish Listing Rules and the UK Listing Rules generally state that a listed company must maintain a minimum free float of 25% at all times.

(46) The CNV Shares are expected to be issued directly to and subscribed by the NPRFC at the same price as the ordinary shares. It is anticipated that the CNV Shares will have substantially the same features as ordinary shares except for the fact that they will not carry voting rights (in particular they will count as core tier 1 capital). They will be convertible into ordinary shares on a one for one basis at any time at the NPFRC's sole discretion.

(47) For the Capital Contribution, the NPRFC will receive a […]% fee on the gross proceeds of the transaction up to 49.9% NPFRC ownership and a […]% fee on the gross proceeds in excess of this amount (rounded upwards to the nearest EUR 100 million). For the Further Capital Contribution, the NPFRC will receive a […]% fee on the gross proceeds if CNV shares are issued, and […]% if only ordinary shares are issued. The total amount of fees to be received by the State is expected to be EUR […] million.

(48) The State's existing warrants (which were issued to the State in May 2009 with the issuance of the Preference Shares), will be repurchased by AIB for a fee of approximately EUR 50 million[16].

(49) […] [17]

(50) AIB will be subject to behavioural conditions under the terms and conditions of the Recapitalisation Measures in addition to those already included in the ELG Scheme and the 2009 State Investment. In particular AIB will need to implement measures to promote availability of credit, will not pay dividends unless agreed by the Irish authorities, will review its corporate governance along lines set by the Irish authorities, and will review its remuneration policy along lines set by the Irish authorities.

3 POSTION OF THE IRISH AUTHORITIES

(51) The Irish authorities accept that the measure constitutes State aid. They are of the view that the measure is compatible with the internal market on the basis of Article 107(3)(b) of the Treaty on the Functioning of the European Union (hereinafter "TFEU") as it is necessary to remedy a serious disturbance in the Irish economy. In particular the Irish authorities submit that the measure is (i) appropriate and well targeted; (ii) necessary and limited to the minimum amount necessary; and (iii) proportionate as designed to minimize negative spill-over effects on competitors.

(52) *Appropriate and well-targeted*. The Irish authorities submit that AIB is systemically important for the maintenance of stability of the financial system in Ireland. AIB is one of the largest financial institutions in the State with 182 main branches, 88 sub-offices, 15 business centres and approximately 7,284 staff. It has a balance sheet size of around EUR 174 billion and accounts for a material share of customer deposits and lending in the Irish economy. Further, the Central Bank recognises the systemic importance of AIB for the Irish financial system in a letter dated 3 December 2010.

---

[16] On purchase of the 2009 Preference Shares, the State received detachable warrants for the equivalent of constituting 25% of the ordinary share capital of the Bank existing on the exercise date of the Warrants calculated on a post-dilution basis. The State may exercise this option from the fifth to the tenth anniversary of the purchase of the New Preference Shares. The warrants are divided into two equal tranches with different strike price. The strike price of the "Core Tranche" of the Warrants is EUR 0.975. The strike price of the balance of the Warrants granted to the State is EUR 0.375.

[17] […]

(53) The Irish Authorities also stress that the purpose of the Recapitalisation Measures is to ensure compliance by AIB with the new capital requirements announced by the Central Bank as part of the Banking System Programme. As such they view the injection of equity capital as a well targeted and appropriate measure to achieve this objective.

(54) *Necessary and limited to the minimum amount*. The Irish authorities submit that the measure is limited in size to what is necessary to ensure the compliance by AIB with the new target capital ratio announced by the Central Bank on 28 November 2010. In addition, they point out that AIB will attempt to raise additional core tier 1 equity prior to the completion of the Further Capital Contribution through a liability management exercise and/or assets disposals. Any amount of core tier 1 raised in such a way will reduce the amount of the Further Capital Contribution.

(55) The Irish Authorities also submit that the purchase price and the conversion price for the Capital Contribution (closing stock price on the last trading day prior to the announcement) will ensure an appropriate level of dilution of existing shareholders. They further recall that the State will receive a fee of between […]% of the gross proceeds as well as a cancellation payment for the warrants. They conclude that the Recapitalisation Measures for AIB are limited in scope and duration to what is strictly necessary to achieve their objective.

(56) *Proportionate*. The Irish authorities submit that the behavioural constraints imposed by the terms and conditions of the Recapitalisation Measures, together with the conditions imposed under the ELG scheme, contain an extensive range of safeguards against possible abuses and distortions of competition.

(57) The measure is subject to a remuneration (bank fees on […]% of the gross proceeds of the transaction). Overall however, the Irish authorities acknowledge that how and when the State may recoup its investment will be dependent on many factors[…]. Nevertheless, the Irish authorities have submitted that the proposed recapitalisation of AIB is consistent with the State commitments agreed under the Programme of Financial Support for Ireland. In particular they submit that it is essential that the State supports AIB as a systematically important bank, essential to maintenance of financial stability in the country. AIB is the biggest Irish clearing bank and accounts for a major share of customer deposits and lending in the domestic economy.

(58) Furthermore, the Memorandum of Understanding setting some of the conditions of the Programme for Support indicates that the Irish Authorities will provide an updated restructuring plan for AIB by the end of the first quarter 2011. For the purpose of this decision, and as indicated in Recital 44 of the Commission Communication on "The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortion of competition" (hereinafter "the Recapitalisation Communication")[18], the Irish Authorities commit to submit a restructuring plan within 6 months of this decision. This restructuring plan will take into consideration the Recapitalisation Measures, as well as reorganisation measures decided under the Banking System Programme.

[18] Commission Communication on "The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortion of competition", OJ C 10 of 15.01.2009, p. 2.

4 ASSESSMENT

4.1 Existence of State aid

(59) The Commission first has to assess whether the measure constitutes State aid within the meaning of Article 107(1) TFEU. According to this provision, State aid is any aid granted by a Member State or through State resources in any form whatsoever which distorts, or threatens to distort, competition by favouring certain undertakings, in so far as it affects trade between Member States. The Commission in this context observes that the Irish authorities do not dispute that the measure constitutes State aid.

(60) The Commission observes that in this case State resources are involved as the measure is entirely financed by the State (regardless of the origin of the funds).

(61) The Commission also has to assess whether the measure confers a selective advantage on the beneficiary of the aid. The Commission considers the measure to be selective as it solely benefits AIB.

(62) The measure furthermore confers an advantage on AIB as it allows AIB to absorb losses on the transfer of NAMA assets and future losses on other assets and as such potentially to avoid insolvency. Although several banks in Ireland and in the EU have benefited from State aid in the course of the ongoing financial crisis, most have received less support in proportion of their risk weighted assets. In addition many banks have not received aid.

(63) The Commission considers that the proposed recapitalisation would not have been provided by a market economy investor expecting a reasonable return on his investment. The measure foresees an upfront remuneration for the State under the form of an underwriting fee of […]% on the gross proceeds of the recapitalisation. However, the ordinary shares do not carry any fixed remuneration and the Irish authorities did not provide evidence that the State will be in a position to recoup its overall investment if and when it sells its participation in the bank.

(64) The Commission finds that the measure is also able to affect trade between Member States as AIB is competing on, amongst others, the Irish retail savings markets, the Irish mortgage lending markets and the Irish and UK commercial lending markets. In the Irish market, some of AIB' competitors are subsidiaries of foreign banks, while in the UK market AIB competes with both UK-based banks and the subsidiaries of foreign banks active on the UK market.

Conclusion

(65) Due to the above considerations, the Commission considers that the measure fulfils all conditions laid down in Article 107(1) TFEU and, therefore, those measures qualify as State aid to AIB.

4.2 Compatibility of the aid

(66) As regards compatibility of the aid provided to AIB with the internal market, the Commission first needs to determine whether the aid can be assessed under Article 107(3)(b) TFEU, i.e. whether the aid remedies a serious disturbance in the economy of Ireland. Subsequently, once the applicable legal basis has been determined, the Commission has to assess whether the measure at issue is compatible with the internal market.

4.2.1 Legal basis for the compatibility assessment

(67) Article 107(3)(b) TFEU provides for the possibility that aid falling within the scope of Article 107(1) TFEU can be regarded as compatible with the internal market where it "remedies a serious disturbance in the economy of a Member State".

(68) Given the present circumstances in the financial markets, the Commission considers that the measure may be examined under Article 107(3)(b) TFEU.

(69) The Commission considers that market conditions deteriorated all over the world since the last quarter of 2008. The Commission observes that Ireland in particular has been severely hit by the financial and economic crisis. The economic downturn combined with the fall in property prices and the exposure of the Irish banks to land and property development loans have led to significant impairments for Irish banks. Irish banks have furthermore been faced with difficulties in obtaining funding and capital from the markets due to the uncertainty associated with the property market in Ireland, the future economic development and the pressure on the sovereign.

(70) The Irish authorities have shown that without the capital injection […]. This position has been confirmed by the Irish Central Bank in a letter dated 3 December 2010. According to the Irish Central Bank, it is essential that AIB receives the recapitalisation in order to avoid severe financial difficulties, as it is a systemically important financial institution. As indicated by the Irish authorities, AIB has a significant number of depositors.

(71) For these reasons the Commission accepts that the EUR 9.8 billion additional net recapitalisation in favour of AIB and the conversion of preference shares into ordinary shares are necessary to avoid a serious disturbance in the economy of Ireland.

4.2.2 Compatibility assessment

(72) In line with point 15 of the Banking Communication[19], in order for an aid or aid scheme to be compatible under Article 107(3)(b) TFEU it must comply with the general criteria for compatibility[20]:

a. *Appropriateness*: The aid has to be well targeted in order to be able to effectively achieve the objective of remedying a serious disturbance in the economy. This would not be the case if the measure were not appropriate to remedy the disturbance.

b. Necessity: The aid measure must, in its amount and form, be necessary to achieve the objective. That implies that it must be of the minimum amount necessary to reach the objective, and take the form most appropriate to remedy the disturbance.

*c. Proportionality**:*** The positive effects of the measure must be properly balanced against the distortions of competition, in order for the distortions to be limited to the minimum necessary to reach the measure's objectives.

(73) The Recapitalisation Communication further elaborates on the three principles of the Banking Communication and states that recapitalisations can contribute to the restoration of financial stability. In particular the Recapitalisation Communication

---

[19] *The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis*, OJ C 270, 25.10.2008, p.8.

[20] See paragraph 41 of Commission decision in Case NN 51/2008 *Guarantee scheme for banks in Denmark*, OJ C 273, 28.10.2008, p.2.

states that recapitalisations may be an appropriate response to the problems of financial institutions facing insolvency.[21]

4.2.2.1 Compatibility with the Banking and Recapitalisation Communications

a. Appropriateness of the measures

(74) This second recapitalisation measure of AIB directly results from the capital requirements imposed by the Irish financial regulator, and will allow the Bank to meet its new target regulatory capital requirements in two steps. The injection of equity capital is the single most efficient and straight forward measure to shore up one bank's capital.

(75) AIB is the second largest banking institution in Ireland with very material shares of Irish retail banking services. As such AIB is a systemically important bank for Ireland. Consequently, a default of AIB would create a serious disturbance in the Irish economy. This serious disturbance would even be aggravated under the current circumstances where all financial institutions in Ireland face severe limitations to access funding, and limit to a certain extent the provisions of loans to the Irish economy. The measure thereby ensures that financial stability in Ireland is maintained. For those reasons, the Commission finds that the measure is appropriate.

b. Necessity – limitation of the aid to the minimum

(76) According to the Banking Communication, the aid measure must, in its amount and form, be necessary to achieve the objective. That implies that the capital injection must be of the minimum amount necessary to reach the objective. In this context, the Commission observes that the amount of the measures will ensure that AIB will fulfil its regulatory capital requirements and will be in line with the terms agreed by Ireland and the Banking System Programme. The proposed amount of recapitalisation is then limited to the minimum necessary to meet such requirements.

(77) On the purchase price per ordinary share, the Commission notes that it is equal to the the lower of (i) the closing price of AIB's ordinary stocks on 26 November 2010 (EUR 0.342 per share) which was the last trading day prior to the Central Bank of Ireland announcement on 28 November 2010; or (ii) the closing price of AIB's ordinary stocks on the last trading day prior to the Government's announcement of the AIB Recapitalisation Measures, which is anticipated to be made following the enactment of the legislation enabling the State to recapitalise the bank without market placement. Both prices could be viewed as the market price, and the lowest of these prices will be chosen, thus maximising the dilution of existing private shareholders. The Commission observes that the level of dilution obtained with such price per share is already very significant: current shareholders will be diluted from approx. 81.4% shareholding of the Bank currently to a maximum of 5% and potentially less.

(78) The Further Capital Contribution will be done at a price that will not exceed the price of the Capital Contribution, and potentially lower if the price of shares declines. It is thus considered as appropriate as it will maximise the shareholding of the State.

(79) The Preference Shares will be converted into ordinary shares at the conversion price used for the Capital Contribution. The Preference Shares will not be converted at a price lower than the subscription price of the ordinary shares purchased with cash as, amongst other reasons, this would contradict the principle of equal treatment of

[21] Recapitalisation Communication, paragraph (6).

ordinary shareholders (i.e. the State as sole holder of the preference shares would be allowed to purchase the same ordinary shares to be issued in the same transaction at a lower price).

(80) The Irish Government will subscribe to CNV shares for a portion of the issue amount, in order to limit State shareholding below 50% in the short term. According to the Irish authorities, this construction is temporary and necessary for regulatory reasons to limit aid to the minimum. The State will convert all the CNV shares into ordinary shares as soon as the Polish regulatory issue is solved if AIB is delisted […]. If AIB retains its existing listing, the State will convert a number of CNV shares so as its ordinary shareholding will remain below 75%. This second option would be acceptable from a State aid perspective, because the CNV and ordinary shares carry the same economic rights, and the State can convert the CNV shares at will.

(81) In conclusion, the measure is necessary in both its amount and form to achieve the objectives of limiting the disturbance in the Irish banking system and economy as a whole.

Remuneration of the aid

(82) The aid granted by the Irish authorities to AIB is fully in the form of ordinary shares (after the conversion of Preference Shares into ordinary shares) . The Irish authorities have not indicated whether they consider it likely that they will recoup their investment in the medium or long term by selling their stake in AIB.

(83) The measure foresees an upfront remuneration for the State under the form of an underwriting fee of […]% on the gross proceeds of the recapitalisation. However, the ordinary shares do not carry any fixed remuneration […]. Overall the remuneration of the State aid is thus very limited.

(84) Paragraphs 15 and 44 of the Recapitalisation Communication explain that lower remuneration in duly justified cases can be accepted in the short-term for distressed banks on the condition that the lower remuneration will be reflected in the restructuring plan.

(85) It is therefore necessary for the Commission to verify whether AIB is fundamentally sound or distressed. The Recapitalisation Communication provides a number of indicators to assess the risk profile of a financial institution, and whether the bank is fundamentally sound or distressed: (i) capital adequacy and sustainability of the business model; (ii) size of the recapitalisation; (iii) current CDS spreads; and (iv) the current rating of the financial institution and its outlook.[22]

(i) *Capital adequacy and sustainability of the business model*. The Recapitalisation Measures account for [10-20]% of AIB Risk Weighted Assets (RWAs)[23]. They will be sufficient for AIB to reach a 12% core tier 1 ratio. Absent the Recapitalisation Measures, the bank could not respect the capital requirements imposed by the financial regulator (10.5% core tier 1) by a large margin. Although the bank has preserved its traditional bank activities, it excessively engaged in the area of land and development property in the past, which have largely contributed to the difficulties of the bank. This excessive exposure is reflected in the bank's contribution to NAMA.

(ii) *Size of the recapitalisation*. In total the Irish Government will have injected EUR 13.3 billion (including the first recapitalisation of AIB and the Recapitalisation

[22] See the Annex to the Recapitalisation Communication.

[23] Recapitalisation measures: EUR 9.8 billion. RWAs 2011 (reference for PCAR 2010 exercise): EUR […]

Measures subject to the present decision), equivalent to [10-20]% of the banks' RWAs, largely in excess of the 2% threshold provided for in the Recapitalisation Communication

(iii) *Current rating of the financial institution and its outlook.* AIB's current credit ratings are […] by Moody's, S&P and Fitch respectively (downgraded by S&P on 8 October 2010 and put on Credit Watch Negative by Moody's on 6 October 2010).

(iv) *Current CDS spreads*. The level of AIB's 5 year Senior CDS spread is approximately 1050 bps as of 8 December 2010. This compares to around 800 bps for Bank of Ireland and to approximately 150 bps for the 5 year senior financials ITRAXX index on the same day (vs. 244 bps 6 months ago on 10 May 2010).

(86) Based on the forgoing indicators, the Commission has come to the conclusion that AIB is in a distressed financial situation according to the criteria laid down in the Annex to the Recapitalisation Communication, and therefore needs to submit a restructuring plan. In particular, AIB cannot meet its regulatory capital requirements without Government support, its ratings are significantly degraded, and the recapitalisation measures will account for more than [10-20]% of its RWAs.

(87) Having established that AIB is a financial institution in distress, which without the State intervention […] could endanger financial stability in Ireland, the Commission considers it justified that a very low remuneration is paid for the measure. That approach is in line also with the Commission's previous decisional practice[24]. AIB is currently not in a position to pay the remuneration required for distressed banks as indicated in the Restructuring Communication. The Recapitalisation Communication also states in paragraph 44 that the use of recapitalisation for a distressed bank can only be accepted on the condition of a far-reaching restructuring.

(88) In addition, under the current economic situation in Ireland combined with the high level of distress of the bank and the lack of perspectives of return to profitability for the bank, no private investor is likely to provide the necessary capital to AIB.

c. Proportionality – measures limiting negative spill-over effects

(89) In spite of the relatively narrow margin of manoeuvre of the Irish authorities ([…]situation of most of the other Irish credit institutions and of the sovereign itself), the transaction provides adequate burden sharing through several points:

(90) Dilution: the transaction will dilute existing shareholders from a current holding of 81.4.%to 0-5%. The Commission views this level of dilution as very material.

(91) *Fees:* the State will receive underwriting fees of […]% of the gross amount of ordinary shares (regardless of any amount taken by private investors or existing shareholders) plus […]% on the gross amount of CNV shares. The Commission views the fees as adequate with regards to financial difficulties of the bank. The fees will be funded through the recapitalisation and paid back to the State. Although it is neutral for the State, the payment of the fees contributes to further dilution of AIB's shareholders.

(92) *Warrants*: it is intended that the State will hand over its existing warrants for a price of EUR 50 million. The Commission considers that the assumptions used to price the warrants are conservative and that the price proposed is a fair amount. In particular at best only one third of this amount consists in the intrinsic value of the warrants (target price minus current price), whereas two third of the price consists in the time value

[24] The same approach was taken in point 64 of Commission decision in Case N 356/2009, Recapitalisation of Anglo Irish bank, OJ C 235, 30.9.2009.

(future gains due to increase in the share price). The time value assumptions appear relatively optimistic, which results in a higher price paid to the State.

(93) *Change in management:* following the announcement of this second recapitalisation, both the Executive Chairman and the Group Managing Director stepped down.

(94) *Higher underwriting fee for the CNV shares*: The CNV shares will be underwritten for a higher fee of […]% which compensates for the loss of voting rights, although the Irish government will exercise a de facto control of the bank and will convert the CNV shares in ordinary shares as soon as feasible.

(95) *Restructuring Plan:* AIB will provide an updated restructuring plan at the latest within 6 months of the date of this decision which will reflect the massive State aid injected in the bank, and the lack of appropriate remuneration for this aid.

(96) *Behavioural measures:* AIB had already proposed a number of behavioural measures as a result of its participation in the Irish guarantee schemes, to help tackle potential competition distortion effects. In light of the state of the Irish economy and banking system and of the systemic importance of AIB, the Commission is of the view that these measures are sufficient to justify the distortion of competition caused by the aid during the restructuring process. This is however without prejudice of additional measures to address distortion of competition that may be attached to the restructuring plan of the bank.

(97) The Commission thus considers the above elements to be sufficient to consider the measure as proportionate and to temporarily approve the measure as emergency aid.

Conclusion

(98) The Commission thus concludes that the measure is: (i) appropriate; (ii) necessary; (iii) that the fact that the capital injection is unlikely to be adequately remunerated by AIB is justified under the circumstances; (iv) AIB is under the obligation to submit a revised restructuring plan; and (v) there are sufficient measures limiting the negative spill-over effects for other competitors. The Commission can therefore approve the measure.

4.2.2.3 Viability review and restructuring plan

(99) The Recapitalisation Communication states in paragraph 44 that the use of recapitalisation for a distressed bank can only be accepted on the condition of a far-reaching restructuring. The Commission furthermore observes that the aid provided to AIB is a high multiple of the established threshold of 2% of its RWA ([10-20]%), which together with the rest of indicators of the Annex to the Recapitalisation Communication (as examined in paragraph (85)), confirms that in-depth restructuring is required.

(100) The Commission furthermore observes that the Banking System Programme stipulates that the Irish authorities will submit a revised restructuring plan for AIB before the end of the first quarter 2011. For the purpose of this decision, and as indicated in Recital 44 of the Recapitalisation Communication, the Irish Authorities commit to submit a restructuring plan within 6 months of this decision.

(101) In line with the provisions of the Memorandum of Understanding of the Banking System Programme, the Commission anticipates the restructuring plan to build on the already completed divestments (paragraph (16)) to include far reaching deleveraging measures to address the bank's funding and liquidity issues. The Commission anticipates the plan to focus on balance sheet reduction to reach the loan to deposits ratio targets to be set for end 2013 by the Irish Authorities consultation with the ECB, EC and the IMF by end Dec 2010. For these reasons, the Commission accepts the

commitment of the Irish authorities to submit a revised restructuring within six months of the present decision.

(102) The Commission therefore requires that the revised restructuring plan will (i) take into account all aid measures AIB has received; (ii) fulfil the requirements of the Restructuring Communication[25] as regards return to viability, burden-sharing and own contribution and measures limiting the distortion of competition and (iii) take into account reorganisation measures decided under the Banking System Programme. In any event, the restructuring plan should be submitted to the Commission within six months of the present decision.

CONCLUSION

- The Commission concludes that the net capital injection of EUR 9.8 billion by the State constitutes State aid pursuant to Article 107(1) TFEU.

- The Commission finds that the rescue measure in favour of Allied Irish Bank fulfils the requirements of Article 107(3)(b) TFEU and is temporarily compatible with the internal market for reasons of financial stability. The rescue measure in favour of Allied Irish Bank is accordingly approved for six months or, if the Irish authorities submit a restructuring plan within the period prescribed in the next point, until the Commission has adopted a final decision on the restructuring plan of the bank.

- The Commission requires the Irish authorities to submit a revised in-depth restructuring plan within six months of the present decision, which takes into account the further aid provided to Allied Irish Bank and the substantial size of the aid – in terms of % of RWA – granted to Allied Irish Bank.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site:

http://ec.europa.eu/community_law/state_aids/state_aids_texts_en.htm

Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Greffe
Rue Joseph II 70
B-1049 Brussels
Fax No: (+32)-2-296.12.42

Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President

25 Communication from the Commission "The return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules", OJ C195, 19.8.2009, p. 9.

DÁIL QUESTION

NO

To ask the Minister for Finance the status of the additional □24 billion needed for Irish banks as a result of the stress tests in early 2011; if the funding has been paid to any Irish bank and if so, the percentage that is being used to provide write-downs for personal and commercial debt, the percentage for boosting reserves at the banks; if it is his intention to formulate an adequate credit policy which will give a clear direction to the banks on personal and commercial debt; and if he will make a statement on the matter.

- Noel Grealish.

* For WRITTEN answer on Wednesday, 18th April, 2012.

Ref No: 18719/12

REPLY

Minister for Finance (Mr Noonan) :

The bank recapitalisation commitments made by the State to date are set out in the following table:

€bn	AIB/EBS	BoI	IL&P	IBRC (Anglo/INBS)	Total
Government preference Shares (2009) - NPRF	3.5	3.5*	-	-	**7.0**
Capital contributions (with Promissory Notes as consideration) /Special Investment Shares (2010) – Exchequer **	0.9	-	-	30.7	**31.6**
Ordinary Share Capital (2009) – Exchequer	-	-	-	4.0	**4.0**
Ordinary Share Capital (2010) - NPRF	3.7	-	-	-	**3.7**
Total pre-PCAR 2011 (A)	**8.1**	**3.5**	**0**	**34.7**	**46.3**
PCAR 2011:	**AIB/EBS**	**BoI**	**IL&P**	**Anglo/INBS**	**Total**
Capital from Exchequer***	3.9	-	2.7	-	**6.5**
NPRF Capital	8.8	1.2	-	-	**10.0**
Total PCAR (B)	**12.7**	**1.2**	**2.7**	**-**	**16.5**
Total Cost of Recap for State (A) + (B)	**20.7**	**4.7**	**2.7**	**34.7**	**62.8**

* €1.7bn of BoI's government preference shares were converted to equity in May/June 2010 (€1.8bn still left in existence). The government also received €0.5bn from the warrants relating to BoI's preference shares (excluded from table above).

** The IBRC amount is made up of a total capital contribution for Anglo / INBS of €30.6bn and a special investment share of €0.1bn (INBS). The Anglo / INBS capital contribution impacted in full on the GGB in 2010. The consideration for the Anglo / INBS capital contribution was €30.6bn of promissory notes. These Promissory Notes are an amount due from the State to IBRC. Each year, on 31 March, €3.06bn is paid by the Exchequer to Anglo / INBS as part of the scheduled repayments of the promissory notes. The first such repayment was made on 31 March 2010.

*** The Exchequer cost of the 2011 BoI recap is shown net of share sale to private investors (Completed in October, 2011)

As the Deputy will be aware, the banks were required to raise a total of €24bn as a result of the Central Bank's 2011 Prudential Capital Assessment Review (PCAR). However, primarily as a result of successful private equity contributions, asset sales and burden sharing with bondholders the Government only had to inject €16.5bn into the relevant institutions.

In addition, the State is committed to acquiring Irish Life for €1.3bn to complete the recapitalisation of Irish Life & Permanent. It is expected that the proceeds of an onward sale of Irish Life in due course will reduce the amount the State has committed to the bank recapitalisation.

In relation to personnel and commercial debt, there is on-going and detailed engagement between my Department and the covered institutions. The current and projected capital requirements of the institutions form part of this engagement and these are monitored and assessed on an on-going basis. The PCAR carried out in 2011 by the Central Bank independently assessed the capital requirements having regard, among other things, to the asset quality and the potential impact of such asset value/quality in base and stressed case scenarios.

However, the Banks' policy in relation to credit decisions is a matter for the management and board of the institution. I have no role in the day-to-day commercial and operational decisions of the banks, which include these matters. These decisions are taken by the board and management of the institutions. Notwithstanding the fact that the State is a significant shareholder in the institutions, the banks are run on a commercial arm's length basis as per the Memorandum on Economic and Financial Policies agreed with the EU Commission, the ECB and the IMF.

To: Michael Torpey

Secretary General

From: Ciaran Callaghan

PQ 18719/12

Please find attached a draft response for the above PQ which is for WRITTEN answer on Wednesday 18th April 2012.

SECRET

Oifig an Aire Airgeadais

Ref No: F514/32 /10 **Date: 30 March 2010**

Memorandum for the Information of Government

Stabilising the Banking System

Decision Sought

1. The Minister for Finance asks the Government to note his intention to announce today the final phase of the stabilisation process of the banking system.

Background

2. The Government has already acted to address the banks liquidity problems through the introduction of the Bank Guarantee Schemes and to remove the riskiest loans from the balance sheets of the participating institutions through the NAMA process.

3. NAMA has decided on the price to be paid for the first tranche of loans to be transferred to the Agency, after detailed loan by loan analysis. The discount, or the so-called haircut, for the first tranche of loans and is as follows: AIB, 43%, Bank of Ireland, 35%; Anglo, about 50%; INBS, 58%, and EBS 37%. The weighted average haircut across these institutions is 47%.

4. While the first tranche is not necessarily reflective of future tranches, the Financial Regulator has determined the additional capital requirement of each NAMA participating institution, which must be in place in each of the institutions by the end of 2010 to meet the Regulator's new capital standards.

5. Bank of Ireland must raise additional core capital of €2.7 billion. While Bank of Ireland expects to be able to raise private capital, the State will commit to

converting part of its Preference Shares in Bank of Ireland into ordinary equity. This process requires no new investment of State funds.

6. Allied Irish Bank must raise additional core capital of €7.4 billion. The disposal proceeds will provide significant capital but it will not be sufficient to address the full requirement. To the extent that the gap is not filled by the private sector the State is willing to convert some or all of its preference shares as required on terms to be agreed to provide full value for the State. Any additional capital requirement will be met from the National Pension Reserve Fund.

7. INBS will need an injection of €2.7 billion. This will come from the State through a combination of €100 million in Special Investment Shares in the society and a Promissory Note for the balance issued to the Society. This Note will be payable over ten to fifteen years, which will reduce the impact on the Exchequer this year.

8. EBS will need an injection of €875 million. While EBS has had an expression of interest from a private party, the State will provide EBS with €100 million of capital through the issuance of Special Investment Shares. To the extent that private capital is not forthcoming, the remaining capital requirement of €775 million will be met either partly or fully through the issuance of a Promissory Note from the State to the institution.

9. In addition, the Minister will this week provide Anglo Irish Banks with €8.3 billion to support its capital position to take account of the bank's losses to date. He asks his colleagues to note that additional capital support of up to €10 billion is likely to be required depending on the NAMA discount on the first tranche of Anglo's loans.

10. These actions will put the banks in a much stronger position than heretofore. The Minister is imposing specific lending targets on AIB and Bank of Ireland so that they will make available not less than €3 billion each for new or increased credit facilities to SMEs in both 2010 and 2011.

Appendix 1:

Bacon Report on Options for Resolving Property Loan Impairments and Associated Capital Adequacy of Irish Credit Institutions

Overview:

The Bacon report identifies and seeks to address two critical issues:

1. That the lack of market confidence in Irish banks - reflected in low share prices and funding outflows despite the guarantee - is founded on uncertainty about the adequacy of capital levels in the banks to meet future loan impairments.
2. That a large part of the increase in sovereign borrowing costs is based on market uncertainty around the State's exposure to the c. €440bn contingent liability assumed with the guarantee of all bank liabilities.

Bacon recommends the establishment of a National Asset Management Agency (NAMA) to take over and manage all the Land and Development loans and Investment Property loans currently held by the covered banks, totalling some €158bn. These assets would be mandatorily purchased by the State, at discounted rates to their original book values, by the issue of c.€124bn worth of Government bonds to the banks. A further €7.5bn recapitalisation of the covered institutions, the sale or controlled winding down of a merged Anglo-INBS entity, and a review of the guarantee Scheme, also form part of Mr. Bacon's proposals.

This approach would address market uncertainty around future capital levels in the banks. This should allow the banks to raise and retain funding, and lend to the economy. In addition, subject to the agreement of the ECB, the banks could use the Government bonds to access c. €118bn in funding from the ECB, thereby addressing current liquidity constraints in the Irish system.

The proposal would involve a sharp increase in the level of national debt (from 41% to 111% of GDP). However, the definitive transfer of all risky bank assets to the State, would bring certainty to the market on the Government's borrowing requirement to address the banking crisis (c.€130bn rather than c.€440bn). Returns from the assets held by the NAMA would accrue to the State. As the assets transferred would be discounted and would include both performing and non-performing loans, the State could expect to recover, over time, at least the greater part of the cost of acquiring these assets.

Summary:

1. Crisis in Irish Banking:

The expansion of credit in recent years has been funded by growth in external funding sources of the banks. The downturn in the economy has brought a lack of market confidence in the ability of the banks to cover losses arising from the credit they extended, which has resulted in funding outflows of €45bn to date in 2009, and a consequent deterioration in the day-to-day liquidity positions of the banks.

It is estimated that between now and 2011, the six covered institutions face a cumulative impairment on their property-related loan exposures of around €34bn, or

20% of the total value of the property loans outstanding at September 2008 of €158.3bn. Of this loss, €20bn relates to land and development lending, and €14bn relates to lending for property investment. These figures are based on the assumption of a 55% peak-to-trough decline in the value of development assets, and a 32% reduction in the value of investment assets, and are broken down as follows:

Projected impairment of Development & Investment Property loans (€bn):

Total	AIB	Anglo	BoI	INBS	IL&P	EBS
34	10.8	12.9	7.6	2.2	0.2	0.3

Using these estimates, retaining the 6 banks' capital levels at above 7.5% in the absence of a transfer of risky assets to the State, would require a further recapitalisation of the banks of €8.4bn, as follows:

Projected additional capital required to raise Tier1 Capital Ratio to 7.5% following projected impairment (€bn):

Total	AIB	Anglo	BoI	INBS	IL&P	EBS
8.4	1.5	5.6	-	1.0	-	0.3

However, because of continuing market uncertainty around eventual losses on the risky assets, even if this projected capital requirement was met by the State, the banks would retain their current 'zombie' status, with depressed share prices, no prospect of private capital-raising, under continued funding pressure and consequently with no capacity to grow lending, thus hindering economic recovery. In addition, market concerns around the sovereign exposure to the banks under the guarantee would remain, complicating further the required adjustment of the public finances and leaving Ireland's international credit rating subject to downward pressures and speculative attacks. Bacon suggests therefore that additional measures need to be undertaken to place the banking system on a sound footing.

2. Constraints on the Public Finances:

From a high of almost 100% of GDP in the early 1990s, national debt stood at 41% of GDP at end 2008, well below the EU average of 61% of GDP. As a result, debt servicing costs reduced from 25% of tax revenue in 1991, to 3.8% in 2008.

However, in 2008, with the widening deficit, there has been a very sharp rise in the relative cost of Government debt issuance in recent times. In the past five months, the interest rate charged for Irish 5-year bonds has trebled, to 280bps (or 2.8%) higher than the rate for German Bunds of similar maturity. Similarly, the credit default swap (CDS) rate on Irish bonds - representing the cost of insuring against default - which had been similar to that of Germany for much of the decade to date, began to increase dramatically from the third quarter of 2008 and now exceeds that for Greece, previously the country with the highest CDS rate in the EU.

In part at least, the deterioration in Ireland's relative cost of funds is related to the contingent liabilities of €440Bn assumed by the Government in respect of banks and credit institutions deposit guarantees. These were taken on from 30 September, and it is from around that date that credit spreads have deteriorated most sharply.

In determining the price to charge for Irish Government borrowing, Capital markets are simply adding contingent liabilities assumed under the guarantee to the State's outstanding debt and its prospective debt as a result of the widening deficit. In effect the sovereign debt rating is being intertwined with the country's banking problems via the guarantee on bank liabilities.

Uncertainty has been created because of the contingent nature of the bank guarantee and it is evident to market participants that credit institutions' deposits have not been stable since the guarantee was put in place. Hence, the probability of the guarantee being called has been raised. At the same time the underlying cause of instability in banks' funding: the question of the capital adequacy of the credit institutions to meet prospective impairments, remains unresolved. In these circumstances the likelihood is that the uncertainty premium in yield being attached to government debt will continue and indeed may increase, as economic conditions deteriorate.

In this context, it is imperative that initiatives should be undertaken that will lead to stability in banks deposit and term debt liabilities and eliminate the need for a renewal of the guarantee. To achieve this requires removing all doubts about capital adequacy of the credit institutions and their capacity to deal with prospective loan impairments.

3. Dealing with Loan Losses:
The report considers three options for tackling the related market uncertainties around capital levels in the banks, and the extent of liability of the State.

<u>A. Recapitalisation:</u>
Building on the assessment above on likely impairment rates, future capital shortage is anticipated by testing the adequacy of current capital in stress scenarios. In current market conditions the only realistic source of capital for the banks is the State. The report notes that where Government is guaranteeing the liabilities of the banks and has injected capital to cover losses on loans, nationalisation may be the most effective means of protecting the interest of all stakeholders.

<u>B. Asset Guarantee:</u>
Under this option, the State guarantees the level of future losses on certain (risky) bank assets. The assets remain on the balance sheet of the bank and the banks commit to covering losses on these assets up to a certain 'first loss' amount. There is no upfront cost to the State and the banks pay a fee or premium for this cover.

<u>C. Asset Purchase:</u>
In this scenario, risky assets are transferred from the bank at an agreed price. The State would have to fund the asset purchase, via the issue of Government bonds to the banks, which would negatively affect the fiscal position. The bank takes a loss on the sale and recognises this up front in its profit and loss account. The bank is then effectively cleansed of these risky assets.

The report considers the merits of asset guarantee versus assets purchase:

	Pro	**Con**
Asset Guarantee	• No upfront cost to State • Earns premium • Risk sharing provides banks	• While risk is partially transferred, assets remain on the banks' balance sheets,

	with incentive to manage loans	creating continuing uncertainty for investors around the banks positions • Creates a further contingent liability for the State •
Asset Purchase	• Banks are cleansed of troubled assets • Earns net income after financing cost • Loss sharing, since the bank has to write off the difference between the book value and the purchase price • Position for investors in the banks is made clear • State gains control over asset management	• Large upfront cost, involving increase in national debt • Losses accruing to banks would result in requirement for a further recapitalisation to maintain CT1 levels above 7.5% • Downside risk on assets accrues to State

While the asset guarantee approach has the initial attraction of having no upfront cost to the State, the approach would be subject to the same issues already encountered with the guarantee of bank liabilities: Capital markets have not grappled well with the uncertainty involved with the contingent liabilities assumed by the State and have priced Irish sovereign debt unfavourably as a result.

A further guarantee approach, this time in respect of banks' property related loan assets, would create a further layer of uncertainty through the creation of another contingent liability on the Exchequer. This would further entwine the sovereign rating with Irish banks capital adequacy problems without actually providing any clarity as to how capital adequacy would be achieved, other than through a calling of the contingent liability. By contrast the asset sales approach, while involving the recognition of 'pain' at the outset has the merit of certainty and clarity, provided the projection of the extent of impairment is accurate.

Also, an Asset Management Agency (NAMA) would offer prospects for avoiding many of the shortcomings associated with a continuation of the existing bank-property developer relationship. Potential advantages include: (i) economies of scale in administering workouts (since workouts require specialized, and often scarce, skills) and in forming and selling portfolios of assets, (ii) benefits from the granting of special powers to the government agency to expedite loan resolution and (iii) the interposing of a disinterested third party between bankers and clients, which might break "crony capitalist" connections that otherwise impede efficient transfers of assets from powerful enterprises. The latter may seem particularly beneficial in circumstances markets, where ownership concentration and connections between borrower and banks are often very close.

The NAMA would have the potential to attract potential to attract long term capital to invest in the assets taken on to achieve higher values by working out the projects rather than disposing of the assets.

The up-front losses that would accrue to the banks under the proposed asset purchase approach (€158bn of assets purchased for €124bn) would require additional recapitalisation to maintain the banks'Core Tier 1 capital ratios at 7.5%, of:

Total	AIB	Anglo	BOI	INBS	ILP	EBS
16.25	5.0	8.5	0.75	1.5	0.0	0.5

To minimise the costs to the State, consolidation of rump of INBS and Anglo (after the asset purchase transaction) to be sold to highest bidder as a business franchise, or wound downs as liabilities mature is recommended. An additional capital injection of c.€2bn would be required from the State to stabilise the (combined) institutions and maintain a Core Tier 1 capital level of around 5%. This approach would leave a requirement for further State capital provision in the banking sector, of around €7.5bn.

The impact on AIB and BoI of a further re-capitalisation as proposed would (depending on the precise terms of the investment) raise the degree of State ownership in these institutions to 90% and 85% respectively. In consequence most of the pre-impairment earnings of these institutions would accrue to the State. However there is a distinction between this position and fully nationalised entities that - similar to the situation now applying to RBS in the UK - in that both banks would retain their stock exchange listings. Therefore as market conditions improve, there will be a natural exist mechanism available for the Government to divest itself of majority ownership should it wish to.

In all circumstances it is imperative that agreement of the ECB to funding a bond of face value of €124bn would be procured before any decision is taken by Government to proceed with the recommended approach.

4. Proposal for a National Asset Management Agency:
Functions to be carried out by a NAMA comprise:

- Management and control of the assets transferred to it;
- Employment/outsourcing whatever resources required to carry out its functions efficiently and professionally;
- As it will control a large segment of the market, it should be able to regulate against further market failure due to oversupply in the future;
- It will carry no previous baggage and will have a single objective - to maximise value over a given period;
- It will not have any other banking functions or aspirations;
- It will not favour any institution or client over another, but can make decisions with the advantage of an overview which individual banks cannot have;
- It will have well marked out procedures to prevent fraud but will encourage a suitable commercial posture;

It is proposed that the NAMA be constituted via an extension of the remit of the NTMA because of the Agency's international reputation, and core expertise and technical know how. The NAMA initiative would require new legislation to establish the NAMA and define its remit, including:

- Provision of powers to price and effect transfers of relevant assets
- Definition of assets eligible for transfer

- Obligation on the banks to co-operate in relevant aspects
- Provision for an Assessor to ensure the constitutionality of the transfers

The NAMA legislation should also provide for mandatory transfer of eligible assets from the banks because a voluntary approach would be slow, prone to breakdown, and would raise difficulties in terms of the pricing of assets. A failure to provide absolute clarity to markets in relation to the timing and terms of the asset transfer could prove fatal to the initiative, and mandatory transfer is therefore recommended.

In relation to valuation of assets, a first valuation would be done by the NAMA prior to transfer, following expedited due diligence. An assessor structure would subsequently follow at a suitable time to ensure that the amount paid was fair.

Income producing assets would have the prospect of being written down to a level where the income (in aggregate and with some headroom) would pay interest and yield a profit. Non-income producing assets could be transferred on the basis of current market value of the underlying security, a 'normalised' value of the security, or an across-the-board discount of the assets of x cents in the Euro. In the later case, the transferring institution could have equity (or other exposure) to the NAMA proportionate to the "value" of the assets transferred.

One way to overcome the difficulties of pricing assets would be for the transferring banks, to provide warrants for the purchase of shares in the bank which can be exercised by the Government in several years time at a price, which depend inversely on the value of the impaired debt at that future date. The future date would need to be set far enough into the future for the market in these kinds of assets to have settled down and their price less imponderable.

The NAMA could be capitalised by:
- Credit-enhanced Bond without a Government Guarantee:
Under this approach the NAMA would issue a bond to the six covered institutions in an amount sufficient to cover the value of the transferred assets. The credit quality of the bond would depend on the equity in the balance sheet of the NAMA. The greater the equity, the lower the exposure of the bondholders to the impaired loans. The principal disadvantage is that the transfer of risk from the banks is only partial, to the extent of equity in the balance sheet of the NAMA. As to the provision of equity, it is unlikely that private equity would participate without the presence of State equity, on say a 50:50 basis. However, there are indications that private equity would be interested to participate in acquisitions of bank property portfolios. The advantage of this approach is that it limits the Exchequer's exposure to funding the transfer of the loans to NAMA, to the extent required to adequately supplement private equity participation.

- Credit bond with a Government Guarantee:
The advantage of this approach is that the bond would be eligible collateral for the purpose of Repo agreements at the Euopean Central Bank and this could be used by the banks to replenish liquidity. The disadvantage is that it would add €123.9Bn to the national debt.

The impact of such an increase in the national debt is difficult to predict. A lot of negative news has already been priced in the State's relative cost of borrowing, so it could not be concluded that funding cost would deteriorate in line with the increase in indebtedness. A key question would be whether the overall NAMA initiative was considered by capital markets to resolve the banks' capital adequacy requirements, and the associated attrition in Irish banks' deposit funding. Another key factor relates to the underlying public finance position and current efforts towards stabilising the deficit. Also, the fact that the proposed debt issuance would only be undertaken with the support of the ECB, would tend to mitigate adverse speculative reaction. There remains the risk however, that the market may focus solely on the headline news, pushing cost of borrowing wider, unless the strategic plan is explained comprehensively and clearly.

In relation to the type of Government bond that could be supplied, while the initial attraction could be to supply an instrument with low Exchequer cash outlays (non-interest bearing bullet bond with long maturity), this would adversely affect income streams and profitability in the banks, and market perceptions around the intentions and capabilities of the State to honour the bond. It is concluded that the most effective approach is to inject a type of bond which is more in line with the sort of asset which a bank would voluntarily hold on its balance sheet: short-term, and with interest rate floating in line with the market. Such an instrument can more easily be made marketable, thereby freeing the bank to move forward with an asset-side strategy that is not dependent on its particular failure history.

The cost of servicing a marketable bond of c. €120bn would be c.€2.1bn per annum. It is calculated - on the basis of €100bn of investment property assets being transferred to the AMC - that even allowing for a high level of impairment of these assets, the cash flows generated would be sufficient to ensure no net burden in terms of additional service costs.

Business Model of the NAMA:
In relation to the various categories of assets taken on, NAMA will be charged with their management in terms of disposal, holding, consolidating and creation of joint ventures for maximising return on the assets. In order to discharge the functions, NAMA will need to establish or source functional competence in: Legal; Project Finance; Project management; Planning and Design (external); Sales & Marketing (external).

Review of the Guarantee Scheme:
It is recommended that the Guarantee of bank liabilities be restructured to:
- extend the Guarantee to cover future longer term bond issuance;
- remove dated subordinated debt (Lower Tier 2), asset covered securities, and senior unsecured debt maturing beyond the 29 Sep 2010, from coverage of the guarantee, because the covered institutions get no benefit from the guarantee of these types of liabilities;
- change some of the commercial conduct provisions to enhance supervisory powers;
- make technical amendments to clarify certain issues raised by the market.

Ref No F513/40/09

8 February 2010

Memorandum for the Government
State Aid Notification of Capital Support for Anglo Irish Bank, Irish Nationwide Building Society and the Educational Building Society

Decision Sought

1. The Minister for Finance requests Government approval for notification to the European Commission for State aid approval for:-

    (i) The capital support measure for Anglo Irish Bank and Irish Nationwide Building Society (INBS) set out in Section 3 of this Memorandum below.

    (ii) The provision of capital into the Educational Building Society (EBS) and INBS through the Special Investment Share (SIS) mechanism put in place through the amendments to the Building Societies Acts contained in the NAMA Act.

2. The Minister requests the Government to note that:-

    (i) Final Government approval will be sought for the implementation of the above measures shortly once:-

    - the extent of the capital support required for each institution is confirmed through the process finalising their end-year (2009) financial accounts;

    - confirmation is received from the Financial Regulator regarding the regulatory capital treatment of the proposed capital support measures; and

    - the Central Statistics Office finalises its position on the treatment of the measures in the General Government accounts.

    (ii) It is proposed that the announcement of these measures will coincide with a broader announcement in early March regarding the capital needs of the domestic banking sector as a whole in the context of the implementation of NAMA and how it is expected that these capital requirements would be met.

3. Proposal

It is proposed that the Minister will issue Promissory Notes to Anglo and INBS that will enable them to meet regulatory capital requirements at end-2009 and also in the context of the capital write-downs and the reduction in the institutions' assets following the loan transfers into NAMA. The Note will, therefore, underpin the institutions' capital positions which might otherwise create the risk of a call under the

Bank Guarantee. Under the proposed terms of the Note the institutions could call on cash payments of a proportion of its principal value for a period of up to 10 years. The Note would be payable in full on wind-up of the institutions should that happen.

The proposal will allow the State to spread the expected capital requirements of Anglo and INBS arising from the incurred losses arising mainly from the transfer of assets into NAMA over an extended period rather than having to provide this level of capital in the first quarter 2010 which would create a major additional burden on the State's funding requirements and would also give rise to a significant increase in the 2010 General Government Deficit.

The timeframe for the implementation of the proposal will be determined by the State aid approval process, the implementation of the NAMA Scheme, the finalisation of the end-year accounts of the institutions and the Minister's proposed announcement on capital requirements in the Irish banks.

4. Background

The Minister stated in his Second Stage Speech on the NAMA Bill on 16 September 2009, that it is likely that some institutions will require additional capital in order to absorb the losses arising from the transfer of their impaired assets to NAMA and in order to maintain appropriate levels of capital. The Minister confirmed that to the extent that sufficient capital cannot be raised independently or generated internally, the Government was committed to providing such banks and building societies with an appropriate level of capital to continue to meet their requirements. This statement has played an important role in maintaining confidence and providing stability and certainty regarding the capital position of institutions which it is expected will participate in NAMA. In addition, the Minister has made clear that additional capital would be required in Anglo once a determination of its losses for 2009 was made.

5. Anglo

In the case of Anglo, it has been clear that the bank would need further support over and above the €4bn injected in mid-2009. The bank has been undertaking a detailed Asset Quality Review for some time to help quantify the scale of its end-year impairments for some time. Prior to end-year the Bank advised that preliminary numbers indicted that the level of likely impairments was such that a capital gap would arise in the bank's end-year accounts and give rise to a risk that a call would be made in respect of debt securities guaranteed by the State. The Bank has been revising its estimates in the light of a through review of its loan book, the NAMA valuations coming through and the continued difficult economic conditions and expects to confirm the final figures shortly.

6. INBS

The Minister's accounting advisors, PwC, confirmed in December that INBS has very significant impairments. The magnitude of these impairments is such that, if all the necessary provisions were included in the institution's end year accounts a capital gap would arise and could trigger a call on the bonds and ultimately the State guarantee.

7. Support Letter

A support letter was provided by the Minister to the Boards of Anglo and INBS on 22 December 2010 to safeguard their balance sheet position. This letter gave a commitment to finding a method to support their capital position in order to maintain minimum levels of regulatory capital.

8. European Commission State Aid

The European Commission was made aware of the proposed measure before Christmas and a draft State aid notification was recently submitted to the Commission. Subject to Government approval for the measure a formal notification will be made to the Commission this week. It is expected that once the measure is notified that State aid approval will be forthcoming within two weeks. It has been indicated that the European Commission in approving the measure will initiate procedures for a formal investigation of the measure under State aid rules.

9. General Government Accounts Treatment

In terms of reporting on the fiscal position under Ireland's Stability Programme, the key consideration will be the impact of the measure on the General Government sector, both in terms of the General Government Balance (GGB) and the level of General Government Debt (GGD). The Department has had an initial discussion with the Central Statistics Office (CSO) and the CSO's preliminary view is that the issue of a Promissory Note would not be included in the measurement of the GGB. However it will need to be recognised in full as part of the GGD to balance the recording of the Promissory Note as an asset in the balance sheets of the institutions. In essence, if the assumption is confirmed by the CSO in line with Eurostat rules, then only cash payment for any annual injections will impact on the deficit.

10. Accounting Advice

The Minister's accounting advice is that the Promissory Note issued will be recognised as capital for accounting and regulatory capital purposes. However, the accounting treatment must be endorsed by the auditors of the respective institutions and the Financial Regulator must confirm the regulatory capital treatment. Discussions are ongoing with these bodies.

11. Views of the Attorney General's Office and the Governor of the Central Bank

[redacted]

The Governor of the Central Bank's view is that there is a benefit in spreading the costs over a number of years but the transaction should not over-capitalise Anglo or INBS. He was also concerned that the proposal also should not effectively pre-empt aspects of the Government's Decision on the long-term future of Anglo or narrow the Government's options in this regard which could potentially result in a higher ultimate Exchequer cost. This risk of overcapitalisation will be addressed through making the value of the Note variable to match only the needs to meet minimum regulatory capital requirements.

12. Special Investment Shares Investment in EBS/INBS

The Minister also proposes to take up Special Investment Shares (SIS) in EBS to recapitalise that institution. EBS are currently in merger discussions with INBS but whether a merger is allowed to go ahead will depend on European Commission State aid approval of the restructuring plans that both institutions will be required to produce.

Similarly, it is intended that the State will also provide capital to INBS through SIS. This capital injection will be undertaken on a de minimis basis to provide the Minister with control over the strategic direction of the Society. It is then planned to provide the majority of the capital support required by INBS by way of the Promissory Note mechanism as explained above.

13. Other Banks

The method proposed by the Minister to support Anglo and the INBS through the issue of a Promissory Note is certainly not an avenue available for AIB and Bank of Ireland who are in need of further capital and may be required to receive this from the State for example through the conversion of the State's Preference Shares or further purchases of bank equity by the NPRF. This is because, unlike Anglo and INBS, the State would wish to demonstrate that the investment into the two banks was a commercial investment into viable institutions and the banks were viable in the medium-term and capable of remunerating or re-paying the capital injected into them.

THEME: C4

Appropriateness and effectiveness of the domestic policy responses

LINE OF INQUIRY: C4d

CISA* – effectiveness of the actions to merge AIB and EBS, Anglo and INBS and deposit transfers

* Credit Institutions Stabilisation Act (2010)

THE HIGH COURT

2011 No. 29 MCA

FRIDAY THE 1ST DAY OF JULY 2011

BEFORE MR JUSTICE MCGOVERN

IN THE MATTER OF IRISH NATIONWIDE BUILDING SOCIETY

AND

IN THE MATTER OF THE CREDIT INSTITUTIONS (STABILISATION) ACT, 2010

AND

IN THE MATTER OF AN APPLICATION BY THE MINISTER FOR FINANCE FOR A TRANSFER ORDER IN RELATION TO IRISH NATIONWIDE BUILDING SOCIETY PURSUANT TO SECTION 34 OF THE CREDIT INSTITUTIONS (STABILISATION) ACT 2010 AND ANCILLARY ORDERS

The ex parte application of the Minister for Finance (the "Applicant") for a Transfer Order pursuant to Section 34 of the Credit Institutions (Stabilisation) Act 2010 (the "Act") along with related reliefs including an application under Section 60 of the Act for restrictions with regard to the disclosure in open Court publication or reporting of material which is commercially sensitive coming before this Honourable Court this day in the presence of Counsel for the Applicant.

And on the application by Counsel for the Applicant for an Order prohibiting publication of the fact of the within application pending the making of a Transfer Order pursuant to Section 34 of the Act

And on hearing said Counsel for the Applicant

The Court doth so Order

Whereas on reading the Affidavit of John Moran sworn the 29th day of June 2011 and the exhibits thereto and on hearing what was offered by Counsel for the Applicant

And whereas the transferee Anglo Irish Bank Corporation Limted ("Anglo") a credit institution licensed in Ireland and whose registered office is at Stephen Court 18/21 St Stephen's Green Dublin 2 has agreed to accept the Transfer on the terms set out in this Order

IT IS ORDERED that the Applicant be granted the following reliefs:

A. A Transfer Order pursuant to Section 34 of the Act in the terms provided hereinafter.

B. On the making of this Transfer Order (the "Transfer Time") all the assets and liabilities of INBS at the Transfer Time (other than the excluded assets and liabilities set out in Paragraphs 2.1 and 2.2 hereinafter) whether situated in or outside the State, whether governed by the laws of the State or any foreign law (and including, without limitation, foreign assets and foreign liabilities) and whether actual or contingent, including, without limiting the generality of the foregoing, all right, title, benefit and interest of INBS in and to and all obligations and liabilities of INBS in respect of those assets and liabilities set out in the Paragraphs 1.1 to 1.23 inclusive hereinafter (the "Assets and Liabilities") shall be transferred by INBS as beneficial owner to Anglo, being the transferee, immediately in accordance with sections 34(7)(a), 39 and 41 of the Act for the consideration and under the terms and conditions specified in this Transfer Order:

1.1 all property (real or personal) and whether registered or unregistered, freehold or leasehold including, without limiting the generality of the foregoing, the branch offices set out in Part 1, the development properties set out in Part 2 and the investment property set out in Part 3 of Schedule 1 to this Transfer Order;

1.2 all fixtures and fittings, plant, machinery, computer and IT equipment, all other equipment, furniture, chattels and other tangible assets (excluding any which are attached to a leasehold property and which are the property of the landlord) attached or not to any real property and owned or used by INBS;

1.3 all motor vehicles owned, leased or used by INBS;

1.4 the goodwill of INBS in connection with its business and the right to carry on the business in succession of INBS;

1.5 all causes of action, claims, entitlements and proceedings that relate to any period prior to the Transfer Time (whether arising from breach of law, regulation, contract, tortious actions or omissions, breach of duty or otherwise howsoever arising and whether actual, contingent or prospective) which INBS is or would at any time in the future (apart from the making of any transfer order) be entitled to take, make or claim against any person, company, body corporate, partnership, limited partnership or any other association or entity ("Person") and all remedies and recourse in respect thereof ("INBS Claims"), including, but without limitation to the generality of the foregoing, all INBS Claims against any director, officer or employee or former director, officer or employee of INBS in respect of any negligence, wrongdoing, default, breach of duty, breach of contract, breach of trust or on any other ground whatsoever;

1.6 all licences, contracts, agreements, deeds, protocols or arrangements (whether or not in writing) to which INBS is a party or to which it is otherwise entitled or by which it is otherwise bound;

1.7 all shares owned or held by INBS in all subsidiaries and subsidiary undertakings of INBS, including the companies and other entities listed in Schedule 3 to this Transfer Order;

1.8 all "available for sale debt securities", all "available for sale equity securities" and all other shares, securities, debentures, stock or other interests of any kind held by INBS in any company or any other Person;

1.9 all trade marks (registered and unregistered), service marks, logos, patents, copyrights (including copyright in computer programs), database rights, confidential information, business or trade names, set up, domain names, know how and all other intellectual property rights;

1.10 all contracts of employment and/or collective agreements in respect of INBS employees existing at the Transfer Time;

1.11 all rights, liabilities and obligations of INBS arising from the provisions of any occupational pension scheme (whether defined benefit, defined contribution or otherwise);

1.12 all:

(a) mandates, terms and conditions, instructions, applications, customer verification documents, directions, files, books, correspondence and other records of any kind of INBS in so far as they relate to the Assets and Liabilities held on whatever medium; and

(b) customer documentation relating to the provision of any banking or other service or facility (including, without limitation, solicitors' undertakings, certificates of title, architects' certificates of compliance, valuation reports, insurance and assurance (whether life and/or non-life) proposals, and declarations, authorisations, consents and application forms from applicants for loans) and all documents (whether for the purpose of disclosure, information, consents, declarations, authorisations or otherwise) received by INBS from its customers or potential customers, including all documents relating to the requirements of the Criminal Justice Act 1994, the Criminal Justice (Money-laundering and Terrorist Financing) Act 2010, the Data Protection Acts 1988 and 2003, the Consumer Credit Act 1995, the Family Home Protection Act

1976, the Family Law Act 1981, the Judicial Separation and Family Law Reform Act 1989, the Family Law Act 1995 and the Family Law (Divorce) Act 1996, the Consumer Protection Code (issued by the Central Bank of Ireland (the "CBI")) and any other enactment;

1.13 all debt securities, loan instruments, bonds, notes, promissory notes, debentures, loan stock, commercial paper, certificates of deposit and all other instruments of any kind constituting or evidencing indebtedness or otherwise involving the extension of credit by, and providing for payment of money to, the holder thereof (whether upon the occurrence of a contingency or otherwise), whether in bearer, registered or dematerialised form or otherwise, issued by INBS or in respect of which it is the debtor or obligor immediately before the Transfer Time, including all amounts outstanding under notes issued by INBS under its €10,000,000,000 Euro Medium Term Note Programme, and related documentation, including, without limitation, any contracts, agreements, instruments or deeds;

1.14 all amounts standing to the credit of any account representing or evidencing funding (whether by means of repurchase transactions, loans, deposits or otherwise) provided to INBS at the Transfer Time by the CBI, the European Central Bank (in each case whether under Eurosystem monetary policy operations or otherwise) or any other central bank or equivalent institution, and the related account;

1.15 all inter-bank deposits and all other accounts designated with holder type codes 04 (Financial Institutions), 20 (Central Government), 24 (General Government) or 99 (EMTN) in the accounting records of INBS;

1.16 all accounts (and any amount standing to the credit or, as applicable, debit thereof) identified in the accounting records of INBS by branch "91" including:

(a) all accounts in the name of or on behalf of any person or persons (including any individual or body corporate) over which INBS has been granted by way of written agreement a lien or any other type of security;

(b) all internal administration accounts designated by the product code DRLFSQ in the accounting records of INBS;

(c) those accounts identified in the accounting records of INBS by reference to the customer sequence number 47973 (mortgage controlled accounts); and

(d) inter-company accounts relating to special purpose vehicle companies;

1.17 all currency, interest rate or other swap contracts or other derivatives of any kind whatsoever to which INBS is a party, including, without limitation, the master swap agreement listed in Schedule 2 to this Transfer Order, and all trades and transactions documented thereunder or entered into pursuant thereto and all confirmations, credit support annexes, credit support deeds and other collateral arrangements entered into in connection therewith and all cash or other assets of any kind provided by or to INBS as collateral in connection therewith;

1.18 the promissory note received by INBS from the Minister for Finance (the "Minister") on 22 December 2010;

1.19 all loan or other facilities made by INBS to any Person and all agreements, contracts, deeds or other instruments or documents relating thereto and all amounts owing to INBS by any Person on any account whatsoever and in any currency and to, in and under every mortgage, charge, pledge, guarantee, indemnity or any other form of security or other collateral (including without limitation to the generality of the foregoing, interests in insurances) (collectively, "Loans and Related Security") held by INBS or to which it is entitled in respect thereof, in each case at the Transfer Time, including, without limitation, (i) all loan accounts identified on the Society's loan administration system (the "Summit" system) with a Global type "L" or "M" or "I" or "SU" and with a process status of either 1, 2, 3 or 4, in each case at the Transfer Time, and (ii) inter-company loans between the Society and subsidiary companies which are recorded on the Society's general ledger system with nominal account numbers 730200, 780500, 780610, 780620, 780630, 780640, 780650, 780700, 781000, 781050, 781280 and 781300;

1.20 all cash in any currency held by or on behalf of INBS at the Transfer Time, including all cash on hand as identified on the Society's general ledger system by nominal account numbers 700100, 700400, 700500, 700600 and 700100 and deposits with the CBI at the Transfer Time in the name of the Society;

1.21 all (i) guarantees, indemnities, bills of exchange, counter-indemnities, (ii) standby or documentary letters of credit and (iii) construction, performance or other bonds, in each case issued or granted by INBS or in respect of which it is the debtor or obligor; and

1.22 all claims, rights and entitlements to or for refunds or abatements of, and liabilities in respect of, taxes assessed against, paid by or collected from INBS by the Revenue Commissioners in Ireland, HM Revenue & Customs in the United Kingdom or the recognised tax authorities in any other jurisdiction in which the Society has undertaken any transactions of whatsoever nature ("Tax Claims") with full power and authority to Anglo (in its own name or in the name of INBS) to make all such claims, execute and file all such documents and do all such other acts and things as may be necessary to enforce or recover all such Tax Claims including authority to compromise and/or settle all such Tax Claims; and

1.23 the Loans and Related Security related to any loan account designated or recorded with or under pool code 'NAMA1' on the Society's loan administration system at the Transfer Time.

but excluding

2.1 the liabilities and obligations of INBS to its members in respect of the Special Investment Shares in INBS held by the Minister together with any balances remaining on the general reserve and capital contribution accounts on INBS' balance sheet; and

2.2 all causes of action, claims, entitlements and proceedings that relate to any period prior to the Transfer Time (whether arising from breach of law, regulation, contract, tortious actions or omissions, breach of duty or otherwise howsoever arising and whether actual, contingent or prospective) which the CBI or any governmental, regulatory or prosecuting authority in any jurisdiction is or would at any time in the future (apart from the making of any transfer order) be entitled to take, make or claim against INBS and/or any Person and all remedies and recourse in respect thereof ("Regulatory Actions"), including, but without limitation to the generality of the foregoing, all Regulatory Actions involving any director, officer or employee or former director, officer or employee of INBS in respect of any negligence, wrongdoing, default, breach of duty, breach of contract or breach of trust or on any other ground whatsoever.

C. The consideration for the transfer of the assets is the assumption by Anglo of the liabilities, in each case, comprised in the Assets and Liabilities (the "Consideration").

D. It is a condition of this Transfer Order that this Transfer Order (including the consequences thereof provided for in the Act) and each and every part thereof is a reorganisation measure to which sections 61 and 62 of the Act apply.

E. The Court further notes that the Minister considers the incidental, consequential and supplemental provisions set out below to be appropriate for implementing the transfer of the Assets and Liabilities and securing that it be fully and effectively carried out and the Court also considers those provisions to be appropriate for those purposes and accordingly orders, under section 37(9) of the Act, as follows:

1.1. INBS and Anglo shall each transfer or disclose to each other such information (including personal data within the meaning of the Data Protection Acts 1988 and 2003 or the Data Protection Act, 1998 (as amended) of the United Kingdom) as is required to enable the other to carry out or undertake any matter or thing provided for under this Transfer Order.

1.2. Any instruction, order, direction, confirmation, declaration, documentation, mandate or authority given to INBS in the course of or incidental to or relating to the Assets and Liabilities and subsisting immediately before the Transfer Time shall be treated for all purposes relating to the Assets and Liabilities as having been given to Anglo.

1.3. Any payment received on or after the Transfer Time by or in relation to INBS that relates to the Assets and Liabilities held by or with INBS immediately before the Transfer Time is to be treated as received by or in relation to Anglo.

1.4. Anything (i) that relates to some or all of the Assets and Liabilities immediately prior to the Transfer Time and (ii) which is in the process of being done in relation to the Assets and Liabilities by INBS immediately before the Transfer Time shall be continued by or in relation to Anglo on the same terms and subject to the same discretions save as otherwise necessitated, and only to the extent necessitated, by the transfer of the Assets and the Liabilities to Anglo.

1.5. Nothing in this Transfer Order shall prejudice or limit in any way the rights of INBS or Anglo (as the successor to INBS in respect of the Assets and Liabilities) to claim or recover from any director, officer or employee or former director, officer or employee or other Person in respect of any negligence, wrongdoing, default, breach of duty, breach of contract, breach of trust or on any other ground whatsoever that relates to any period prior to the Transfer Time.

1.6. Nothing in this Transfer Order shall prejudice or limit in any way the right of INBS or Anglo (as the successor to INBS in respect of INBS Claims and Tax Claims) to any existing privilege or to claim privilege in respect of any documentation or other information relating in any way whatsoever to any INBS Claim, Tax Claim or Regulatory Action.

1.7. Without prejudice to the generality of section 39 of the Act, the Guarantee in favour of the CBI, dated 18 February 2011, wherein the Minister guarantees all sums due to the CBI by INBS under the facility agreement between INBS and the CBI dated 18 February 2011, shall remain in place with full force and effect after the Transfer Time.

1.8. From the Transfer Time, and without prejudice to any authorisation of INBS under section 17 of the Building Societies Act 1989 after the Transfer Time, in any instruments or documents relating to the Assets and Liabilities, any reference to INBS holding or being required to hold an authorisation under section 17 of the Building Societies Act 1989 (or any similar former statutory provision) or INBS being authorised for the purposes of or under the Building Societies Acts 1989 to 2006 (or any similar former enactment), shall have effect as if such references were instead references to Anglo holding or being required to hold a licence from the CBI under section 9 of the Central Bank Act 1971 or any replacement thereof.

1.9. The reference in clause 5.1 of the transfer support agreement dated 23 February 2011 between INBS and Irish Life & Permanent PLC to the final transfer of loans and related assets from INBS to the National Asset Management Agency ("NAMA") shall be read and construed after the Transfer Time as a reference to any transfer by Anglo to NAMA before 30 September 2011 of any such loans and related assets which are transferred by INBS to Anglo pursuant to this Transfer Order and the Act.

F. Declaring pursuant to Section 34(4) that this Transfer Order and each and every part of it is a reorganisation measure for the purposes of Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions (the "CIWUD Directive"), and the European Communities (Reorganisation and Winding-Up of Credit Institutions) Regulations 2011 (S.I. No. 48 of 2011) (the "2011 Regulations") and accordingly, it is intended that this transfer order should have full effect in all applicable jurisdictions (including, without limitation, the United Kingdom of Great Britain and Northern Ireland) in accordance with the CIWUD Directive, the 2011 Regulations and the Act, including, in particular, but not limited to section 61 of the Act.

G. An Order pursuant to Section 60 of the Act directing that there be no disclosure in open Court, publication or reporting of paragraphs 28.5, 30, 50, 53, 54, 64 and 100 of the Affidavit of John Moran sworn on 29th day of June 2011 which are highlighted in yellow in said Affidavit, or those documents contained in exhibits JM7, JM9, JM10, and the Report of the Central Bank at exhibit JM13.

H. An Order pursuant to Regulation 9 of the European Communities (Reorganisation and Winding-Up of Credit Institutions) Regulations 2011 directing that the Courts Service arrange for publication forthwith of an extract of this Order.

MARY KELLY
REGISTRAR
1ST JULY 2011

David J O'Hagan
Chief State Solicitor
Solicitor for the Applicant

SCHEDULE 1

Part 1 - Branch offices of INBS

Freehold & Leasehold Property

Freehold

Location	Address	Ownership
Athlone	35 Church St., Athlone	Freehold
Bantry	New St., Bantry	Freehold
Bray	116 Main Street, Bray	Freehold
Camden Street	8/9 Camden Street, Dublin 2	Freehold
Carlow	73 Burrin St., Carlow	Freehold
Castlebar	Ellison St., Castlebar	Freehold
Cavan	19 Main St., Cavan	Freehold
Clonmel	63 O'Connell St., Clonmel	Freehold
Drogheda	113 West St., Drogheda, Co. Louth	Freehold
Drumcondra	159 Lwr Drumcondra Road, Dublin 9	Freehold
Dun Laoghaire	64 Lwr Georges Street, Dun Laoghaire, Co. Dublin	Freehold
Dundalk	86 Clanbrassil St., Dundalk, Co. Louth	Freehold
Dundrum	6 Main Street, Dundrum, Co. Dublin	Freehold
Ennis	Bank Place, O'Connell Square, Ennis, Co. Clare	Freehold
Galway	11 Eyre Square, Galway	Freehold
Grand Parade	Nationwide House, Grand Parade, Dublin 6.	Freehold
Grand Parade	Site at Dartmouth Road, Dublin 6	Freehold
Kilkenny	1 High St., Kilkenny	Freehold
Killarney	93 New St., Killarney, Co. Kerry	Freehold
Kimmage	3 Sundrive Road, Kimmage, Dublin 6W	Freehold
Letterkenny	5 Upr. Main St., Letterkenny, Co. Donegal	Freehold
Limerick	32 Cruises St., Limerick	Freehold
Longford	8 Main St., Longford.	Freehold
Mallow	56 Main St., Mallow, Co. Cork	Freehold
Midleton	88 Main St., Midleton, Co. Cork	Freehold
Monaghan	Alma House, The Diamond, Monaghan	Freehold
Mullingar	Austin Friar St., Mullingar, Co. Westmeath	Freehold
Navan	26 Market Square, Navan, Co. Meath	Freehold
Nenagh	81/82 Pearse St., Nenagh, Co. Tipperary	Freehold
Newcastle West	1 Church St., Newcastle West, Co. Limerick	Freehold
O'Connell Street	1 Lwr O'Connell Street, Dublin 1	Freehold
Palmerstown	Main Street, Palmerstown, Dublin 20	Freehold
Phibsboro	68 Phibsboro Road, Dublin 7	Freehold
Portlaoise	78 Main St., Portlaoise, Co. Laois	Freehold
Roscrea	Castle St., Roscrea, Co. Tipperary	Freehold
Skibbereen	49 North St., Skibbereen, Co. Cork	Freehold
Sligo	Wine St., Sligo	Freehold
Tallaght	Main Street, Dublin 24	Freehold
Terenure	130 Terenure Road North, Dublin 6W	Freehold
Tipperary	17/19 Main St., Tipperary	Freehold
Tralee	7 The Mall, Tralee, Co. Kerry	Freehold
Tullamore	11 O'Connor Square, Tullamore, Co. Offaly	Freehold
Waterford	55 High St, Waterford	Freehold
Wexford	The Bullring, Wexford	Freehold

Long Leasehold

Location	Address	Ownership
Cork	33 Patrick St., Cork	Longlease 800y to 2655
Crumlin	251 Crumlin Road, Dublin 12	Longlease 490y to 2424
Douglas	East Douglas St., Douglas, Co. Cork	Longlease 500y to 2444
Fairview	5 Marino Mart, Dublin 3	Longlease 149y to 2074
Rathmines	278 Lwr Rathmines Road, Dublin 6	Longlease Part 99y to 2063 Part Fee Farm Grant.
Stillorgan	Lenehans Shopping Centre, Stillorgan, Co. Dublin	Longlease 999y to 2977
Swords	Unit 1 Plaza Shopping Centre, Swords, Co. Dublin	Longlease 999y to 2988
Outside Rep Ireland		
London	51-61 Wigmore St, London, W1	Longlease 125y to 2124

Short Leasehold

Location	Address	Lease Details	Start Date	Expiry Date
Cork	34 Patrick St., Cork	35 year lease	14/03/1981	31/07/2022
Grafton Street	113 Grafton Street - B, G & 1st Flr, Dublin 2	30 year lease	14/03/1984	14/03/2014
Grafton Street	112/113 Grafton St - Upper Flrs, Dublin 2	40 year lease	01/02/1970	01/02/2012
Naas	5 Poplar Square, Naas, Co. Kildare	9 years 11 Months	18/12/2007	18/11/2017
Outside Rep Ireland				
London	122 Wigmore St, London, W1	Month to Month		28 Day Notice
Belfast	Flr 7 Centrepoint Bdg, 24 Ormeau Avenue	15 Years	01/05/2008	30/04/2023

Part 2 – Development Properties of INBS

Unit	Address	Unit type
2	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
4	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
5	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
6	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
7	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
9	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
10	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
14	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
16	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
17	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
18	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
19	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
20	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
22	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
23	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
24	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
25	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
27	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
28	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
29	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
37	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
39	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
43	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
44	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
45	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
46	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
48	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
50	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
51	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment

52	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
56	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
57	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
59	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
60	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment
62	Booterstown Wood, Booterstown Avenue, Booterstown, Co. Dublin	Apartment

Part 3 – Investment Property

The freehold interest in the property at 78 Lower Georges Street, Dun Laoghaire, Co Dublin.

SCHEDULE 2

Derivatives

ISDA Master Agreement dated 21 April 2005 between BNP Paribas and the Society as amended, supplemented and modified from time to time, together with all schedules thereto and confirmations entered into in connection therewith or pursuant thereto.

SCHEDULE 3

Subsidiary and Subsidiary Undertakings

Irish

Company Name	Registered Office	Company Number	Shares Held	Share Holding
Nationwide Foreign Exchange Limited	Nationwide House, Grand Parade	147494	2	100%
Nationwide Properties Limited	Nationwide House, Grand Parade	146717	2	100%
Nationwide Estate Agents Limited	Nationwide House, Grand Parade	146703	2	100%
Nationwide Property Services Limited	Nationwide House, Grand Parade	146719	2	100%
Nationwide Property Development Limited	Nationwide House, Grand Parade	146720	2	100%
Nationwide Personal & Corporate Finance Limited	Nationwide House, Grand Parade	146752	2	100%
Nationwide Fund Management Limited	Nationwide House, Grand Parade	146747	2	100%
Nationwide Legal Services Limited	Nationwide House, Grand Parade	146735	2	100%
Nationwide Home Builders Limited	Nationwide House, Grand Parade	146715	2	100%
Nationwide Stockbrokers Limited	Nationwide House, Grand Parade	146753	2	100%
Nationwide Unit Trust Management Limited	Nationwide House, Grand Parade	146755	2	100%
Nationwide Home Loan Management Limited	Nationwide House, Grand Parade	146738	2	100%
Nationwide (Auctioneers & Valuers) Limited	Nationwide House, Grand Parade	146702	2	100%
Nationwide Moneybrokers & Treasury Services Limited	Nationwide House, Grand Parade	146733	2	100%
Nationwide Trustees Limited	Nationwide House, Grand Parade	146729	2	100%
Nationwide Investment Services Limited	Nationwide House, Grand Parade	146736	2	100%
Nationwide International Financial Services Limited	Nationwide House, Grand Parade	146737	2	100%
Nationwide Nominees Limited	Nationwide House, Grand Parade	146728	2	100%
Nationwide Taxation & Financial Planning Services Limited	Nationwide House, Grand Parade	146754	2	100%
I.N.B.S. (Irish Nationwide) Limited	Nationwide House, Grand Parade	146739	2	100%
Nationwide Financial Services Limited	Nationwide House, Grand Parade	146751	2	100%
Nationwide Life & Pensions Limited	Nationwide House, Grand Parade	146727	2	100%
Nationwide Insurances Limited	Nationwide House, Grand Parade	146716	2	100%
Irish Nationwide Foreign Exchange Limited	Nationwide House, Grand Parade	147492	2	100%
Irish Nationwide Properties Limited	Nationwide House, Grand Parade	146718	2	100%
Irish Nationwide Estate Agency Limited	Nationwide House, Grand Parade	146706	2	100%
Irish Nationwide Estate Agents Limited	Nationwide House, Grand Parade	146705	2	100%
Irish Nationwide Property Services Limited	Nationwide House, Grand Parade	146708	2	100%
Irish Nationwide Property Development Limited	Nationwide House, Grand Parade	146709	2	100%
Irish Nationwide Personal & Corporate Finance Limited	Nationwide House, Grand Parade	146746	2	100%
Irish Nationwide Fund Management Limited	Nationwide House, Grand Parade	146741	2	100%
Irish Nationwide Legal Services Limited	Nationwide House, Grand Parade	146745	2	100%
Irish Nationwide Home Builders Limited	Nationwide House, Grand Parade	146714	2	100%
Irish Nationwide Stockbrokers Limited	Nationwide House, Grand Parade	146748	2	100%
Irish Nationwide Unit Trust Management Limited	Nationwide House, Grand Parade	146750	2	100%
Irish Nationwide Home Loan Management Limited	Nationwide House, Grand Parade	146742	2	100%
Irish Nationwide (Auctioneers & Valuers) Limited	Nationwide House, Grand Parade	146704	2	100%
Irish Nationwide Leasing Limited	Nationwide House, Grand Parade	146712	2	100%

Irish Nationwide Moneybrokers & Treasury Services Limited	Nationwide House, Grand Parade	146734	2	100%
Irish Nationwide Trustees Limited	Nationwide House, Grand Parade	146707	2	100%
Irish Nationwide Investment Services Limited	Nationwide House, Grand Parade	146744	2	100%
Irish Nationwide International Financial Services Limited	Nationwide House, Grand Parade	146743	2	100%
Irish Nationwide Nominees Limited	Nationwide House, Grand Parade	146710	2	100%
Irish Nationwide Taxation & Financial Planning Services Limited	Nationwide House, Grand Parade	146749	2	100%
Irish Nationwide Insurances Limited	Nationwide House, Grand Parade	146713	2	100%
Irish Nationwide Financial Services Limited	Nationwide House, Grand Parade	146740	2	100%
Nationwide Direct Limited	Nationwide House, Grand Parade	234670	2	100%
Irish Nationwide Life & Pensions Ltd	Nationwide House, Grand Parade	146711	99,999	100%
Pangrove Limited	Nationwide House, Grand Parade	182919	2	100%
Cedarclose Limited	Nationwide House, Grand Parade	219852	2	100%
Vernia Limited	Nationwide House, Grand Parade	247388	2	100%

UK

Company Name	Registered Office	Company Number	Shares Held	Share Holding
UK				
Nationwide Personal & Corporate Finance Limited	122 Wigmore Street, London	2732753	2	100%
Irish Nationwide Estate Agency Limited	122 Wigmore Street, London	2732748	2	100%
Nationwide International Financial Services Limited	122 Wigmore Street, London	2732752	2	100%
Irish Nationwide Financial Services Limited	122 Wigmore Street, London	2732751	2	100%
Irish Nationwide Insurances (Agents) Limited	122 Wigmore Street, London	2732749	2	100%

THEME: C4

Appropriateness and effectiveness of the domestic policy responses

LINE OF INQUIRY: C4e

Cost of crisis and sharing of the impact

Stabilising and Healing the Irish Banking System: Policy Lessons

Dirk Schoenmaker[1]

Duisenberg school of finance

This version: 12 January 2015

Paper prepared for the CBI-CEPR-IMF Conference

Ireland—Lessons from its Recovery from the Bank-Sovereign Loop

19 January 2015, Dublin

Abstract

Ireland has recovered from a historic banking crisis. This paper reviews the policies to restore order to the Irish banking system. The overall assessment is that the Irish authorities have been successful in the management of the Irish banking crisis.

On balance, there was a strong focus on stabilising banks (restoring solvency, replacing management and closing bad banks), but less emphasis on restructuring loans. The Irish banks are not yet healed with 25 per cent of non-performing loans. A small but important group of highly indebted households and firms cannot resume consumption and investment due to debt overhang. Intensifying write offs of bad loans would broaden the economy recovery.

The Irish taxpayers have been brave in shouldering the full costs of recapitalising the Irish banking system, while part of the resulting stability benefits accrued to the wider European banking system. In the new Banking Union setting with ECB supervision for the large euro-area banks, we recommend that the European Stability Mechanism (ESM) should directly recapitalise troubled banks after resolution measures are taken. The ESM would then become an effective vehicle for risk sharing and cut the bank-sovereign loop.

[1] I am grateful to CBI and IMF staff for the provision of data and useful factual comments. Any opinions are those of the author.

1. Introduction

In the wake of the Global Financial Crisis, Ireland faced its own banking crisis after the bursting of the property bubble. The property boom, fuelled by domestic and cross-border banking credit, did not only lead to unsustainable residential and commercial real estate prices but also to massive new construction. This resulted in losses on large commercial real estate loans of over 50 per cent. To restore the capital base of the Irish banking system, the Irish government provided up to € 64 bn to the banks (amounting to about 40 per cent of GDP). As taxpayers had to fund this new capital, several question arise. Has the Irish government been successful in stabilising the banking system? Are the bank balance sheets cleaned up? And ultimately, what is the social return on this massive government investment? As the Irish economy is turning the corner, it is timely to answer these questions.

This paper provides a high-level overview of the crisis management by the Irish authorities. For this post-mortem analysis, we adopt the classical drama structure of three acts: the setup, the confrontation and the resolution. The first act concerns the run-up to the crisis. The Minsky theory of the credit boom-bust cycle is applied to the Irish setting (Minsky, 1986). The second act covers the stabilisation of the Irish banking system. This confrontation involved 'high' drama with the closure of two of the six Irish banks, the take-over of a smaller bank and the establishment of a bad asset agency. Four consecutive rounds of recapitalisation were needed to bring the remaining banks back to solvency. The Irish authorities have finished this act largely successful, as confirmed by the ECB Comprehensive Assessment in October 2014. The two broad banks, Bank of Ireland and Allied Irish Banks, have passed the test, while the smaller building society, Permanent TSB, is in need of some further capital. The third and final act is about the healing of the Irish banks. While much has been achieved, our assessment suggests that the climax is not yet reached. Bank balance sheets still carry up to 25 per cent of non-performing loans. This legacy is not only holding back banks in new business, but also indebted households and firms. Firms and households faced with debt overhang suppress new investment and consumption (Myers, 1977; Mian and Sufi, 2014).

The paper draws several policy lessons from the Irish crisis management. First, the establishment of the bad asset agency, NAMA, serves as an international example of successful management of bad assets. Second, the assessment of capital shortfalls should be comprehensive and bottom-up. In that way, the full scale of problems becomes clear. Third, when providing taxpayers money to banks, the government should set policy targets for writing off bad loans. In that way, the health of banks as well as their customers (firms and households) can be restored. On the latter, there is some outstanding work for banks. Only when bad loans are appropriately restructured (including partially written off), the social return on the bank recapitalisations can be fully captured.

More broadly, the Central Bank of Ireland has put in place a macroprudential policy framework to mitigate future credit boom-busts. The decision-making can be further strengthened by the inclusion of external members. Finally, the ECB supervises the large euro-area banks in the new

Banking Union. This centralised ECB supervision should be complemented with direct recapitalisation by the European Stability Mechanism, when needed and justified (Allard *et al*., 2013; Schoenmaker, 2013a). In that way, the bank-sovereign loop would be cut. Such burden sharing would also have been appropriate in the rescue of the Irish banking system, as this rescue prevented further instability of the wider European banking system.

The paper takes a macro-finance approach, an emerging new field in academia (Brunnermeier *et al*., 2009; Schoenmaker, 2014). Such an approach is warranted, as the ultimate objective of financial stability policies is to promote sustainable economic growth. We refrain therefore from micro-supervisory issues (see the Investigation Committee, 2011, for a review of the Financial Regulator). The paper is organised as follows. Sections 2 to 4 contain the analysis of the run-up, the stabilisation and the restructuring of the Irish banks. Section 5 makes an assessment of the Irish banking policies and draws policy lessons. Finally, Section 6 concludes.

2. Run-up to crisis

2.1. Theory

The review starts with the macro picture of the financial system. The global financial crisis has revived interest in Minsky's 'financial-instability' hypothesis (Minsky, 1986). In the Minsky model the events leading up to the crisis start with a 'displacement' -some exogenous, outside shock to the macroeconomic system- an invention or an abrupt change of economic policy about which investors get excited. Subsequently there are five stages to the boom and eventual bust:

1. credit expansion, characterised by rising assets prices;
2. euphoria, characterised by overtrading;
3. distress, characterised by unexpected failures;
4. discredit, characterised by liquidation; and
5. panic, characterised by the desire for cash.

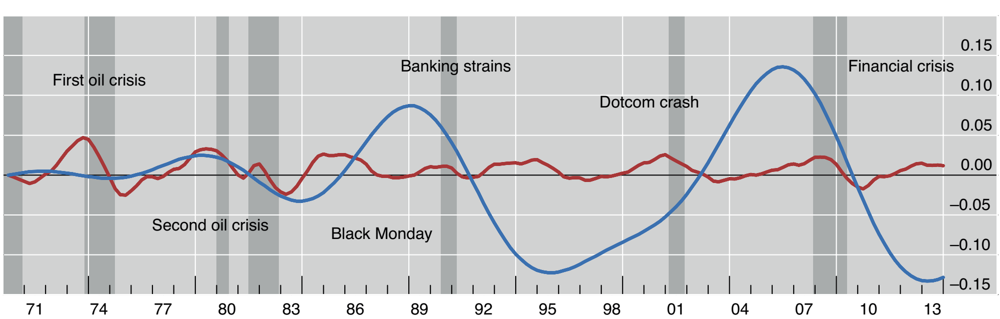
The displacement sets in a boom fuelled by credit. As a boom leads to euphoria, banks extend credit to ever more dubious borrowers, often creating new financial instruments to do the job. Then, at the top of the market, some smart traders start to cash in their profits. The onset of panic is usually heralded by a dramatic event, such as a bank not being able to meet its obligations. Losses on loans begin to mount, and the value of the loans falls relative to liabilities, driving down the capital of financial institutions. With less capital, financial institutions cut back on their lending (deleveraging).

Minsky's financial-instability hypothesis highlights the pro-cyclicality of the financial system. Several factors contribute to this pro-cyclicality. First, the role of risk assessment is important.

While risk tends to be underestimated in good times (euphoria with 'low risk'), it is overestimated in bad times (distress with 'high risk'). Moreover, risk can be endogenous. For example, when financial institutions sell a particular asset to reduce risk, the price of that asset may fall further. Second, the amount of debt (leverage) is a key factor explaining the depth of the financial crisis. The more debt is built up in the upswing, the more severe is the deleveraging in the downswing. This is not only an argument for more equity financing in general, but also for more equity capital for banks. Adrian and Shin (2008) show that banks have contributed to the upswing prior to the crisis, by increasing their leverage (more debt; less equity). This resulted in a declining leverage ratio, defined here as equity divided by total assets. Third, Gorton and Ordonez (2014) stress the pro-cyclical role of collateral. Investors are willing to lend short term (e.g. via repos) against collateral without producing costly information about the collateral backing the debt. When the economy relies on such informationally insensitive debt, firms or households with low quality collateral can borrow, generating a credit boom. Financial fragility builds up over time as information about counterparties decays. A crisis occurs when a (possibly small) shock causes investors to suddenly have incentives to produce information. Fourth and last, capital requirements play a role. Banks have to keep minimum capital against new loans. In good times, retained earnings boost capital, which enables banks to increase lending. In bad times, capital shrinks through losses, which may hamper the granting of new credit.

Expanding on Minsky, Borio (2014) argues that not only credit, but also house prices are important macro-drivers of financial cycles (see also Claessens, Kose and Terrones, 2014). Figure 1 illustrates how the financial cycle (measured by credit and house prices) can amplify the business cycle (measured by GDP). The amplitude of the financial cycle over the 1970-2013 period is five times that of the business cycle in the United States (US). Moreover, the duration of the financial cycle tends to be longer than that of business cycle.

Figure 1. The Financial and Business Cycles in the US



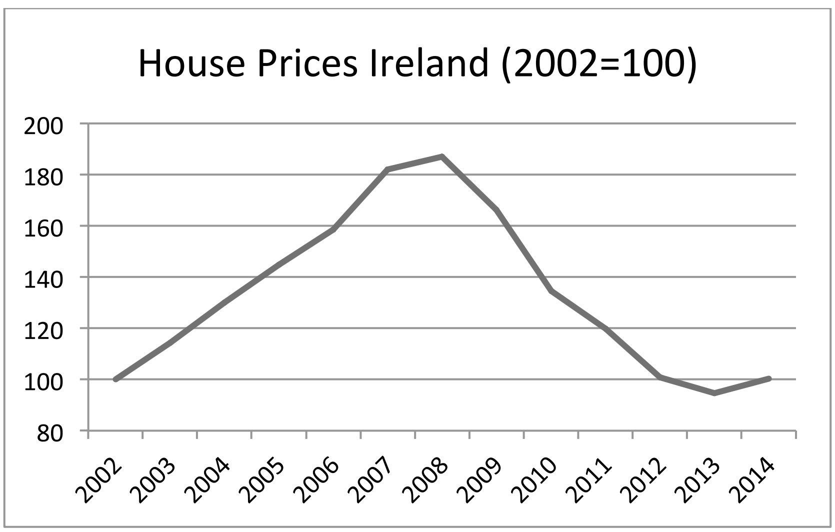
Note: The blue line traces the financial cycle measured by the combined behaviour of the component series (credit, the credit to GDP ratio and house prices). The red line traces the GDP cycle.

Source: Updated from Borio (2014)

2.2. The macro-finance side of the Irish crisis

For a full review of the run-up to the Irish banking crisis, we refer to Regling and Watson (2010), Honohan (2010) and the Investigation Commission (2011). These papers show that not only macro factors, but also a weak supervisory approach played an important role. On the macro-finance side, we examine house prices and credit growth as important components of the financial cycle in Ireland. Figure 2 shows that house prices (i.e. residential property) almost doubled from 2002 to 2008. Commercial real estate prices were also rising fast. The Investigation Commission (2011) indicates that 'groupthink' among bankers, supervisors, and central bankers may explain that the dangers of the strong build-up of house prices were not appreciated. This is a characteristic feature of the euphoria stage in the Minsky model. The strong rise in property prices led to massive new construction in Ireland.[2] With hindsight the construction bubble caused a misallocation of resources, aggravating the problems (Gros and Alcidi, 2013).

Figure 2. Residential property prices in Ireland



Note: Index of residential property prices, 2002=100.
Source: BIS Residential Property Price database

Moving to the second component of the financial cycle, Ireland experienced strong credit growth, with total banking assets almost tripling from 2002 to 2008 (see Table 1). This credit growth was fuelled predominantly by credit flows from other EU countries. Figure 3 indicates

[2] France and the Netherlands, for example, also experienced a housing price bubble, but without a construction bubble.

that domestic banking assets and third country banking assets (though a very minor component of 10 per cent, as Table 1 shows) grew with an overall rate of 250 per cent over the full period from 2002 to 2008. By contrast, EU country banking assets increased with almost 400 per cent over this period. The relative share of banking assets from other EU countries rose from 30 per cent in 2002 to 40 per cent in 2007/2008 and is now back at 30 per cent (see Table 1). Foreign credit (from EU and third countries) was 50 per cent of overall credit in Ireland at the height of the financial crisis.

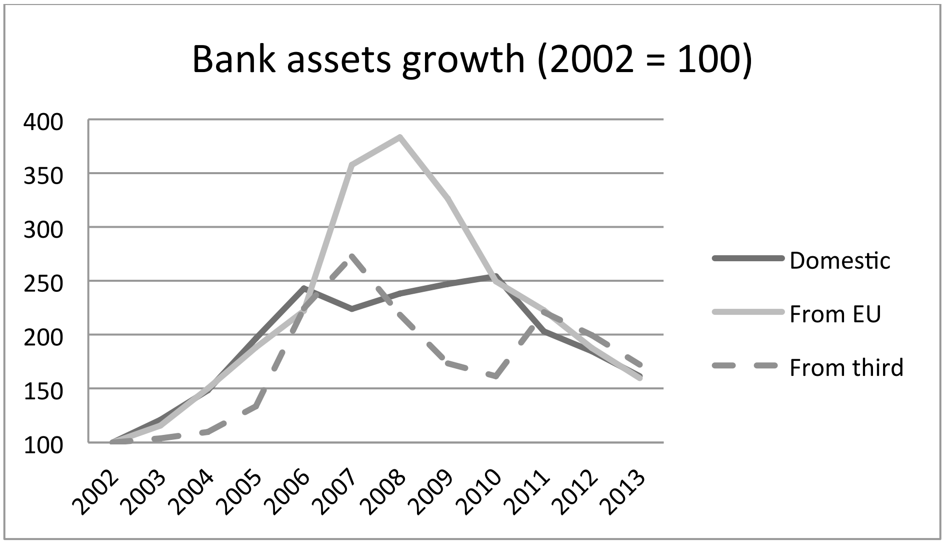
It may be interesting to compare credit growth in Ireland with other crisis-stricken countries like Spain and Portugal. Figure 4 illustrates that both domestic credit and credit from other EU countries were growing at a more or less even pace in Spain. Moving to Portugal, Figure 5 shows that credit growth was mainly domestic and more subdued than in Ireland or Spain. Moreover, credit from other EU countries went up to 300 in Spain (with the index at 100 in 2002), while this went up to close to 400 in Ireland. So, Ireland had both higher and more foreign-fuelled credit growth preceding the global financial crisis than Spain and Portugal.

Table 1. Irish banking system, 2002-2013.

In € bln	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Total assets	600	708	873	1,128	1,412	1,607	1,672	1,577	1,462	1,264	1,124	972
Domestic	366	444	544	719	890	819	872	904	930	743	676	590
From EU	175	202	263	330	388	625	670	570	436	389	328	279
From third	60	62	66	80	134	163	130	103	96	132	119	103
In %												
Domestic	61%	63%	62%	64%	63%	51%	52%	57%	64%	59%	60%	61%
From EU	29%	29%	30%	29%	27%	39%	40%	36%	30%	31%	29%	29%
From third	10%	9%	8%	7%	9%	10%	8%	7%	7%	10%	11%	11%

Note: Total assets of the Irish banking system are split in domestic, from the rest of the EU and from third countries.
Source: Author calculations based on ECB Structural Financial Indicators.

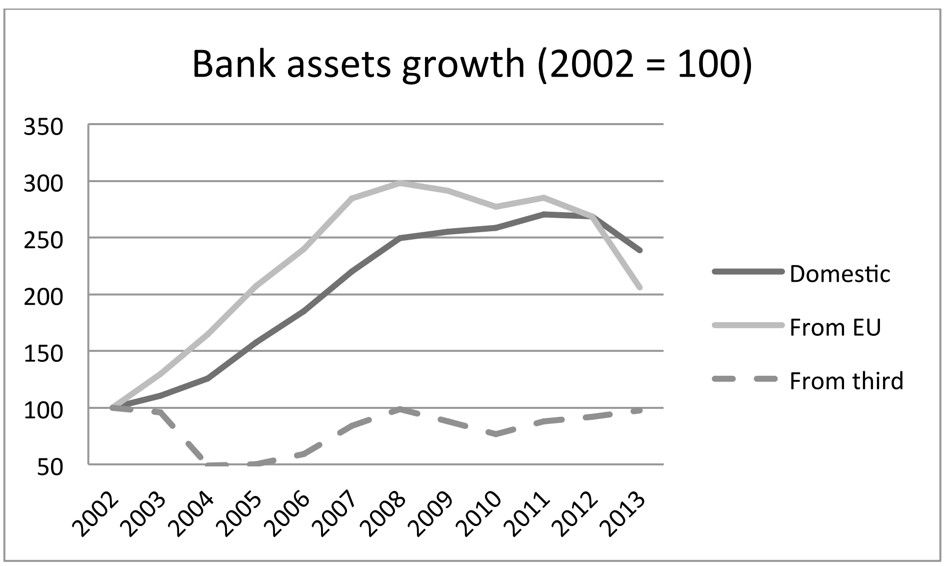
Figure 3. Banking assets Ireland (foreign vs domestic)



Note: Growth in total assets of the Irish banking system is split in domestic, from the rest of the EU and from third countries; Figure represents an index with 2002=100.

Source: Author calculations based on ECB Structural Financial Indicators.

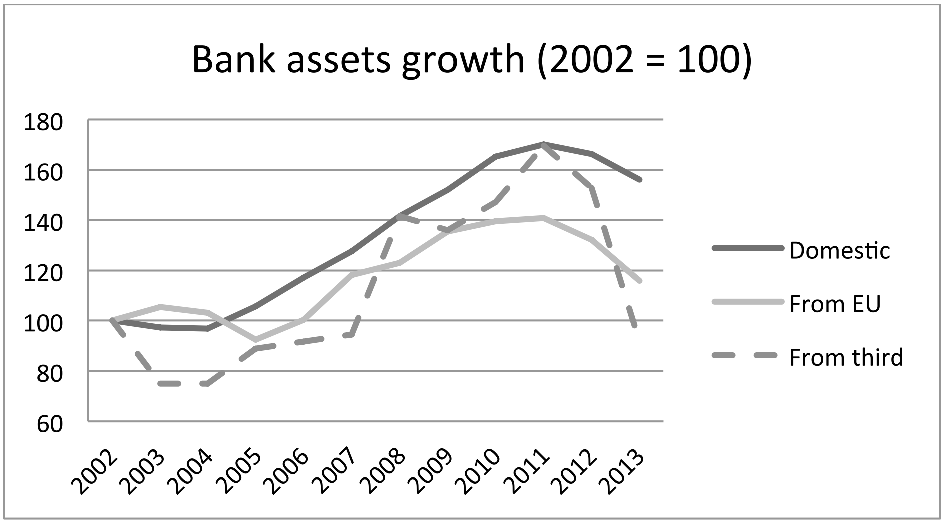
Figure 4. Banking assets Spain (foreign vs domestic)



Note: Growth in total assets of the Spanish banking system is split in domestic, from the rest of the EU and from third countries; Figure represents an index with 2002=100.

Source: Author calculations based on ECB Structural Financial Indicators.

Figure 5. Banking assets Portugal (foreign vs domestic)



Note: Growth in total assets of the Portuguese banking system is split in domestic, from the rest of the EU and from third countries; Figure represents an index with 2002=100.

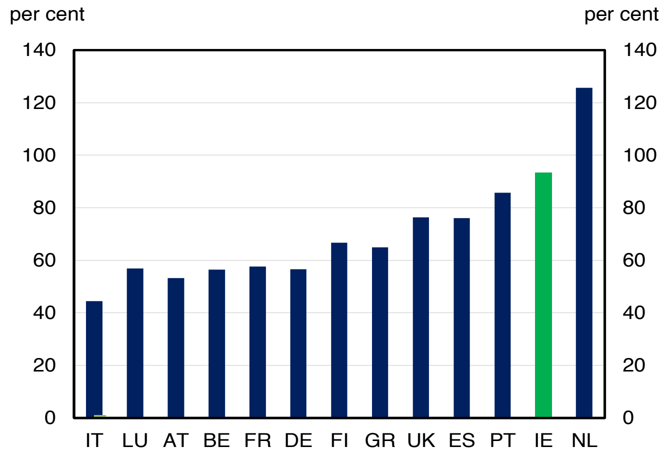
Source: Author calculations based on ECB Structural Financial Indicators.

It should be noted that the financial cycle components, house prices and credit growth, are correlated, as 80 per cent of the new credit in Ireland went to housing and commercial real estate (Gerlach, 2014). A salient feature of the increase in house lending is that banks lowered credit standards. High loan-to-value (LTV) ratios indicate loose credit standards. While in 2005, only half of first time buyers had LTV rates above 90 per cent, with very few above 100 per cent, these numbers went up in 2005 and 2006. By then, two-thirds of mortgages to first time buyers had LTV rates over 90 per cent and one third over 100 per cent (Honohan, 2009).

Jorda, Schularick and Taylor (2014) show in a historical overview spanning 140 years that the link between loose monetary conditions and booms in mortgage lending and house prices has become stronger post-WW2. Loose monetary conditions are in particular a problem when monetary policy is largely set elsewhere, for example in a monetary union, like EMU, or in a currency board, like Hong Kong. Applying the Taylor rule, Jorda *et al.* (2014) estimate that the policy interest rate was 5 to 10 per cent too low for Ireland and Spain during the 1999-2008 period. The level of mortgage debt to GDP in each country subsequently doubled in the space of about eight years. Next, the house price to income ratios in Ireland and Spain rose by 65%–75% over the same time frame.

More generally, Jorda *et al.* (2014) show that the 20th century has been an era of increasing "bets on the house". The strong rise in aggregate private debt over GDP in many Western economies in the second half of the 20th century has been mainly driven by a sharp increase in mortgage debt (see Figure 6). Mortgage credit has risen dramatically as a share of banks' balance sheets from about one third at the beginning of the 20th century to about two thirds today. The next sections indicate that the restructuring of mortgage loans appears to be one of the most intricate challenges in the crisis management of the Irish banking sector.

Figure 6. Household debt-to-GDP ratio in Europe, 2014



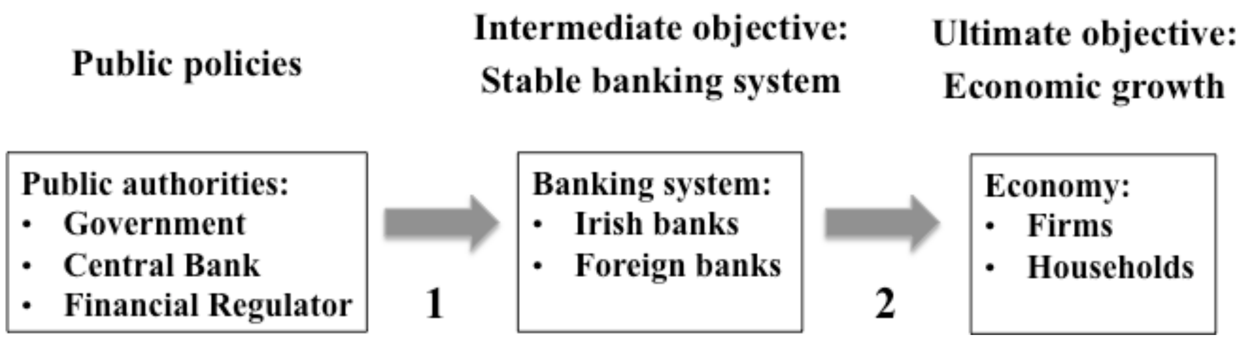
Source: Central Bank of Ireland, Macro-Financial Review, 2014-II

3. Crisis management – stabilising banks

The management of the Irish banking crisis happened in several stages. In the first stage, the emphasis was on public policies to stabilise the banking system. In the second stage, the restructuring of loans to firms and households (mainly mortgages) took centre stage. Although the two stages are interrelated, we make this split for analytical purposes. Figure 7 illustrates the banking system and public policies, whereby the first arrow reflects the first stage and the second arrow the second stage. This section discusses public policies to stabilise the banking system and the next section analyses the restructuring of bank loans ("healing the banks").

It is important to note that stabilising and restructuring the banking system is only an intermediate objective in the overall policy framework for the monetary and financial system (Schoenmaker, 2013b). The ultimate objective of the government and the central bank is stable economic growth. Nevertheless, the credit channel theory stresses that an efficient working banking system is crucial for economic growth (Bernanke and Gertler, 1995). So, the effectiveness of Irish policies to stabilise and restructure the banking system should be judged on their contribution to resuming stable economic growth in Ireland.

Figure 7. Public policies and the banking system



3.1. Blanket guarantee and early recapitalisation

The global financial crisis started with the fall of Lehman Brothers on 15 September 2008. This panic stage of the Minsky model put pressure on wholesale funding of banks, including Irish banks. In response, the Irish government introduced a blanket guarantee scheme covering virtually all Irish bank liabilities on 30 September 2008 (Gerlach, 2014). The original assumption was that the guarantee scheme had to cover liquidity problems at banks (Investigation Committee, 2011). But as almost always, liquidity problems forebode underlying solvency problems at the troubled banks. In contrast, most other European countries as well as the US provided only government guarantees for new borrowings or injections of preference or ordinary shares.

The underlying solvency problems -and subsequent capital injections- were revealed over an extended period of about three years from late 2008 to 2011 (see Table 2). Whereas the groupthink prior to the crisis led to a massively overheated property market building up over several years (the euphoria stage), it also took some time to grasp the full scale of the unfolding banking crisis (the distress and panic stages). Several factors contributed to the slow recognition of bank loan-loss estimates (Honohan, 2012): 1) the slowness of bank management to face up to the scale of the losses; 2) inadequacy of management information; 3) declining property prices, and 4) importantly, the inherent uncertainty about the ability of debtors to service loans where collateral fell well below loan amounts (negative equity).

Table 2 provides an overview of the recapitalisation efforts (Honohan, 2012). The initial capital injection in phase 1 was € 3.5 bn for Bank of Ireland (BOI) and Allied Irish Banks (AIB). In the face of continuing outflows, Anglo Irish Bank (Anglo) was nationalised in early 2009 and received a capital injection of € 4 bn. Phase 2 started with the creation of the National Asset Management Agency (NAMA) to take care of the large loans to property developers. By purchasing the large property loans at 'long-term economic value', banks had to recognise prospective losses. The first tranche of larger property developer exposures was valued first (phase 2A) and the full NAMA sample later (phase 2B). A similar exercise was done for the smaller loans to SMEs and mortgages to households, which stayed on the balance sheet of the banks.

In a top-down stress test exercise, the Central Bank of Ireland estimated loan losses for the NAMA and non-NAMA loans of the Irish banks. The subsequent calculation of the capital shortfall is known as the Prudential Capital Adequacy Review (PCAR). The March 2010 PCAR amounted to € 32 bn.

Table 2. Recapitalisation of Irish banks, 2009-2011, (in € bn)

	BOI	AIB	Anglo	INBS	EBS	ILP	Total
Phase 1: Early 2009	3.5	3.5	4.0				11.0 (14%)
Phase 2A: March 2010 (PCAR)	2.7	7.4	18.0	2.6	0.9		31.6 (40%)
Phase 2B: September 2010	0.0	3.0	7.3	2.8		0.1	13.2 (16%)
Phase 3: March 2011 (PCAR)	5.2	13.3			1.5	4.0	24.0 (30%)
Total	11.4	27.2	29.3	5.4	2.4	4.1	79.8 (100%)

Source: Honohan (2012).

3.2. Expiration of guarantee and further recapitalisation

The blanket government guarantee was for 2 years, expiring on 30 September 2010. Due to maturing bank paper and non-renewal of deposits, emergency liquidity assistance (ELA) was needed from the Central Bank of Ireland. The backing-up of the banking system moved thus from the government to the central bank (which is *de facto* also government guaranteed). The growing ELA as well as reliance of the Irish banks on Eurosystem funding were not sustainable, as central banks should not use liquidity assistance to prop up ailing banks for a longer time.

Due to the government's lack of market access, the EU-IMF Programme of Financial Support was meant to provide the Irish government with sufficient funding to adequately recapitalise the Irish banks. Importantly, the European Financial Stability Facility did not recapitalise the Irish banks directly, but provided funds to the Irish government for bank recapitalisation.

A contentious issue was, and still is, the burden sharing of bondholders in the recapitalisation. While subordinated bondholders had born losses of € 15.5 bn (Honohan, 2012), senior bondholders were exempted. The IMF negotiation mission and the Irish authorities were preparing a proposal to involve senior bondholders. But to prevent contagion effects to Irish and other European banks, the ECB pressured the Irish government to bail out senior bondholders. The US Treasury Secretary also urged the Irish authorities to exempt senior bondholders because of fears of the potential negative effects on the CDS markets (Pisani-Ferry *et al*., 2013).

As part of the EU-IMF Programme, Ireland had to do another PCAR exercise. But this time a more granular bottom-up approach -involving external consultants- was required. More stringent conditions were applied: 1) higher percentage capital ratios; 2) higher projected 3-year loan losses; 3) buffer for post-3 year loan losses; and 4) projected losses from selling non-core assets (deleveraging). The PCAR2011 exercise led to an additional capital injection of € 24 bn.

Table 2 summarises the overall capital injections amounting to € 80 bn into the Irish banks, whereby € 64 bn was provided by the government and € 15.5 bn from exchanges on subordinated debt and some private equity.[3] The first conclusion is that the capital injections were done in several rounds. Next, it is clear that the comprehensive assessments (PCAR) lead to larger estimates than ad-hoc calculations. Finally, a bottom-up approach with loan-by-loan estimates, by an independent third party, has been instrumental in getting the full picture. A parallel may be drawn with the ECB Comprehensive Assessment, which also employed a very detailed estimation of loan provisions as well as external consultants.

3.3. Nationalisation / mergers

While all Irish banks were involved in residential and commercial property lending, Anglo and Irish Nationwide Building Society (INBS) were the most aggressive both in growth and riskiness of the property portfolio (Investigation Commission, 2011). Anglo was active in commercial property, while INBS was involved in speculative site finance. Moreover, these two banks were found to have severe shortfalls in corporate governance. To prevent throwing good money after bad, the government decided to nationalise Anglo in January 2009 and INBS in August 2010. Anglo deposits were moved to AIB, and INBS deposits to Irish Life and Permanent (ILP). The two banks were subsequently merged into the Irish Bank Resolution Corporation (IBRC), which was put in special liquidation in February 2013.

Next, the bank-insurance conglomerate ILP was split. The profitable insurance part Irish Life was sold on by the government, and the banking part received state aid and was renamed permanent TSB (PTSB). Finally, the smallish Educational Building Society (EBS) needed substantial capital injections and had to restructure, just like the other Irish banks with state aid, under European Commission approved plans. Its restructuring was to merged into by AIB in July 2011.

The result of these liquidations and mergers is a domestic banking system with six banks turning into a consolidated (and concentrated) system with two broad banks, BOI and AIB, and one small bank, PTSB. The surviving banks had to rebuild profitability through cutting operations costs and some widening of interest margins. Moreover, the foreign-owned resident banks have stopped or substantially downscaled their banking operations in Ireland.

---

[3] It should be noted that the € 80 bn estimate of Table 2 only deals with the six Irish banks covered by the blanket guarantee of the Irish government. A further € 40 bn can be added for losses by the non-Irish banks (McArdle, 2012).

4. Restructuring – healing banks

After stabilisation, the next stage in crisis management is to restructure banks in order to return their business to viability. First, the restructuring or healing of banks involves the splitting of good and bad assets. Only when its bad assets are written down and/or hived off, a bank can start to plan for the future. Next, banks may need to downscale their operations (deleveraging) living up to the new reality of a smaller banking system, as the banking system had outgrown itself prior to the crisis. Finally, restructured banks may then resume their core function of providing credit to firms with positive NPV investment projects and to households wanting to buy a house on the basis of reasonable LTV rates.

4.1. NAMA

In 2009, the National Asset Management Agency (NAMA) was set up as agency of the Department of Finance to deal with the bad assets of the banks. The Irish banks were allowed to transfer property related loans to NAMA at a discount. Table 3 shows that banks transferred loans of € 74 bn at a discount of 57 per cent. Only loans in excess of € 20 mn were transferred. There was a plan (NAMA II) for the transfer of smaller commercial real estate loans out of the banks, but the government elected in early 2011 decided not to proceed. The latter was not appropriate. The great advantage of transferring bad assets is that banks had to recognise losses on these loans early on. The sale of loans to NAMA at November 2009 values protected the banks from any further deterioration of the Irish property market (NAMA Review, 2014).

Table 3. Transfers by the covered Irish banks to NAMA, (in € bn)

Transfers to end-2011	BOI	AIB	IBRC	Total
Nominal loan value	9.9	21.3	43.0	74.2
Discount	43%	56%	61%	57%
Transfer value	5.6	9.4	16.8	31.8
Realised Loss	4.3	11.9	26.2	42.4

Note: Only five of the six Irish banks (see Table 2) participated in the NAMA process. Anglo and INBS merged into IBRC. EBS was acquired by AIB.

Source: NAMA Review (2014).

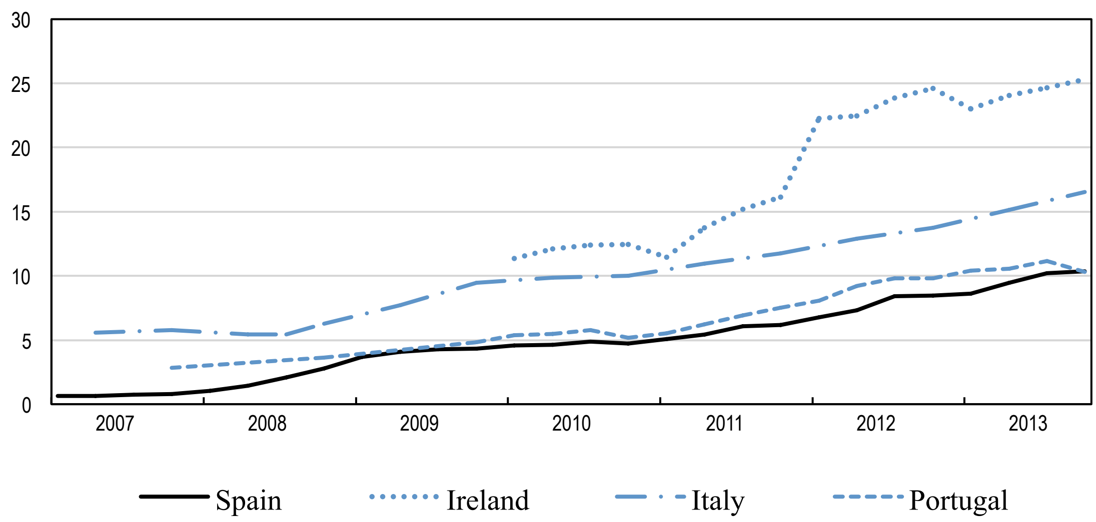
Within some overall targets, NAMA had the freedom to time the selling of its assets. As the London property market recovered first, these assets were initially disposed. Irish properties were disposed at a later stage, when the Irish market recovered. This freedom to run down the portfolio, depending on market circumstances, worked very well so far (NAMA Review, 2014).

Almost 60 per cent of the bad assets were taken over from the most troubled banks Anglo and INBS, which also had the largest and riskiest commercial real estate portfolios. This is reflected in the higher discount rate of 61 per cent for IBRC (the merged entity of Anglo and INBS). Unfortunately, NAMA could not help for the smaller commercial residential loans (below € 20 mn) and the mortgages.

4.2. Small loans

But what happened to the remaining loans in the banks? Figure 8 illustrates that non-performing loans (NPLs) as a percentage of total loans are very high for Ireland at 25 per cent in 2013. NPLs are usually well below 10 per cent. The other crisis-stricken countries have NPLs at 15 per cent (Italy) and 10 per cent (Spain and Portugal). Irish banks have taken large provisions for NPLs at 53 per cent in June 2014. But write offs as a percentage of provisions are extremely low at 5.2 per cent in June 2014 (data obtained from the Central Bank of Ireland). The emerging picture is that banks have made provisions for losses in their accounts, but are still holding out to write down bad loans. Households (as takers of mortgages) and firms (in particular SMEs) are thus burdened with a large debt overhang. This debt overhang is a drag on consumption and investment (Main and Sufi, 2014; Myers, 1977).

Figure 8. Non-performing loans in selected countries, 2007-2013 (% of total loans)



Note: The data cover gross value of loans on which payments of principal and interest is past due by 90 days or more as a percentage of the total value of the loan portfolio (including non-performing loans, and before the deduction of specific loan loss provisions). Data are not strictly comparable across countries.

Source: OECD Economic Surveys: Spain 2014

Looking to property loans in more detail, the small commercial property loans (below € 20 million) and mortgages stayed on the balance sheet of the Irish banks. Table 4 indicates that commercial real estate (CRE) loans and mortgages amounted to almost € 160 bn at end 2013, while table 3 shows that about € 74 bn of large CRE loans was transferred by end 2011 to NAMA. About two thirds of property loans thus stayed on the balance sheets of the surviving banks.

Table 4. Outstanding loans and impairments of Irish banks, end-2013, (in € bn)

	Outstanding loans				Impaired loans	
	BOI	AIB	PTSB	Total	Impairment rate	Impaired loans
Mortgages	51.6	40.7	29.0	121.3	17.7%	21.5
CRE	16.8	19.7		36.5	56.9%	20.8
SME	13.6	13.7		27.3	25.1%	6.9
Corporate	7.8	4.3		12.1	25.1%	3.0
Consumer	2.8	4.3	0.3	7.4	6.1%	0.4
Total	92.6	82.7	29.3	204.6	25.7%	52.6

Note: Only five of the six Irish banks (see Table 2) participated in the NAMA process. Anglo and INBS merged into IBRC. EBS was acquired by AIB.

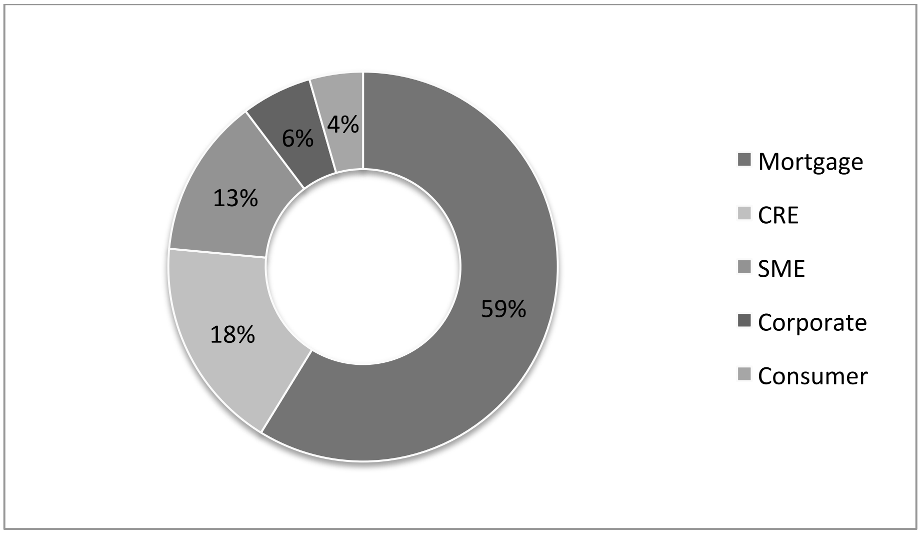
Source: Annual reports 2013 of banks for outstanding loans; Central Bank of Ireland for impairment rates; there is only a joint impairment rate for SME and Corporate available.

With an impairment rate of 18 per cent for mortgages and 57 per cent for CRE, more than € 40 bn of impaired property loans are still in the banks. While they have substantial loan provisions for impaired loans (53 per cent at June 2014; data from Central Bank of Ireland), banks have not yet taken write offs. If they would take write-offs, the losses would crystallise.

Table 4 and figure 9 also provide details of outstanding loans for the other sectors. SMEs count for 13 per cent and corporates for 6 per cent of total loans. The NPLs are also broken down by sector. Figure 10 shows that NPLs have increased to about 25 per cent for SME, corporate and consumer loans. While Irish SME and corporate debt has been declining in recent years, the sector is still highly indebted (Macro-Financial Review, 2014 II). It should be noted that SMEs, that are not active in the property sector, could also have property loans on their books. McCann and McIndoe-Calder (2014) show that about 20 per cent of non-real estate SMEs has property exposures, aggravating the debt overhang problem. These SMEs have a 5 per cent higher probability of default than SMEs with only debt related to their core enterprise activity.

Banking data cover only SMEs and corporates with a loan. Survey data indicate that 34 per cent of SMEs has no debt, while a further 50 per cent has debt of less than one third of turnover (McCann, 2014). Table 5 shows that the remaining 16 per cent has higher debts (a debt to turnover ratio of more than one third). In particular, the medium sized firms are at risk with higher debts of 23 per cent. More than half of this latter group has even a debt to turnover ratio of greater than one. Combining Table 4 (25 per cent of loans are impaired) and Table 5 (66 per cent of SMEs has a loan) indicates that 16.5 per cent of SMEs has arrears on its loans.

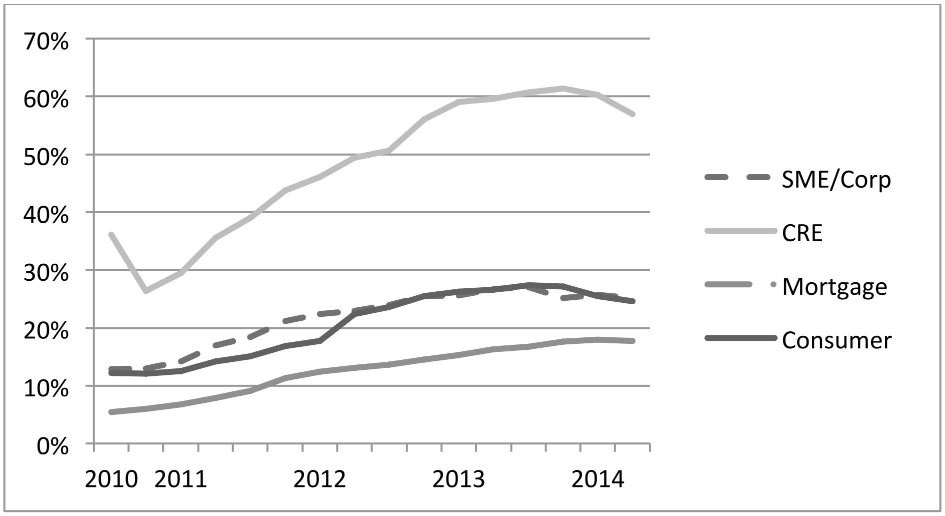
Figure 9. Outstanding loans by sector, end-2013 (% of total)



Note: The data cover outstanding loans of the Irish banks.

Source: Table 4

Figure 10. Non-performing loans by sector, 2010-2014 (% of total loans)



Note: The data cover gross value of loans on which payments of principal and interest is past due by 90 days or more as a percentage of the total value of the loan portfolio (including non-performing loans, and before the deduction of specific loan loss provisions). The weighted average of NPLs for the total banking sector is 25 per cent for 2013, as shown in Figure 8.

Source: Central Bank of Ireland.

Table 5. Debt to Turnover by firm size (as %)

Size	Zero debt	0 to 1/3	1/3 to 1	>1
Micro	36.1	49.8	8.3	5.9
Small	32.2	52.9	9.4	5.4
Medium	32.4	45.0	11.0	11.7
Total	33.8	49.9	9.3	7.0

Note: Rows sum to 100.

Source: McCann (2014).

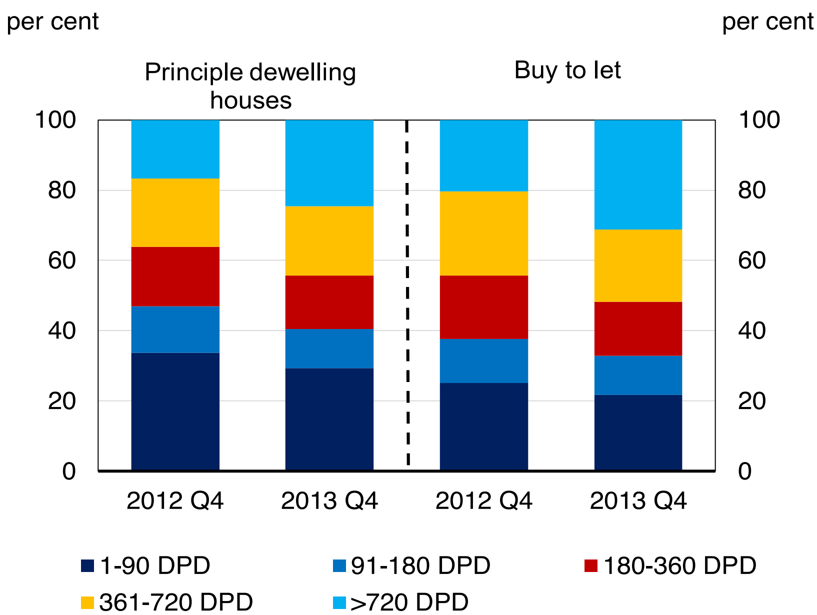
4.3. Mortgages

Mortgages are the most important component of bank balance sheets at 59 per cent of outstanding loans (see Figure 9), as also indicated in Section 2. We therefore examine mortgage in arrears in more detail. Mortgage arrears as a percentage of total outstanding mortgages balances are very high at 20 per cent for principle dwelling houses (PDH) and 36 per cent for buy to let houses (BLT) end-September 2014 (CBI, 2014b). These figures for mortgage arrears are given for all arrears, including arrears up to 90 days. NPLs contain only arrears at 90 days or more. The NPL figure is 16.5 per cent for PDH and 30.5 per cent for BTL. The weighted average NPL for mortgages is 19.5 per cent. External asset management, like NAMA for commercial property loans, should have been considered for distressed mortgages. That may have accelerated their resolution. But the ECB made such schemes financially unattractive as it limited ECB funding to banks only, excluding resolution vehicles.

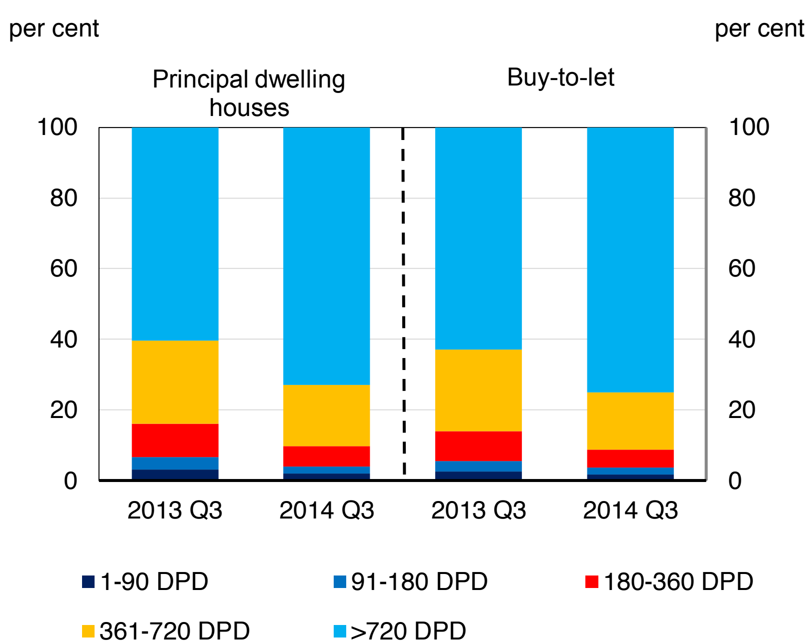
The composition of the arrears is also important. Panel A of Figure 11 indicates that the proportion of mortgages with arrears over 2 years (720 days past due) is growing and well above 20 per cent for both categories. Panel B shows that this category is very large with about 75 per cent of arrears in value terms for both categories.

Figure 11. Mortgage accounts in arrears by duration

Panel A: Mortgages in arrears as a percentage of total mortgages in arrears (number)



Panel B: Mortgages in arrears as a percentage of total arrears (value)



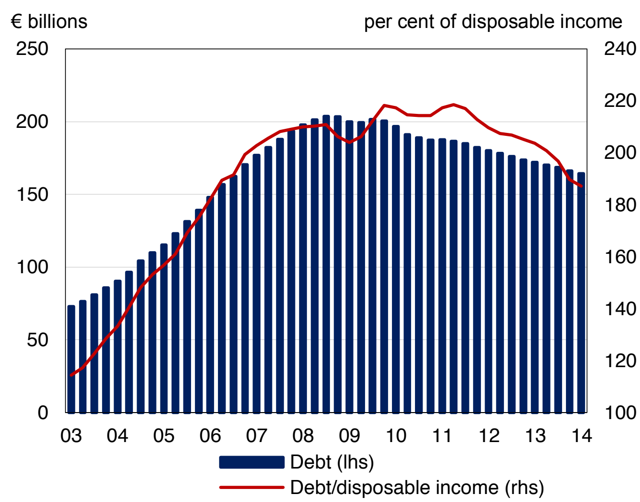
Note: DPD means days past due.

Source: Central Bank of Ireland, Macro-Financial Review, 2014-I and 2014-II

While banks seem to be on track to meet the Central Bank's MART targets for restructuring mortgages, the impact is limited. It is telling that the largest component of restructures is arrears capitalisation. This component amounts to 26 per cent of the number of restructured PDH mortgages reflecting 47 per cent of restructured PDH mortgages balances (CBI, 2014b). Capitalising arrears does little to reduce household indebtness.[4] Banks are thus more or less rolling over rather than writing off mortgages. Beck (2014) observes that antiquated insolvency laws prevented a proper workout of non-affordable mortgages and restructuring of viable enterprises. Reforms of personal insolvency were enacted in late 2012, which included a shortening of the discharge period for bankruptcy from the former penal 12 years to 3 years.

While household debt has increased at a fast pace in the run up to the bursting of the bubble in 2008, the decline in household debt is slow. Figure 12 shows that household debt levels remain high at 190 per cent of disposable income. The level of Irish household debt to GDP is only second to the Netherlands[5] in the European context (see Figure 6).

Figure 12. Household debt



Source: Central Bank of Ireland, Macro-Financial Review, 2014-II

Again banking data only cover households with a mortgage. There are some 1.650.000 private households in Ireland (Irish Central Statistics Office). The number of outstanding PDH

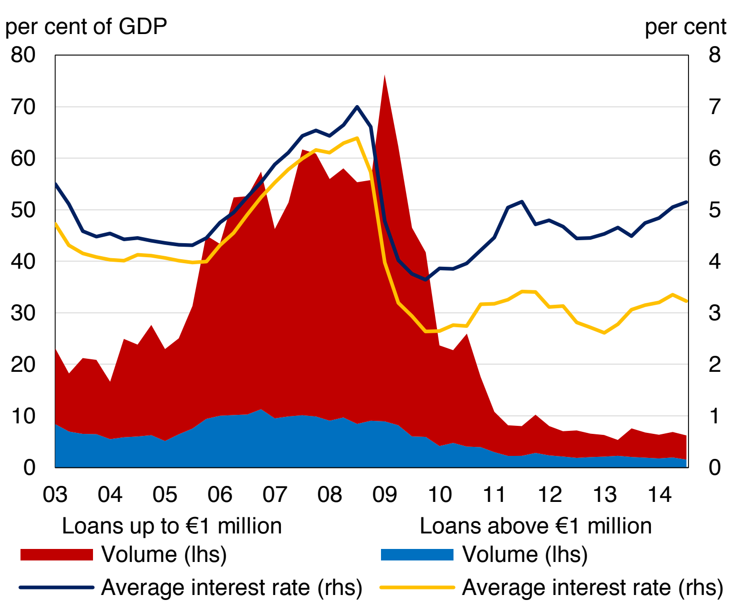
[4] While the housing market shows some signs of recovery (Macro-Financial Review 2014-II), the number of transactions is still thin compared to the boom days of 2006.
[5] The high mortgage debt in the Netherlands can be explained by the generous interest rate deductibility for income tax. As the effective interest payments are only half of the nominal amounts (with a marginal income tax rate of about 50 per cent), the Dutch mortgage debt at 120 per cent of GDP is about twice the European average of 60 per cent (see Figure 6).

mortgages is about 760.000, with 118.000 of these mortgages in arrears (CBI, 2014b). So, up to 7.2 per cent of Irish households have a mortgage in arrears (as some distressed households have more than one mortgage outstanding).

4.4. New lending

New lending to domestic non-financial corporations remains extremely weak, with interest rates at slightly above 5 per cent for loans up to € 1 million (see Figure 13). SMEs, which have limited access to other sources of finance, face thus a high lending rate. Section 3.3 explains that the Irish banking sector has become very consolidated with two broad banks and one small bank remaining. In response, the public authorities have taken several initiatives to support *inter alia* SME financing (Macro-Financial Review, 2014-II). The recently launched Strategic Banking Corporation of Ireland will lend to SMEs via the banks on longer and more favourable terms than currently available. The Strategic Banking Corporation of Ireland will have €800 million to lend and will be initially financed by the German Promotional Bank (KfW), the European Investment Bank (EIB) and the Ireland Strategic Investment Fund. Next, the National Pension Reserve Fund (valued at € 6.8 bn) is being re-oriented from a long-term pension fund to a domestically focused investment fund, the Ireland Strategic Investment Fund (ISIF), to support economic activity and employment.

Figure 13. New lending by banks to NFCs



Note: This chart shows lending by credit institutions resident in Ireland to euro area NFCs (non-financial corporates, which consists of SMEs and corporates). Irish NFCs represent about 87 per cent of the sample.

Source: Central Bank of Ireland, Macro-Financial Review, 2014-II

5. Assessment and policy lessons

The previous sections contain a high-level overview of the run-up to the Irish crisis and the subsequent crisis management. This section provides an outsider's assessment of Irish banking policies from a macro-finance perspective. Figure 7 above highlights that the effectiveness of Irish policies to stabilise and restructure the banking system should be judged on their contribution to resuming stable economic growth in Ireland. Are firms and households ready to resume investment and consumption?

We will also draw policy lessons from an international perspective. This section follows the structure of the earlier sections: 1) preventive macroprudential policy; 2) stabilising policies; and 3) restructuring policies.

5.1. Macroprudential policy

The dangers of the building up of the strong housing bubble -fuelled by abundant credit- were neither appreciated by the banks nor by the authorities. Ireland was not unique in this respect. A similar assessment can, for example, be made for the US and Spain. Three features stand out in the Irish case, as described in section 2. The first is the 'groupthink' among high-ranking policymakers and bankers. The second is the loosening of credit standards on mortgages, with LTVs well above 90 per cent. The third is the strong contribution of cross-border banking flows from other European countries.

External views can be helpful to counter groupthink. External reviews, such as the regular IMF Article 4 Mission, are useful, but can still be ignored by the authorities. Ireland participates in the European Systemic Risk Board (ESRB), which can provide warnings and recommendations, and in the ECB's Financial Stability Committee. The ECB can tighten macro-prudential tools, if it believes that a country sets them too low. The ECB has only this power for CRR/CRD IV related measures like the countercyclical capital buffer, but not for important tools such as the LTV and LTI ratios. The most powerful mechanism to counter groupthink is to incorporate external views in the decision-making process of macroprudential policy. The UK Financial Policy Committee provides an interesting example, with four external members, including one foreign-based.

With a one-size-fits-all monetary policy for EMU, country specific macroprudential policy is very important. This also applies to Ireland, whose contribution to the euro-area is less than 2 per cent. So, monetary policy is thus not set to Irish conditions, but *de facto* exogenous. This is similar to Hong Kong, where the Hong Kong dollar is linked to the US dollar and the Hong Kong Monetary Authority (HKMA) runs a currency board. To contain housing and real estate prices, the HKMA follows a time-varying LTV policy (HKMA, 2011). When house prices rise too fast, the HKMA reduces the LTV ratio to constrain credit availability and vice versa.

The LTV ratios were at the high end in Ireland, just as in the Netherlands, resulting in a high mortgage debt to GDP ratio. LTV ratios at 95 or higher were not uncommon, as documented in Section 2. But more recent evidence suggests that such high LTV ratios have become less common (see Table 6). International experience suggests maximum LTV ratios of 80 to 90 per cent. In a consultation paper, the Central Bank of Ireland (2014a) proposes to restrict lending by banks for primary dwelling purchase above 80 per cent LTV to no more than 15 per cent of the aggregate value of the flow of all housing loans for PDH purposes. Furthermore, a lower threshold is proposed for BTL mortgages, requiring banks to limit BTL loans above 70 per cent LTV to 10 per cent of all BTL loans, as purchasing properties for investment purposes is riskier. These proposals are sensible to limit the risk from over-borrowing. We assume that the LTV caps will be applied to all mortgage providers (not only banks) and further suggest applying dynamic (time-varying) application of the LTV ratios (see below).

Lower LTVs (and thus less debt) are only possible, when households have sufficient savings for the necessary equity component. Germany has an interesting system of 'bausparen', which encourages German households to accumulate savings for buying their house. Another example is Canada and Switzerland, where households can draw on their own pension fund assets for equity financing of their first house.

Table 6. LTV and LTI ratio breakdown on new PDH mortgage lending in 2013

LTV ratio	% of the euro amount of new lending	% of the number of new loans	LTI ratio (times)	% of the euro amount of new lending	% of the number of new loans
Over 90%	12	11	Over 4.5	7	6
Between 85% and 90%	23	21	Between 4 and 4.5	6	5
Between 80% and 85%	9	8	Between 3.5 and 4	10	9
80% and below	56	60	3.5 and below	77	80

Source: Central Bank of Ireland (2014a).

More broadly, the macroprudential authority is at the minimum responsible to increase the resilience of the financial system against financial shocks (see also CBI, 2014a). Gersbach and Rochet (2014) go further, preferring countercyclical policies to constrain financial booms, which are largely related to housing and property markets. They recommend 'stabilisation of the credit cycle' as aim of macroprudential policy. The countercyclical capital buffer (which is implemented as part of the CRD4 package) and the LTV ratio are based on the residence of the borrower. So domestic banks and foreign-owned banks operating in Ireland face the same capital buffer and LTV ratio for Irish borrowers. In that way, the Central Bank of Ireland can contain domestic as well as cross-border banking credit simultaneously.

Policy lessons

1. The Central Bank of Ireland, as macroprudential authority, should aim to stabilise the credit and housing cycle. It should adopt *inter alia* time-varying LTV ratios, which in the long run should not exceed 80 to 90 per cent.
2. The Central Bank of Ireland may consider establishing a formal Financial Stability Committee with external members. A separate committee with published minutes also increases accountability.

5.2. Crisis management - stabilising banks

From the start of the global financial crisis, the Department of Finance and the Central Bank of Ireland have been pro-active to stabilise the Irish banks. The outcome of the ECB Comprehensive Assessment shows the success of the Irish authorities. The two broad Irish banks, BOI and AIB, passed the test, and only the small bank, PTSB, experienced a capital shortfall.

In this high-level review, we cannot assess whether the blanket guarantee of Irish bank liabilities to address wholesale funding pressures was appropriate (see Investigation Commission, 2011). It may have served its purpose initially, but it forestalled timely resolution with burden sharing by creditors. With hindsight, the expiration of the two-year government guarantee was a watershed in the Irish banking crisis. While an expiration of a guarantee is generally a 'tipping point', there was no clear exit strategy of the guarantee.

A contentious issue in the early days of the crisis management was the handling of senior debt holders: writing down to absorb losses or rescuing because of contagion. At the time, the contagion concerns were real. Be that as it may, if the ECB (and others, like Brussels and the US Treasury Secretary) argues for protecting senior debt holders because of potential contagion to the wider European banking system, then the costs should be borne at the European level (see Goodhart and Schoenmaker, 2009, on burden sharing).[6] But European and IMF support was

[6] A distinction can be made between general and specific burden sharing. General burden sharing is based on some fixed key, such as the ECB capital key used by the ESM, while specific burden sharing is based on the location of the banking assets (in this case Ireland for the six Irish banks). To the extent that EU-wide financial stability is affected, general sharing is preferable. When only stability in the countries where the bank is located is affected, specific sharing is the preferred solution. Goodhart and Schoenmaker (2009) argue to apply a division of general and specific sharing, depending on the relative stability concerns.

channelled to the Irish government, which subsequently rescued the Irish banks on its own risk and account. That is clearly a policy mistake. The IMF staff (Allard *et al*. 2013) recommends that the European Stability Mechanism (ESM) should recapitalise banks directly, and not through the books of the government. Similarly, Goodhart and Schoenmaker (2014) argue that the ECB instead of the national central banks should provide Emergency Liquidity Assistance (ELA) to banks under ECB supervision in the new Banking Union.

More generally, the financial trilemma suggests that authorities have to choose two out of the three objectives of financial stability, cross-border banking and national financial policies (Schoenmaker, 2013a). With the advance to Banking Union, a choice is made for supranational financial policies, which should not only be applied to banking supervision (micro component) but also financial stability (macro component).

Next, the Irish authorities set up NAMA to deal with bad property loans in excess of € 20 mn. The establishment of NAMA was instrumental in the successful management of the Irish banking crisis. It allowed the banks to recognise fully the losses on these loans, and thus removed an important source of uncertainty for the banks. Next, the government set only overall targets for NAMA in its resolution of the bad assets. The relative freedom in running down the bad loan portfolio allowed NAMA to realise a relative good price for its assets disposals.

The recapitalisation of Irish banks happened in several rounds. Early top-down calculations appeared to be imprecise and insufficient, which is of course partly due to fact that the full depth of the crisis was not yet known. Acharya *et al*. (2011) advise, therefore, to slightly overdo recapitalisations and overcapitalise banks, as a no-regret policy. Any excess funds can later be returned to the government, while the probability of further capital shortfalls is reduced. Next, a bottom-up approach, preferably aided by independent consultants, is needed to assess the full scale of the capital needs. The second PCAR in Ireland was bottom-up. The Dutch government followed a similar bottom-up approach, when it provided a 90 per cent guarantee of ING's Alt A portfolio. To ensure an appropriate price for the guarantee, the government had (in secret) hired a consulting agency for a valuation of the US houses underlying the Alt A mortgages

Policy lessons

3. In the new setting of the Banking Union with ECB supervision of the large euro-area banks, the ECB and the ESM should provide directly the liquidity and capital backstop to these large banks when needed.
4. Ireland followed international best practice by setting up NAMA, as asset management agency to run down the bad assets of the Irish banks. Releasing bad assets from bank balance sheets is instrumental in the path to recovery.

5. Assessment of capital needs for troubled banks should be comprehensive, aided by external consultants, and ideally bottom-up. Ad-hoc assessments may lead to repeated rounds of recapitalisation.

5.3. Crisis management - restructuring banks

The next step after stabilisation is the restructuring of the Irish banks. The restructuring involved rearranging the banking system and cleaning the balance sheet (“healing”). On the banking system, the authorities took several decisions on closures and mergers. As Anglo Irish and the smaller INBS appeared to be beyond salvage, it was a good decision to put these banks into liquidation. Another decision was to find a safe haven for EBS, a small building society. EBS became a subsidiary of AIB. The result is a two-pillar banking system, with two broad banks, BOI and AIB, with € 80 to 90 bn in total loans (see Table 4) and a smallish bank, PTSB, with only € 30 bn in total loans. While a reduction of the oversized banking system of six Irish banks was clearly needed, the two-pillar system may lead to too little competition in Irish banking. This may result in high interest rate margins with high borrowing costs and low saving rates for business and retail customers.

An alternative would have been to merge EBS and PTSB becoming a third bank. In that setting, there would be two broad banks with € 70 to 90 bn in assets and one medium-sized bank with about € 45 bn in assets. Although PTSB is still loss making, a properly restructured combined bank can turn into an affective challenger of the two larger banks. To compare, the troubled SNS bank in the Netherlands was nationalised as stand-alone bank and not taken over by one of the three large banks (ING, Rabobank, ABN AMRO). The SNS has adopted a challenger strategy in the pricing of its mortgages, savings and payment services.

Competition from foreign banks will be very limited in the near future, due to disaster myopia (Guttentag and Herring, 1984). As the recent Irish banking disaster is still fresh in everybody’s memory, foreign bank managers will not enter the Irish market. The foreign banks, Lloyds, Rabobank and Danske Bank, are running off their Irish operations. Only Ulster Bank, which is part of the RBS Group, is on record to remain active in Ireland.

Turning to cleaning bank balance sheets, progress is still slow. With non-performing loans (NPLs) at 25 per cent, there is a lot of work to do for banks. But banks are holding out to achieve write backs when the economy turns around (thus generating returns for shareholders and distressed debt investors), instead of writing off bad loans. After several years of strong provisioning, banks have built sizeable provisions (up to 53 per cent, which is coming close to the discount of 57 per cent on the property loans transferred to NAMA), which would allow them to take write offs.

This 'wait and see' approach (forbearance) comes with a cost, both for the banks and their borrowers. For banks, the outstanding NPLs are a continuing source of uncertainty, which may refrain them from new lending. The Department of Finance has recently created a national development bank, the Strategic Banking Corporation of Ireland, to support lending to SMEs at a time when they have difficulties accessing finance and face financing costs that are higher than the European average. These challenging credit conditions primarily reflect legacy issues in the banking sector. The SBCI will lend to SMEs via the banks on longer and more favourable terms than currently available at the private banks.

For borrowers, the debt overhang causes subdued investment and consumption (Myers, 1977; Main and Sufi, 2014). Our calculations in Section 4 suggest that 16.5 per cent of SMEs and 7.2 per cent of households face payment arrears. But that is a conservative estimate of firms and households confronted with debt overhang, as some firms and households struggling with high debts still fulfil their payment obligations to their bank. So, up to 20 per cent of SMEs and 10 per cent of households are suppressing new investment and consumption. While the Irish economy is fortunately recovering, there is a two-track economy with the majority of firms and households contributing to economic growth but a significant minority standing on the sidelines.

Ireland appears to be struck between the Anglo Saxon system of easy credit provision and the Roman system of strong creditor's rights. In the US, mortgages were (too) easily provided in the run-up to the subprime crisis, but indebted households could walk away from their house without further debt because of the so-called non-recourse mortgages. In the European tradition of strong creditor's rights, Ireland had recourse mortgages and antiquated personal bankruptcy procedures. In the wake of its banking crisis, Ireland has already modernised personal bankruptcy procedures. But it is still difficult for borrowers (firms and households) to free themselves from old debts. Moreover, it is not in the mindset of bankers to write off loans in an equitable way, as they are afraid of moral hazard by setting a precedent of debt forgiveness.

Nevertheless, the Irish banking crisis can be seen as a one-off, justifying a unique programme of (partial) debt forgiveness.[7] A government-enforced programme of debt forgiveness would free both the banking sector and its borrowers from lingering legacy issues, broadening the base for economic recovery. As banks were recapitalised with taxpayers funds, the argument could be made that banks in turn have the responsibility to write off legacy loans in order to support new lending to firms and households, and thus increase the social return on the recapitalisations. The taxpayer-funded recapitalisations are now sitting partly idle in the banks. Writing off loans should have been set as a condition for the EU-IMF support package.

[7] It could be argued that this argument was used for the recapitalisation of the Irish banks. Under normal conditions, the government would not recapitalise the banking sector, but due to the severity of the crisis the government did recapitalise.

Policy lessons

6. The Irish authorities took some bold restructuring decisions, such as replacing management and closing two troubled, property-lending banks. While banking consolidation is a key tool of crisis management, it is important to ensure that the banking system remains competitive post-crisis.
7. Taking sufficient provisions for NPLs is a first step to heal banks. A necessary second step is to write off bad loans, to clean up bank balance sheets. On the first step, Ireland has been pro-active. On the second, progress is very slow.
8. Recapitalisation of ailing banks may be needed for economic growth. When providing financial support to banks, the government should set targets for banks to partially write off bad loans to corporates and households.

6. Conclusions

Ireland faced a very severe banking crisis when the credit fuelled property bubble burst. Our overall assessment is that the Irish authorities have been successful in the management of the Irish banking crisis. This success has been instrumental in the economic recovery. Ireland has turned the corner.

On balance, there was a strong focus on stabilising banks (restoring solvency, replacing management and closing bad banks), but less emphasis on restructuring loans. The Irish banks are not yet healed with 25 per cent of non-performing loans (NPLs). A small but important group of highly indebted households and firms cannot resume consumption and investment because of debt overhang. Intensifying write offs of bad loans would broaden the economy recovery and increase the social return on the publicly funded bank recapitalisations.

The Irish taxpayers have been brave in shouldering the full costs of recapitalising the Irish banking system. While European authorities argued strongly against loss sharing by senior debt holders because of contagion fears for the wider European banking system, they did not cover part of the burden. That is enjoying the stability benefits, but not paying for it. In the new Banking Union setting with ECB supervision for the large euro-area banks, we recommend that the European Stability Mechanism (ESM) should directly recapitalise troubled banks after resolution measures are taken (Allard *et al.*, 2013; Schoenmaker, 2013a). The ESM would then become an effective vehicle for risk sharing and cut the bank-sovereign loop (the theme of the conference).

Finally and importantly, a repeat of the ‘irrational housing exuberance’ should be avoided. We recommend using the new macroprudential tools of countercyclical capital buffers and LTV ratios in a pro-active way to stabilise the credit cycle. Establishing a financial stability committee at the Central Bank of Ireland with external members may be helpful to avoid groupthink.

References

Acharya, V., D. Schoenmaker and S. Steffen (2011), How much capital do European banks need? Some estimates, VoxEU Column, CEPR, 22 November.

Adrian, T. and H. Shin (2010), Liquidity and leverage, *Journal of Financial Intermediation* 19, 418–437.

Allard, C., P. Koeva, J. Bluedorn, F. Bornhorst, K. Christopherson, F. Ohnsorge, T. Poghosyan, and an IMF Staff Team (2013), Toward a Fiscal Union for the Euro Area, IMF Staff Discussion Note No. 13/9, IMF, Washington D.C.

Beck, T. (2014), Ireland's Banking System – Looking Forward, *The Economic and Social Review* 45, 113–134.

Bernanke, B. and M. Gertler (1995), Inside the Black Box: The Credit Channel of Monetary Policy Transmission, *Journal of Economic Perspectives* 9, 27-48.

Borio, C. (2014), The Financial Cycle and Macroeconomics: What Have We Learnt?, *Journal of Banking and Finance* 45, 182-198.

Brunnermeier, M., A. Crockett, C. Goodhart, A. Persaud, and H. Shin (2009), The Fundamental Principles of Financial Regulation, Geneva Reports on the World Economy, No 11, ICBM, Geneva, and CEPR, London.

Central Bank of Ireland (2014a), Macro-Prudential Policy for Residential Mortgage Lending, Consultation Paper 87, Dublin.

Central Bank of Ireland (2014b), Residential Mortgage Arrears and Repossessions Statistics: Q3 2014, Statistical Release, 3 December, Dublin.

Claessens, S., A. Kose and M. Terrones (2014), Understanding financial cycles, in: D. Schoenmaker (ed.), *Macroprudentialism*, VoxEU eBook, CEPR, London.

Gerlach, S. (2014), Banking and Finance: Back to Stability, in: R. Lissek and M. Coleman (eds), *Ireland and Germany: Partners in European Recovery*, Oak Tree Press, Cork.

Gersbach, H. and J.C. Rochet (2014), Capital regulation and credit fluctuations, in: D. Schoenmaker (ed.), *Macroprudentialism*, VoxEU eBook, CEPR, London.

Gros, D. and C. Alcidi (2013), Country adjustment to a 'sudden stop': Does the euro make a difference?, Economic Papers No. 492, Brussels.

Goodhart, C. and D. Schoenmaker (2009), 'Fiscal Burden Sharing in Cross-Border Banking Crises', *International Journal of Central Banking*, 5, 141-165.

Goodhart, C. and D. Schoenmaker (2014), The ECB as Lender of Last Resort?, DSF Policy Brief No. 36, Duisenberg school of finance, Amsterdam.

Gorton, G. and G. Ordoñez (2014), Collateral Crises, *American Economic Review* 104, 343-378.

Guttentag, J. and R. Herring (1984), Credit Rationing and Financial Disorder, *The Journal of Finance* 39, 1359-1382.

Hong Kong Monetary Authority (2011), Loan-to-value ratio as a macroprudential tool – Hong Kong SAR's experience and cross-country evidence, *BIS Papers,* No 57.

Honohan, P. (2009), Resolving Ireland's Banking Crisis, *The Economic and Social Review* 40, 207–231.

Honohan, P. (2010), The Irish Banking Crisis and Regulatory and Financial Stability Policy 2003 - 2008, A Report to the Minister for Finance by the Governor of the Central Bank, Dublin, 31 May.

Honohan, P. (2012). Recapitalisation of Failed Banks – Some Lessons from the Irish Experience, Address at the 44th Annual Money, Macro and Finance Conference, Trinity College, Dublin, 7 September.

Investigation Commission (2011), Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, Report of the Commission of Investigation into the Banking Sector in Ireland, Dublin.

Jorda, O., M. Schularick, and A. Taylor (2014), Betting the House, NBER Working Paper No. 20771.

McArdle, P. (2012), The Euro Crisis: Refinancing the Irish bailout – the options post the June 2012 Summit, Working Paper, The Institute of International and European Affairs, Dublin.

McCann, F. (2014), Profiling the indebtness of Irish SMEs, *Economic Letter Series*, Vol 2014, No.3, Central Bank of Ireland.

McCann, F. and T. McIndoe-Calder (2014), Property debt overhang: The case of Irish SMEs, VoxEU Column, CEPR, 23 September.

Mian, A. and A. Sufi (2014), House of Debt, Chicago University Press, Chicago.

Minsky, H. P. (1986), *Stabilizing An Unstable Economy*, Yale University Press.

Myers, S. (1977), Determinants of Corporate Borrowing, *Journal of Financial Economics* 5, 147-175.

NAMA Review (2014), National Asset Management Agency – Section 227 Review, Department of Finance, Dublin.

Pisani-Ferry, J., A. Sapir and G. Wolff (2013), EU-IMF assistance to euro-area countries: an early assessment, Bruegel Blueprint Series, Vol. 19, Brussels.

Regling, K. and M. Watson (2010), A Preliminary Report on the Sources of Ireland's Banking Crisis, Dublin.

Schoenmaker, D. (2013a), *Governance of International Banking: The Financial Trilemma*, Oxford University Press, New York.

Schoenmaker, D. (2013b), An Integrated Financial Framework for the Banking Union: Don't Forget Macro-Prudential Supervision, Economic Papers No. 495, European Commission, Brussels.

Schoenmaker, D. (ed.) (2014), *Macroprudentialism*, VoxEU eBook, CEPR, London.