TUARASCÁIL ón gComhchoiste Fiosrúcháin i dtaobh na Géarchéime Baincéireachta

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

REPORT of the Joint Committee of Inquiry into the Banking Crisis

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

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

NTMA: Core Book 44

January 2016

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THEME: C3

Appropriateness and effectiveness of the Department of Finance actions during crisis

LINE OF INQUIRY: C3b

Appropriateness of the bank guarantee decision

From: Brendan McDonagh <BMcDonagh@ntma.ie>
Sent: 28 September 2008 14:54
To: Beausang, William
Subject: FW:

From: john.loughlin@ie.pwc.com [mailto:john.loughlin@ie.pwc.com]
Sent: 28 September 2008 13:55
To: Brendan McDonagh
Cc: denis.g.oconnor@ie.pwc.com; aidan.walsh@ie.pwc.com
Subject:

Brian,

As requested, there follows a summary of the scenarios for the 3 banks discussed this morning.

Anglo

. for the week ending 3 October management's best estimate shows a small cash balance at the end of
the week of E84m. However, because of the assumption that interbank deposits of E1.5b will not
rollover on 30 September there is a negative cash balance of E128m on 30 September

. if the Irish CMBS is not completed on 30 September the negative cash balance increases to E2.2b on
that day

. the estimate assumes that theE1.5b of interbank deposits will again be available on 1 October. If this
assumption is correct, but the CMBS is not completed, then the shorfall at the end of the week is about
E2b. If the interbank deposits cannot be reniewed the shortfall at the end of the week is about E3.5b.
Please note that management believe that these can be reniewed, consistent with recent experience.
However, as you know the markets are extremely volatile at the moment and it is difficult to predict
whether the funding will be available

. under management's "worst case" scenarion the shortfall increases to E2,449m on 3 October. If the
CMBS is not completed this increases to E4.6 billion. To avoid this the withdrawal of deposits needs to
cease, assuming that the interbank and capital markets remain effectively closed for the immediate
future

. by Friday 24 October the shortfall increases to E4.9 billion and to E9.8b in the "worst case" scenario.
If the Irish CMBS is not complete by the end of October these numbers increase to E7b and E11.9b

. the "worst case" scenarios include substantial cash outflows, in excess of experience in the past week

INBS

. closing cash on 27 September was E3b

. management's estimate shows a reduction to about E2b at the end of October

. the key assumption is the level of deposit withdrawal. If this increased from E25m to E50m per day in
ROI there would be further withdrawals of about E700m, reducing headroom at the end of October to
about E1.3b.

. if the current level of deposit withdrawal continues in November and December there may be
insufficient funds to finance 2 EMTN payments totalling E630m

. it would be advisable to have a contingency plan for E1b in December to allow for the EMTN
payment and some headroom on deposit withdrawal

ILP

. there was cash of about E2b on Friday 27 September

. This was higher than expected because an estimated level of corporate deposit withdrawals of E1.5b
did not materialise

. management have prepared a very worst case scenario assuming no corporate deposits roll. This
indicates a shortfall of E81m on Monday 29 September rising to E1.2b by Friday 3 October. The
shortfall reaches its peak on Thursday 9 October when it reaches E2.1b

. historically about 80% of corporate deposits have been renewed. Reducing this to 50% in light of
current market conditions would increase available cash on Friday 3 October by E1.2b i.e just about
covering the deficit on that day. The deficit on the previous days would also be covered, by about
E780m on 29 September, the best of the days, and by about E100m on Thursday 2 October, the best of
the days prior to 3 October. The 50% of deposits not renewing assumption has been applied to the
E1.5b rolled on Friday 25 September since I understand that this is 24 hour money and so 50% is
assumed not to renew on Monday.

. based on the 50% assumption there will be a shortfall of about E200m on Monday 6 October, rising to
E500 to E600m by 9 October, just prior to a E1.8b increase in available ECB collateral

. assuming the ECB collateral increases by E1.8b on 10 October, and corporate deposits are renewed at
a rate of 50%, there is headroom after this date. This will be increased if the proposed Residential

Mortgage securitisation of E2b can be completed on 10 November. Futher securitisations are possible in December

. I stress that the 50% is an assumption that we have made for illustrative purposes and we need to get maangement's working assumptions when we see them tomorrow. We will update our report for this

Summary

. in the week commencing 29 September it would be advisable to have contingency plans in place to finance Anglo's E2.1b CMBS if this the paperwork is not completed on time. It would also be advisable to have a further E1.5b to E2b available if Anglo is unable to raise E1.5b in the interbank market on Wednesday, to cover the estimated shortfall of E128m on Tuesday, and if corporate and retail deposit withdrawals are more than estimated

. it would also be advisable to have contingency plans in place for ILP, since the assumption of 50% non renewal of corporate deposits leaves the cash position very tight by Friday. Perhaps E500m to E1b. Even if this is not required in the week commencing 29 September there is a higher possibility it would be required the following week, unless the deposit outflow stops

. longer term Anglo's deficit increases to E4.9b by 24 October and is likely to increase further thereafter, unless the outflow of deposits stops. In a "worst case" scenario the deficit increases to E9.8b by 24 October. If deposit withdrawals continue the numbers get progressively worse thereafter

. it would be advisable to have a contingency plan for INBS for December of up to E1b. However, if the deposit outflow stops or reduces in this period this may not be necessary

I am providing these comments at your request but please note that our work is not complete and our final comments will be contained in our final reports in accordance with our engagement letters. Also we have not had an opportunity to discuss the comments with management of the 3 institutions. In partcular the assumptions for ILP will need to be changed when we receive management's working estimate. This may improve or disimprove the situation. Finally, as we all know the markets are extremely volatile at the moment and it is impossible to accurately the actual level of deposit withdrawals. The numbers above are simply estmates to faciliate contingency pland to be drawn up.

Please feel free to call me on 086 3210050 if you have any questions.

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

William,

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

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

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

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

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

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

Regards

Brendan

From: Brendan McDonagh <BMcDonagh@ntma.ie>
Sent: 20 September 2008 21:55
To: Beausang, William
Subject: Re: Tomorrow Sunday

William

Ok, inbs seems okish per gs, its crucial gs get a look at anglo. Cb are optimistic, I hope they are right.

I hope you, michael and karen understood our comments on draft bill and exclusions.

Regards

Brendan

-----Original Message-----
From: Beausang, William <William.Beausang@finance.gov.ie>
To: Brendan McDonagh
Sent: Sat Sep 20 21:42:45 2008
Subject: RE: Tomorrow Sunday

Brendan,

[redacted]

Kevin C has already had a read from GS via Con Horan. Message is apparently that loan book is "better than expected". Suggests if a similar read emerges from GS for Anglo that this heading in particular direction [redacted]

CB have strong view that there is more time in hand now following Friday's inflows and today's guartantee statement. You wd have seen language in it which bank were v keen on to imply support for wholesale lenders. KC or I will cover tomorrow's briefing and let you know what the initial GS view is.

regards

From: Brendan McDonagh <BMcDonagh@ntma.ie>
Sent: 20 September 2008 20:12
To: Cardiff, Kevin; Beausang, William
Subject: Fw: Update

Fyi

-----Original Message-----
From: Geoghegan, Basil <Basil.Geoghegan@gs.com>
To: Brendan McDonagh
CC: John Corrigan
Sent: Sat Sep 20 20:04:22 2008
Subject: Re: Update

We are now involved on Anglo and will meet David Drumm on Monday. Separately we will meet FR tmrw at 4 to go thru due diligence to date and options for funding (commercial and gov't sector) for INBS.
Basil

----- Original Message -----
From: Brendan McDonagh <BMcDonagh@ntma.ie>
To: Geoghegan, Basil
Cc: John Corrigan <JCorrigan@ntma.ie>
Sent: Sat Sep 20 11:37:45 2008
Subject: Update

Basil,

Any progress with FR re Anglo? Are there any other issues that we can assist you with?

Regards

Brendan McDonagh

Director Finance, Technology & Risk

National Treasury Management Agency

Treasury Building

Grand Canal Street

Dublin 2, Ireland

From: Beausang, William
Sent: 26 September 2008 13:26
To: 'Brendan McDonagh'
Cc: 'Oliver Whelan'; Cardiff, Kevin
Subject: URGENT Query from SG

Brendan

We met with the SG this morning and he is raised the following issue for us to follow-up with the NTMA.

He said he want an analysis from the NTMA to crystallise the issues that might be expected to arise for our sovereign rating in the event that the State provides a guarantee for all the deposits / credits of the domestic banking system or would have to provide substantial funding (e.g. ML analysis suggests this could run up to €100bn?) for institutions taken into the protection regime and for the banking system more generally (e.g. ILP / EBS on assumption that AIB and BOI can meet their own needs).

There appears to be two views on when the system wide guarantee option might arise:-

1. As a last resort following-on to a public intervention (with liquidity support) and 'soft' guarantee (i.e. Minister confirms intention to provide guarantee if required) which did not resolve the situation and the other big banks banks were under very significant stress. In this case you could clearly make the case for a "serious economic disturbance" and forbearance under State aid rules

2. As part of a resolution package with funding being provided for all banks in need of it (from the CBFSAI / NTMA 'war-chest') you would provide a system-wide guarantee. This is likely to be more problematic from a State aid perspective as the case for either "serious economic disturbance" and rescue aid would be a good deal less clear-cut.

A funding issue of the scale indicated above could presumably arise under any of the scenarios we are looking at.

It would be useful, therefore, to have your views taking into account the different scenarios that might arise (as outlined above) and any others that may occur to you.

thanks

Lonergan, Ciara

13

From: Beausang, William
Sent: 26 September 2008 14:48
To: Doyle, David
Cc: Cardiff, Kevin; Manley, Michael
Subject: FW: URGENT Query from SG

-----Original Message-----
From: Brendan McDonagh [mailto:BMcDonagh@ntma.ie]
Sent: 26 September 2008 14:22
To: Beausang, William
Cc: Oliver Whelan; Cardiff, Kevin; Michael J Somers
Subject: Re: URGENT Query from SG

William

This is very difficult to answer as the potential real exposure to the Exchequer of wriiteoffs is not yet independently quantified.

The rating agencies will be taken aback at the scale of the state involvement in any ean up operation and the speed of it occurring. Clearly the length of the workout ill be an important factor in their assesment of Ireland's credit rating also. We expect to be put immediately on negative watch and probably soon after be downgraded, how many notches from AAA we just don't know.

Combining the takeon of banks Balance sheets of Anglo and Inbs of 110bn and guaranteeing the others of over 420 bn with a deteriorating budget deficit will lead at least in our estimation, an increase in the cost of funding of perhaps at least 1 percent in funding costs. If the state is funding a 50bn national debt and a 110 nationalised bank then a 1 percent increase in funding costs would cost cost a 1.6 bn extra pa

For your information Greece with a single A rating is trading at 76 pa over germany and Ireland is at 44 in 10 year area. We expect to pay a lot more than Greece due to the scale relative to our GNP as the market will be unforgiving about our problems.

The credit rating agencies have pointed out the housing issue and its impact on the banks as a key concern which would negatively impact our credit ratings.

I hope this answers the query.

gards

Brendan

-----Original Message-----
From: Beausang, William <William.Beausang@finance.gov.ie>
To: Brendan McDonagh
CC: Oliver Whelan; Cardiff, Kevin <Kevin.Cardiff@finance.gov.ie>
Sent: Fri Sep 26 13:26:19 2008
Subject: URGENT Query from SG

Brendan

We met with the SG this morning and he is raised the following issue for us to follow-up with the NTMA.

He said he want an analysis from the NTMA to crystallise the issues that might be expected to arise for our sovereign rating in the event that the State provides a guarantee for all the deposits / credits of the domestic banking system or would have to provide substantial funding (e.g. ML analysis suggests this could run up to €100bn?) for institutions taken into the protection regime and for the banking system more generally (e.g. ILP / EBS on assumption that AIB and BOI can meet their own needs).

There appears to be two views on when the system wide guarantee option might arise:-

1. As a last resort following-on to a public intervention (with liquidity support) and 'soft' guarantee (i.e. Minister confirms intention to provide guarantee if required) which did not resolve the situation and the other big banks banks were under very significant stress. In this case you could clearly make the case for a "serious economic disturbance" and forbearance under State aid rules

2. As part of a resolution package with funding being provided for all banks in need of it (from the CBFSAI / NTMA 'war-chest') you would provide a system-wide guarantee. This is likely to be more problematic from a State aid perspective as the case for either "serious economic disturbance" and rescue aid would be a good deal less clear-cut.

A funding issue of the scale indicated above could presumably arise under any of the scenarios we are looking at.

It would be useful, therefore, to have your views taking into account the different scenarios that might arise (as outlined above) and any others that may occur to you.

thanks

Sunday 28th September

Memorandum from Merrill Lynch

1) Introduction

The Department of Finance and NTMA have been working with the Financial Regulator and the Central Bank of Ireland to establish the current liquidity and financial position of the Irish banking sector. They have appointed PwC accountants to investigate the liquidity position and asset quality of the loan books of Irish Nationwide Building Society ("Irish Nationwide"), Anglo Irish Bank ("Anglo") and Irish Life & Permanent. They engaged Merrill Lynch on 24 September to advise on the liquidity and strategic options available to the Government and Arthur Cox to advise on legal aspects. This is the initial report of Merrill Lynch based on information as at 6pm on Sunday 28th September.

The analysis has been undertaken in a short period of time and is based only on information from and conversations with the three institutions. The implications for the broader financial sector have also been considered as well as the impact on Ireland as a financial centre and as a sovereign issuer.

The markets on a global basis are witnessing unprecedented levels of volatility. In the past two weeks many major financial institutions have either filed for bankruptcy (Lehman, Wamu, Roskilde) or have had to be rescued by either the state (Fannie, Freddie, AIG) or acquired by a rival (HBOS, Alliance & Leicester). Libor levels have, in the past week, risen to highs since 1992 with banks choosing to hoard cash or deposit it with central banks. The Bank of England last Thursday was holding £6bn of bank deposits against a long term average of around £1bn. Much of the Commercial Paper market (circa 90%) is currently rolling overnight. The Irish financial sector is experiencing extreme difficulties with wholesale market access all but non existent. Even post the quarter end (30 September 2008) we feel this is unlikely to improve in the context of a worsening macro economic environment and a general backdrop of deteriorating asset quality.

While Irish banks have not had the same exposure as other banks to structured credit and US mortgage/real estate risks, their loan assets are concentrated in residential and commercial property where asset values have been falling and are expected to continue to fall as the international economy contracts. The liquidity issues facing Irish banks are compounded by investor concerns with regard to the high concentration of commercial property risk in their respective asset portfolios.

The three institutions where these liquidity issues have been most pronounced have been Irish Nationwide, Anglo Irish Bank and Irish Life & Permanent. AIB, Bank of Ireland and EBS, while experiencing reduced access to liquidity continue to have access to wholesale funding (for example with the ECB) and do not have such acute near-term liquidity issues based on the information provided to the Financial Regulator. EBS as a smaller institution is likely to be more vulnerable as time goes on.

It is important to stress that at present, liquidity concerns aside; all of the Irish banks are profitable and well capitalised. However, liquidity for some could run out in days rather than weeks. Anglo Irish has recently approached the Central Bank with a proposal to create a new funding facility that the Central Bank would accept commercial mortgage assets in return for cash. Anglo are rapidly approaching the point where they have exhausted all possible sources of liquidity available via the market or their ECB eligible collateral is close to being fully utilised..

This memo sets out the strategic options available to the Government. There is no right or wrong answer and the situation is very fluid with financial institutions experiencing difficulty and being supported by governments on a daily basis. Preserving flexibility is key and the solution may be different for each institution. The important issue is for the Government to preserve the stability of the Irish financial system overall and to safeguard the interests of individual bank customers to avoid widespread panic. That said, there is a limit on the financial resources available to the Government and there may be a need to preserve firepower as events unfold. The implications of each option in terms of whether it constitutes State Aid also needs to be carefully considered.

It is clear that certain lowly rated monoline banking models around the world, where there is concentration on a single asset class (such as commercial property) are likely to be unviable as wholesale markets stay closed to them. This has inevitably had an impact on our conclusions and we believe it is important to act quickly to deal with these institutions to avoid a systemic issue.

2) Summary description of the reviewed institutions

Further information is contained in Appendix A

Irish Nationwide Building Society

INBS is primarily a retail deposit funded, commercial property lender with a relatively small residential mortgage book of just over €2 billon. The asset quality of the commercial loan book is regarded as being generally good. Based on their own management projections, INBS have liquidity sufficient to meet their needs for around one to two months depending on the level of withdrawals. However there are concerns over the influence of the Chief Executive. In the extreme stress case analysis the total writeoffs including loss of interest income would just deplete most of INBS reserves of €1.8 billon.

Anglo Irish Bank

Anglo are a commercial property lender with loan assets of Eur 72bn. Only 3% of the loan book is currently regarded as impaired by Anglo management however falling property prices are likely to impact their book particularly where they have lent on speculative development. If one was to apply the INBS stress case scenario the writeoffs would by deplete ordinary shareholders and other lower category subordinated debt of €7.5 billon. The main issue for Anglo is a pressing need for liquidity as a result of a sustained outflow of corporate deposits and overnight funding being unavailable to banks of their credit rating. Based on current market conditions, management is projecting a funding deficit of €0.1bn on Tuesday 30th September growing to €4.9bn by 24th October. Anglo have formally requested a short term liquidity advance of €1.7bn from the Central Bank on Friday 26 September for the end of the month.

Irish Life and Permanent

IL&P is a bancassurer with a leading life insurance company and a retail bank focused on providing residential mortgages. The asset quality is good but IL&P rely heavily on wholesale funding and are approaching the limit of their eligible collateral at the ECB. Under a "worst case" scenario, where interbank cannot be rolled and corporate deposits are withdrawn upon maturity whilst retail deposits remain flat, Irish Life & Permanent would have a negative net cash position of €2.1bn by 9th October 2008.

3) Strategic options

The strategic objective is to address the immediate liquidity issues of the three institutions and allow the situation to unfold. Given current instability in financial markets this could happen quite quickly and there could be a need to implement a combination of the options below. All solutions require financial resources from the Government and could add pressure to the sovereign credit rating and the borrowing costs of the Irish Government.

Whilst we set out the various strategic options within this memo, we have also fully considered, and ultimately discounted, one additional outcome - allowing an Irish bank to fail and go into liquidation without any government intervention. Whilst this option would initially have no financial impact to the government, the resulting shock to the wider Irish banking system could, in our view, be very damaging. The ensuing 'firesale' of assets could precipitate dramatic asset deflation and hence force other Irish banks to take significant write downs on their own asset portfolios thus depleting their capital positions. The significant volatility in the equity and capital markets that would likely follow would mean access to any form of new capital for Irish banks would be severely restricted for a protracted period. Therefore, in order to minimise the impact of any bank failure on the rest of the broadly sound domestic financial institutions, we strongly advocate a more controlled interventionist approach.

(a) Immediate Liquidity Provision

The short-term liquidity issues for the banks need to be immediately addressed, most notably at Anglo which may have a net deficit as early as Tuesday 30 September. The wholesale markets are closed and the three banks have limited access to the ECB facility as self originated commercial property assets are not accepted as collateral and Irish Life & Permanent is reaching the limit of its available eligible collateral. If the ECB were to change this stance and accept a broader type of collateral then arguably there would be no need for the Central Bank to offer any additional liquidity.

If that is not the case, the Central Bank should be prepared to provide auxiliary overnight liquidity facilities at **<u>a penal interest rate</u>** to the banks that request it. There is then the question of whether this becomes known to the market. We believe it could be sensible to let it be known that the Central Bank has been asked to provide additional liquidity to certain financial institutions so that debt and equity investors do not criticise the Government if/when further State intervention needs to take place, in particular if equity is acquired in the institutions for zero value. Taking the worst case scenarios of each bank we estimate there could be an immediate funding requirement of €5bn.

(b) State protective custody

The additional liquidity provided would allow Anglo and Irish Nationwide to offset any continuing deposit outflows with liquid assets. However, even if markets stabilise both institutions are likely to find it hard to fund themselves independently and the penal interest rate if they use the Special Liquidity Scheme (outlined below) will deteriorate their earnings. For that reason and to avoid systemic risk, the Government should make preparations for State intervention in either or both institutions, once it becomes evident to the market that they need to intervene. This could occur over a very short period of time i.e. within days, but at the point at which it occurs it will not be a surprise to debt or equity investors as knowledge of the institution's financial position will be obvious and they should expect such intervention in the absence of a private sector solution. At Anglo the majority of equity and debt investors are Irish, UK and US institutional holders, but there are significant retail interests including a major shareholding by Sean Quinn.

Irish Nationwide and Anglo either together or separately could be taken into State custody using either (i) common equity and/or (ii) a preferred plus warrants investment akin to the one used in the Freddie Mac and Fannie Mae situation.

A State guarantee would be given to all depositors and senior creditors as well as dated subordinated debt holders (given the crossover between these two holders) which would again send a strong implicit message to the investor community that this level of protection would be afforded to all other Irish banks. The business would be run off with no new loans extended and it would be logical to use this entity for the base for the "Bad bank" in Option (d) below. Equity holders and undated junior subordinated debt holders would receive nothing providing a capital cushion of €1.4 billion in the case of Irish Nationwide and €7.5 bn in the case of Anglo. It is important that all other creditors are reimbursed to avoid a contagion effect with the other Irish banks that continue to raise capital in the senior and subordinated debt markets.

The investment by State can be in the form of preferred instrument and/or common equity. In either case the Government will own and control the bank and its decision making. The advantage of the preferred investment is that it establishes a clear priority ranking for the government's investment over shareholders, the existing preferred investors, and undated subordinated debt holders. The preferred effectively leaves the shares outstanding, would still require the government to hold public shareholder meetings as well as file regular statements. This may be considered impractical. If the Government were to take over the equity in its entirety there would be no need to report on an ongoing basis and hold any AGMs.

A common equity investment effectively either dilutes or completely removes the existing shareholders and places the government's investment pari passu with the existing common shareholders and below any preferred investment; therefore, it provides the potential for any upside at the expense of the existing common holders who either are heavily diluted or completely removed. This equity investment does not necessarily need to be the funding instrument. As the common ownership does make the State a direct shareholder (and likely the majority or sole shareholder) in the bank and thus responsible for the corporate governance, it can have the bank issue a subordinated instrument that effectively has clear priority ranking to any existing preferred investors and undated subordinated debt instruments. This will provide the government with downside protection as well as current yield. This form of common equity investment is effectively taking over the company and providing funding in consideration. The Fannie and Freddie investments by the US Government is similar in nature and combined the two instruments (see description in appendix C) with a preferred investment coupled with warrants in order to maximise the benefits of the two instruments. It is likely situation specific in terms of what the appropriate form of the investment should be. The State should have flexibility to pursue either or both.

(c) Secured Lending Scheme ("SLS")

In conjunction with the State protective custody option, it is also recommended that the Government introduce a secured lending scheme which would accept both commercial property and non ECB eligible tradable securities as collateral to be either exchanged for government bonds or cash. This would be based on the following terms:

Available:	All Irish Building Societies and Banks listed on the Irish Stock Exchange. Available only once ECB eligible collateral is exhausted by an individual financial institution.
Tenure:	Liquidity provided for any term up to 9 months
Assets eligible:	Irish, UK Commercial loans secured with a first legal charge and certain securities tradable on a recognised exchange
Advance Rate:	No more than 60% of outstanding loan balance for commercial loans / no more than 75% of the lesser of last observable trade / currently marked price of the tradable securities
Size:	€20bn
Cost:	Minimum cost will be Euribor +[150]bps
Disclosure:	System announced but no publication of individual usage to market

<u>Advantages</u>

- Converts non ECB-eligible collateral into immediate liquidity

- The existence of a public announcement of an additional liquidity facility benefits whole financial system and is positive for Ireland
- May assist Irish Life & Permanent's, EBS, AIB, BOI [or INBS] short-term liquidity issues post any action on protective custody of Anglo [and INBS].

Disadvantages

- Of itself does not deal with longer-term funding issues associated with lowly rated monoline businesses whose model is unlikely to be sustainable long-term
- Irish Government could end up funding over €100bn albeit at a highly attractive rate for an unknown period
- Money supply from the Irish Central Bank must be co-ordinated with ECB operations for injecting liquidity

The SLS scheme is recommended because it would offer immediate liquidity and stabilise the sector. The option to subsequently own or separate assets out of the banks into State ownership or to stronger banks will be preserved, and can be done with full market support.

The announcement of the creation of this SLS facility should be made public to the market in order to maximise the impact it could have of promoting confidence that all Irish financial institutions have access to an additional liquidity facility provided by the State for its own institutions. All banks should be coerced to publicly support the SLS facility as a strong indicator of State support for the Irish banking system and no one institution should confirm or deny its use of SLS. However, SLS will only be considered positive for the market if the individual financial institution usage is not made public. Any institution seen or rumoured to be relying on this SLS liquidity facility will likely suffer a dramatic loss of confidence by the wholesale market and result in significant outflows of deposits and will be unable to refinance its short term debt if it is perceived as a substitute or as sign of an inability to obtain longer term funding.

It is an interim solution until either the market settles or a suitor in some cases is found to acquire or stablilise the individual institution. In any event the identity of any individual institution using SLS could become known in a small country and the move into Emergency Lending Access (ELA) could happen sooner than expected.

The Central Bank of Ireland's Emergency Lending Access already performs the role of providing liquidity of **last resort** in a way that would become known to the market due to the fortnightly reporting requirement of the Central Bank. A Bank in ELA in reality is close to the end of its existence because the market will not longer regard it as suitable credit risk to provide funding to.

The SLS would require new legislation which is currently being drafted and should be available before the end of the week. In the meantime the Central Bank is working on auxiliary measures which would allow the primary regulated Irish banks to post security backed by commercial property assets in return for cash or securities at a penal interest rate. This could be announced if needed to stablise concerns about the remaining Irish banks immediate liquidity.

(d) Good banks / Bad banks

If the financial situation worsens there is the possibility of allowing other banks to contribute their bad commercial property loans to the State Banks(s) to allow a State-controlled orderly unwind of property holdings and limit asset deflation. This would also help restore investor confidence in the now ‘cleansed’ banks and enable them to continue in business.

The structuring of this option would be the most complex and time consuming. Considerations such as third party management required, upside/downside for tax payers, purchase price of the assets and the impact that would have on marks for other bank portfolios would have to be carefully thought through. This system was used in Scandinavia in the early 1990’s but only as the second phase of the state rescue of the banks. It is also difficult to predict how long the work out of the assets would take but recent Bank of Ireland published projections show a three to five year period is required to recover 80% – 90% of book value.

(e) Consolidation of financial institutions

Irish Life & Permanent has a good business franchise with a leading life insurance company and a residential mortgage book similar to Bank of Ireland and AIB, which is not experiencing significant arrears. It may be that they can come through the crisis unscathed. However if this looks unlikely, at the same time as providing short-term liquidity facilities, the other large banks can be approached to be ready to acquire and integrate the Irish Life & Permanent business in a private sector transaction. Similarly EBS could be easily acquired and absorbed by an entity with a larger balance sheet. Depending on the acquirer, the competition issues may need to be addressed by the State as they were on the Lloyds TSB / HBOS transaction in the UK.

(f) Guarantee for six Primary Regulated Banks

The alternative to a SLS facility is to offer a complete State guarantee to all depositors and senior creditors of the six primary regulated financial institutions. This should stem outflows and encourage inflows of deposits. However, the scale of such a guarantee could be over €500bn. This would almost certainly negatively impact the State's sovereign credit rating and raise issues as to its credibility. The wider market will be aware that Ireland could not afford to cover the full amount if required. It might also be poorly perceived by other European states if they come under pressure to do the same as liquidity flows migrate. A coordinated response across Europe could make this option more viable. Comments in such regard have already been made by the several European governments.

4. Conclusion

The extension of a discreet emergency facility is important to stabilise Anglo [and INBS] and avoid immediate contagion risk. The market environment is highly uncertain with international developments adding to the pressure on Irish financial institutions. Even if the situation stabilises, the immediate outlook for monoline, single asset class, lenders is increasingly uncertain. In this context, it is important for the Government to be prepared to act quickly and decisively as required to step in and prevent a systemic problem.

Appendix A

1) Summary of capital, liquidity and asset position

<u>Irish Nationwide Building Society</u>

Description: Mortgage provider: 80% commercial, 20% residential

Overview of Loanbook:

- Total size: €11.8bn
  - European CRE: €1.1bn (9%)
  - UK CRE: €5.3bn (45%) LTV 77%
  - Irish CRE: €2.9bn (25%)
  - Irish residential: €2.4bn (21%) LTV 51%

- Land Bank exposure, few large loans (>€100m), loans to deposits ratio as at August 2008 of 187%, average maturity of loans is 2 years

- Irish residential:
  - No significant deterioration of book
  - 40% of loans with LTV >75%

- UK and EU CRE:
  - 47% development, 13% construction, 40% asset enhancement
  - 2005-2007 account for 84% of loans

- PwC and Merrill Lynch had a review with Irish Nationwide's CEO and CFO on the loan book. A sample of the top 60 CRE loans (~46% of total) was reviewed. The explanations from management regarding the Company addressed LTV of these loans as well as the quality of counterparty do not seem unreasonable. The short-dated nature of the loans as well as relying on the value uplift in the underlying property could pose risks if the real estate market continues to slide

Capital Position:

Tier 1 Capital:	€1,365m
Which includes:	
Undated junior	
Subordinated	*€0m*
Tier 2 Capital:	€476m
Which includes:	
Dated subordinated	*€314m*

Funding Profile:

- As of 27th September 2008, Irish Nationwide had a net cash position of €3bn
- Irish Nationwide was experiencing net outflows of circa €40m and €11m a day from Ireland deposits and Isle of Man deposits, respectively, in the early part of

last week. Outflows from Ireland deposits reduced to €25m / €20m by the end of last week

- On the basis of a scenario where outflows continue at the rate of €25m and €11m a day from Ireland deposits and IOM deposits, respectively, for the whole month of October, Irish Nationwide's net cash position at the end of October would be circa €2bn. This scenario is deemed to be a "stress" scenario by the management
- Assuming the "stress" scenario is prolonged for the month of November, the Company could have a net cash position of circa €1.3bn at the end of November. Starting December with only €1bn net cash position could prove challenging for the Company given the €630m EMTN redemption in the third week of December
- Management believes that outflows should reduce in the coming weeks
- The company has a €750m ECB repo-able Promissory Note pool (circa €600m taking into account the 20% required haircut) of which about €500m has been borrowed already – circa €100m capacity left
- The company estimates that it has another €600m residential mortgages pool that could be securitised and repo-ed with the ECB at a 16% discount. The company estimates that it would take about two to three months to put in place such programme
- The company has no securitisation programme in place for its €9.5bn commercial real estate portfolio

<u>Anglo Irish Bank</u>

Description: Monoline lender, commercial property assets

Overview of Loanbook:

- Total size: €72bn (as of August 2008)
  - Ireland: €43.2bn (60%)
  - UK: €17.9bn (25%)
  - North America: €9.1bn (13%)
  - Wealth Management: €2.7bn (4%)
  - Other €0.9bn [intercompany lending to Wealth Management]

- Total loans neither impaired nor past due: 97.0%
- Approximately 82% of loan book is CRE, 1% residential and about 17% other corporate loans
- Ireland – top 20 represent 26.5%; ~€13bn (30%) related to land and development loans; 2.9% of loans are on watch list
- UK – top 20 represent 45.9%
- North America – top 20 represent 32.0%
- UK, US and Wealth Management watch list total 2.13%
- Anglo has €9.4bn of available for sale financial assets:

	FV Mar-08	%
Government securities	3.1	33.0%
CDs	0.8	8.5%
Bank bonds	3.6	38.3%
ABS	*0.2*	*2.1%*
RMBS	*1.1*	*11.7%*
CDO	*0.5*	*5.3%*
SIV	*0.1*	*1.1%*
Other listed securities	1.9	20.2%
	9.4	

Capital position

Tier 1 Capital: €7,113m
Which includes:
Preference shares *€370m*
Undated junior
Subordinated-: *€2,151m*

Tier 2 Capital: €2,642m
Which includes:
Undated subordinated *€424*
Dated subordinated *€2,136m*

Funding Profile:

As of 18 Sept, 2008 € in bn	18/09/08	Sept 2007
Corporate Deposits	26.1	29.9
Retail Deposits	16.9	15.4
Private Client	2.5	3.2
ST Debt Capital	5.3	6.9
LTDebt Capital	10.7	14.5
Inter Bank	8.1	5.0
Repos and Others	12.6	1.9
Secured Funding	1.4	1.4
	83.6	**78.2**

- Total deposits went down by €3bn between Sept 2007 and 18th Sept 2008. On 19th Sept, deposits declined by a further €1.1bn
- Repo financing with the ECB went up by €10.7bn over the past year. Assets eligible for ECB repo tenders will be almost fully utilised by 30th Sept 2008
- Based on current market conditions, management is projecting a funding deficit of €128m on Tuesday 30th September growing to €4.9bn by 24th October. This scenario is based on the following assumptions:
  - Wholesale capital markets remain closed and overnight is unavailable on the 30th Sept (but available the following days)
  - €2.1bn realisable of 30th September from recently closed CMBS
- In a "worst case" scenario of significant deposit withdrawals and unavailable overnight funding, Anglo would face a negative cash position of €2.45bn on 3rd October (€4.6bn if CMBS facility is executed)

- If overnight funding becomes available on 1st October but the CMBS is not completed than the shortfall at the end of the week is €2bn (€3.5bn if overnight funding remains unavailable)
- Management have indicated that approximately €30bn (out of the total loan book of €71.9bn) may be suitable for securitisation / collateral.

Irish Life & Permanent

Description: banc assurance – residential mortgage provider mainly

Note that the information on IL&P has not been properly reconciled at this stage with IL&P management

Overview of Loanbook:

Loans and Receivables	30 June 08 (€m)	31 Dec 2007 (€m)
Residential Mortgage loans	36,456	34,817
Commercial Mortgage Loans	2,002	1,861
Finance Leases	1,843	1,666
Term loans/ other	638	601
Money Market funds	148	159
Loans and receivables to JV		90
Net Loans and receivables to Customers	**41,005**	**39,120**

- Residential mortgage loans made up circa 89% of gross loans and receivables to customers
  - Primarily made of first charge residential mortgages
  - 20% are UK loans mostly in the BTL market which are secured on 3 properties on average

Capital position

Tier 1 Capital (gross): €4,798m
Which includes:
Undated junior subordinated *€0m*

Tier 2 Capital: €1,487m
Which includes:
Undated subordinated *€455m*
Dated subordinated *€1,144m*

Funding Profile:

Funding Position at 18 September 2008: Interbank: €1.3bn; ST Market Reps: €2.3bn; ECB €12bn; USCP: €0.8bn; ECP: €0.9bn; X Notes: €0.3bn; French CD: €0.6bn;

Corporate Deposits: €6.3bn; Retail Deposits: €7.7bn; Securitisation: €3.1bn; Long-Term (>12 months): €10.9bn

Note that the numbers above and the statements below are all subject to reconciliation with management

- Corporate deposits had declined to €5.4bn as of 25th September 2008. There are €1.9bn of contractual maturities in September 2008 and €1.8bn in October 2008. The average duration of the overall corporate deposit book is estimated at 28 days
- Of the total corporate deposits, the largest accounts are Irish Life Assurance plc (€1.9bn), BGI (€0.5bn maturing on 29th September 2008) and ABP Investments (€250m maturing on 12th November 2008)
- Retail deposits have been relatively flat. Circa €2.5bn of these are in current and notice accounts which tend to be stable
- Under a "worst case" scenario, where interbank cannot be rolled and corporate deposits are withdrawn upon maturity whilst retail deposits remain flat, Irish Life & Permanent would have a negative net cash position of €89m on 29th September rising to €1.2bn by Friday 3rd October and €2.1bn by 9th October
- Note that management deems this scenario to be extreme as historically circa 80% of corporate deposits roll over upon maturity.
- Based on a 50% deposit outflow assumption, there will be a shortfall of about €200m on Monday 6th October, rising to €500m by 9th October just prior to a €1.8bn increase in collateral available for repo with the ECB

Source: Company data

Appendix B

2) Bank of England Special Liquidity Scheme ("SLS" Overview)

On 21st April 2008, the Bank of England (the "Bank") announced the SLS to enable banks and building societies to swap temporarily assets that are currently illiquid in exchange for UK Treasury bills.

Maturity:
The bills lent under the SLS are for an original maturity of 9 months and will have been created within the month preceding the drawdown. Bills must be delivered back to the Bank 10 days prior to their maturity and will be exchanged for a further 9-month Bill. Banks can renew, at the discretion of the Bank, these transactions for a total of up to 3 years.

The SLS was originally open for a period of 6 months (until October 2008) and was recently extended to January 2009.

Eligible Banks:
All of the banks and building societies that are eligible to sign up for the standing deposit and lending facilities within the Bank's Sterling Monetary Framework.

Eligible Securities:

- UK and EEA Covered bonds rated AAA. The underlying assets must be either residential mortgages (Buy-to-let loans to private residential landlords are eligible) or public sector debt

- AAA-rated tranches of UK and EEA Residential Mortgage-backed Securities (RMBS) backed by UK and EEA mortgages (the underlying asset must not be synthetic)

- AAA-rated tranches of UK, US and EEA Asset-backed Securities backed by credit cards (not synthetic)

- Debt issued by G10 sovereigns rated Aa3 or higher, excluding securities eligible in the Bank's normal Open Market Operations, subject to any settlement constraints

- Debt issued by G10 government agencies guaranteed by national governments, rated AAA

- Conventional debt by the US government Sponsored Enterprises (Freddie Mac, Fannie Mae and Federal Home Loans), rated AAA

Participating institutions may deliver securities held, or formed from assets held on the balance sheet of the participating entity. Subsidiaries' assets are also eligible provided that the subsidiary is owned by the participating legal entity (ownership is defined as holding of a majority of the voting rights is the subsidiary)

Securities, including covered bonds, formed in whole or in part from underlying commercial loans are not accepted by the Bank. Commercial loans include loans to SMEs, including those secured on land or commercial property.

Participants may deliver as collateral only eligible securities held on balance sheet as at 31 December 2007 and eligible securities formed from underlying loans, including sellers' claims on Master Trusts, held on balance sheet at that date. For RMBS issued via a Master Trust where the pool of assets includes mortgages originated after 31 December 2007, 100% of the level of such securities or underlying loans outstanding on balance sheet as at 31 December 2007 will be eligible in the first year of the SLS. In year 2 two-thirds of those securities will be eligible. In year 3, one-third of those securities will be eligible.

Securities, including covered bonds, formed in whole or in part from residential mortgages secured on properties not located in the UK or other EEA countries are not accepted by the Bank.

Securities may be denominated in Sterling, EUR, USD, AUD, CAD, SEK, CHF and JPY (for Japanese government bonds only).

All eligible securities must be rated by two or more of Fitch, Moody's and S&P

Eligible securities will be valued by the Bank using observed market prices that are independent and routinely publicly available.

Collateral substitutions are permitted throughout the life of the schemes

Pricing and haircut

The fee payable on borrowings of Bills is the spread (to be re-fixed every 3 months) between 3m Libor and 3m General Collateral gilt repo, as observed by the Bank, subject to a floor of 20bps. The fee may vary at the Bank's discretion.

Haircut (%)	OMO eligible and G10 Sovereign paper	G10 Government guaranteed agencies	US GSEs	RMBS, covered bonds and Credit Cards ABS
Credit rating (Moody's scale)	Aa3 or higher	AAA	AAA	AAA
All floating rate	1	3	3	12
Fixed rate, under 3 years of maturity	1	3	3	12
Fixed rate, 3-5 years to maturity	1.5	4	4	14
Fixed rated, 5-10 years to maturity	3	8	8	17
Fixed rate, 10- 30 years to maturity	5.5	14	14	22

3% will be added to haircuts to allow for currency risk when securities are non-Sterling

An additional 5% will be applied to own-name eligible covered bond, RMBS and credit card ABS

An additional 5% will be applied to securities for which no market price is observable

Appendix C Examples of Recent Assistance to the Financial sector

Fannie Mae and Freddie Mac

On September 7, 2008, Treasury announced that it had placed Fannie Mae and Freddie Mac in "conservatorship" resulting in significant implications across the companies' capital structures. Treasury's stated goals in appointing the Federal Housing Finance Agency (FHFA) as Conservator: *"…to preserve and conserve the Company's assets and property and to put the Company in a sound and solvent condition. The goals of the conservatorship are to help restore confidence in the Company, enhance its capacity to fulfil its mission, and mitigate the systemic risk that has contributed directly to the instability in the current markets".*

The assistance package consisted in:

1. **Capital injection:** Treasury entered into a Senior Preferred Stock Purchase Agreement with each GSE receiving up to $100 billion and indefinite in duration. In exchange for entering into these agreements, Treasury receives:
   - $1 billion of senior preferred stock in each GSE. The senior preferred stocks shall accrue a dividend of 10% per year, increasing to 12% if, in any quarter, the dividends are not paid in cash, until all accrued dividends have been paid in cash
   - Warrants representing 79.9% ownership in each GSE if exercised (at a nominal price).
     - Exercise price of one-thousandth of a U.S. cent ($ 0.00001) per share, and with a warrant duration of twenty years

2. **Credit Facility:** Treasury has agreed to create a back-stop short-term secured lending facility for each GSE available generally at LIBOR +50 bps
   - The facility will offer liquidity if needed until December 31, 2009
   - Loans expected to be less than 1 month but no shorter than 1 week

   "All loans will be collateralized and collateral is limited to mortgage-backed securities issued by Fannie Mae and Freddie Mac and advances made by the Federal Home Loan Banks."

3. **Support of the Agency MBS Market**: Treasury will set up an investment fund to purchase GSE mortgage-backed securities (MBS) in the open market. This move should assuage investor concerns about the functioning of the market, improve liquidity, and lower borrowing costs. The investment fund's goals:

   "By purchasing these guaranteed securities, Treasury seeks to broaden access to mortgage funding for current and prospective homeowners as well as to promote market stability.
   Treasury is committed to investing in Agency MBS with the size and timing subject to the discretion of the Treasury Secretary. The scale of the program will be based on developments in the capital markets and housing markets".

Implications by category of investors

Debt / MBS	Preferred Equity	Common Equity
■ enhanced ability of the GSEs to meet their obligations ■ Additional security and clarity to GSE debt holders – senior and subordinated ■ Ability to purchase GSE MBS in the open market should improve market liquidity and lower borrowing costs thereby providing additional confidence to investors in GSE MBS ■ Covenants prevent debt from being increased to more than 110% of its debt as of June 30, 2008	■ Preferred stock will continue to trade ■ No voting rights ■ Preferred dividends are suspended ■ Existing preferred shareholders will bear any losses ahead of the government and not already absorbed by common shareholders ■ Covenants prevent purchase or redemption of capital stock ■ Covenants prevent new capital issues	■ Common stock will continue to trade ■ No voting rights ■ No common dividends to existing shareholders ■ Existing common stock shareholders will bear any losses ahead of the government and preferred shareholders ■ Dilution due to issue of warrants ■ Negative impact on EPS available to common due to dividends on senior preferred ■ Covenants prevent purchase of redemption of capital stock ■ Covenants prevent new capital issues

AIG

On September 23rd, 2008, AIG announced that it had signed a definitive agreement with the Federal Reserve Bank of New York aimed at addressing the liquidity needs of AIG. AIG Chairman and CEO Edward Liddy said:" AIG made an exhaustive effort to address its liquidity needs through private sector financing, but was unable to do so in the current environment. This facility was the company's best alternative".

The agreement consisted in:

1. **2 year, $85bn revolving credit facility** provided by the Federal Reserve Bank of New York to provide a
   - Interest to accrue on 3m libor + 8.50%, initial commitment fee of 2% (payable at closing) and a commitment fee of 8.50% per annum on any undrawn amount
   - AIG is required to repay the facility from, among other things, the proceeds of certain asset sales and issuances of debt or equity securities. These mandatory repayments permanently reduce the amount available to be borrowed under the facility

2. **Convertible Participating Serial Preferred Stock** to be issued by AIG to a trust that will hold the Preferred Stock for the benefit of Treasury
   - The Preferred Stock will be entitled to participate in any dividend paid on the common stock, with the payments attributable to the Preferred Stock being approximately, but not in excess of 79.9% of the aggregate dividend paid
   - The Preferred Stock will vote with the common stock on all matters and will hold approximately, but not in excess of 79.9% of the aggregate voting power

- The Preferred Stock will be convertible into common stock following a special shareholders meeting to amend AIG's restated certificate of incorporation.

Implications by category of investors

Debt / MBS	Preferred Equity / Hybrid Capital	Common Equity
■ Enhanced ability of AIG to meet on-going obligations ■ Additional security and clarity to AIG debt holders – senior and subordinated ■ Incentive to reduce balance sheet through asset disposal	■ The fate of hybrid capital holders remains uncertain. Current secondary trading levels seem to indicate that AIG will suspend coupon payments on these securities	■ Common stock will continue to trade ■ Diluted voting rights ■ AIG suspended dividends on Common Stock on 23rd September ■ Existing common stock shareholders will bear any losses ahead of the government and preferred shareholders ■ Negative impact on EPS available to common due to dividends on senior preferred

Roskilde

On 24th August 2008, Roskilde Bank A/S (the "Bank") announced that a new bank (the "New Bank") established by the Nationalbanken and the Private Contingency Association for the Winding up of Ailing Banks, Savings Banks and Cooperative Banks ("Private Contingency Association") has offered to buy all assets and assume all debts and other liabilities of the Bank except hybrid core capital and subordinated loan capital.

The purpose of the New Bank is to carry out banking activities and other legally allowed activities with a view of ensuring the best possible financial return from the winding up of the operations taken over from the Bank.

The agreement consisted:

1. **A capital base contribution at a level of DKK4.5bn**
   - Interest payment on the capital injection was set at spread of 4.85% over the lending rate of the Nationalbanken (corresponding to a total coupon of 9.45% as of 22nd August, 2008)

Implications by category of investors

Debt / MBS	Preferred Equity	Common Equity
■ Enhanced ability of the New Bank to meet on-going obligations ■ Additional security and clarity to New Bank debt holders – senior ■ Suspension of coupon payments on subordinated debt which is by nature deferrable and loss absorbing in Denmark	■ N.A	■ Common stock of the Bank will continue to trade ■ No voting rights ■ Profits generated in connection with the termination of the ownership of the Nationalbanken (after payment of the interest on the capital base contribution) will be transferred to the Bank to be distributed to the subordinated and hybrid capital and equity holders

Northern Rock

Step 1:
The government (Treasury) stepped in to provide liquidity to Northern Rock whilst simultaneously announcing to the market this was in its role as "Lender of Last Resort". Northern Rock was fast approaching the point where they would not be able to meet their obligations as they became due.

This announcement prompted a run on retail deposits due to the then protection scheme in the UK providing cover of only the first £2,000 and 90% of the next £33,000 for each depositor. This run lead to the Chancellor subsequently announcing that all deposits and senior obligations of Northern Rock would be guaranteed for the full amount "during the current instability in the financial markets".

All wholesale funding was suspended and allowed to roll off but new retail deposits were taken in with a full govt guarantee.

No public data was given on the emergency facility that preceded the SLS. The funding rate on the facility was 'punitive' but again not disclosed.

Step 2:

When all commercial exit strategies were ruled out, Northern Rock was taken into 'Temporary Public Ownership' with a view to a future re-float or orderly run down.

All common stock and non innovative preference shares that had voting rights were wiped out with an independent body set up to assess the compensation levels that would be due to investors.

All other non voting Tier 1, UT2 and LT2 securities continue to pay coupons.

The Government loan continues to pay down but they have announced the intention to convert up to £3bn of the loan into new common equity to ensure the bank is 'adequately capitalised'.

Debt / MBS	**Preferred Equity / Hybrid Capital**	**Common Equity**
■ enhanced ability of the Bank to meet on-going obligations ■ Additional security and clarity to the Bank's debt holders – senior, subordinated, Upper Tier 2 and non voting hybrid Tier 1	■ Only preference shares with voting rights were cancelled ■ Compensation for holders to be determined by an independent body	■ Common equity de-listed ■ Compensation for holders to be determined by an independent body

4) Market Backdrop

Market Backdrop For Financial Institutions

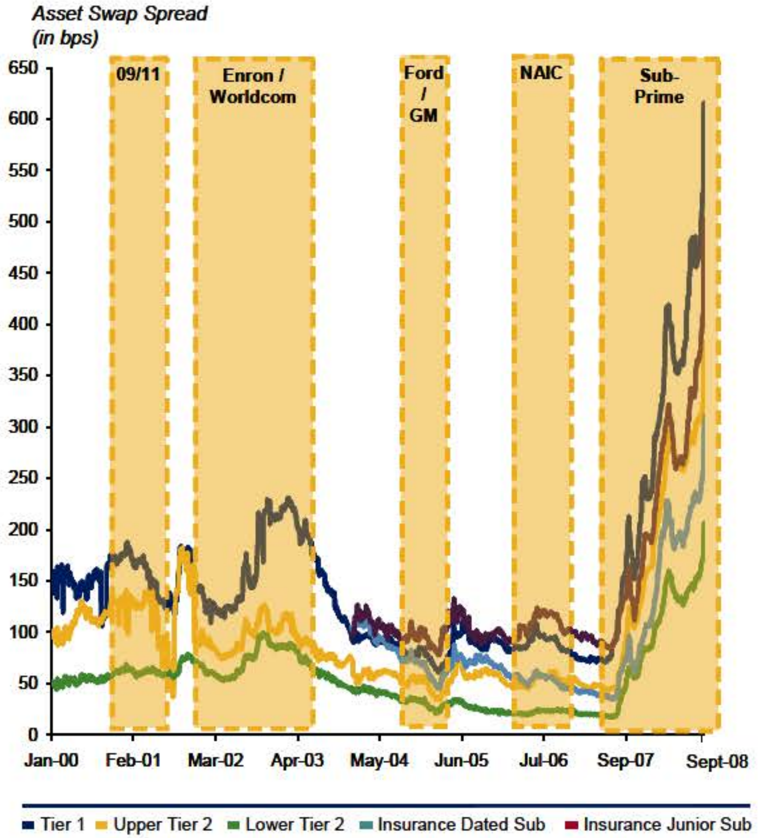
Severe Stresses In The Financial Markets Remain Amidst Volatility

Aggregate Spread Performance By Asset Class

- Over the last few weeks we have seen a dramatic worsening of market conditions. Uncertainty regarding the faith of financial institutions have lead to a total paralysis of the capital markets with only overnight funding currently available
  - USCP volumes circa 90% now only placed overnight
  - Massive flight to quality with the 2 yr Tbill currently yielding 2% nearing the lows reached at the time of the Bear Sterns collapse
  - Banks deposited £6bn in low yielding facility with BoE on Thursday 26th September (vs historical maximum of £1bn) rather than lend to each other

Asset Class	Product Type	Jan / Jun 07	Sept / Oct 07	Nov / Dec 07	Current
CP	A1/P1	-7 / -4 bps	-5 / -10 bps	Flat / -5	Flat / +30 bps
	US CP Outstanding	$2.2 trillion	$1 8 trillion	$1.8 trillion	$1.77 trillion
ABCP	A1/P1	-2 / +5 bps	20 / 30 bps	20 / 40 bps	40 / 50 bps
	US ABCP Outstanding	$1.2 trillion	$892bn	$800bn	$761bn
Senior Unsecured	5y AA CDS	8 / 12 bps	35 / 40 bps	45 bps	100 / 150 bps
	5y A CDS	15 / 25 bps	60 / 70 bps	70 / 80 bps	150 / 200 bps
Covered Bonds	10y Mortgage Backed	7 bps	17 bps	20 / 30 bps	60 bps
	10y Public Sector	-2 bps	3 bps	5 / 6 bps	30 / 35 bps
Securitisation	AAA	10 / 12 bps	35 bps	75 bps	130 / 150 bps
	BBB	45 bps	250 bps	300 bps	400 bps
Bank Capital	Sterling Tier 1 (AA)	70 bps	140 / 170 bps	210 / 230 bps	500 550 bps
	Euro Tier 1 (AA)	80 bps	150 / 180 bps	220 / 250 bps	500 / 600 bps
	US$ Tier 1 (AA)	80 bps	150 / 180 bps	220 / 250 bps	500 / 600 bps
Insurance Capital	Subordinated (A/AA)	90 bps	130 / 150 bps	225 bps	250 / 300 bps
iTRAXX	5y Senior Index	8 / 10 bps	30 bps	50 / 55 bps	135 bps
	Crossover Index	200 bps	300 / 310 bps	370 bps	580 bps
VIX	Equity index	14 points	24 points	28 points	35 points
Government Bonds	2 year Treasury Yield	4.617%	4.157%	3.781%	2.043%

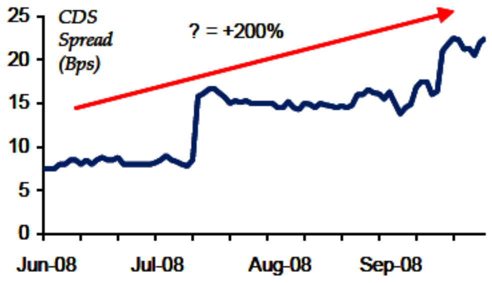
Current Cycle Much More Severe Than Previous



Market Backdrop For Financial Institutions

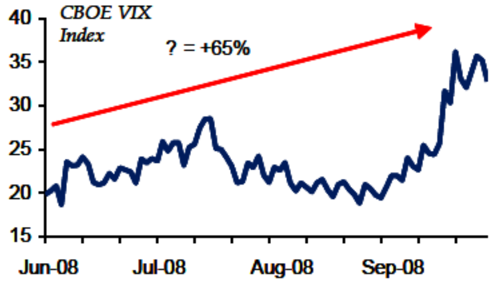
Severe Stresses In The Financial Markets Remain Amidst Volatility

10-Year US Treasury CDS



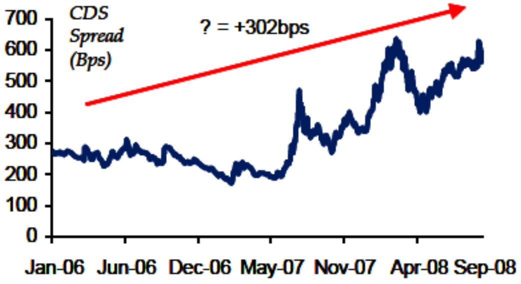
The cost to insure the debt of 10 year US treasuries has risen to an all time high as over the US fiscal position

VIX Volatility Index



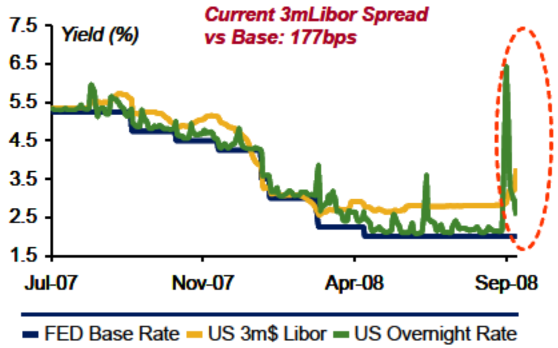
The VIX volatility index, one of the best guides to risk in the market rose close to six year highs as risk aversion jumped

iTRAXX Cross-Over

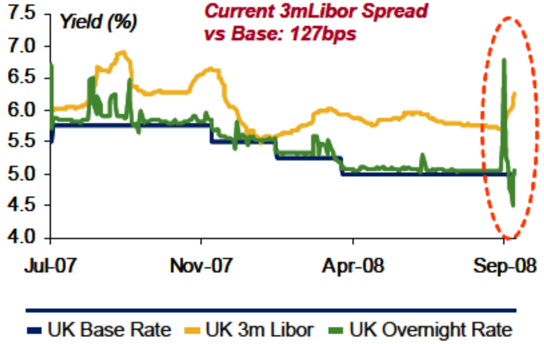


The iTRAXX Crossover index has again breached the 600 mark with substantial pressure being seen on secondary spreads

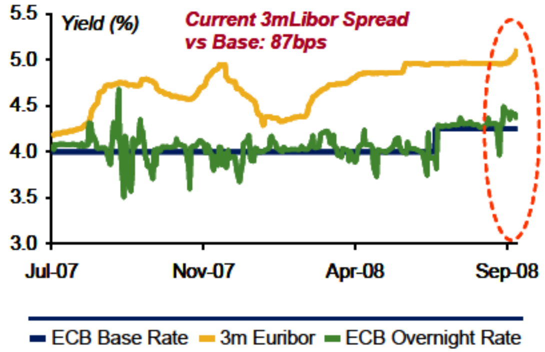
US Interbank Rates



UK Interbank Rates



EUR Interbank Rates



Interbank rates have reached record highs with a large collapse in market liquidity and severe risk aversion being seen. Furthermore, tension is rising as companies and banks face the end of the third quarter next week. Money market funds have traditionally been large sources of liquidity in both the interbank and commercial paper markets but these lenders have seen substantial fund outflows

Market Backdrop For Financial Institutions

Acceleration of Bank Failures & Impact on Capital Markets

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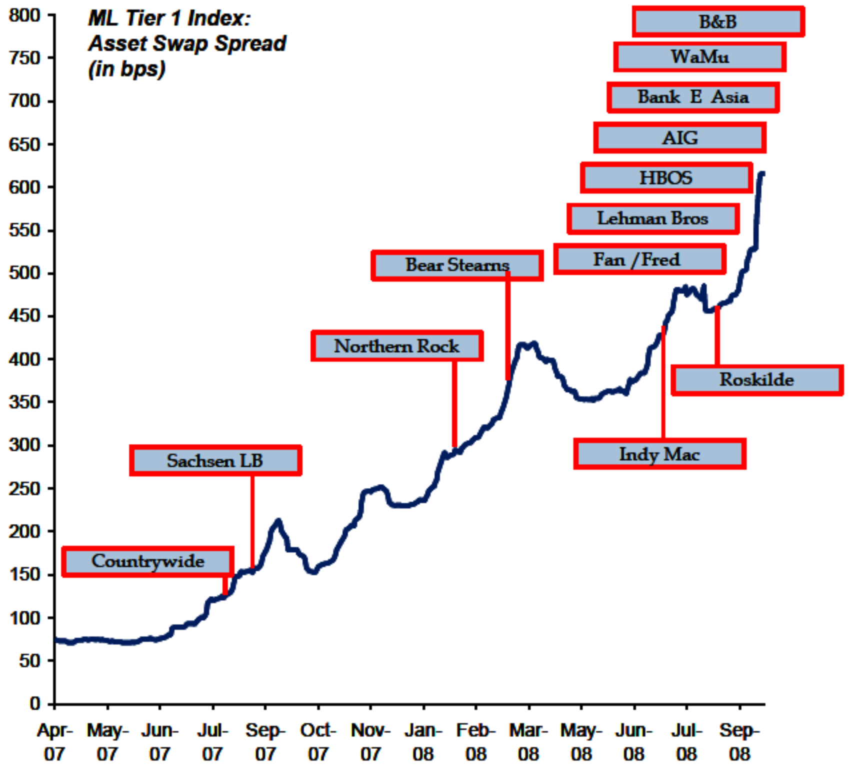
Bank Failures Substantially Impact Credit Markets



Draft Preliminary Analysis

Presentation to

National Treasury Management Agency

26 September, 2008

Merrill Lynch

Global Markets & Investment Banking Group

7

Draft Preliminary Analysis

Strategic Options

Observations

- Merrill Lynch has been engaged with the NMRA and the Department of Finance for 48 hours
- Analysis is based on the information from and conversations with:
  - PwC regarding Anglo
  - Goldman Sachs regarding Irish Nationwide
  - Limited verbal information from the Ministry of Finance and IFSRA
- We have not spoken to the management at any of the Irish Banks
- Scope has been evolving
  - Initially focused on Anglo and INBS, but now encompasses ILP, EBS and the effects on BoI and AIB given recent developments
- Must calibrate long-term impact on Ireland as a financial centre and implications for sovereign rating
- Every action should be assessed with respect to impact on share prices of AIB / BoI
  - Note rating agencies's concern that declining share price represents lack of confidence in the bank as a counterparty which can contribute to a downgrade
  - Impact on ability to raise capital
- Need to consider deposit guarantee in any event
- The following considerations are therefore preliminary and subject to further consideration

Draft Preliminary Analysis

Strategic Options

	Secured Lending Scheme / ELA	Good Bank, Bad Bank	Protective Custody of ANG / INWE	Guarantee for 6 Primary Regulated Irish Banks	Liquidation
Pros	■ Converts non ECB-eligible collateral into liquidity ■ Deals with immediate liquidity problem / buys time ■ Leaves Irish Nationwide / Anglo Irish temporarily as going concerns ■ Benefits the whole financial system ■ "Positive" for Ireland Inc. from outsiders' point of view	■ Deals with the most problematic assets causing headline risk ■ Will help restore confidence and help banks carry on business ■ Promotes orderly unwind / minimises asset deflation	■ Deals decisively with the most problematic institutions ■ Demonstrates implicit commitment to Irish banks as a whole ■ Interim step before formal guarantee if needed ■ Protects senior / subordinated creditors ■ Deposit guarantee will stem outflows and may result in inflows	■ Best / most decisive / most impactful from market perspective ■ Deposit guarantee will stem outflows and may result in inflows ■ Protects senior and subordinated creditors	■ Does not have an immediate cost to the Exchequer, but likely to be longer term implications
Cons	■ Does not deal with problem that monoline / lowly rated business are unlikely to work ■ Irish Government could / will likely end up funding the entire Anglo Irish / Irish Nationwide balance sheets (€84bn ~ €120bn?). Even with zero usage by other Irish banks	■ No critical mass remaining at Irish Nationwide / Anglo Irish ■ Most complex option for Government – will require more time ■ Capital / liquidity hits (€80bn++)	■ Government ends up funding combined balance sheet ■ Irish tax payer exposed beyond shareholders' equity ■ Potential negative impact on share price of Bank of Ireland / Allied Irish Banks / ILP	■ Will market find it credible given scale (€500bn+)? ■ Can Ireland afford it? ■ Ratings impact? ■ Will it pass the test with other EU countries given broader implications? ■ How long will it last?	■ Significant read across to other banks ■ Mark assets down at other banks to liquidation levels ■ Capital and liquidity impact ■ Investor perception of Ireland Inc. and financial stability more generally ■ Perception that authorities not in control of developments
Considerations	■ Commercial vs. penal rate funding ■ Over-collateralisation possible ■ Appropriate tenure ■ Shareholder control maintained as well as management structure ■ ELA or AIB / BoI ECB access could also be used	■ Should it be available to all Irish banks? ■ Can be structured to place government capital injection ahead of existing Equity ■ If this is the chosen path, most likely to be a second stage solution ■ Will require guarantee for senior / subordinated debt holders	■ Irish Nationwide / Anglo Irish to be taken into state control ■ Will require guarantee for senior / subordinated debt holders ■ Put business into run-off	■ Irish Nationwide / Anglo Irish to be taken into state control ■ All cards played immediately ■ Equity market perception?	■ Option discounted due to impact on state / other financial institutions

Draft Preliminary Analysis [redacted]

Strategic Options

<table>
<tr><th></th><th>Secured Lending Scheme / ELA</th><th>Good Bank, Bad Bank</th><th>Protective Custody of INWE / ANG</th><th>Guarantee for 6 Primary Regulated Irish Banks</th><th>Liquidation</th></tr>
<tr><td>Quantification</td><td colspan="2">■ Anglo has €3.3bn of loans on the watchlist
■ A 10% fall in commercial property value would result in an additional provision of €7bn
■ €23bn liquidity deficit by the end of the year
■ Additional €17bn of liquidity expected to be lost once information becomes public
■ → Total €40bn</td><td colspan="2">■ INBS has €11.7bn of loans
■ Writedowns of 30% - 60% results in an impairment of €3.6bn - €7bn
■ Liquidity of €3bn to end-2008 out of total creditors of €16bn
■ Losing €50m - €100m of deposits per day</td><td>redacted</td></tr>
<tr><td>Legal</td><td>■ Relatively straightforward (subject to checking existing powers)
■ NTMA to be granted relevant powers in current bill
■ Property structured, should not encounter a state aid issue (commercial terms and as non-selective as possible)</td><td>■ Very difficult to identify and address all legal issues in immediate timeframe
■ New legislation required</td><td>■ Legislation in hand
■ Preferred share approach could be accommodated in timeframe
■ Guarantee based on either
(a) rescue aid basis, applying for approval for restructuring aid within 6 months; and/or
(b) Art 87 (3)(b) to remedy serious disturbance to the economy
■ Legislative power to be drafted into current bill to provide further guarantees if necessary
■ Clear statement by Minister of intent to provide further aid as necessary should not attract additional state aid problems</td><td>■ Legislation in hand
■ Preferred share approach could be accommodated in timeframe
■ Rescue aid rules applicable to the intervention with Anglo / INBS
■ General guarantee to banking system would be based on Art 87(3)(b) – serious disturbance to the economy (systemic risk)
■ Should investigate whether on basis of Art 87(3)(b), guarantee limited to the 6 banks would be allowable
■ Danger that the Commission would not accept this basis for the general guarantee</td><td>■ N/A</td></tr>
</table>

[redacted]

DOF01B02

DOF03334-004

Draft Preliminary Analysis

Strategic Options

	Secured Lending Scheme	Good Bank, Bad Bank	Protective Custody of INWE / ANG	Guarantee for 6 Primary Regulated Irish Banks	Liquidation
Impact on Primary Regulated Banks	■ ILP – Potentially €4bn limit on collateral available under ECB facility, insufficient to fund forthcoming funding needs so ILP likely to be part of the solution ■ AIB / BoI – Deposit base fine, could use ECB facility to fund ILP ■ AIB / BoI could be encouraged to buy out ILP / EBS with State funding ■ EBS theoretically viable as an independent institution, though concerns remain regarding funding given size and scale				
Impact on Non-Primary Regulated Banks	■ Restrict collateral to commercial real estate and to primary regulated banks to deter foreign-owned institutions	■ N/A	■ Other institutions scope for possible complaints but no legal grounds ■ Long-term reputational issues for Ireland	■ Other institutions scope for possible complaints but no legal grounds ■ Long-term reputational issues for Ireland	■ N/A
Systemic European Impact	■ No effect	■ No effect	■ No effect	■ Most contentious	■ No effect
Timing	■ Immediate liquidity issues need to be addressed ■ Maximum 2 week window, more likely 7 – 9 days ■ No reason to expect significant liquidity improvement in the market ■ TARP issues in US still to work through ■ 30 September quarter end money market redemptions will prevent any meaningful change in market conditions				

Draft Preliminary Analysis

Market Backdrop For Financial Institutions

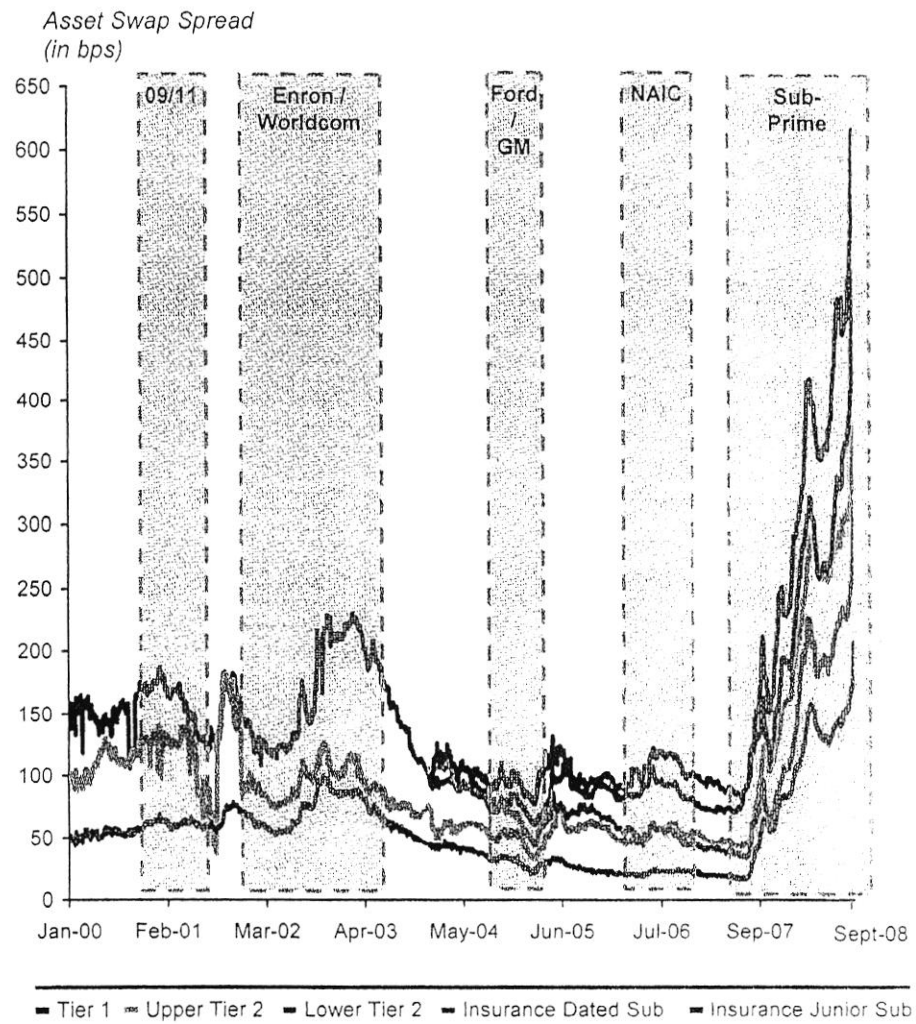
Severe Stresses In The Financial Markets Remain Amidst Volatility

Aggregate Spread Performance By Asset Class

- Over the last few weeks we have seen a dramatic worsening of market conditions. Uncertainty regarding the faith of financial institutions have lead to a total paralysis of the capital markets with only overnight funding currently available
  - USCP volumes circa 90% now only placed overnight
  - Massive flight to quality with the 2 yr Tbill currently yielding 2% nearing the lows reached at the time of the Bear Sterns collapse
  - Banks deposited £6bn in low yielding facility with BoE on Thursday 26th September (vs historical maximum of £1bn) rather than lend to each other

Asset Class	Product Type	Jan / Jun 07	Sept / Oct 07	Nov / Dec 07	Current
CP	A1/P1	-7 / -4 bps	-5 / -10 bps	Flat / -5	Flat / +30 bps
	US CP Outstanding	$2.2 trillion	$1.8 trillion	$1.8 trillion	$1.77 trillion
ABCP	A1/P1	-2 / +5 bps	20 / 30 bps	20 / 40 bps	40 / 50 bps
	US ABCP Outstanding	$1.2 trillion	$892bn	$800bn	$761bn
Senior Unsecured	5y AA CDS	8 / 12 bps	35 / 40 bps	45 bps	100 / 150 bps
	5y A CDS	15 / 25 bps	60 / 70 bps	70 / 80 bps	150 / 200 bps
Covered Bonds	10y Mortgage Backed	7 bps	17 bps	20 / 30 bps	60 bps
	10y Public Sector	-2 bps	3 bps	5 / 6 bps	30 / 35 bps
Securitisation	AAA	10 / 12 bps	35 bps	75 bps	130 / 150 bps
	BBB	45 bps	250 bps	300 bps	400 bps
Bank Capital	Sterling Tier 1 (AA)	70 bps	140 / 170 bps	210 / 230 bps	500 550 bps
	Euro Tier 1 (AA)	80 bps	150 / 180 bps	220 / 250 bps	500 / 600 bps
	US$ Tier 1 (AA)	80 bps	150 / 180 bps	220 / 250 bps	500 / 600 bps
Insurance Capital	Subordinated (A/AA)	90 bps	130 / 150 bps	225 bps	250 / 300 bps
iTRAXX	5y Senior Index	8 / 10 bps	30 bps	50 / 55 bps	135 bps
	Crossover Index	200 bps	300 / 310 bps	370 bps	580 bps
VIX	Equity index	14 points	24 points	28 points	35 points
Government Bonds	2 year Treasury Yield	4 617%	4.157%	3.781%	2.043%

Current Cycle Much More Severe Than Previous

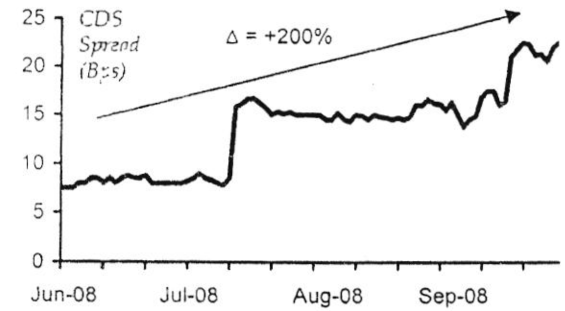


Draft Preliminary Analysis

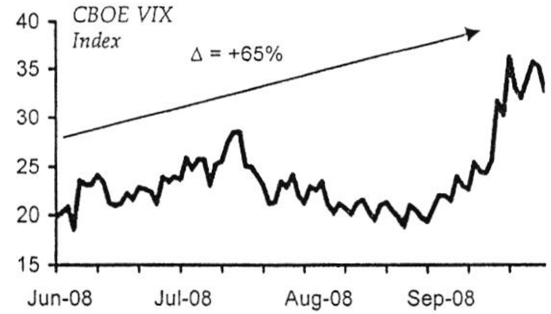
Market Backdrop For Financial Institutions

Severe Stresses In The Financial Markets Remain Amidst Volatility

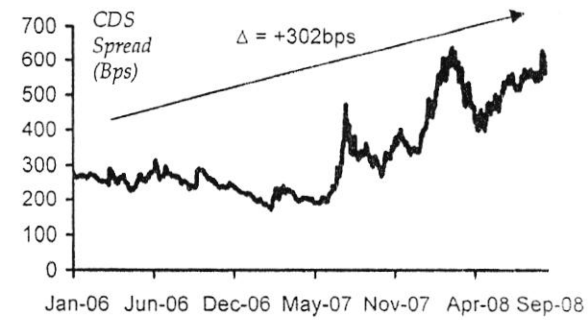
10-Year US Treasury CDS



VIX Volatility Index



iTRAXX Cross-Over



The cost to insure the debt of 10 year US treasuries has risen to an all-time high as over the US fiscal position

The VIX volatility index, one of the best guides to risk in the market rose close to six year highs as risk aversion jumped

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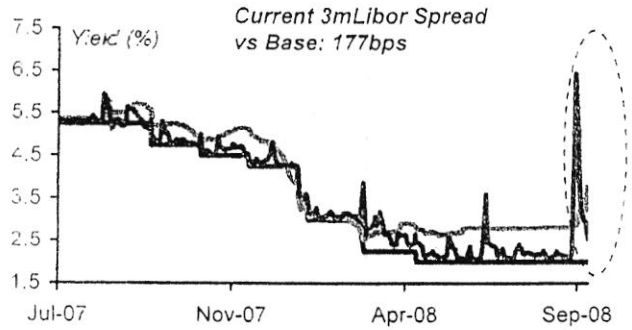
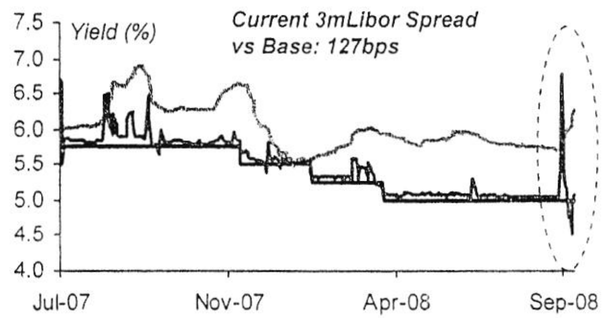


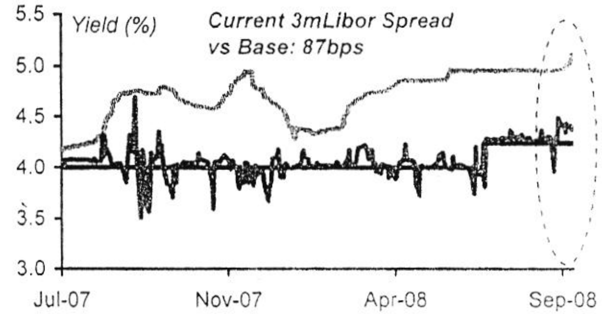
FED Base Rate — US 3m$ Libor — US Overnight Rate

UK Interbank Rates



UK Base Rate — UK 3m Libor — UK Overnight Rate

EUR Interbank Rates



ECB Base Rate — 3m Euribor — ECB Overnight Rate

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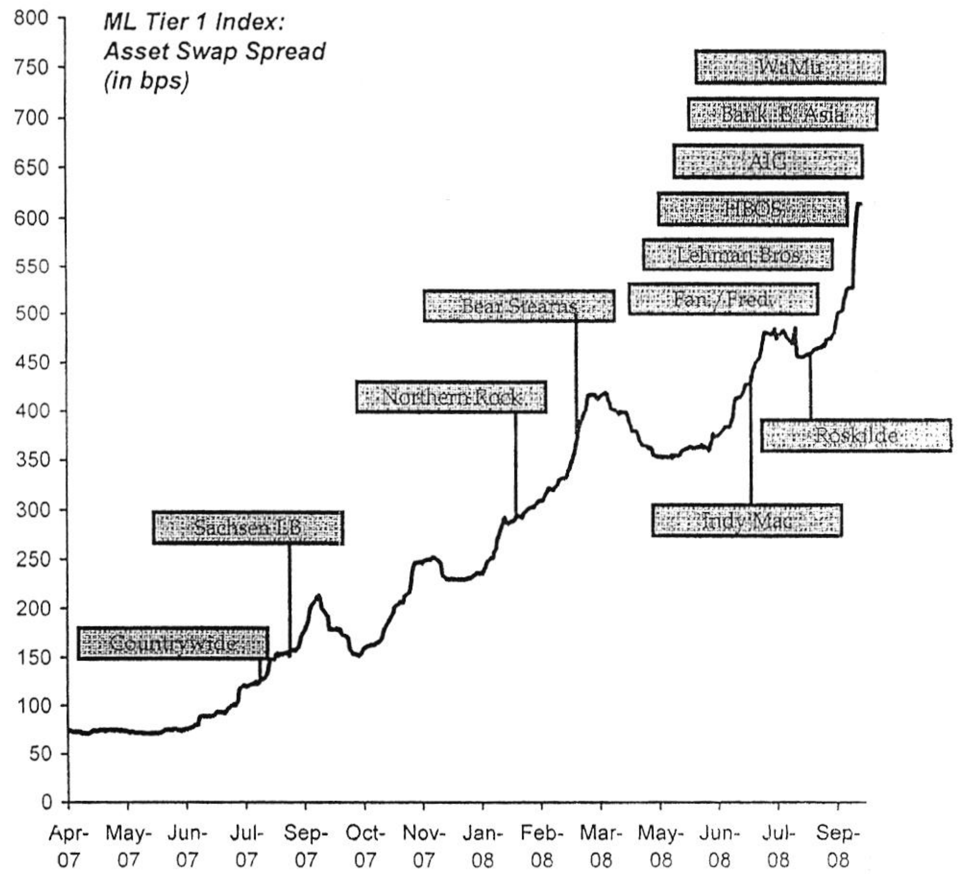

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This proposal is confidential, for your private use only, and may not be shared with others (other than your advisors) without Merrill Lynch's written permission, except that you (and each of your employees, representatives or other agents) may disclose to any and all persons, without limitation of any kind, the tax treatment and tax structure of the proposal and all materials of any kind (including opinions or other tax analyses) that are provided to you relating to such tax treatment and tax structure. For purposes of the preceding sentence, tax refers to U.S. federal and state tax. This proposal is for discussion purposes only. Merrill Lynch is not an expert on, and does not render opinions regarding, legal, accounting, regulatory or tax matters. You should consult with your advisors concerning these matters before undertaking the proposed transaction.

(26)

Nolan, Kevin

From:	Manley, Michael
Sent:	07 May 2008 19:50
To:	Beausang, William
Subject:	FW: For file
Importance:	High
Sensitivity:	Confidential
Attachments:	Summary re Irish banks.doc; Briefing for Minister for Finance May, 2008.rev1.doc; Briefing on financial sector issues.doc

William,

In addition to the note for the new Minister, you asked for a short summary of key issues in relation to the principal banks/building societies, including a note in relation to the SQ group. The notes are attached, including an outline of the size of each of the institutions.

Michael

Summary re Irish banks.doc (5...

From:	Manley, Michael
Sent:	07 May 2008 12:14
To:	Beausang, William
Subject:	FW: For file

William,

Draft note for new Minister attached.

This is based on the note you provided below, with material added in relation to periodic reports that the bottom of the credit crunch has been reached. Given its going to be a Minister new to this area, I've added material in relation to the division of responsibilities (Dept, CB and FR) and also material setting out briefly the background on the origins of the present financial stability difficulties. I'd propose to ask BEPD for a view on the Economic material.

Michael

Briefing for Minister for Fina...

From:	Beausang, William
Sent:	06 May 2008 14:38
To:	Manley, Michael
Subject:	FW: For file

My previous email refers

Taxation and Financial Services Division
Dept of Finance
Government Buildings
Upper Merrion Street
Dublin 2

From: Beausang, William
Sent: 25 April 2008 17:18
To: Manley, Michael
Subject: For file

Briefing on financial sector i...

From: Beausang, William
Sent: 06 May 2008 14:35
To: Manley, Michael
Subject: FW: We will need a note for new confidential note for new min on all the current financial stability issues and what is being done

Michael

Could you prepare a first draft of this which we can review tomorrow am. The recent note prepared for Tanaiste's meeting with some bankers might provide a good basis for this.

wb

From: Cardiff, Kevin
Sent: 06 May 2008 12:49
To: Beausang, William
Subject: We will need a note for new confidential note for new min on all the current financial stability issues and what is being done

<u>CONFIDENTIAL</u>

This note contains highly confidential material relevant to the financial interests of the State, provided in confidence on the understanding it would not be disclosed other than to the Minister for Finance and /or for use in material to be provided to the Government, and under the terms of the confidential EU Memorandum of understanding on the exchange of information

Summary of key information re Irish banks

In addition to issues affecting individual banks, there are a number of generic factors impacting across all banks, but with potentially greater problems for smaller institutions:

- o Virtual cessation of normal wholesale lending activity where all banks have in recent years sourced a growing share of their funding.
- o Increased cost of funds and shortening of funding periods
- o General negative international sentiment against Ireland and reluctance to lend to Irish banks, based on a perceived vulnerability to contraction in construction activity and property prices (IMF has pointed to a potential 30% decline in property prices)
- o Contraction in lending activity (due to both decline in demand and reduced funding availability) putting pressure on profitability, potentially leading to ratings decline which in turn has the potential to affect share prices and capital adequacy.

Allied Irish Bank (figures from Annual Report December 2007 unless otherwise stated)

- One of two main universal banks in Ireland (other is BoI) – also active in UK, US and Poland
- Profits (before tax) of €2.508 bn, €1.263 in Ireland
- Market capitalisation (7 May) €12.29 Bn
- Loan book €128.716bn, of which €30.101bn are home mortgages and €46.410 are construction and property loans (Ireland €85.706 bn - €24.07 home mortgages €29.973 construction and property loans)
- Issues
  - o No specific funding risks identified – funding diversified
  - o No specific short selling risks identified - 1.75% of shares reported to be held on loan
  - o Exposure to Irish property market – esp commercial

Bank of Ireland (figures from Annual Report March 2007 unless otherwise stated)

- One of two main universal banks in Ireland (other is AIB), also has significant UK operations.
- Profits (before tax) €1.9658 bn, €1.603 bn in Ireland
- Market Capitalisation (7 May) €9.2bn
- Loan book €125.048, of which €59.690bn are home mortgages and €26.382 are construction and property loans (Ireland €68.609 bn - €24.634 home mortgages €16.305 construction and property loans)
- Issues
  - o No specific funding risks identified – 80% of funding from deposits and wholesale funding with maturity of grater than one year
  - o No specific short selling or other share-related risks identified – 5.3% of shares reported to be held on loan
  - o Exposure to Irish and UK property market

Anglo Irish Bank (figures from Annual Report September 2007 unless otherwise stated)

Oireachtas-p

- Smaller than AIB and BoI, focus on business banking and commercial real-estate-backed lending
- Profit (before tax) €1.243bn
- Market capitalisation (7 May) €7.3bn
- Loan book €65.949 bn 42% of loans in Ireland, 40% in UK
- Issues
  - Funding – 63% of funding base is deposits (commercial and retail), a significant proportion of deposits are understood to be in larger, potentially mobile accounts.
  - Exposure to commercial property market
  - Risk of short selling of shares by hedge funds- 12.78% of shares reported to be held on loan
  - Financial Regulator currently investigating short selling of shares in March when shares prices fell 15% in one day.

Irish Life and Permanent

- Significantly smaller than two main banks. Essentially a combination of two businesses, banking (previously Irish Permanent Building Society and Irish Permanent Building Society) and Insurance (Irish Life). Over 50% of profits contributed by insurance component.
- Profit (before tax) €448m
- Market capitalisation (7 May)
- Loan book €39.2bn, - residential mortgages €34.807bn (Ireland residential mortgages €27.310bn
- Issues
  - Key risk – currently accessing circa 20+% of funding requirement from the ECB, no sign of this improving in the near future
  - Exposure to Irish property market
  - Difficulty in accessing funding from commercial sources due to negative sentiment about the Irish property market.

Irish Nationwide (figures from Annual Report 2006 unless otherwise stated)

- Building Society
- Has been seeking to buyer which would enable it to convert from a building society to a bank, with the aim of realising gains for its 'members'. Recent offer by Icelandic bank Landsbanki rejected
- Key business is non-residential mortgage provision
- Loan book €10.4096 bn
- Issues
  - Little interest in current international market in its takeover.
  - Recently downgraded by Fitch
  - Difficulty in accessing funding from commercial sources due to negative sentiment about the Irish property market.

EBS

- Building Society
- Focus on home lending in loan portfolio
- Income (before tax) €€66.6 mn
- Loan book - €15.8822 bn – 76% home lending
- Issues
    - Funding – 52 % total funding from customer deposits.
    - Difficulty in accessing funding from commercial sources due to negative sentiment about the Irish property market.

[redacted]

Oireachtas P

Minister for Finance from .....

<u>Note for the Minister for Finance in relation to Financial Stability Issues</u>
<u>7 May, 2008</u>

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

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

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

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

<u>Economic Outlook</u>
The fundamentals of the Irish economy remain relatively strong but short-term economic prospects are worsening. Several of the downside risks to our economic performance identified at Budget time have materialised including in particular:

- marked slowdown in the US economy
- sharp downturn in the Irish property market
- a strong appreciation in the Euro
- spillover into the real economy and lending from the credit crunch

The market consensus for real GDP growth in 2007 is now around 2.25%, as compared to the Budget day forecast of 3%. The deterioration in economic conditions has been reflected in tax revenue, particularly those reflecting activity in the property market. Ireland's fiscal position and debt ratio is such that it can accommodate the impact of the changed budgetary position providing tight control is exercised over growth in current public expenditure while maintaining our programme of capital investment under the NDP.

Employment is still expected to increase this year and while unemployment has increased, the unemployment rate remains low by international standards and is below the European average.

The shift in economic conditions highlights the importance of maintaining Ireland's international competitiveness through moderate pay increase and boosting our productivity growth.

Prognosis for the International Financial Situation

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

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

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

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[1] In the near term, tight funding conditions mean banks are vulnerable to adverse news and rumours, as highlighted by the run on Bear Stearns in mid-March, tight credit conditions can be expected to lead to a pickup in defaults among vulnerable borrowers, including some households/ parts of the commercial property sector, and financing difficulties could emerge in some emerging markets, including countries in Central and Eastern Europe with large current account deficits

In Summary:

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

Funding Position of Irish Banks

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

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

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

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

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

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

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

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

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

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

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

7 May, 2008

cc Secretary General, K Cardiff,

Appendix 1

Background on

Responsibilities in relation to financial stability

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

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

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

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

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

Appendix 2

Background note on origins of current financial stability concerns

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

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

Tánaiste from William Beausang

Briefing as requested below.

<u>If the banking sector representatives have any suggestions on how to address current funding difficulties they could be advised to communicate these to the Governor of the Central Bank and the Financial Regulator and to keep the Department informed</u>.

Briefing on banking sector issues – 24 April 2008

Economic Outlook

The fundamentals of the Irish economy remain relatively strong but short-term economic prospects are worsening. Several of the downside risks to our economic performance identified at Budget time have materialised including in particular:

- marked slowdown in the US economy
- sharp downturn in the Irish property market
- a strong appreciation in the Euro
- spillover into the real economy and lending from the credit crunch

The market consensus for real GDP growth in 2007 is now around 2.25%, as compared to the Budget day forecast of 3%. The deterioration in economic conditions has been reflected in tax revenue, particularly those reflecting activity in the property market. Ireland's fiscal position and debt ratio is such that it can accommodate the impact of the changed budgetary position providing tight control is exercised over growth in current public expenditure while maintaining our programme of capital investment under the NDP.

Employment is still expected to increase this year and while unemployment has increased, the unemployment rate remains low by international standards and is below the European average.

The shift in economic conditions highlights the importance of maintaining Ireland's international competitiveness through moderate pay increase and boosting our productivity growth.

International Financial Situation

Financial market conditions remain very difficult and the international financial sector remains under considerable stress.

- There is no indication that any sustained improvement will be achieved for some time.
- The concerns that initially led to credit markets seizing up last August are persisting.
- Major financial institutions continue to disclose major write downs.
- Estimates of the total losses by authoritative international bodies continue to increase.

- International initiatives and in particular the activities of the Federal Reserve and the ECB / Eurosystem have helped in important respects to stabilise financial market conditions at particular times.
- International efforts to resolve the root causes of the crisis for example by promoting increased transparency or new valuation approaches are yet to bear fruit.

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

Irish Financial System

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

However, Irish banks are subject to specific pressures and stresses – over and above those applying more generally internationally - owing to wide-spread international concern regarding the exposure of Irish banks to the property market and in particular commercial lending. This has been demonstrated by heavy and intense speculation against Irish banks by hedge funds at times over recent months. Over recent weeks the funding environment for Irish banks has disimproved further and there is evidence that some previously established credit lines in the US are being restricted. Notwithstanding the continuing positive statements by Government and the CBFSAI vouching for the strength of the Irish banking system, international investors are being influenced by the views expressed by some domestic commentators.

Funding Position of Irish Banks

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

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

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

EU Actions

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

See below for summary information regarding domestic financial stability planning arrangements:-

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

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

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

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

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

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

24 April 2008

cc Secretary General, K Cardiff, G Steadman

DATE? ~ about 25/9/08

(6) 6

PWC reported on the Anglo loan book – 13 billion land/development under way of which 700m unzoned; 4.5 billion zoned no planning; over 3 billion zoned with planning; balance incomplete development

Of the other 55 bn there was a broad mix of income generating assets.

It would be difficult for them to convert their loans to useful collateral, with the exception of an amount of around 2.2bn.

There was a discussion of various forms of state interventions. The FR (Pat Neary) said that there is no evidence to suggest Anglo is insolvent on a going concern basis – it is simply unable to continue on the current basis from a liquidity point of view. He felt INBS was in a similar situation.

D Doyle noted that Government would need a good idea of the potential loss exposures within Anglo and INBS – on some assumptions INBS could be 2bn after capital and Anglo could be 8½ .

Various intervention possibilities were discussed: 'Ordinary' liquidity support, SLS-type scheme, guarantees, nationalisation, bad bank approach.

A subsequent meeting took place to present conclusions and possible approaches.

Attendance:

Baldock & Prasath, Merrill Lynch
Pat Neary, Jim Farrell FR
Governor, Tony Grimes CB
Dan O'Connor PWC
Eugene McCague Arthur Cox
Attorney General
Taoiseach
SG to the Government
Minister for Finance, D Doyle, K Cardiff Department of Finance
CEO NTMA
J Corrigan NTMA
Basil Geoghegan (for a short part)

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