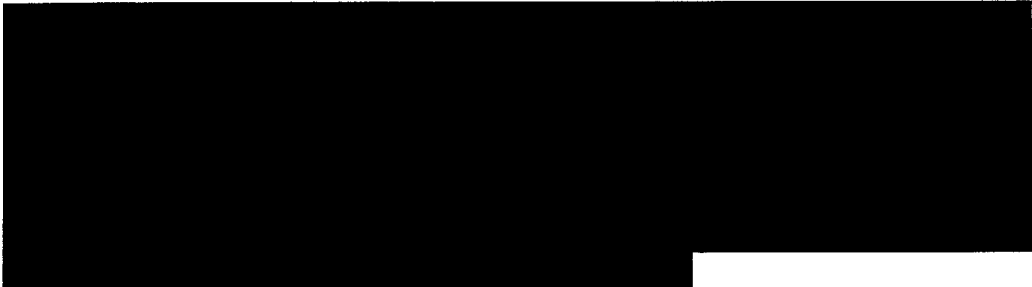
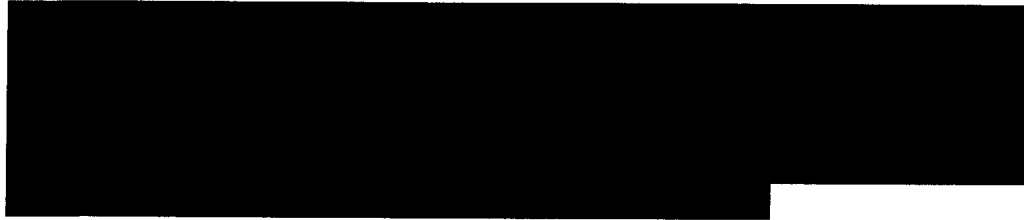


## Briefing on the Banking position

### *Background*

1. Between the years 2000 to 2007 the Irish banking system borrowed large amounts of cheap funds from the international wholesale money markets and the international corporate deposit markets. Much of this money was of short duration and rolled over frequently. The banks and building societies lent this money for land and development, commercial property and house mortgages in both Ireland and the UK. The availability of cheap, plentiful credit fed a property bubble and very significant asset price inflation. Liquidity began to dry up in 2007 following the subprime crisis in the US and property prices stalled and then began to fall.
2. The banking system therefore has two related problems. They are capital and funding.
3. The capital problem principally arises from loan losses from property assets which are now worth significantly less than the outstanding loan balance. This problem arises not simply from the very significant losses which have already accrued, but the perception that the economy has not yet recovered sufficiently to prevent further losses. All of the banks and building societies have either substantially eaten into (BOI and ILP), or eaten through (Anglo, INBS, EBS, AIB) their original shareholder funds, raised capital through sale of assets and buy back of subordinated debt and, with the exception of ILP, capital contribution from the taxpayer. Only BOI has successfully raised capital from the markets.
4. 
5. Overall, the Irish banking system grew too large (covered bank assets >2.5x GDP) and needs to be significantly downsized. This is being done through removal of all land and development loans (€80bn so far) to NAMA, forcing the banks to recognise the losses on these loans; the winding down of Anglo Irish Bank and INBS and the deleveraging of the other banks.
6. The IMF/EU package seeks to address the banking problem by ensuring the banks are highly capitalised (to meet possible further stress), deleveraged to bring the loans and the sustainable level of funding more in line and addressing the confidence problem through publishing the results of the stress tests; validated by external consultants and peer reviewed by other central banks. Details of the EU-IMF Programme are in Appendix A.

7.



***PCAR and PLAR***

8. The Central Bank and its advisors are currently conducting two important reviews which will fundamentally influence the shape and size of the banking system. A PCAR (Prudential Capital Assessment Review) is determining what the appropriate level of capital should be in the viable banks ( ). In addition a PLAR (Prudential Liquidity Assessment Review) is underway to establish a path to a smaller leveraged but more stable banking system with a more appropriate funding base. These two exercises are interwoven and when complete will generate the key inputs for a plan that will ideally see a fundamental restructuring of the banking system, and possibly higher capital requirements for certain institutions.

9.



10.



11. At this point four options have been analysed by the Central Bank, only two of which can really be considered: 1) adopt the current deleveraging plans presented by the banks without further reorganisation of the system; 2) engage in an accelerated disposal programme of assets; 3) reorganise the system around two pillar banks by extracting the “core” assets out of AIB and possibly BOI into new entities, together with the good assets from the other banks, while all other assets are left in a series of deconsolidated run-off vehicles and 4) do a similar

reorganisation as under 3, except the two pillar banks are reformed from the existing banking entities with on balance core/non-core splits while the remaining bad assets of the other banks are left in situ and become run-off vehicles.

12. Option 1 is not radical enough for confidence that will help the banks to recover. However, it provides a benchmark against which other options should be measured- if they are not better than continuing as is they clearly should not be adopted.
13. Option 2 would create a significant capital hole and would therefore be very expensive for the State. [REDACTED]
14. Option 3 is a possibility, [REDACTED]
15. At this point option 4 seems the most feasible and it is being prioritised for study.

*Capital*

16. As a first measure the External Authorities requested that the financial institutions core tier 1 capital ratios be brought up to 12% using the PCAR 2010 projections for forward looking losses out to 2012. This was to be completed by end February in the cases of AIB, BOI and EBS and end May for ILP. When the PCAR was completed at the end of March, the capital would be increased if necessary depending on the outcome of a severe stress test. Going forward banks are now required to keep their reported core tier 1 ratio above 10.5% at all times.
17. In the event, the outgoing Government decided not to inject any capital after the election was called [REDACTED]
18. [REDACTED]
19. [REDACTED]

[REDACTED]

20. In October, EBS was put up for sale and there were two bids. [REDACTED]  
[REDACTED]

[REDACTED]

- [REDACTED]

21. [REDACTED]

*Funding*  
22.

[REDACTED]



***Subordinated debt and liability management exercises (LMEs)***

27. Sub debt holders have contributed almost €10bn to the recapitalisation of the Irish banks. To date the Anglo Irish LME has been the most aggressive when tier 1 security holders exited at 5% of par with their LT2 exiting at 20% of par. According to figures just released by the Central Bank, there is now c. €6.9bn of subordinated debt left on the banks' balance sheet down from over €20bn before the crisis began.

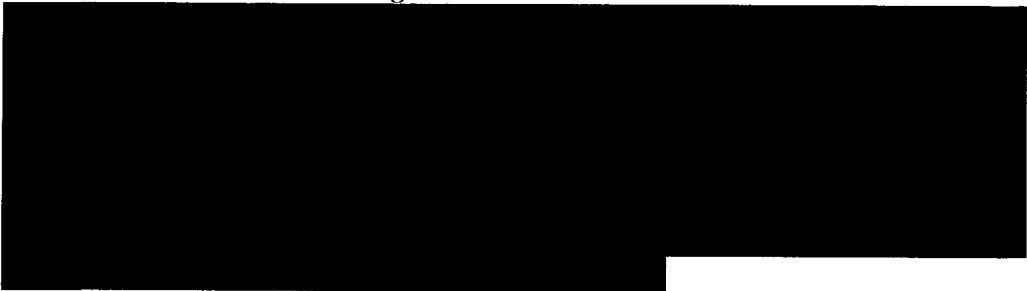
28.



29. Under EU rules banks in receipt of State aid and subject to their restructuring process cannot pay out discretionary coupons which covers all tier 1 and hybrid securities.

***Senior bond holder burden sharing***

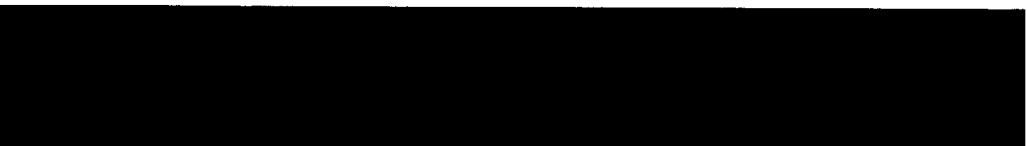
30.



31. As of the end of February, there was €16.4bn in unguaranteed unsecured senior bonds in issue of which €3.7bn of the total was sitting in Anglo Irish and INBS.

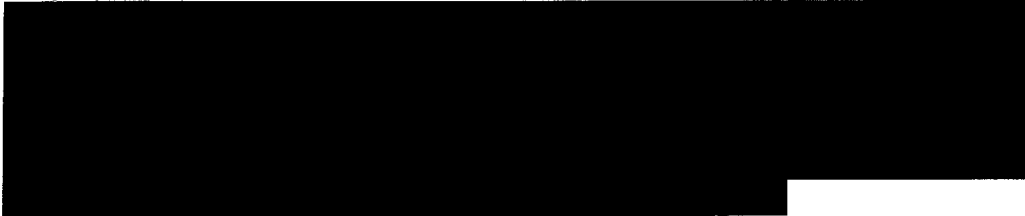


32.





*NAMA for sub €20million loans*

33. 

34. 

35. 

*Special Resolution Regime*

36. In line with the commitment in the EU/IMF Support Programme for Ireland, legislation was published on 28 February 2011 in Seanad Eireann to strengthen the legal framework for dealing with distressed deposit-taking institutions (i.e. banks, building societies and credit unions)<sup>1</sup>.

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<sup>1</sup> For the duration of the period where a credit institution is a relevant institution as defined in the Credit Institutions (Stabilisation) Act 2010 such an institution is not within the scope of the Central Bank and Credit Institutions (Resolution) Bill 2011. The Credit Institutions (Stabilisation) Act will cease to have effect on 31 December 2012

37. The purposes of the legislation include the provision of an effective and efficient resolution regime for credit institutions that are failing or likely to fail that is effective in protecting the Exchequer, the stability of the financial system and the economy. The legislation provides powers to the Central Bank to achieve these purposes. The powers can only be exercised if, in the public interest, the credit institution cannot be liquidated immediately.
38. Key elements of the regime include the provision for the appointment of a special manager where, in the opinion of the Central Bank, an institution's financial condition has severely deteriorated, the granting of power to the Central Bank for the transfer of assets and liabilities to other institutions, a framework for the establishment of bridge banks and a requirement for credit institutions if requested by the Central Bank to prepare Recovery Plans, with associated Resolution Plans to be prepared by the Central Bank on the basis of information and analysis from the credit institution concerned (i.e. "living wills").
39. The legislation also provides for an enabling power for the establishment of a Resolution Fund funded by credit institutions to minimise taxpayers' exposure to future financial sector difficulties. The legislation does not include any provision to impose losses on holders of senior bonds. Any such provision could be modelled on Subordinated Liabilities Order in the Credit Institutions (Stabilisation) Act, 2010.

40.



[REDACTED]

41. [REDACTED]

42. [REDACTED]

43. [REDACTED]

*Central Bank Bill 2011*

44. A Bill is at an advanced stage of preparation which will provide for the enhancement of financial regulation, expanding the supervisory and enforcement powers of the Central Bank. Publication of Bill is a quarter two commitment under the Joint Programme.

45. [REDACTED]

46. [REDACTED]

[Redacted]

Strategic Review of the Credit Union Sector in Ireland

47. The Central Bank is carrying out the Strategic Review of the Credit Union Sector in Ireland.

[Redacted]

*Commission of Investigation into the Banking Sector*

48. The Minister for Finance formally appointed Mr. Peter Nyberg as sole member of the Commission of Investigation on 22 September 2010. In accordance with its terms of reference, the Commission must complete its report within six months of its establishment. The Commission is on schedule to submit its report to the Minister by end March 2011.

49. [Redacted]

50. [Redacted]

51. [Redacted]

[REDACTED]

***EU-IMF Joint programme – Financial sector***

52. Financial sector commitments under the Joint Programme are heavily weighted towards the first quarter. We have delivered on the commitments for end-December, end-January and end-February, apart from the structural benchmark to make further capital injections into Allied Irish Banks, Bank of Ireland and the EBS, which was deferred to be addressed by the incoming Government. The remaining commitments for the first two quarters of 2011 are set out in summary form in the Appendix – more detailed notes on each of these issues have been included in the main brief.

***Conclusion***

53. There are a number of major strategic decisions which will have to be made of the next few weeks in the banking area. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]


**54.** As well as meeting the programme commitments, all of the restructuring plans have to comply with EU competition law. [REDACTED]

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Ann Nolan  
9 March 2011

### Appendix A - EU-IMF Joint programme – Financial sector

Structural benchmarks	Deadline	Status
Submit the draft legislation on a special resolution regime to Dáil Éireann.	End-February 2011	Central Bank and Credit Institutions (Resolution) Bill 2011 published on 28 February 2011 to meet structural benchmark.
Banks required to submit deleveraging plans to the Central Bank.	End-February 2011	Detailed deleveraging plans submitted to the Central Bank by 28 February to meet structural benchmark.
The Central Bank to complete the assessment of the banks' restructuring plans.	End-March 2011	Expected to finalise reorganisation options, deleveraging plans as well as funding options by end of March.
The Central Bank will complete a Prudential Liquidity Assessment Review (PLAR) for 2011. The PLAR will establish target funding ratios for 2013 for each of the banks, identify non core assets and set an adjustment path to these targets based on specified non public annual benchmarks. <sup>1</sup>	End-March 2011	Underway and on-track.
Complete Prudential Capital Assessment review (PCAR) stress tests.	End-March 2011	Underway and on-track. Central Bank has issued final stress test instructions.
The Irish Authorities to draw up a schedule of assets to progress early deleveraging by asset disposals and/or credit enhancement, to be achieved by end March 2011.	End-March 2011	Underway – schedule to be drawn up by end-March.
Complete the diagnostic evaluation of banks' assets and communicate findings.	End-March 2011	Underway and on-track.
Strategy for future structure, functioning and viability of Irish credit institutions will be developed in detail and agreed with the external authorities.	End-March 2011	Consideration of a range of 'solutions' is ongoing in terms of reorganisation and asset disposal.
Further deleveraging of the banks will be achieved by the extension of the NAMA programme to include approximately €16bn of land and development loans in AIB and Bank of Ireland, which had previously been	End-March 2011	NAMA (Amendment) Bill published on 26 January with a view to consideration in the next Dáil session. Loans expected to

excluded as they were below a value threshold of €20m.		be transferred by end March
The deposits and NAMA bonds of Anglo Irish and INBS will be transferred to other institutions in an open process, leaving the remaining loan books to be unwound in an orderly manner.		Deposits and NAMA bonds were transferred to AIB (Anglo) and ILP (INBS) in February 2011. The joint restructuring and work out plan was submitted to the European Commission on 31 January 2011, and is awaiting approval.
Consistent with EU State aid rules, burden sharing will be achieved with holders of subordinated debt in relevant credit institutions over the period of the programme.		<ul style="list-style-type: none"> <li>• Liability management exercises underway:</li> <li>• Anglo burden sharing completed in Dec 2010.</li> <li>• AIB LME completed and a further LME being considered</li> <li>• INBS: LME proposal with NTMA.</li> <li>• BoI: LME exercises underway on sub-debt.</li> <li>• ILP Burden sharing depends on ILP bid for EBS.</li> </ul>
Complete a full assessment of credit unions' loan portfolios and prepare a comprehensive strategy to enhance the viability of the sector.	End-April 2011	Work ongoing
The Central Bank will direct the recapitalisation of Irish Life and Permanent to achieve a capital ratio of 12 percent core tier 1.	End-May 2011	
Introduce legislation for the enhancement of financial regulation, expanding the supervisory and enforcement powers of the Central Bank.	End June 2011	