Statement on Banking Matters in Ireland
Mr Michael Noonan, TD, Minister for Finance
Issued following publication of the results of the stress testing of Ireland's Banks
March 31, 2011.

Tuesday, 30th September, 2008 will go down in history as the blackest day in Ireland since the Civil War broke out.

The 30th September 2008 was the day on which the then Government extended the infamous guarantee to the Irish banks and decided that Anglo Irish Bank should be supported and maintained.

It quickly became apparent that Anglo was insolvent in the absence of State support, that the other banks were illiquid and that the banking system was not fit for purpose.

The banks were too big for the economy. The JCB and the swinging crane had become the logos of the banks, and Irish bankers were as likely to be funding apartment blocks on the Black Sea or dabbling in property schemes in Singapore, as they were to be investing in the Irish economy.

We are now in the third year of the banking crisis. The previous Government failed to act. They ducked and dived and procrastinated as they lurched from one crisis to the next. They went through periods of denial and periods of self justification. They paved the road to disaster with good intentions.

They never fixed the broken banks however.

The country has been left with an appalling legacy: a legacy of debt, of unemployment, of emigration, of falling living standards and of low morale.

The new Government has received a very strong mandate, it is a mandate for change, for renewal and for doing things differently. It is a mandate to act, and act we will.

Today, we set about that task in earnest. The Government is announcing decisions that will:-

- lead to a radical restructuring of the domestic banking system;
- return the banking system to long-term viability and profitability; and
- finally break the vicious cycle of the massive dependence of the banks on the State.

The banking system must be the enabler of economic recovery by restoring public and market confidence in its financial health, management competence and ethical integrity.

In order to accomplish this, we will reduce the number of domestic banks by creating two new strong universal Pillar banks. We will also ensure that they are fully recapitalised so that the world looks at these core banks with confidence and they in turn help instil confidence in our economy.

Structure of the Irish Financial System

In just two years, the State has contributed €46.3 billion of capital to the domestic banks. Despite this huge commitment of resources the banking system remains distressed, with each institution continuing to rely on the lifeline of State and central bank support.

Confidence in the banking system can be restored, albeit gradually, by now taking the right steps to restructure our banking system.

Strong capitalisation of the banks is only part of that process and I will discuss that process later. But the banking system itself first needs to be restructured to build a new core banking system that is fit for purpose for the economy, businesses and households by providing substantial new lending into the economy.

Reducing the size of the Banking System

Both Government parties have consistently stated that the Irish banking system needs to be reduced to a size appropriate to our economy.

The capital injections will be provided to create a banking system that has two universal full-service banks as its core pillars and a restructured Irish Life and Permanent. The first Pillar banks will be created from the already strong franchise of Bank of Ireland and it is our intention to combine the businesses and strengthen the franchises of Allied Irish Bank and the EBS Building Society to form the second Pillar bank. Overseas banks operating in Ireland will help maintain the competitive fabric of the market.

To attract foreign investment and funding these new banks must realign themselves with the best international norms. The Central Bank's announcement today is based on:-

- Strong minimum Core Tier 1 capital ratios of 10.5%;
- More acceptable loan to deposit ratios compared to international norms;
- Stress testing to 6% over three years and beyond; and
- A realignment of their balance sheet capital and funding so as to meet the upcoming new regulatory requirements under Basel III.

In essence, our banks will need to be smaller, more focussed on core operations, better funded and better capitalised.

Each of these banks will reorganise their operations into core and non-core functions. With a carefully managed programme of deleveraging, by 2013, as the non-core assets which do not serve growth on the island of Ireland disappear, the Pillar banks should start to better serve the economy as functioning banks rather than the oversized, overleveraged banks they now are.

The core parts will be designed, from the outset, to provide the economy with the services and credit it needs.

Non-core businesses and assets of the banks will be sold or run off over time avoiding fire-sales. This will allow for a significant reduction of the level of assets relative to deposits over time. With these sales, recapitalisations and other measures the banks will repay their ECB and Central Bank funding and in time will be better able to raise their own funds.

Future Banking Landscape

Pillar 1 - Bank of Ireland

The first Pillar bank will be designed from Bank of Ireland. Splitting into separately managed non-core and core divisions, the bank will begin to shed €30 billion of assets by 2013. It will become a significantly more domestically focused bank and retain its businesses in Northern Ireland, its Post Office deposit venture in the United Kingdom and limited capital markets businesses.

Although backstopping the Central Bank capital requirements, we will provide the management time to raise additional private capital and limit the State's need to invest in the banks.

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Pillar II – Allied Irish Bank and EBS

We have already announced that the recent bid for the EBS did not represent good value for the State as shareholder. We intend to combine the operations of AIB and the EBS to build a second Pillar bank from the strengths of both institutions. Again, this will be a largely domestically focused bank, retaining its Northern Ireland operations and certain deposit funded operations in the UK.

During the transition, customers should continue to do business with either bank as before and over time the fuller services of AIB will become available to the customers of the EBS who will obviously retain the protection of the state guarantee for their deposits.

The non-core division of the combined entity will see deleveraging of €23 billion of assets by 2013.

Irish Life and Permanent (ILP)

To satisfy the Central Bank's capital requirements, Irish Life & Permanent must raise very substantial additional equity capital. This will require a significant restructuring of their business and their shareholding, involving in all likelihood a majority stake held by the government. The management of ILP have agreed to produce a detailed capital plan to me shortly.

The basic elements of this plan are already clear and are reflected in their deleveraging plans agreed with the Central Bank. ILP will immediately commence a process to sell its life insurance subsidiary Irish Life Assurance, as well as other non-banking assets such as its life and pensions business which is strong, well capitalised and will continue to operate normally. In line with the other institutions, banking assets will be divided between core and non-core, and €10 billion of non-core assets will be available for sale or run-off to help to reduce the imbalance between assets and deposits.

The sale of valuable insurance and other assets should raise significant capital for the Group. It is the intention of the State to provide the remaining PCAR capital to the group.

Throughout this period of restructuring, the group will operate as normal. Customers and policyholders should continue to carry out their business with the group in the normal way and depositors of PTSB can be assured that their deposits remain fully guaranteed under the Deposit Guarantee Scheme and the Eligible Liabilities Guarantee Scheme.

We will submit new restructuring plans for the banks to the European Commission for approval under State aid rules in respect of all of the above issues.

Bank Stress-Testing (PCAR)

The PCAR bank stress tests carried out by the Central Bank are certainly among the most thorough and demanding such tests ever performed in Ireland and or indeed anywhere. The detailed results methodology and assumptions underlying these stress tests are being published, emphasising Ireland's firm commitment for this critical exercise to be fully open and transparent.

These tests assume higher base levels of capital, a more stressed underlying banking environment, conservative loan loss and recovery assumptions and substantial buffers over and above the results modelled by the Central Bank and advisors. These capital levels are well above the 10.5% internationally accepted target rate and would withstand very significant economic and financial shocks.

The stress scenarios while not implausible are highly unlikely and are not meant to be, nor should they be, interpreted as being forecasts.

This is not "business as usual" here – these are demanding stresses against demanding capital targets. As the Governor of the Central Bank, Professor Patrick Honohan has made abundantly clear, this is a very conservative assessment of our banks' capital assessment.

The State's investment in the banks will lead to very high level of capital in the banks that we own. For instance if their PCAR requirements were met today, AIB and Bank of Ireland would have core tier 1 ratios of circa 22% and 16% respectively while IL&P would be in excess of 32%. Should the actual results prove to be better than the highly conservative assumptions used in the Central Bank's stress scenarios, we will redeem any surplus capital from the banks.

It is very reassuring that our external partners have signalled their support for, in their own words, this "rigorous capital needs assessment".

Bank Recapitalisation

I understand that ordinary people, investors and the financial markets as well as our international partners wish to have clarity on the Government's plans for ensuring that the banks meet these demanding capital requirements.

A key objective for Government is of course to strengthen overall fiscal sustainability by separating bank risk from that of the Sovereign. Clearly this can be achieved only by returning the banking system to health.

It is acknowledged by all that a large part of the €46.3 billion already invested by the State into the banks will not be recovered. But the State has not borne the full burden of the collapse. Around €60 billion of private equity value in Irish banks has also been destroyed since early 2007, much of it held by domestic citizens. Subordinated bond holders have also already contributed around €10 billion to the cost of the bailout.

Based on the Central Bank's work, a further €24 billion, including €3 billion of contingency funds, is now required by the banks for capital purposes. This is a significant sum, though it is within the funding envelope available for this purpose from the EU/IMF programme of support. This Government's view is that there should be no half measures. If it has to be done it will be done without delay.

This is not to say that this burden should fall first on the taxpayer without any mitigation. Actions to significantly reduce the cost to the taxpayer will include providing some element of capital up to €3 billion on a contingent basis – if not required, the capital must be returned to the State.

We will also seek direct contributions to solving the capital issues of the banking system by requiring further significant contributions from other sources including from subordinated debt holders, by the sale of assets to generate capital and where possible by seeking private sector investors.

It is important that, after going through the reorganisation, these three new banks are able to operate in the market place as strong banks with a positive future and ongoing positive relationships with counterparties of all kinds.

Anglo Irish Bank and INBS

Neither Anglo Irish Bank or Irish Nationwide were subject to the stress tests announced today. Consequently, there is no immediate need for additional capital for either institution. It is Government policy to work out these institutions in an orderly manner over time and to minimise further injections of taxpayer capital into either institution. A further assessment of the capital requirements of both institutions will be available in May. Should additional capital be required at that point, the Government will then consult with the external partners on the timeframe and means of recapitalising those institutions at minimum cost to the taxpayer, having regard to the financial stability impacts in Ireland and abroad..

We will act with due care and in close consultation with all the appropriate partners, having regard to the market situation, and the need to have regard to financial stability impacts in Ireland and abroad.

Throughout the process of addressing the problems in the banking system, including Anglo and INBS, we recognise that confidence in our banks and clarity about our proposed planned actions is necessary. I wish therefore to reiterate the commitment of the Government to the protection of those parties who have advanced funds which are guaranteed by Irish State and those others who continue to support our banks with deposits, interbank lending, derivative contracts and the like. Of course, bank depositors can be assured that their funds remain safe. Actions taken by the Government will, of course, be careful and proportionate, having regard to the principles I have outlined above.

Funding of Capital Investment
The agreement with the external authorities provided that the State would provide €17.5 billion of funding towards the programme of support for Ireland. Given the actions that the Government has decided to adopt to reduce the cost of capitalisation, it will be possible for much of the remainder of the cost to be met from existing resources. This will reduce the additional debt service cost to the State associated with new capital injections as there is no interest charged on funds from the National Pensions Reserve Fund which will provide €10 billion towards the cost of capitalisation.

My predecessor put almost €7 billion of the State's resources on deposit in the banks and this can now be used towards capitalisation.

Bank Funding
The covered banks continue to attract significant and largely stable deposit funding with the security provided by the State guarantee.

The ECB and our own Central Bank also continue to demonstrate an extremely high level of commitment to the funding of the Irish banking system Ensuring the recapitalisation of the banks underpins this solvency and thus their continued access over time to Central Bank liquidity facilities, and also facilitates the task of asset reduction and a return to more normal funding conditions.

Governance of our Banks
We would not be in the position we are today, had banks adhered to best governance practise. It is now vital that the efforts to financially restructure the banking system are supported by real improvements in corporate governance and the management of financial institutions in Ireland. It is crucial that the reputation of Ireland's banking system is restored.

In that context, I welcome recent initiatives made by the Central Bank in this area including the introduction of a new Code on Corporate Governance and the recent issuance of a consultation paper on fitness and probity standards by the Head of Regulation at the Central Bank, Mr Matthew Elderfield. Mr Elderfield has made it clear that the track record of those holding senior positions in financial services will be taken into account in assessing their suitability for taking up or indeed retaining a senior role in a financial institution.

I fully anticipate that as a result of this exercise there will be further changes at board level in the banks focused in particular on directors whose tenure pre-dates end-September 2008.

Reorganisation of Responsibility for Banking

We intend to implement the commitment in the Programme for Government to create a more integrated decision making structure among all relevant Departments and Agencies with banking responsibilities.

Therefore, another key plank of our proposed measures is to strengthen and enhance the capacity of the Department of Finance in the area of banking policy. We have seen how a problem in the banking system can significantly damage the economy and put the fiscal sustainability of the State at risk. This cannot be allowed to happen again. It is essential that the Department of Finance has the appropriate policy responsibilities and financial market and banking expertise to be able to advise Government on potential systemic threats and on measures to address and mitigate these.

The end-result will be that banks that have received taxpayer support will be far more accountable to Government and parliament for their performance in responding to the needs of the economy.

Conclusion

Finally, I want to be clear, too, for the benefit of our people and of market participants, that we are committed to the EU/IMF programme. We have issues that we wish to raise and changes that we need to make in the context of ensuring growth and recovery in the Irish economy. But we will respect the overall fiscal parameters of the programme and where adjustments to the programme affect these, we will make appropriate offsetting adjustments, and it is clear from contacts to date that there is already a good level of understanding between us and the funding parties in this regard.

This radical restructuring of the banking system is designed to put the banking system on a firm footing for the future and break the bonds with our toxic banking past. This is essential for our economy. It is essential for our country. From here, therefore, we move forward with purpose.