TUARASCÁIL ón gComhchoiste Fiosrúcháin i dtaobh na Géarchéime Baincéireachta

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

REPORT of the Joint Committee of Inquiry into the Banking Crisis

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

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THEME: R3

Clarity and effectiveness of the nexus of institutional roles and relationships

LINE OF INQUIRY: R3c

Effectiveness of the communication between the Central Bank and the Department of Finance

Update note for the Minister in relation to financial institutions for Government meeting 29 October, 2008.

Summary/Speaking Points

1. The bank guarantee has achieved its objective of stabilising the liquidity position of the Irish financial institutions. Share prices of the Irish banks have continued to fall very sharply.

2. The Minister believes that banks should first look to their own business plans to secure their capital base, review dividend policy and measures (joint ventures, private placements) to raise capital. A critical part of their business planning is a realistic assessment of their loan book exposure and to determine the scale of any write downs. Ultimately they may need additional share capital. The State may have a role so it is prudent to engage in appropriate contingency planning to have a State supported capitalisation process prepared.

3. It may that amalgamations of some institutions could be required, with State support, in some instances.

4. Mr Maurice O'Connell is reviewing the role of the NPRF for the future, including in relation to the extent to which the Minister might give policy directions, and whether it is appropriate to continue to invest each year. The Fund could ultimately be the investor in the banks.

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5. The Minister's key concern is to ensure that Irish banks are sound and viable while also being in a position to meet the banking needs of both individuals and businesses and at the same time retain the confidence of the money markets. Currently there is a loss of confidence affecting demand for loans. But there is also evidence that banks are imposing much tighter lending criteria. They need to get the balance right.

Impact of the Guarantee Scheme

The Guarantee announced on 30 September achieved its aim in stabilising the liquidity position of the covered institutions, but it has not given rise to any large net new sources of funding and the liquidity position of the banks is now at or about its late June position.

The share prices of the domestic banks are now circa 90% off their peak of 20 months ago, a markedly greater fall than in the case of a number of banks internationally, e.g. Banco Santander -53%, BNP Paribas -37% and HSBC -26%. Share prices have continued to fall sharply over the four weeks since the guarantee announcement of 30 September, and are typically down 40% in that four week period. (Table attached as appendix 1). In addition, Credit Default Swaps (CDS) rates for Irish banks remain very high, suggesting that the markets are still very unsure about the long term future of the banks, in their current shape.

Market sentiment remains firmly negative on the Irish financials, with many investors holding the view that their profitability will fall dramatically as they absorb impaired loans and as the downturn bites further. This will directly impact earnings, but will also feed through to balance sheets as the expected scale of losses eats into capital reserves. Investors see relatively little prospect of dividends in the coming years and the prospect of equity stakes being diluted as fresh capital is raised. The real risk is that share price falls will trigger further concerns about Irish banks and that, despite the guarantee, liquidity issues will come back. The persistent lack of confidence in the Irish financial sector is a very significant issue.

Order Naming Covered Institutions

The order designating the first group of banks and building societies to participate in the Credit Institutions (Financial Support) Scheme 2008 was made on Friday 24 October, 2008. The covered institutions (subsidiaries and parents) have each executed a Guarantee Acceptance Deed as specified by the Minister, whereby they have undertaken to comply with the terms of the Guarantee Scheme and have given an irrevocable indemnity to the Minister.

Five subsidiary banks had sought to be included under the Guarantee scheme and the intention that they would be included was announced by press release on 9 October, 2008. At this stage, Halifax Bank of Scotland (HBOS) has announced it will not now join the scheme and two others (First Active and Ulster Bank) have indicated they may not join the scheme. Contacts are being maintained, but it is unclear how the HBOS decision will influence the others.

A significant number of institutions not covered by the guarantee have sought such coverage (e.g. certain IFSC firms, certain credit unions, certain lending companies). We are not recommending extension to these types of firms as there are trillions of Euro at stake which are beyond the capacity of the Irish State to guarantee. In any event these institutions do not pose a direct systemic threat to Irish banking.

Next Steps

The Minister considers that while the Guarantee Scheme has resolved immediate liquidity issues, it is important that the banks take immediate action to plan and work to meet their capital needs. In this regard, the development of restructuring plans is a condition of their participation in the guarantee scheme and this will be a priority focus of the information and monitoring processes under the Scheme.

The Minister would ideally like the banks to address their own capital needs. However the Minister believes it is necessary to consider, on a contingency basis, steps that would be necessary to allow a State capital provision in the event the banks are unable to secure adequate capital from the market. The steps to be considered include how State capital could be provided either directly through the NPRF or otherwise.

In this regard the Government might like to note that the Minister has requested Mr. Maurice O'Connell (former Governor of the Central Bank) to prepare a report on the appropriate role of the NPRF in the future. This will include consideration of the extent to which the Minister for Finance can give directions to the NPRF based on policy considerations and the extent to which contributions should continue to be made annually in cash terms or whether contributions might be given in kind (eg shares)

Summary

The Guarantee has achieved its objective of stabilising the liquidity position of the Irish financial institutions. The share prices of the Irish banks have continued to fall. This reflects investor belief that the likely write downs on impaired loans will eliminate profitability and threaten reserves to an extent that capitalisation will have to be addressed. The Minister believes that banks should first look to markets for any required capital. It is prudent to for the State to engage in appropriate contingency planning to have a State supported capitalisation process prepared.

Appendix 1

Share price changes for quoted Irish financial institutions over the twenty months to October 2008 (i.e. fall since peak of financial share prices generally)

	BOI Price	BOI %Δ	AIB Price	AIB %Δ	IPM Price	IPM %Δ	ANGL Price	ANGL %Δ
Today	1.47	-	3.30	-	2.12	-	1.28	-
2w	2.35	-37.4	3.20	+3.1	4.00	-47.0	2.12	-39.6
30/09/2008	3.95	-62.8	5.90	-44.1	4.85	-56.3	3.84	-66.7
29/09/2008	3.27	-55.0	5.00	-34.0	3.57	-40.6	2.30	-44.3
3m	5.01	-70.7	7.40	-55.4	4.60	-53.9	5.36	-76.1
20m (peak)	18.65	-92.1	23.50	-86.0	22.80	-90.7	16.12	-92.1

SECRET
Oifig an Aire Airgeadais

Ref No **Date: 24h February 2009**

Memorandum for Government
Discussion with EU Commission re revision of Guarantee to Covered Credit Institutions

1. Decision sought
The approval of the Government is sought for the Minister for Finance:-

(i). to develop proposals for agreement with the European Commission to extend the bank guarantee Scheme to cover long-term bond issuance by covered institutions (i.e. up to five years)

(ii) . to amend the Credit Institutions (Financial Support) Act 2008 to allow a State guarantee to be provided for longer-term bond issuance consistent with EU State aid requirements.

2. Background
On 30 September 2008 the Government announced a guarantee of deposits and certain specified funding instruments, up to 29 September 2010, for named systemically important credit institutions (covered institutions) in the Irish market. While public attention has focussed on the guarantee of deposits, a critical function of the Guarantee is in enabling credit institutions access funding in capital markets, which would not otherwise be prepared to lend to the covered institutions. The Guarantee was initially successful in achieving its purpose, reversing the outflow of deposits and enabling covered institutions to successfully raise funding in debt markets.

3. Review of Scheme
The terms of the Scheme, in accordance with EU requirements, require the Minister to formally review its functioning at no later than six-month intervals to ensure its continuing justification and that it is meeting its objectives. That review is currently being undertaken by the Minister and provides a timely opportunity to agree an extension of the guarantee with the Commission to support the covered institutions in accessing crucial longer-term funding.

4. Proposals to revise Guarantee Scheme
The Government, in its recapitalisation decision of 11 February 2008 approved the announcement that, discussions would be commenced with the European Commission about revision of the Scheme to encompass longer-term bond issuance by the Banks, consistent with State aid requirements. This is considered an essential confidence building measure in the Irish banking system as it is clear the financial crisis will extend for some time and it is important that planning and measures are now

undertaken to ensure the longer term funding of the covered institutions which remain under significant liquidity pressures.

5. Guarantees in the EU

To 6 February 2009, 15 guarantee type schemes introduced by EU Members States have been approved by the European Commission (see summary attached). A number of these schemes lengthen the guarantee period, providing a guarantee to the maturity of the instruments, enabling institutions in these countries to raise longer term funding e.g. up to five year bonds in limited and exceptional circumstances.

6. Position in Ireland

Due to the end-September 2010 legislative deadline applying to the guarantee Scheme under the Credit Institutions (Financial Support) Act, 2008, Irish banks have in practice been unable to issue new bonds for a period extending beyond the guarantee. Irish covered institutions are therefore disadvantaged in relation to the period over which they can seek to raise funding with the benefit of the guarantee (now down to 19 months). Additionally, there is increased risk due to the concentration of funding in short-term instruments that need frequent roll-over. This has been the subject of unfavourable comment by market analysts and commentators.

The Minister understands that covered institutions have issued about €10billion of bonds under the existing Guarantee and that on the basis of any extension in the guarantee to three or five year issuance seek to issue at least as much again as soon as possible.

As much as possible it is not proposed to increase the State's contingent liability under the guarantee Scheme, but to develop proposals in consultation with the banks for agreement with the Commission to encompass longer-term bond issuance by the banks. This should allow for some shift in covered liabilities to longer-term rather than short-term issuance. However, on account of the fragile position of the Irish banking system agreement on an extension of the 'blanket' guarantee of liabilities beyond end-September 2010 is also likely to be essential in the course of 2009.

5. European Commission State Aid approval

The European Commission has sole authority to approve State Aid measures, and intensive negotiations were conducted with the Commission prior to the presentation to the Oireachtas of the Guarantee Scheme on 17 October 2008. The Government's approval is therefore sought to the initiation of discussions with the Commission as a matter of urgency with a view to reaching agreement on amendments to the Irish Guarantee Scheme to enable covered institutions to raise longer term funding with the benefit of the guarantee and reduce risk arising from concentration and shortening of funding periods. While the Commission communication does provide for adjustments to deal with evolution of financial markets, the Commission are likely to seek additional safeguards and constraints on the commercial conduct of institutions seeking to benefit from the guarantee (including restructuring requirements) as well as a 'market orientated' charge for the guarantee.

Addendum

DETAILS OF GUARANTEE SCHEMES IN EU MEMBER STATES

DATED 6th FEBRUARY, 2009

OVERVIEW

- To date, guarantee schemes[1] have been taken or proposed in a total of **17 cases**. This does not include guarantee measures taken for individual banks.
- **Approvals** have been granted in **15 cases** and **2 cases** are currently **under assessment.**
- **Approval decisions** have been published by the Commission in **12 cases.**

ISSUANCE WINDOW AND DURATION

General

In the first two guarantee schemes that were approved by the Commission (Denmark and Ireland), both the issuance window for covered liabilities and the duration of the guarantee was set at two years.

In all subsequent guarantee schemes, the **issuance window is shorter** (i.e. six months in many cases and longer in some cases) and the **duration of the guarantee is longer** (i.e. usually three years from the date of issuance of the liability and five years from the date of issuance in exceptional cases). Consequently, it appears that the Commission tends to favour a shorter issuance window than two years, but is comfortable with a guarantee enduring for longer than two years where a shorter issuance window applies.

In relation to the duration of guarantee schemes, we would note that the majority of other schemes differ from the Irish and Danish schemes in one key respect. Under the Irish and Danish schemes, there is a final backstop date at which time all guarantees under the scheme expire, i.e. two years from a specified date. In contrast, in the other schemes (aside from the French scheme), the guarantee covers liabilities with a specified maturity term (e.g. three years) from the date of issuance of such liabilities until their maturity dates, i.e. provided a liability is issued during the issuance period and has a maturity within the specified limit (e.g. three years), the liability will be covered from issuance to maturity.

Of the 15 approved schemes, eight have an **issuance window of six months** and cover liabilities issued during this window that have a maturity of up to **three years** (in some cases, liabilities with a maturity of up to **five years** may be covered in exceptional circumstances).

[1] Note: Some guarantee schemes have been taken in conjunction with other financial support measures for institutions. For the purposes of this document, we focus on details of the guarantee schemes, and, in particular, the issuance window and duration for such schemes, and provide a summary only of other financial support measures undertaken at the same time.

These cases are: Austria, Finland, Greece, Latvia, Slovenia, Spain, Sweden, UK. This appears to be the favoured approach to the length of the issuance window and the duration of the guarantee.

In addition, in many cases, the issuance window, whether it is six months or longer, may be extended subject to approval from the Commission.

Aside from Ireland and Denmark (as noted above), the following cases depart from this general approach:

- **France**: this scheme differs in that only one institution, the SRAEC, is covered by a State guarantee. The SRAEC issues securities that are guaranteed by the State with a view to making loans to credit institutions against collateral. The activities of the SRAEC are limited to **five years**.

- **Germany**: this scheme differs in that the issuance window lasts until **21st December, 2009**, i.e. approximately **14 months** from the date of approval of the scheme by the Commission, rather than six months.

- **Italy**: as for the German scheme, the issuance window for the two guarantee measures under this scheme last until **21st December, 2009**, i.e. approximately **13.5 months** from the date of approval of the scheme by the Commission, rather than six months.

- **The Netherlands**: this scheme differs in that the issuance window lasts until **30th June, 2009**, i.e. **8 months** from the date of approval of the scheme by the Commission, rather than six months.

- **Portugal**: as for the German and Italian schemes, the issuance window for this scheme lasts until **21st December, 2009**, i.e. approximately **12.5 months** from the date of approval of the scheme by the Commission, rather than six months.

- **UK**: the issuance window for the UK scheme is **six months**, but under modifications to the scheme which were approved on 23rd December, 2008, participating institutions will now be able to roll over the guarantee on some individual instruments for an **additional two years**, ending in **April, 2014**, i.e. some instruments issued during the issuance window of six months may now be guaranteed for a period of five years from the date of issuance rather than three years as was originally the case.

<u>**Longest issuance window and longest duration**</u>

The **longest issuance window** is **two years**, which applies in the Irish scheme and the Danish scheme.

The **longest duration** for a guarantee is **five years** from the date of issuance of the liability in question. However, in general the extension of duration from liabilities with a maturity of three years to liabilities with a maturity of five years only applies in exceptional circumstances or for limited classes of liability. In each of these cases, we would note that the issuance window is shorter than two years. The cases where the period of cover is five years are:

- **Austria** (only in exceptional circumstances as demonstrated in the six month reports).

- **Finland** (only for covered bonds or in justified cases).

- **Germany** (only under certain circumstances and for limited amounts).

- **Italy** (individual cap per bank applies: liabilities exceeding a maturity of three years cannot exceed 25% of total liabilities covered).

- **Portugal** (only in exceptional circumstances when duly justified by the Portuguese Central Bank).

- **Slovenia** (only in exceptional circumstances and liabilities exceeding a maturity of three years cannot exceed 30% of total liabilities covered or a maximum amount of €3.6 billion).

- **Spain** (only in exceptional circumstances)

- **Sweden** (covered bonds only).

- **UK** (participating institutions will now be able to roll over the guarantee on some individual instruments for an additional two years, ending in April, 2014).

SECRET

Ref No. **September 2009**

Oifig an Aire Airgeadais

Memorandum for Government

Financial Stability Contingency Planning

1. Decision Sought

The Minister for Finance requests the Government's approval for:-

1.1 An announcement to be made as part of the Second Stage debate on NAMA legislation in the Dáil to the effect that the Government remains committed to provide systemically important financial institutions with an appropriate level of capital to continue to meet their capital requirements, in a manner consistent with EU State aid rules.

1.2 The letters attached in Annex II of this Memorandum to be issued to the relevant institutions.

1.3 The Minister requests the Government to note:-

(i) The draft text to this effect (set out in Annex to this Memorandum) included in the Minister's Second Stage speech on NAMA (which may be subject to final drafting changes but which will not affect the substance of the commitment on capital).

(ii) This text will form the basis for letters which it is proposed will issue to the two guaranteed building societies shortly in advance of the Second Stage debate to underpin their capital position in case there is any attempt to trigger a claim under the State Guarantee.

(iii) That the Attorney General [redacted]

(iv) The contingencies relating to financial stability identified by the Minister's financial advisors which could potentially arise following the Minister's NAMA statement (set out in Section 4 below)

(v) The contingency arrangements in place to respond to these contingencies if they arose (set out in Section 6 below)

2. Context

The Irish banking system has stabilised since the difficult period in late 2008 and early 2009. This reflects the intervention of the Government and the various associated measures taken to reassure the market over the solvency and liquidity of systemically important banking institutions. However, the banking system remains extremely vulnerable, as evidenced by:

- Continued share price volatility and lack of consensus in the analyst community.
- Shift in the shareholder registers of the listed institutions with significant retail ownership.
- Balance sheet funding with material dependence on short-term liquidity.

Furthermore, the State's flexibility to act is restricted by the existing State guarantee and risk of triggering payment under this, EU State aid requirements and the absence of a special resolution regime for credit institutions.

3. Position of the Building Societies

A detailed analysis undertaken by the Department, the National Treasury Management Agency ("NTMA") and Rothschild indicates that the capital related consequences of NAMA are likely to be more significant for the two building societies – Irish Nationwide Building Society (INBS) and the Educational Building Society (EBS) - than for other participating institutions. Indicative capital impact assessments prepared by Rothschild illustrate the requirement for the commitment to provide appropriate capital as necessary to these institutions to safeguard their financial position. INBS have recently written to the Minister seeking reassurance in relation to the institution's capital position in the context of the implementation of NAMA. It is essential, therefore, to provide this confirmation to the Board, as well as to the Board of EBS.

4. Possible Scenarios

If following the Minister's statement on NAMA the market believes it has clarity on the amount of capital required by each participating institution following the transfer of eligible assets into NAMA, on account of the write-down in the book value of its loans that would arise, the advice of the Minister's financial advisors Rothschild is that the following risks may arise:-

- A downward share price spiral for the listed institutions as investors will see the likelihood of significant dilution and may conclude that outright nationalisation is a more likely scenario. This could lead to significant liquidity risk throughout the banking system.
- For the building societies, there is a particular risk that bondholders on the basis of a claim of insolvency (or the breach of regulatory capital requirements) would seek to trigger an event of default in order to be paid in full under the State guarantee.
- In circumstances of significantly increased financial stress and instability, there is also some risk of a loss of confidence among retail deposit holders.

5. Assessment

The Minister's statement has been carefully drafted to minimise the risk that it will give rise to unfavourable market developments. Nonetheless, the statement will provide for the first time sufficient clarity to allow the market to start to estimate the potential losses that may arise from the transfer of assets into NAMA and the consequent capital requirements thereby arising. It is accepted by the financial advisors that the risks outlined in Section 4 may be mitigated, to some extent, by positive sentiment in the event that the market concludes that the NAMA legislation is likely to be passed.

The CBFSAI's assessment is that anticipation of NAMA with likely haircuts in line with the 30% indicated in recent press comment has coincided in recent months with an increase in the share prices of covered institutions, a substantial fall in their CDS spreads, positive liquidity flows and a reduction in borrowings from the Eurosystem. In this regard, the market is conscious not just of the balance sheet improvements that will follow but also the increase in ECB eligible collateral that NAMA will provide, which will considerably improve the funding situation. The CBFSAI believe that while it is never possible to predict market reactions, the indications are that the market does not see an increase in State ownership as negative, as long as it stops short of full nationalisation, and the commitment by the Minister that he would ensure adequate capitalisation of the banks is a key support.

It is intended, therefore, that the Minister's commitment in relation to the provision of capital will mitigate the risk that the contingencies outlined above will materialise.

6. Contingency Planning Measures

The steps proposed to address the main risks outlined in Section 4 above are as follows:-

(i) Call on the State Guarantee

It is proposed that the Minister will issue a letter to the Boards of INBS and EBS shortly in advance of his statement to the Dail confirming the Government's intention to provide capital to the institution in the circumstances and subject to the conditions set out in the Minister's statement. This will ensure that the institutions themselves will be in a stronger position to dispute any attempt to claim an event of default had taken place.

A statement for the Minister has also been prepared if required in that situation rebutting any claim of any capital insufficiency and stressing that any claim is invalid and opportunistic. The legal assessment is that this approach will buttress the State's position in resisting any claim under the Guarantee. Legislation has also been prepared on a contingency basis if further steps are required to safeguard financial stability.

(ii) Serious Liquidity Pressures

The CBFSAI have confirmed that there is very significant capacity available to provide ECB liquidity support to the Irish banks. Current data show total available capacity of the order of €45 billion. In addition, arrangements have been made for AIB and Bank of Ireland each to access €2-2.5bn of funding from NTMA. Any additional liquidity from the Eurosystem would take the form of Emergency Liquidity Assistance (ELA) at the State's own risk. This would require agreement of the Governing Council of the ECB not to object to the proposed provision of ELA. The Governor stands ready to request the convening of an Emergency Governing Council Meeting, which can be held in a matter of hours with the agreement of the President. ELA is in effect lending by the Eurosystem to a national central bank which in turn lends the funds at its own risk to a credit institution.

(iii) Sharp share price decline

If this particular scenario developed it is likely that the banks affected would rapidly approach the Government seeking to accelerate capital support and certainty would be needed quickly on the terms of this support. The Minister would bring forward further proposals for consideration by Government in those circumstances. Legislative authority to provide capital to the banks in order to maintain financial stability is contained in the Credit Institutions (Financial Support) Act, 2008.

Annex I – Draft text for Dáil statement regarding capital commitment

"As the work of NAMA progresses we will see its impact on all of the participating institutions. It is likely that there will be institutions that require additional capital in order to absorb the losses arising from the transfer of their impaired assets to NAMA and in order to maintain a capital position that is in compliance with regulatory requirements. If, following a transfer of loans to NAMA, a credit institution is required to raise additional financing to meet its regulatory capital requirements then I want to make it clear that the Government would expect such an institution to explore all available options for raising such capital. It is the Government preference that private market solutions are found and implemented. The banks and building societies will be expected to rebuild the equity component of their capital base in conjunction with the implementation of NAMA.

To the extent that sufficient capital cannot be raised independently or generated internally, the Government remains committed to providing such banks and building societies with an appropriate level of capital to continue to meet their capital requirements. This will be done in a manner consistent with EU State aid rules and the credit needs of the Irish economy. I should also state that any recapitalisation of a credit institution in such circumstances must be followed by a restructuring of the credit institution involved in a manner which complies with EU State aid requirements."

Annex II – Letters to be issued to EBS and INBS

Risk Sharing

9. The Minister indicated in April, when announcing the establishment of NAMA, that down the line should NAMA be faced with losses, consideration would be given to the imposition of a levy or some equivalent measure to ensure the protection of taxpayer's interests.

10. In the consultation period, other risk sharing mechanisms have been put forward. The proposal receiving much commentary is a proposal to give the banks equity in NAMA as part payment for the assets. This proposal has difficulties of its own – including how it would be valued on bank's balance sheets – and would also give the banks access to the upside at the expense of the taxpayer. The Minister does see merit in further addressing risk sharing along with his advisors will be examining risk sharing options in the coming weeks. An alternative option under consideration would be to grant the banks subordinated debt in NAMA as part payment for loan assets. Various risk sharing mechanisms will be considered and the Minister will revert to Government with a proposal for the NAMA Bill or to incorporating a mechanism into the practical operation of NAMA. However, it must be a key principle that NAMA results in a very substantial cleansing of the banking system.

Nationalisation

11. The Labour Party and other commentators have proposed the blanket nationalisation of the banking sector. The Government has at all times stated its preference for a banking system that has a market presence and operates within market disciplines and constraints. This position has been reinforced by the ECB's opinion issued yesterday, where the ECB notes that the NAMA proposal is preferable to nationalisation and avoids the high costs over the short and medium tem associated with such a policy, while giving more reserved views on other issues.

12. The outcome of the NAMA process may require further State capital injection in Irish banks but this is a more discriminate and effective policy than blanket nationalisation.

Restructuring of Institutions

13. In parallel to the NAMA process, the Minister along with his advisors is examining the likely impact of NAMA on the institutions who participate. Participation in NAMA is likely to impact significantly on the capital positions of each institution that participates which may result in the restructuring of the banking sector in Ireland. The Minister will be bringing forward proposals to Government in the coming weeks.

ECB Opinion

14. As required under European law, the Minister sought the views of the ECB on the draft legislation. The ECB opinion published on its website supports the establishment of NAMA and notes that it is broadly consistent with principles issued by it in relation to the treatment of impaired assets. The ECB notes the positive effect the proposal will have on the stability of the Irish banking system and the ability of Irish banks to raise the funds on international markets.

UK Position

15. The UK Government has expressed concerns about the NAMA structure and the treatment of UK parented banks. Further discussions are to take place at official level in this regard.

Next Steps

16. It is the Minister's objective that the legislation be officially published on the 8th of September. The Dáil will then be recalled to discuss the Bill in the context of a wider debate on the future of the financial sector in Ireland on the 16th of September and the second stage of the Bill will be held in the week that follows. Committee stage of the Bill will be held in early October following the referendum on the Lisbon Treaty.

SECRET

Oifig an Aire Airgeadais

Ref No: F514/72/09 **Date: 13 October 2009**

Memorandum for Government
National Asset Management Agency Bill 2009

Decision Sought

1. The Minister for Finance requests Government to approve proposed Committee Stage amendments to the NAMA Bill, subject to further drafting amendments to be made by the Minister in consultation with the Attorney General and to amendments, if any, which may be required for EU State aid approval.

2. The list of proposed Committee Stage amendments is attached. The majority of the changes are technical improvements or clarifications. A small number of substantive amendments are also proposed and these are summarised below.

Substantive Amendments

Valuation Methodology

3. [redacted]

Amendments to Section 169 – Limitations on Certain Dealings in Land etc

4. Section 169 is being amended (i) to restrict the power given to NAMA in order to protect third parties who have purchased an interest in the land concerned in good faith, and (ii) to restrict the effect of subsection (3). As drafted subsection (3) restricts a debtor or an associated debtor that has at any stage defaulted on a debt owed to NAMA from purchasing any asset that was acquired by NAMA. As currently drafted the impact of this subsection would be very severe and may significantly limit the market for NAMA's assets. The definition for associated

debtor would encompass a wide range of potential buyers. The proposed amendment narrows the scope of the section and restricts a borrower from purchasing the security for their own loan while they are in default.

Duty to Co-operate

5. It is proposed to insert a provision into the Bill requiring borrowers to co-operate and act in good faith with participating institutions during the preparation for the transfer of loans. This should improve the accuracy of information provided and the efficiency of the transfer process.

Overall Limit on Securities Issues

6. Section 48 currently provides for the Minister by Order to set the limit for the issue of securities in respect of acquisition by NAMA of bank assets. The proposed amendment limits the issuance of securities to €54 billion. This can be subsequently amended by Order but only where the Dáil has passed a positive resolution.

Part Payment in Subordinated Debt

7. As indicated in the Minister's Second Stage speech, section 47 is amended to ensure that the maximum amount to be paid to a participating institution in subordinated debt is 5% of the aggregate amount due to that institution.

Taxation of Windfall Gains on Re-Zoned Land

8. A provision has been drafted to introduce a new Capital Gains Tax (CGT) rate of 80% for windfall gains relating to the disposal of rezoned development land.

The provision will apply to disposals of land which have gained in value resulting from a rezoning decision, where the disposal and the rezoning occur after publication of the amendment. Existing banks of rezoned land sold at some future date will not, therefore, be covered.

The provision will not apply to compulsory purchase orders, normal building activity and sales of sites smaller than 1 acre where the value of the land is less than €500,000. An anti-avoidance mechanism is also included to ensure owners of land cannot sub-divide their land to avoid the rate.

Review of Valuation Panel

9. The relevant section of the Bill is being amended to restrict the circumstances in which the Minister can refer a valuation assessment back to the valuation panel to cases where the panel's valuation exceeds the market value and where he considers the panel's valuation to be too high.

Code of Practice on NAMA's dealings with Non-Participating Institutions

10. In response to concerns raised concerning the impact of NAMA on non-participating institutions, it is proposed to amend section 34 to require NAMA to produce a code of practice setting out how it will engage and interact with non-participating institutions. As with other codes under section 34, this code will be subject to Ministerial approval.

Common membership of Central Bank Board and Regulatory Authority

11. In advance of the Bill to provide comprehensively for the reform of the institutional structures for financial regulation, the Department has proposed amendments to the Central Bank Act 1942 to enable the membership of the board of the new unitary Central Bank of Ireland to be put in place using the structures in the current legislation. The Department and the Central Bank consider it is important that strategic decisions to be taken in the transition period concerning the new unitary Central Bank should be made by the persons who will be in place for the future. The proposed amendments to the Central Bank Act 1942 will enable the Minister to appoint the same persons to the Board of the Central Bank and to the Authority and will also permit the Minister to appoint the Governor of the Central Bank as Chair of the Authority. When the amendments are enacted, the Minister proposes to initiate a process to replace current appointed members of the Board and Authority with persons with substantial experience and recognised expertise in relevant specialist areas such as financial regulation, international finance, risk management and economics. These would be in addition to the Governor and the ex officio members of the Board (Secretary General Dept of Finance, Director General of the Central Bank and the new Chief Executive of the Financial Regulator.)

EU Commission Consultation

12. Consultations with the EU Commission are ongoing. A number of minor amendments are being proposed to meet the types of concerns raised by the Commission. These are (i) extending the application period for institutions from 30 days to 60 days; (ii) clarify that NAMA when it takes over a loan, it does not adversely affect the position of the financial institutions in sections 106 and 214. The code of practice in paragraph 10 above should also help to meet EU concerns.

13. Senior Department officials, the interim NAMA management and advisors met with EU officials recently. The Commission have sought further clarifications on the eligibility criteria for financial institutions, the powers of NAMA vis-à-vis other market participants (eg non-participating financial institutions) and the actual operation of the valuation methodology. We are advised that it is unlikely that further amendments to the Bill will be needed to meet Commission requirements. However, the possibility of them requesting amendments remains.

.64D

Tanaiste from Kevin Cardiff

Aide Memoire for Government on financial markets developments

Attached is an aide memoire for Government on the subject of financial markets developments.

It has been agreed with the Department of the Taoiseach that the item would arise under AOB at the Government meeting of 5 September.

The aide memoire provides a summary of the Central Bank and Financial Regulator view on recent developments and their expectations as regards the possible future trend of events. The basic message is reassuring in terms of impact of the financial markets developments on Ireland to date, but short term 'hits' in terms of further difficulty among internationally trading investment vehicles cannot be entirely ruled out, and there is a risk also that if market dislocation continues for much longer it could start to spill over into the real economy, for example through increases in lending rates.

Kevin Cardiff
4 September 2007

Cc Secretary General, Mr Steadman.

64D

5 September 2007

Oifig an Aire Airgeadis

Aide Memoire for the Government

Financial Markets Developments

1. Matter-Issue for Information

The Tánaiste submits this Aide Memoire to inform the Government of recent developments in the financial markets and their possible impact on Ireland

2. Background-Reason for Aide Memoire

There was considerable turbulence in the global financial market for credit during August, triggered by difficulties in the US subprime market, ie the US market providing mortgages to less creditworthy customers.

As interest rates increased in the US, customers for this category of lending were finding it increasingly difficult to meet their obligations, leading to a re-evaluation of the value of securities issued using mortgage obligations as collateral. As it was difficult for lenders and investors to identify easily which institutions were exposed to these assets, and similar assets in other parts of the world, a generalised shortage of credit materialised, leading to particular difficulties for banks and other institutions with a high reliance on shorter term wholesale credit. Central Banks, especially the ECB and the Federal Reserve, responded by injecting funds (liquidity injections) into the interbank market, which helped considerably in easing tensions, but was of less use to non-bank financial institutions.

The shortage of credit has led to difficulties in a number of firms around the world – examples are Barclays, Bear Stearns, Banque Nationale de Paris and certain German banks, including one – SachsenLB – which has had to be sold to stronger buyers.

It should be noted that much of this difficulty has arisen not because there is necessarily a deficiency in the asset quality of investments made by these institutions or their offshoots (although this may turn out to be the case in some instances) but because in an uncertain market, wholesale lenders have been unwilling to provide funds to them. As a result they have had to sell assets quickly or call on their sponsoring banks to provide funds (often on foot of pre-existing credit lines or guarantees) – in the Sachsen case, the German head office could not meet its obligations without assistance.

3. Special Purpose Vehicles

Certain Special Investment Vehicles (conduits) operating in or otherwise connected to Ireland (for example by having a company registration or stock exchange listing here) have been involved. The difficulties encountered by some of these individual conduits has drawn media attention to the regulation of such firms in Ireland, even though such firms are spread widely around the world – of around 50 such vehicles with German sponsoring banks, for example, only 7 are in Ireland.

64D

4. Irish Impacts

These developments have not seriously affected the Irish domestic financial system but obviously there would be concern about the potential for reputational damage to Ireland as a financial centre. The attached report summarises the Central Bank/Financial Regulator view on recent Irish developments and on the broader picture.

On the longer term economic situation, the report indicates that it is as yet too early to ascertain whether the global credit difficulties could begin to have an effect beyond the purely financial realm and result in damage to the real economy in the form of production and jobs. So far this has not happened to any significant extent, but there is a danger that ongoing uncertainty could impact on interest rates and credit availability.

On regulatory issues, the Financial Regulator is being proactive in protecting the reputational standing of the IFSC, both through regulatory action and considerable briefing of the media, but there are still risks.

5. Conclusions

Taking into account the assessment by the Bank and the Regulator in the attached report, and the Department of Finance's own examination, the following points can be made:

- So far the dislocation in global financial markets has had only a limited effect on the Irish domestic financial sector and the Irish economy.
- Our regulatory regime is well up to international standards and there is no question of the IFSC being any less regulated than the best regulated financial centres elsewhere
- ***Confidential:*** the Regulator is watching closely any firms which it believes may be under stress in current circumstances – while the number of such firms is small, it cannot be ruled out that one or more could run into some level of difficulty.
- Subprime lending is a very small segment of the overall Irish domestic market (whether such lending takes place at home or abroad). However, the Department of Finance has already been working on legislation to apply additional consumer protections to this sector (and to equity release lending), with a view to inclusion by way of amendment to an existing Bill
- The Department of Finance will continue to monitor the situation closely and the Tánaiste will make a further report to Government as appropriate.

40D (44)

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Tánaiste
Subject to your approval, it is intended to circulate the Aide Memoire by hand at next Tuesday's Government meeting, in advance of the publication of the Central Bank's Financial Stability Report on Wed. 14 Nov.
W Beausang
8/11/07

To:
Mr W Beausang – to see WB 8/11
Mr K Cardiff ✓
Tánaiste

13/11/07

Agreed by Minister
P Mooney

RE: Aide Memoire for the Government on Financial Market Developments

The attached Memorandum for the Information of the Government is;

1. to update the Government on recent developments in the financial markets, and
2. outline the key messages of the forthcoming Central Bank Financial Stability Report, which will be published on Wednesday 14 November.

The Memorandum includes an appended report of the Central Bank and Financial Services Authority of Ireland, which outlines the CBFSAI's assessment of current market developments. The report is based on discussions at a meeting of the Domestic Standing Group on Financial Stability on November 2 as well as more recent updates received from the CBFSAI.

The Memorandum outlines the key messages of the CBFSAI's Financial Stability Report. This report, which is an independent report of the Bank and is highly confidential until its publication at 11.00am on Wednesday 14 November, sets out the Bank's independent, comprehensive and authoritative assessment of the state of financial stability in Ireland. The Department understands that the Bank's overall assessment is that financial stability risks have increased since the publication of last year's report. However their expectation is that, notwithstanding the international financial market turbulence, the Irish banking system continues to be well placed to withstand adverse economic and sectoral developments in the short to medium term.

Michael Manley
Michael Manley
8 November 2007

cc: Secretary General, Mr. G Steadman

F9/24/08, part 1.

individual banks; and the fourth line of defence was the Central Bank, which retained responsibility for systemic financial stability. In the banking crisis which befell us here in Ireland, all of these defences failed for complex and interrelated reasons.

As well as setting up a completely new organisation, the Financial Regulator achieved much in developing its consumer protection mandate, in implementing very complex EU directives, as well as regulating insurance, credit unions and the many other areas under its supervision. However, it clearly failed in its duty to uphold the safety and soundness of Irish banks. As chairman of the authority, I accept responsibility for my part in that failure. It's something I regret deeply. Had I known then what I know now, things could have been very different. The authority and the executive of the Financial Regulator took their responsibilities very seriously. They were diligent, hard working and, at all times, acted in good faith. Contrarian opinions were encouraged. So why did things go so wrong? That is the question on which I'll try to shed some light, and to do so without in any way seeking to evade my responsibility. I'll outline a number of reasons that, in my view, led to the ultimate failure of banking regulation. I'll describe these briefly under two main headings - structure and practice.

Let me first deal with structure. The interim regulatory authority was set up in 2002 following a long debate which followed the McDowell report about how it might best be structured. The main issues were: one, which financial services should be brought into its remit; two, whether a new structure would be independent of, or be part of, the Central Bank; and, three, whether it should focus on consumer protection alone or be combined with prudential regulation. The impetus for an integrated and separate regulator to cover the whole of the financial services industry came from a number of sources. One, following the radical deregulation of financial services under Presidents Reagan and Bush in the US during the 1980s followed by the "Big Bang" deregulation of 1986 in the UK, financial services had become more deregulated, more complex and were converging across traditional sector boundaries, which, in Ireland, and for historical reasons, had been regulated by separate entities reporting to different Government Departments. No. 2, it was believed that banks and other financial services were mis-selling to their customers and that stronger emphasis need now to be placed on consumer protection. Three, the DIRT inquiry and a number of other matters in the 1990s had raised persistent questions as to how effective the Central Bank was in supervising the banks. So it was believed that a more independent structure with a substantial focus on consumer protection was required. However, there were strongly competing views as to how this should be done. Following a lengthy debate, the structure that resulted was a complicated compromise. The Irish Financial Services Regulatory Authority would have responsibility for both consumer protection and the supervision of individual financial services providers, including over 50 banking entities plus 30 EU banks operating on a "passport" basis into Ireland, two building societies, 180 insurance companies, 3,400 funds, 4,000 intermediaries, as well as re-insurance companies, stockbrokers and the Stock Exchange, bureaux de change, licensed moneylenders and 430 credit unions who were vocally opposed to the new regulatory arrangements. The organisation, with supervisory responsibility for over 8,000 different entities, had a lot on its plate. Of its approximately 350 staff, around 45 were initially allocated to banking supervision.

The authority reported to the Oireachtas through the Minister for Finance. It had a degree of independence, but, at the same time, operated within the overall framework of the Central Bank in what was to be known as the Central Bank and Financial Services Authority of Ireland, CBFSAI. The Central Bank and its Governor retained responsibility for financial stability and had powers to direct the authority in that regard; it remained the "competent authority" under EU directives; it was the sole point of contact with the ECB.

foreign and domestic banks had to be treated the same, a level playing field, in order to avoid giving substance to any impression that Ireland was host to an off-shore centre that was being treated more lightly than its domestic banks. Furthermore, sector limits are notoriously difficult to define and so were used more as guidelines than rules. And as banking supervision got closer to the full implementation of Basel II, it became less and less tenable to give any weight to sector limits, which were to be superseded by the Basel II approach. Nevertheless, and again in hindsight, while sector exposure was monitored by the executive, we paid insufficient attention to this indicator.

The regulator paid close attention to the Central Bank's stress tests, which were largely carried out in the banks themselves under supervision of the Central Bank. As presented to the authority, they indicated that even under their most pessimistic scenarios, for example, slowdown in economic growth, rise in unemployment, the banks were well capitalised and capable of withstanding any external threats. However, in hindsight they did not factor in, number one: the degree of reliance on international wholesale funding which, as events were to prove, was highly volatile - the banks were borrowing short to lend long; two, the risk of a calamitous collapse in property prices and the consequent impact on the banks' balance sheets; and, three, severe economic recession, which impaired the ability of borrowers to repay loans. The authority took great comfort from the results of these stress tests. Had they shown a risk to any bank's solvency, let alone to the banking system as a whole, the alarm bells would have been ringing loudly and action would surely have followed.

The annual financial stability report, as you have heard, was issued by the Central Bank in each of the years 2004 to 2007, inclusive. The report was prepared by a joint Central Bank-Financial Regulator committee under the chairmanship of the then director general of the Central Bank. The report was based on the Central Bank's economic analysis and most recent stress tests, plus input from staff in banking supervision. Even though the magnitude of the risk was not properly understood, there was often disagreement in this committee about how strong the report should be in identifying risks to the banking system. The report was finalised by the Governor and the board of the Central Bank. As the clouds gathered, there were concerns that a strongly worded financial stability report could have resulted in the unintended consequence of causing the very collapse the Financial Regulator and the Central Bank were seeking to avoid. However, the Governor had regular one-to-one meetings with the Minister and it was believed that he could be more direct in private than he could be in public.

The authority was also given a false sense of security by a series of external reports: number one, audit reports on the regulated banks, which did not raise any concerns about liquidity or solvency; number two, the 2006 IMF financial sector assessment programme report, which gave the banks and the Financial Regulator a glowing report; number three, the PwC 2007 report, which again concluded that the banks were in good health and able to weather any storm; and, number four, the IMF report of September 2007, which found that the banking system is "well capitalised, profitable and liquid, and non-performing loans are low". Again, the authority took great comfort from these reports. They seemed to confirm what the internal processes and reports were saying, that is, that the banks were well capitalised, and could withstand any downturn or external shocks.

To summarise this section on practice, the regulator was operating a system of principles-based regulation, which was internationally accepted as best practice at the time. It was also embedded in the Basel II accord, a regulatory system to which the Irish Government was committed and which called for dramatic increases in data gathering from the banks. Implementing

Deputy Kieran O'Donnell: So ... and what was the actual circumstances around it?

Mr. Brian Patterson: It was a consumer protection issue. It wasn't a prudential issue and it was a very high profile one at the time and there was great heat in the system between the Financial Regulator and this bank. And there was a meeting between myself and the chief executive, Liam O'Reilly, at the time – that'll give you a timeframe - and the chairman and chief executive of this bank and it was at this meeting that this incident happened.

Deputy Kieran O'Donnell: Can I ask you two final things? Looking back now in hindsight - and you made reference there, there was measures available to the bank - did you have much interaction as chair – you reported it to the Minister for Finance - did you have much interaction with the Ministers of the time, Charlie McCreevy and Brian Cowen, in your time?

Mr. Brian Patterson: I met ... with the chief executive I met the Minister probably around twice a year, largely, I think, almost totally at our request and the purpose of that was, less to kind of report to the Minister, in some sort of supervisory capacity; it was more to keep the Minister informed with, for example, EU developments, directives and so on. And also, a recurring theme at the time was to ask the Government to strengthen the legislation in relation to credit unions which we were worried about at the time, something, incidentally, the Government was reluctant to do.

Deputy Kieran O'Donnell: Did you have discussions with the Minister of the time in 2006, where you spoke about the compliance statements and you got a letter back in November 2006 that not to proceed? Did you go to the Minister and impress upon him the need for this to happen? And also there was obviously worries at the board level in terms of the state of the loans in the banks. Did you, as chair, meet with the Minister?

Mr. Brian Patterson: In all of my interaction with the Ministers, other than the credit union issue, which I mentioned, I don't recall us discussing in any depth any prudential issues.

Deputy Kieran O'Donnell: Why not?

Mr. Brian Patterson: Because again and I'll be very boring on this, at the time we didn't see what was coming down the track. It's as simple as that. We didn't see it.

Deputy Kieran O'Donnell: So, looking back now, what would you have done differently. You were there for five years, okay-----

Mr. Brian Patterson: Yes.

Deputy Kieran O'Donnell: -----and during that time, the balance sheets of the banks and property loans were growing at about 30% per annum, consistently across all the major banks, and clearly ... and you had the ECB saying at the time that loans should have gone up by, maybe, up to 4% per annum. So, looking back now, are you ... do you believe that the financial, we'll say, regularity authority failed in its role? And what would you have done differently?

Mr. Brian Patterson: Well, I've said, Chairman, very plainly in my statement that they did fail and I've accepted my responsibility for my part in that. What would I have done differently? In the first few years of the new Financial Regulator, there was a huge priority put on consumer protection. If you examine the agendas and the minutes of the authority, consumer protection loomed large.

Deputy Kieran O'Donnell: And yet, Mr. Patterson, there was no consumer interest on the

Mr. Brian Patterson: No, they were mostly public.

Chairman: Mostly public-----

Mr. Brian Patterson: Public sector, yes.

Chairman: All right. And given what you said earlier, it was inevitable that the appointment was going to come from the public sector most likely.

Mr. Brian Patterson: It wasn't inevitable, Chairman, but it was heavily slanted in that direction, yes-----

Chairman: But the ... okay but the .... traditionally that would have been the appointment-----

Mr. Brian Patterson: Yes-----

Chairman: -----so it would be consistent with that. Thank you. Deputy Doherty.

Deputy Pearse Doherty: Go raibh maith agat, a Chathaoirligh. Fáilte roimh an tUasal Patterson. I'm glad to see you're in good health before us today. Can I ask you just in terms of some of the dates? You retired from the board in April of 2008, is that correct? And you mentioned to us that you were in a ... you were ill for a period and I don't want to intrude in relation to that. But can you ... were you fulfilling the duties of chairperson up until April 2008 or were ... did your illness happen prior to that and impede in that ... in that position?

Mr. Brian Patterson: Sure, and I don't mind talking about this because it's all on the public record anyway.

Deputy Pearse Doherty: Okay.

Mr. Brian Patterson: I was diagnosed with cancer in October 2007. I had a major operation. I was expected to return to normal service in January but I developed secondaries and I had a year of chemotherapy, which included the dinner which was referred to. At the time, I put in place ... there was no legal ... legal deputy chair position. But I ensured when I was in hospital that my ... the man who eventually was my successor, Jim Farrell, that he chaired the authority meetings and was available to the executive at all time. And then when I had the second round of it, I put in place that system again. I went to the Minister in February of 2008 and said that I was not ... I didn't want to seek reappointment and he wasn't maybe going to reappointment me anyway, but I certainly didn't want to seek reappointment. So I put him on notice that as of April, he had to have a new chairman. Did I fulfil my duties? Not 100%. Absolutely, I was ... I was ... I wasn't firing on all cylinders. But I believe that I put in place arrangements to make sure that the authority was in good hands.

Deputy Pearse Doherty: Okay ... okay. In relation to your own experience and skills, did you have the necessary experience and skills to become the chairperson of the board from 2003 onwards?

Mr. Brian Patterson: I think there are ... there are two parts to this answer, Deputy, if I may. The first is that in relation to governance, organisation development, leadership, human resources, consumer stuff, yes, I had a lot of experience in those kind of areas. In relation to banking regulation and banking supervision, I had no experience. And when I was being asked to become the chairman, I pointed that out to the Minister. I was reassured at the time that consumer protection was going to be the majority of this job, and that prudential regulation was already in good hands through the executive and the Central Bank and that, therefore, I shouldn't worry too much about that.

Deputy Pearse Doherty: That's ... I appreciate that. And that's what happened at the time. You gave your reflections to the committee in relation to how a board should be constituted in terms of experience and skills based on hindsight, based on where you are today. Based on where you are today, looking at your own position, did you have the necessary experience and skills to fulfil the role that you were challenged and tasked with?

Mr. Brian Patterson: If I look back, it would have been far better that the chairman of the authority from its inception would have had either banking experience, or better still, banking regulatory experience. And I didn't so, therefore, the answer to your question is "No".

Deputy Pearse Doherty: Okay. You've mentioned, and, indeed, Deputy O'Donnell has mentioned it, but you've mentioned it in response to myself in terms of that ... that dinner they ... what's been dubbed as the ''bankers' last supper''. Can you just explain to me how that came about? Who made the phone call? Did somebody phone you and say, "We have an idea of bringing all the chief executives together to have dinner with you or-----

Mr. Brian Patterson: I had ... I had a phone call from the chief executive of the IBF and he said, "We're thinking about having a little dinner for you to mark your retirement." This was ... this was, as I say, months after I had retired. And that was how it started.

Deputy Pearse Doherty: So months after you retired but ... which is April, but before the guarantee which is September.

Mr. Brian Patterson: Correct, correct. It was around about, I don't know, probably around June or something like that, July.

Deputy Pearse Doherty: Did he ... did he mention that he was planning to invite the likes of David Drumm and Eugene Sheehy and Richie Boucher? Did he tell you that these-----

Mr. Brian Patterson: I don't think they were all there, incidentally but------

Deputy Pearse Doherty: No, I think some of them didn't turn up-----

Mr. Brian Patterson: Well, some of them maybe, but some of those names I don't think I've ever met some of those people.

Deputy Pearse Doherty: Okay.

Mr. Brian Patterson: He didn't, no, he didn't.

Deputy Pearse Doherty: Okay, did he suggest ...did you ask who would be there or?

Mr. Brian Patterson: No, I didn't, no, I didn't think at the time-----

Deputy Pearse Doherty: No, just turn up on the night-----

Mr. Brian Patterson: It was to be ... it was to be a small dinner and that was it, you know, I didn't see it was a big deal-----

Deputy Pearse Doherty: See who was there, okay. It's reported that you defended your ...

quickly, as CEO did you ever refuse a request for additional resources in the banking supervision department, in particular?

Mr. Liam O'Reilly: No.

Senator Marc MacSharry: Okay.

Mr. Liam O'Reilly: You know at this stage, I think from looking at earlier, there was a process, the process was that, at the end of the day, it was the ... the budget and remuneration committee that decided on ... on staff numbers. And my abiding memory of that was that there were times when we had not filled our complement and the board said, ''Well, how can we say you need any more when you haven't even got what you asked for in the first place?''

Senator Marc MacSharry: It was a difficulty getting the quality or the specifics-----

Mr. Liam O'Reilly: Exactly, exactly.

Senator Marc MacSharry: Very last question then. Yesterday we had some testimony from Mr. O'Connell, who, I know, was on the Central Bank side of the house and was the chief economist. But you served on the board of the authority for about six years, isn't that right? Three years?

Mr. Liam O'Reilly: Mr. O'Connell?

Senator Marc MacSharry: No, you did.

Mr. Liam O'Reilly: Oh, I did?

Senator Marc MacSharry: You did, yes. He mentioned to us how difficult he found it to-----

Mr. Liam O'Reilly: Sorry, the authority I served on it for ... 2003-----

Senator Marc MacSharry: Three years.

Mr. Liam O'Reilly: Three years.

Senator Marc MacSharry: Three years, sorry, yes. He was mentioning to us how difficult he found it to get his dissenting voice and points of view to the board level. He stated, that in his view, this was down to the political and property interests at the board. In your experience, at the board, did you feel there were political or property interests promoting an agenda, or suppressing another agenda?

Mr. Liam O'Reilly: Well, first of all, I'll say that if, if Mr. O'Connell was going up a line, he'd be going up to the Governor; that's the side of the building he was on. But I was a member of the Central Bank and Financial Services Authority of Ireland board, and I never saw a board member making any comments but those in the public interest.

Chairman: Thank you, Senator. Just in addition there to Senator MacSharry's question with regard to your request for additional staffing and resources, could I invite you, Mr. O'Reilly, to maybe comment upon the statement that Mr. Hurley gave that no request for staff was refused in a testimony here earlier and also to Mary Burke's statement that her department was under-resourced and request for additional staff were, were refused? Do you have any observation or comment you'd like to make on those two remarks?

Mr. Liam O'Reilly: Well, on the first one I ... I ... the Governor never refused staff. The way the matter operated was that staff requirements were set by the authority, and our budget was approved by the Minister. That's the way that worked. I never worked with Ms Burke at all so I can't make any comment on that.

Chairman: Okay, thank you. Right. Deputy Michael McGrath.

Deputy Michael McGrath: Thank you, Chair. You're very welcome, Mr. O'Reilly. Can I start by asking you, in relation to the banking crisis, and I suppose the fact it happened is the ultimate measure of the effectiveness of the use of supervisory powers, but, in your view, essentially what went wrong and who was responsible, given the fact that banking supervision from 2003 to 2008 failed to prevent an unprecedented systemic crisis? What do you believe are the essential factors that led to that crisis, and what went wrong?

Mr. Liam O'Reilly: I think, No. 1, the risks were not quantified properly and the financial stability reports and the IMF reports were all too sanguine even after my term in office - much too optimistic. So, I would say that that certainly didn't help in getting a sense of readiness or a feeling of danger around the place, okay. That's the first thing I'd say. The second thing I think I could say is that the system itself was not ... was not conducive to digging down into ... into detail enough. So the principles-based system didn't work. The Basel accord was not fitted in terms of what it required in terms of capital-----

Deputy Michael McGrath: Basel II is it?

Mr. Liam O'Reilly: Basel II.

Deputy Michael McGrath: Yes.

Mr. Liam O'Reilly: And even Basel I. The actual Basel system was not ... not fitted in terms of having enough capital available. And then on a personal level, I suppose, the ... and that might be to do with not having enough resources to dig down ... not recognising the extent of the exposures that were around at the time.

Deputy Michael McGrath: But can I put it to you, Mr. O'Reilly, that, you know, according to the evidence from Cyril Roux yesterday, principles-led regulation doesn't necessarily have to be non-intrusive, that it doesn't have to be light-touch, as such. Could principles-led regulation have been implemented better by the authority during the years in question?

Mr. Liam O'Reilly: If ... if on the condition ... it really is a question of definitions etc, what's principles-based and what's rules-based, but, basically, you have to have principles, you have to have rules. I think it's the way you implement it, and the dependence that you place on the internal auditors and the external auditors of institutions, the risk committees of institutions. No longer can you trust those, and if you have to do the job then, the resources is the issue and, certainly, the way we had set up our system we didn't have enough resources. If we had had enough resources and, and applied ... I think whether it's principles-based or not, it's more about intrusive, aggressive, or, if you like, depending on boards too much. So, I think, principles-based plus intrusive, aggressive plus resources, I would agree-----

Deputy Michael McGrath: But is it the case that principles-led regulation could have been done differently, that it could have been more aggressive, it could have been more intrusive?

Mr. Liam O'Reilly: If it had the resources to do it. That, that-----

F09/145/10/003

(9)

Report of DSG meeting of 8 February 2007

Present:

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

1. Update on the financial market environment and situation of Irish banks.

Please see attached CBFSAI assessment as prepared for the Tánaiste for use at Government meetings.

2. Follow-up to scoping paper – overview of resolution issues

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

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

3. Next Steps for Review of Deposit Guarantee Scheme

Key discussion points:

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

4. Action Points

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

CBFSAI assessment of financial market developments
8 February 2008

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

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

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

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

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

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

Other developments

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

SIGNED by:

Kevin Cardiff

Second Secretary

DEPARTMENT OF FINANCE

Date 3/7/07

SIGNED by:

Liam Barron

Director General

CENTRAL BANK AND FINANCIAL SERVICES AUTHORITY OF IRELAND

Date 2/7/2007

SIGNED by:

Patrick Neary

Chief Executive

IRISH FINANCIAL SERVICES REGULATORY AUTHORITY

Date 2 July 2007

F009/105/14/003

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1. Mr Beausang (to see)
2. Secretary General
3. Tánaiste

Note for the information of the Tánaiste for Government meeting 22 April 2008 re financial market developments

Please find attached briefing note outlining recent financial market developments based on the CBFSAI's assessment of market developments at a meeting of the Domestic Standing Group on Financial Stability on 17 April 2007.

The key points reported in the note are:

- In the US negative sentiment towards the Irish economy has increased, impacting the Irish banks' ability to access their required medium-to longer-term funding.
- The US has been an important source of funding for the Irish banks as they have found it difficult to access funding in Europe.
- In response to the increased difficulty in accessing long term funding, the banks are reducing their rate of increase in lending, concentrating on facilitating existing customers.
- The Irish banks are solvent, well capitalised, and their loan books remain strong, but notwithstanding the robust health of the sector, liquidity issues could lead to problems in the broader economy through the impact of a shortage of credit.
- The CBFSAI suggest that Government communication should continue to focus on the fundamental strengths of the Irish economy, as well as its adjustment capacity, and emphasis any actions being undertaken to deal with perceived difficulties in the economy.
- Interest rates on the interbank market have been increasing and are now at the same level as last October, at 0.747% above the ECB base rate.
- The CBFSAI's initial view is that a plan such as the Bank of England move to exchange mortgage-backed-securities for Government bonds to help banks access funding would not seem to address the key issue for all the Irish banks – the ability to access funds on an unsecured basis from the market.
- The Irish banks continue to have adequate collateral to access ECB funding, but the CBFSAI are concerned that extensive recourse to ECB funding could be perceived as a negative signal in the market place

Conclusion

The situation in international markets remains volatile. Negative sentiment towards Irish banks is growing, despite their strong loan book. The banks are working to ensure that they access their funding requirements from the market, and are reducing the level of liquidity required by reducing lending. They are also maximising their eligible collateral should recourse to the ECB be required. **The CBFSAI and industry are continuing to highlight the strength of the Irish banking sector and the quality of the financial regulatory system. Governmental and Ministerial comment on the fundamental strengths of the Irish economy will continue to be important.**

Michael Manley
21 April 2008

Note for the information of the Tánaiste for Government meeting 22 April 2008 re financial market developments

Interbank market

The spread between the ECB base interest rate (4%) and the 3-month interbank rate continues to increase. On Friday 18 April the 3-month interbank rate was 4.794%. This is significantly above what would have been considered normal levels before the market turmoil, and it has been steadily increasing since February.

Irish banks

Funding

In the US in the last few weeks there has been a very negative shift in sentiment towards the Irish economy. This shift reflects continuing negative international perceptions of the Irish economy and property market. The IMF World Economic Outlook reported that Irish property was considerably overpriced to an extent of 30%, and this, as well as other coverage of the Irish property market in the international media including the New York Times, has affected US investors' willingness to invest in Irish banks. The US market had become an increasingly important source of liquidity for the Irish banks, as liquidity in Europe has not been easily accessible for the Irish banks during the current market turmoil. Before the current difficulties Irish banks would have been able to access funding in the US in the form of an extendible note with a maturity date of at least 13 months and up to 3 years. Following this shift in sentiment, the maturity date has been reduced to 6 months. As well as the reduced maturity of funding, the level of funding has also reduced. While there are no Irish banks in funding difficulties at the moment this reduction in the level and maturity of funding is likely to have a significant impact on the Irish banks. There are no clear signs of alternative sources of funding available.

At an interbank level the banks are discussing methods to assist each other such as sharing surplus liquidity and maintaining lines of funding with each other. However, none of the banks are prepared to jeopardise their own operations and any sign that they were acting inconsistently with their own interests would be noted by the market. However, the banks do recognise that in the current climate serious difficulties in one bank would have significant impacts on all Irish banks.

All the banks are also concentrating on maximising their eligible collateral for recourse to the ECB if required. However, relying on the ECB for funding could be perceived as a sign of stress in the current climate, and the banks remain committed to continuing to access their required liquidity through market channels if at all possible. Currently Ireland accounts for approximately 8% of the borrowing from the ECB, of which 2% is by domestic Irish banks. This is not evenly spread between all the banks.

Lending

In response to their worsening funding position, the Irish banks are changing their strategies. They are reducing the rate of increase of lending and basing their level of lending on their deposit growth only. In February 2008 the monthly increase in mortgage lending was €712million, the lowest monthly increase in 5 years. The banks are concentrating on facilitating their current customers. This "retrenchment" movement by the banks will reduce the level of credit available in the economy. This is likely to exacerbate the current situation and if it continues long term and spills over

Ref F513/33/09

12 October 2009

Secret

Memorandum for the Government
Financial institutions restructuring post-NAMA

Decision Sought

1. The Minister for Finance:-

- Requests the Government's approval for the proposed changes in the Building Society Acts set out in this Memorandum for inclusion as Committee Stage amendments in the NAMA Bill in order to allow the State to provide capital to building societies participating in NAMA if this was necessary to safeguard financial stability.
- Requests the Government to note the current position in relation to the prospect for a merger of the two building societies Irish Nationwide Building Society and the Educational Building Society which is believed to be important to maintain financial stability and provide an initial step in the consolidation of the financial sector post-NAMA.

Context

2. The NAMA legislation is proceeding through the Oireachtas and, as detailed previously, it will have a significant impact on the participating financial institutions once the assets concerned pass to NAMA

3. In relation to the mutual building societies (EBS and INBS) there will be a need for new capital. In the case of mutuals, because of their structure, they are not in a position to raise capital as companies do through shareholders and the State would be the source of new capital if the building societies are to avoid failure and a call on the Government Guarantee.

4. In particular, INBS is likely to be the most affected with about €8bn of its loan book out of a total loan book of €10.5bn moving to NAMA. This will leave it with a loan book of about €2.5bn only and dependent on its residential mortgage book with little prospect of being able to grow or to raise capital in the longer term. There are also concerns about the quality of the remaining INBS loan book and further impairments will no doubt emerge. It is estimated that the INBS would face a capital shortfall of about €1bn to meet its solvency ratios on transfer of assets to NAMA in the absence of re-structuring.

5. In the case of EBS they need to raise additional capital to survive. EBS will transfer €1bn to NAMA and it is estimated it will have a capital shortfall of about €300m. Even if capital is injected, they will be a small organisation in the future with little ability to grow.

6. Besides the covered institutions it is also clear that the UK sponsored institutions are looking to exit the market (Ulster and Bank of Scotland Ireland).

- In relation to Anglo it has been decided in consultation with NAMA to accelerate the transfer of all its remaining NAMA loans to NAMA by end October to bring certainty to its capital requirements.

Impacts on financial institutions

Allied Irish bank

4. [redacted] To date AIB has raised capital of €2.5bn from the sale of its Polish operation and it is expected to raise approximately €1bn. From the sale of its interest in the US bank M&T. AIB had proposed to raise the balance of €3.9bn from other minor sales, the market and from Government.

5 To bring greater certainty in relation to future capital requirements NAMA has further reviewed the quality of loans yet to transfer from AIB. To date AIB has transferred €6.02bn of loan assets to NAMA at an aggregate discount of 45%. The NAMA discount to be applied to the remaining €13.5bn tranche of AIB loans to transfer to NAMA has been calculated at 60% – significantly higher than estimated in calculating the Financial Regulator's (PCAR) in March last. [redacted]

6 The Minister proposes to announce that this capital requirement will be met through an open offer of AIB shares, similar to the RBS open offer in the UK, to the value of €Xbn. which will be underwritten by the National Pensions Reserve Fund Commission (NPRFC). This underwriting will be paid for through a combination of cash and conversion of some of the Government's preference shares.

7 Meeting the AIB capital requirement will not require additional funding to be provided by the taxpayer outside of the NPRF investment and conversion of the preference shares.

8 As a consequence of the Government underwriting and conversion of preference shares, the State will acquire a substantial majority shareholding in AIB. A considerable amount of detailed work is yet required on the precise structure of the underwriting by the NPRF, but it will be undertaken in such as way that the Bank will retain its market listing. The high level of State support being provided to AIB is absolutely necessary to sustain it given the central role that AIB plays in the Irish economy and in the Irish financial system.

9 In the coming weeks the Minister proposes to work closely with the Board of the Bank on behalf of the Government to ensure that AIB successfully overcomes its current challenges and develops a renewed strategic focus on the Irish market following the divestiture of its overseas operations. An orderly renewal of the board and senior management will be undertaken when the State takes control of the bank..

[redacted] Oireachtas-L

16. While the market focus will be on the higher stress number the Minister does not intend to capitalise the bank to that level since it is a significant stress case scenario and to do so would risk overcapitalising the bank.

17. The extra capital to both Anglo Irish Bank and INBS will be provided through an increase in the existing Promissory Note which will spread the cash injections over 10 to 14 years although this will have implications for our General Government Debt and Deficit measures (see below).

Subordinated Debt and Senior Bonds

18. The issue of the position of bond holders in Anglo Irish bank has been raised on a number of occasions. The Attorney General has advised that senior bond holders rank *parri passu* with deposit holder under existing law and must be treated equally. The NTMA and other advisors are very strong in their view that while some senior bonds will be unguaranteed (about €4bn) after the end of the Guarantee in September that to coerce these bondholders would be extremely detrimental to raising of finance by both the State and the Banks. The Minister is strongly of the view that in relation to senior bonds there should be no default or coercion of bondholders given the very stressed funding position of financial institutions and the State.

19. In relation to subordinated debt this is divided between dated subordinated debt (€1.7bn) and perpetual debt (€.7bn). Of this subordinated debt €.37bn is preference shares which the State already owns. This leaves dated sub debt of €2bn outstanding and which will be unguaranteed after Sept 29. The Minister is of the view that every effort should be made to ensure that the dated subordinated debt holders constribute to the resolution costs for Anglo Irish. The Attorney General, is working on reorganisation and resolution legislation specific to Anglo Irish Bank and INBS which will address the issue of the priority of this debt as against the investment by the taxpayer which is securing the continuation of this institutions. The legislation would be consistent with the requirements for the measures to be recognised as a re-organisation under the relevant EU Directive in other EU Member States. However, the issue is complex. The Minister intends to reference this matter in his Statement. The bank and NTMA has also devised a proposal for a buyback of this debt at a very significant discount price. Any legislation on this issue it will be confined to Anglo Irish bank and INBS because of its unique position in relation to the amount of capital provided by the State. If it was not confined there could be adverse implication for other institutions and risk further market turbulence.

FS20/02/09

Ref No. 9 Márta 2010

Oifig an Aire Airgeadais

Memorandum for Government
Draft text of the Central Bank Reform Bill 2010

Decision Sought

1. The Minister for Finance requests the approval of the Government:
   (a) for the draft text of a Bill to reform the institutional structures for financial regulation in Ireland set out in Appendix 1; and
   (b) to present the Bill to Dáil Éireann, to circulate it to Deputies and to provide for additional changes of a technical or typographical nature and, if necessary, those changes specifically mentioned in paragraphs 23 to 25 below prior to presentation.

2. As noted by Government at its meeting on 9 February 2010, proposals for another Bill to enhance the regulatory powers and functions of the restructured Bank, consistent with best practice in the EU and internationally, will be brought to Government after the completion of the first Bill. A final Bill – to consolidate all of the legislation relating to the Central Bank and financial regulatory arrangements – will be brought forward as soon as is feasible thereafter.

3. There has been close consultation with the Department of Enterprise, Trade and Employment, the Office of the Attorney General and the Central Bank and Financial Services Authority of Ireland (CBFSAI) throughout the drafting of the attached Bill. A formal consultation process as required by EU law has been initiated with the European Central Bank (ECB). It is anticipated that the formal opinion of the ECB will be available to the Oireachtas during its consideration of the Bill. Advance copies of this memorandum have been circulated to the Taoiseach, the Tánaiste and Minister for Enterprise, Trade and Employment, the Minister for Health and Children, the Minister for Environment, Heritage and Local Government and the Attorney General.

Departure from approved Heads

4. In all major respects, the Bill as drafted reflects the Heads as approved by Government on 9 February. There are a number of differences, mainly of a technical nature, and the details of these are set out in paragraphs 11 to 14 below.

Background and summary of proposals

5. At its meeting on 9 February 2010, the Government approved the drafting of the text of a Bill to reform the institutional structures for financial regulation in Ireland and to provide for a number of other matters the details of which are summarised at paragraph 6(x) below (Government decision ref. S180/20/10/1296 of 9 February 2010 refers). The approval followed an earlier Government decision of 16 June 2009 which set out the key elements of the

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Government's reform programme in respect of the institutional structures for financial regulation in Ireland.

6. The main proposals contained in the draft Bill are as follows:

(i) The CBFSAI will be reformed as the Central Bank of Ireland (the Bank).

(ii) The Irish Financial Services Regulatory Authority (IFSRA), which is a constituent part of the CBFSAI, will be dissolved, the posts of Chief Executive of the Regulatory Authority and Consumer Director will be abolished. Two new posts – Head of Financial Regulation and Head of Central Banking – will be provided for. The Registrar of Credit Unions will continue and will be appointed by the Commission.

(iii) The Bank will be a single fully-integrated structure with a unitary Board, "the Central Bank Commission", which will be chaired by the Governor.

(iv) The Bank will be responsible for the stability of the financial system overall, for prudential regulation of financial institutions and for the protection of consumer interests. The Governor will remain solely responsible for European System of Central Banks (ESCB) related functions.

(v) The Bank's current statutory function of promoting the development within the State of the financial services industry is being removed.

(vi) The Bank will have power to impose levies for the purpose of funding the regulation of financial service providers.

(vii) New enhanced accountability and oversight mechanisms will include:

a) A specific focus of the Commission to be on regulatory performance, including development of performance benchmarks.

b) Annual Performance Statements on regulatory performance prepared by the Bank, presented to the Minister for Finance and laid before the Houses of the Oireachtas. (Note that this will be in addition to the Bank's Strategy Statement which is to be prepared at least every three years and its Annual Report and Accounts).

c) Regular international peer reviews of regulatory performance with the report of same forming part of the Performance Statement for the relevant year.

d) A committee of the Oireachtas may call the Governor and/or the Heads of Functions to be examined on the Performance Statement.

(viii) The Consumer and Industry Panels will be replaced with new arrangements to advise the Bank on the exercise of its statutory functions - including on consumer matters. The current statutory monitoring role of the Consumer Panel will be removed.

(ix) Responsibility for consumer information and education in respect of financial services will transfer to the National Consumer Agency (NCA) along with associated staff. The NCA will have power to impose levies on financial service providers for the purpose of funding the functions assigned to it under the Bill. The Bank or a body prescribed by the Minister for Finance, including the Pensions Board, the Financial Services Ombudsman and the NCA, may collect the various industry levies as an agent of the others in order to maximise efficiency and minimise the administrative burden on the industry.

(x) The Heads provide for the amendment of section 35 of the Credit Union Act 1997 to allow credit unions greater flexibility in re-scheduling loans in arrears subject to appropriate liquidity provision and accounting transparency. Provision is also being made for the Bank to regulate appointments within financial service providers to help ensure the fitness and probity of key office-holders. Section 59 of the Insurance Act 1989 will be amended to enable the Bank to appoint employees of the Bank or other suitably qualified persons to be authorised officers for the purposes of the Insurance Acts to give the Bank flexibility in its approach to ensuring compliance with insurance regulations.

7. The reform measures provided for in the Bill are consistent with the relevant provisions of the Renewed Programme for Government.

Proposed approach to implementation

8. Subject to Government approval as requested above, it is proposed to present the Bill to the Houses of the Oireachtas on 24 March with the intention of having the Bill read at second stage in Dáil Éireann in the week beginning 29 March 2010. Within this tight timeframe, it is proposed that a short consultation process with representative of all relevant stakeholders will commence immediately following publication. The Minister intends that the Bill will be enacted as soon as possible after the Easter recess.

Purpose behind the structural reform

9. The main purpose of the proposed new structure to be put in place, through the combined effect of the two Bills mentioned in paragraph 2, is to ensure that the domestic regulatory framework for financial services meets Government objectives for the maintenance of the stability of the financial system as well as effective and efficient supervision of the financial institutions and markets and to safeguard the interests of consumers and investors.

10. The aims of these measures are:

(i) to underpin confidence,

(ii) to have more responsible and transparent management and lending policies in financial institutions, consistent with their long-term sustainability,

(iii) to support the availability of appropriate credit to businesses and individuals, and

(iv) to ensure a more focused and proactive financial services sector that acts in the interests of customers and the economy as well as shareholders.

Issues where the text of the Bill differs from the approved Heads

11. There are a number of mainly technical issues that the Minister wishes to bring to the Government's attention. These relate to the areas where the text of the Bill differs from the approved Heads as set out below.

Title of the Bill

12. The Minister proposes to accept the view of the [redacted] There can only be one Bill with a given title in any one year, and the change in the name of the Bill now will leave open the possibility that the Consolidation Bill mentioned in paragraph 2 above, if initiated this year, can be entitled the Central Bank of Ireland Bill. However, it should be noted that the CBFSAI's preference is for a more neutral title such as the Central Bank Restructuring Bill. Notwithstanding this, the Minister is recommending to Government that the word *reform* should appear in the title. The use of the word *reform* conveys more accurately the purpose of the Bill as well as an appropriate sense of change.

Peer reviews of regulatory performance

13. The approved Heads proposed that the an international peer review of the regulatory performance of the Bank would be carried out every two years with the resulting report forming part of a proposed Regulatory Performance Statement which is to be produced on an annual basis. In the course of the drafting of the Bill, there have been further discussions with the Bank on this matter. Arising from those discussions, the Minister now proposes that the peer review process should cover the entire regulatory system within the institution every four years rather than biennially. The revision of the timeframe within which the reviews are to be carried out has regard to the volume of reviews to which the institution will be subjected under arrangements separate from the Bill. These include proposed reviews by new European Supervisory Authorities and reviews under the IMF's Financial Sector Assessment Programme. There is also a cost dimension associated with the overall peer review arrangements both in financial terms and in terms of potential disruption to the regulatory work of the organisation and this has been taken into account also.

Independent oversight mechanisms

14. When the Heads were submitted to Government for approval, it was indicated in the accompanying memorandum that the issue of an audit committee to provide independent oversight of risk management and internal controls and processes which would report to an Oireachtas Committee would be further examined in the drafting of the text of the Bill. Under the ESCB Statute, the Bank is required to operate an internal audit function. This function already provides an oversight mechanism in respect of risk management and internal controls and processes. The Bill as drafted requires the Bank to report on the internal audit function in the annual Regulatory Performance Statement. As noted in paragraph 6(vii)(d) above, a committee of the Oireachtas may call the Governor and/or the Heads of Functions to be examined on the Performance

Statement. The combination of the measures outlined will deliver the required level of independent oversight of risk management and internal controls and processes in the institution.

Matters of note

15. The Minister asks the Government to note a number of issues as set out in paragraphs 16 to 25 below.

Central Bank's responsibility for the promotion of financial services

16. As indicated in paragraph 6(v) above, the Bank's responsibility for the promotion of the development of financial services in the State under section 5A(1)(b) of the Central Bank Act is being removed. This change was sought by the Governor of the Bank on the basis that the provision gave rise to a confusion of roles and led to problems in the past. The Minister supports the Governor's view for the following reasons:

a) It is necessary that the new Central Bank structures should have a single focus on financial regulation and core central banking functions;

b) Subsidiary functions to promote the financial services industry do not belong within these new structures;

c) Publishing a Central Bank Reform Bill without removing the anomalous statutory obligation on the Bank to promote the development of financial services would diminish the impact of the message being sent out both domestically and overseas;

d) The removal of the obligation now is in tune with the direction of change in these matters in other EU countries – in particular Germany;

e) There is plenty of time to address the question of robust alternative arrangements for promoting the development of financial services in the State between now and the coming into force of the legislation; and

f) Eliminating the Central Bank's role in promoting financial services now can be aligned with the announcement of a central figure to promote the IFSC.

Fitness and probity provisions in the Bill

17. The Bill as drafted includes provisions in sections 19 to 41 to enable the Bank to regulate appointments within financial service providers to help ensure the fitness and probity of key office-holders. These are important provisions which were signalled when the draft Heads were submitted to Government on 9 February. The key elements of the provisions include:

- Enabling the Bank to prescribe functions which are to be "controlled functions" and to suspend persons performing such functions pending an investigation into whether they should be prohibited from performing such functions on the basis that they are not a fit and proper person to perform them;
- Suspension of a person for a maximum period of 3 months where the Head of Financial Regulation, or his nominee, is of the opinion that there is sufficient reason to suspect that a person is not a fit and proper person;

- Powers for the Bank to prohibit a person from carrying out controlled functions with the Order being contingent on, among other things, the Governor of the Bank, or his nominee, forming a reasonable opinion that the person is not a fit and proper person;
- Powers for the Bank to apply to the High Court for an order prohibiting a person from performing a controlled function in the event that a direction by the bank is not complied with;
- Enabling the Bank to prescribe a subset of controlled functions which allow the person concerned to exercise a significant influence on the conduct of a regulated financial service provider. In respect of these functions, the prior approval of the Bank is required before persons are appointed to perform them; and
- Enabling the Bank to issue standards of fitness and probity in respect of controlled functions and prohibiting regulated financial service providers from permitting people who do not satisfy these standards from performing controlled functions.

It should be noted that, as per the approved Heads, credit unions are being excluded from the ambit of the fitness and probity provisions. The reason for this is that a strategic review of credit unions is to be carried out and the Minister considers that it would be appropriate to await the outcome of that review before extending the ambit of the provisions.

Amendment of section 35 of the Credit Union Act

18. The Bill provides for the amendment of section 35 of the Credit Union Act 1997 to allow credit unions greater flexibility in re-scheduling loans in arrears subject to appropriate liquidity provision and accounting transparency. While it has not been possible to achieve an all-round consensus on this proposal, it has the support of the Registrar of Credit Unions and of the Irish League of Credit Unions (ILCU), which represents 90% of credit unions overall. The Registrar of Credit Unions is concerned that credit unions are attempting to lend beyond their capacity to do so and has recommended that a 20% liquidity requirement for all credit unions be introduced as a counter balance to increasing the percentage of the loan book which may apply to loans over 5 years from 20% to 30%. The Registrar has stated that he will work constructively with any credit union having difficulty meeting this target. The Credit Union Development Association (CUDA) is opposed to this requirement and to certain other aspects of the changes being made. The Minister will discuss these matters with CUDA representatives after publication of the Bill.

19. It is proposed to include a full review of section 35 as part of the Strategic Review of the Credit Union Sector in Ireland which has been initiated by the Financial Regulator at the Minister's request.

Annual Regulatory Performance Statement

20. The Bill includes provisions which requires the Bank to prepare an annual Regulatory Performance Statement in respect of regulatory performance which must be submitted to the Minister and laid before the Houses of the Oireachtas. Within this general arrangement it is proposed that the

performance of the Registrar of Credit Unions will be presented as a distinct element in the Performance Statement.

Superannuation arrangements for staff transferring to the NCA

21. It will be necessary in the period following enactment of the Bill to make appropriate arrangements in connection with the transfer of superannuation entitlements of staff being transferred from the Bank to the NCA. The Minister will revert to Government on this matter, most likely later in the year in the context of the second Central Bank Reform Bill.

Collection of levies

22. The Bill (Schedule 1, Part 1, Item 73) includes a provision that the Bank may collect levies from regulated financial services providers on behalf of itself and other agencies such as the Pensions Board, the Financial Services Ombudsman and the NCA. The Department of Enterprise, Trade and Employment is concerned that the provision is not strong enough as it does not oblige the Bank to carry out this function. However, the Minister considers that it would not be appropriate to place such an obligation on the bank and requests the Government's approval for the arrangements as set out in the Bill.

Possible inclusion of amendment to the NAMA Act in the Bill

23. The Minister asks the Government to note that it may be necessary to include an amendment to the NAMA Act in the Bill subject to further consultation with the Office of the Attorney General. If necessary, an appropriate provision to do this will be included in the text of the Bill before publication. The details are as set out in the following paragraph.

24. Arising from consultations with the European Commission regarding the NAMA process, certain adjustments to the powers of NAMA to be made at the earliest opportunity have been committed to. These include a restriction to the power provided in the NAMA Act for the passing of information to the Agency by the Revenue Commissioners regarding certain people, as provided for in section 204(3) of the NAMA Act. The concern is that such a power would provide NAMA with an unwarranted commercial advantage over potential competitors since the Revenue Commissioners would not normally provide information about a person or company to a commercial agency. NAMA have confirmed that the power to obtain information from Revenue is not essential to the overall performance of the Agency and would have been applied only on a restricted basis.

Transfer of intellectual property

25. The transfer of intellectual property relating to the "itsyourmoney" domain will form part of the arrangements whereby consumer information and education functions are being relocated from the Bank to the NCA. The question of whether it is necessary to provide for the transfer in a specific legislative provision is currently being examined in conjunction with the Office of the Attorney General. The Minister asks the Government to note that he proposes to make provision for this in the text of the Bill if it proves to be necessary to do so.

Consultations

Consultation with the European Central Bank

26. On the 22 February 2010, the Minister initiated a formal consultation process with the ECB as required by EU law. The Heads of the Bill as approved by Government were provided to the ECB and it is the Minister's intention that the text of the Bill, if and when approved by Government, will also be provided to the ECB as part of the consultation process. The intention is that this opinion will be available for consideration by the Oireachtas during the passage of the Bill through Dáil and Seanad Éireann. The ECB will publish its opinion. It is clear from its previous opinions that the core ECB requirements in relation to the changes now proposed are likely to include:

(i) Clear protection of the independent discharge of the Governor and Central Bank's ESCB obligations;
(ii) Organisational structure (funding, staffing, etc) that underwrites the Central Bank's independence;
(iii) Effective contribution of Central Banking functions to prudential supervision; and
(iv) Consolidation of Central Bank legislation.

It is considered that each of these elements will be catered for in the proposed arrangements.

Consultations with the Department of the Taoiseach, the Department of Enterprise, Trade and Employment, the Office of the Attorney General and the CBFSAI

27. Consultations on the proposals contained in the draft Bill were held with the Department of the Taoiseach, the Department of Enterprise, Trade and Employment, the Office of the Attorney General and the CBFSAI. The question of [redacted]

28. With the exception of the question of the exchange of information between the restructured Bank and the NCA to enable both organisations to carry out their statutory functions, each of the main issues raised by the Department of Enterprise, Trade and Employment has been addressed as far as possible in the draft Bill. In the limited time available, it has not been possible to resolve the exchange of information issue. In the circumstances, the Minister proposes that his Department will continue to work to resolve the issue with the Department of Enterprise, Trade and Employment and the Bank with a view to bringing forward a legislative solution at Committee Stage.

29. There has been close consultation between the Office of the Attorney General and the Department of Finance in the drafting of the Bill. The Minister wishes to acknowledge the considerable assistance provided by the former to draft the text of the Bill within a very tight timeframe. It is proposed that the cooperation between his Department and the Attorney General's Office will continue during the passage of the Bill through the Oireachtas.

30. Detailed consultations have taken place with representatives of the CBFSAI. All issues of significance raised by the Bank have been addressed in the drafting of the Bill.

Impacts

31. The financial crisis has affected confidence in the structures of financial regulation in Ireland and change is required. The proposed amendment to the regulatory framework, of which the proposals in the attached Bill form part, will have benefits in terms of restoring and underpinning confidence in Ireland. The new regulatory regime will benefit economic growth and employment by facilitating the continued development of the financial services sector and the financial stability of the State.

32. The costs of the current regulatory structures are shared on a 50/50 basis between the CBFSAI and the financial services industry. In the context of the reform proposed, further consideration of the funding model will be required.

33. While there will be costs for the Central Bank of Ireland (e.g. arising from the fitness and probity provisions in the Bill), it is important that these are minimised where possible.

Regulatory Impact Assessment

34. Most of the changes and enhancements in financial regulatory functions will be provided for in the second Bill. An appropriate Regulatory Impact Assessment will be undertaken as part of the arrangements for the second Bill mentioned in paragraph 2 above.

Costs to the Exchequer

35. The proposals will not give rise to extra costs to the Exchequer.

Costs to Industry

36. The proposals in the attached draft Heads will not, of themselves, add significantly to the cost burden on the financial services industry.