

### 3.3



19 July 2010

Mr Ted Mc Enery  
Clerk to the Committee of Public Accounts  
Leinster House  
Dublin 2

Dear Mr Mc Enery

I refer to your letter of 15<sup>th</sup> July 2010 concerning the Committee's private session on that date and the items the Committee has requested the Department to furnish.

I have enclosed a schedule of key documents in relation to the bank guarantee that were not released to the Committee. Also enclosed is a schedule of the DSG meetings that have been held since that group commenced in July 2007. Notes of most of the DSG meetings listed have already been provided to the Committee.

I should note of course that in identifying documents as 'key' we have exercised a certain amount of judgement to avoid the necessity of producing a large volume of documentation of lesser importance to the deliberations of the Committee. The documents concern the 'run-up' to the decision to give a general Government guarantee, and do not include any record of the actual deliberations of Ministers in preparation of the Government decision or the subsequent process leading to the legislation a few days later, and thereafter. I think the Committee will see from the volume of documents provided that we are endeavouring to be as helpful as possible.

Finally, attached to this letter is a note on the working of the DSG as a mechanism to facilitate information exchange between the relevant national authorities.

Yours sincerely

Kevin Cardiff  
Secretary General

### Domestic Standing Group on Financial Stability

The EU Economic and Financial Committee (EFC) agreed in September 2006 and the Ecofin Council endorsed in October 2006, a list of measures that Member States were to implement with respect to their domestic financial stability frameworks. One of these measures was the establishment of a domestic standing group on financial stability.

Under the agreed EU position the purpose of the national DSGs was to facilitate cooperation and information exchange between the relevant national parties with different roles and responsibilities with respect to the maintenance of stability. It was also envisaged that national DSGs would undertake the preparation of contingency plans and arrange and participate in simulation exercises.

An Irish DSG comprised of representatives of the Department, the Central Bank and the Financial Regulator commenced meeting in January 2007 and agreed a MoU in July 2007 which sets out the principles for cooperation between the authorities. Formal meetings of the DSG began following the signature of the MoU in July 2007.

The primary focus of the DSG following its establishment was to begin to strengthen financial stability planning arrangements in Ireland. This work intensified following the onset of the liquidity crisis in August 2007. While the MoU between the parties provided for a rotating Chair the Department of Finance called and chaired most of the meetings.

The discussion at the DSG was generally recorded in the form of a Note to the Tánaiste/Minister for use at Cabinet, or a Memorandum for the Information of the Government. Matters raised at the DSG were considered important enough that the Minister was kept informed and speaking notes were sometimes prepared for his use at Cabinet if he deemed it appropriate. For this reason and to protect the confidentiality of discussions at the DSG, a separate set of additional meeting notes was not generally kept by the Department.

Paragraph 8.7 of the Honohan Report on the banking crisis draws attention to the importance of good communication channels between the main public agencies dealing with financial sector matters confirming the different roles of the various agencies in Ireland:-

- The FR intended to have the best knowledge of the condition of each of the banks
- The Central Bank with policy responsibility for financial stability and decision making responsibility on the provision of emergency liquidity and
- the Department of Finance representing the Government interest in relation to the fiscal costs of a crisis.

As discussed in paragraph 8.8 of Governor Honohan's report the Memorandum of Understanding establishing the DSG made clear that the role of the DSG did not



impact on the legal responsibilities of each of the participants. Rather its primary focus encompassed the following matters:-

- the provision of information on market and regulatory issues
- contingency planning for crisis management
- participating in crisis simulation exercises
- principles for resolution of financial crises

Reflecting the deterioration in the international financial environment and the dislocation in credit markets in particular from August 2007, the priority in respect of the work of the DSG as evidenced by the reports produced following its meetings in the course of 2008 was to provide the Minister and Government with an up-to-date assessment of the financial market conditions and to inform contingency planning arrangements. These reports were intended to fully represent the exchange of information at the meetings of the Group.

**Table of Key Documents not released to the PAC**

<b>Date</b>	<b>Document</b>	<b>Comment</b>
Tuesday 29/01/2008	Letter from the Office of the Attorney General to Department re Financial Stability Contingency Planning and Legal Issues Arising	Not released – the document is subject to legal privilege as it contains advice received from the Office of the Attorney General (AGO)
Tuesday 01/04/2008	Note for Tánaiste to update Government on Financial Market Developments	Not released – Document was submitted to Tánaiste for use at Government meeting and is subject to Cabinet confidentiality
Tuesday 29/04/2008	Letter from Department to the Office of the Attorney General re Financial Stability Contingency Planning and Legal Issues arising	Not released – the document is subject to legal privilege as it reveals AGO's advice. Consultation note enclosed with letter was released to Committee. [No. 32 on Bank Guarantee Documents schedule]
Wednesday 07/05/2008	Summary re Irish banks for new Minister	Not released – document contains confidential institution-specific information
Monday 19/05/2008	Note to Minister re Funding situation	Not released - document contains confidential institution-specific information on the funding position of a particular institution
Tuesday 20/05/2008	Advice from the Attorney to Department re Financial Stability Contingency Planning and Legal Issues Arising	Not released – the document is subject to legal privilege as it contains advice received from the Attorney
Friday 13/06/2008	Letter from Department to the Office of the Attorney General re Financial Stability Contingency Planning and Legal Issues Arising	Not released – the document is subject to legal privilege as it reveals AGO's advice
Sunday 20/07/2008	Advice from Attorney to Department re Submission to Minister re Financial Stability Contingency Planning (with associated e-mail of 21/07/2008)	Not released – the document is subject to legal privilege as it contains advice received from the Attorney
Thursday 07/08/2008	Internal e-mail re position of Heads of Bill	Not released – the document restates advice received from the

<b>Date</b>	<b>Document</b>	<b>Comment</b>
10.50		AGO and therefore is subject to legal privilege
Monday 08/09/2008	Letter from Office of the Attorney General to Department re Legislative proposals – financial stability contingency planning	Not released – the document is subject to legal privilege as it contains advice received from the AGO
Monday 08/09/2008	Letter from Department to Office of the Attorney General re Contingency planning	Not released – the document is subject to legal privilege as it reveals AGO's advice
Wednesday 10/09/2008	Letter from Office of the Attorney General to Department re Financial Stability Bill	Not released – the document is subject to legal privilege as it contains advice received from the AGO
Wednesday 10/09/2008	Letter from Department to Office of the Attorney General re Contingency Planning	Not released – the document is subject to legal privilege as it reveals AGO's advice
Thursday 11/09/2008 14.42	Internal e-mail re advice from the Office of the Attorney General	Not released – the document is subject to legal privilege as it reveals AGO's advice
Friday 12/09/2008	Copy of letter from INBS to the Financial Regulator dated 9 September with cover letter from Financial Regulator	Not released. The note enclosed with the letter was received separately by the Department directly from INBS and this copy was released to the Committee [No 8 on the Bank Guarantee Schedule Documents]
Friday 12/09/2008	Letter from Office of the Attorney General to Department re Financial Stability Bill	Not released – the document is subject to legal privilege as it contains advice received from the AGO
Friday 12/09/2008	Letter from Department to Office of the Attorney General re Contingency Planning	Not released – the document is subject to legal privilege as it reveals AGO's advice
Saturday 13/09/2008 17.32	E-mail from Office of the Attorney General to Department re contingency planning	Not released – the document is subject to legal privilege as it contains advice received from the AGO

Date	Document	Comment
Saturday 13/09/2008	Copy of letter from Anglo Irish Bank to the Financial Regulator	Not released –confidential material received from Financial Regulator
Sunday 14/09/2008 10.32	E-mail from Office of the Attorney General to Department re contingency planning	Not released – the document is subject to legal privilege as it contains advice received from the AGO
Sunday 14/09/2008 17.48	E-mail from Department to Office of the Attorney General re contingency planning	Not released – the document is subject to legal privilege as it reveals AGO’s advice
Sunday 14/09/2008 19.10	Internal e-mail re draft contingency legislation with attached draft Government Memorandum and draft Explanatory Memorandum	Not released – the document is subject to legal privilege as it reveals AGO’s advice. The attached Memorandum for Government is subject to Cabinet confidentiality.
16/09/2008	Briefing for Minister in case required for cabinet meeting 17 September	Not released – Document was submitted to Tánaiste for use at Government meeting and is subject to Cabinet confidentiality. Redacted copy of associated background document was released. [No.16 on Bank Guarantee schedule]
Wednesday 17/09/2008 00.23	E-mail from Department to Office of the Attorney General re Contingency Planning	Not released – the document is subject to legal privilege as it reveals AGO’s advice
Wednesday 17/09/2008	Letter from Office of the Attorney General to Department re Contingency Planning	Not released – the document is subject to legal privilege as it contains advice received from the AGO
Thursday 18/09/2008	E-mail from Financial Regulator to Central Bank and Financial Regulator forwarding earlier e-mail and attachment from Goldman Sachs	Not released – Contains institution-specific information received in confidence.
Saturday 20/09/2008	Notes of Financial Regulator meeting with Anglo Irish Bank	Not released – Confidential information received from Financial Regulator



<b>Date</b>	<b>Document</b>	<b>Comment</b>
Saturday 20/09/2008	Notes of Financial Regulator meeting with Bank of Ireland	Not released – Confidential information received from Financial Regulator
Saturday 20/09/2008	Notes of Financial Regulator meeting with Allied Irish Bank	Not released – Confidential information received from Financial Regulator
Saturday 20/09/2008	Notes of Financial Regulator meeting with EBS	Not released – Confidential information received from Financial Regulator
Saturday 20/09/2008	Notes of Financial Regulator meeting with INBS	Not released – Confidential information received from Financial Regulator
Saturday 20/09/2008	Notes of Financial Regulator meeting with Irish Life and Permanent	Not released – Confidential information received from Financial Regulator
Sunday 21/09/2008	Draft Discussion Documents prepared by Goldman Sachs regarding strategic options	Not released – Contains confidential institution-specific information received in confidence
Wednesday 24/09/2008	Letter from Office of the Attorney General to the Department re Contingency Planning	Not released – the document is subject to legal privilege as it contains advice received from the AGO
Thursday 25/09/2008 12.12	E-mail and attached letter from the Department to the Office of the Attorney General re Financial Stability Planning	Not released – the document is subject to legal privilege as it reveals AGO's advice
Thursday 25/09/2008 12.52	E-mail from Department to the Office of the Attorney General re section 23 of the Central Bank Act 1997	Not released – the document is subject to legal privilege as it reveals AGO's advice
Thursday 25/09/2008	Letter from Office of the Attorney General to the Department re Contingency Planning	Not released – the document is subject to legal privilege as it contains advice received from the AGO
Thursday 25/09/2008	Letter from Office of the Attorney General to the Department re ECB Consultation	Not released – the document is subject to legal privilege as it contains advice received from

Date	Document	Comment
		the AGO
Thursday 25/09/2008 16.52	E-mail from Office of the Attorney General to the Department re State Aid	Not released – the document is subject to legal privilege as it contains advice received from the AGO
Friday 26/09/2008 09.03	E-mail from Department to Office of the Attorney General re State Aid	Not released – the document is subject to legal privilege as it reveals AGO's advice
Friday 26/06/2008 14.48	Internal e-mail forwarding NTMA e-mail of 14.22 responding to Secretary General's query re issues for Ireland's sovereign ratings from a guarantee	Not released – release of document could impact on the effectiveness of the guarantee to maintaining the stability of the financial system and as such would be exempt from release under section 31 of the FOI Act on grounds of its possible potential negative impact on the economic interests of the State.
Friday 26/06/2008 22.19	E-mail from Goldman Sachs to Department forwarding an update on INBS prepared by Goldman Sachs.	Not released – Contains confidential institution-specific information received in confidence
Friday 26/06/2008 23.18	E-mail from Department to Office of the Attorney General re guarantees and ELA	Not released – the document is subject to legal privilege as it reveals AGO's advice
Friday 26/09/2008	Letter from Department to the Office of the Attorney General re Financial Stability Planning	Not released – the document is subject to legal privilege as it reveals AGO's advice
Friday 26/09/2008	Letter from Department to Office of the Attorney General re Financial Stability Planning – National Pensions Reserve Fund	Not released – the document is subject to legal privilege as it reveals AGO's advice
Saturday 27/09/2008	Letter from Attorney General to Minister re State Aids and System Wide Bank Guarantee	Not released – the document is subject to legal privilege as it contains advice received from the Attorney
Saturday	Letter from Office of the Attorney	Not released – the document is

Date	Document	Comment
27/09/2008	General to the Department re Financial Stability Planning – National Pensions Reserve Fund	subject to legal privilege as it contains advice received from the AGO
Saturday 27/09/2008	Extracts from PwC material re liquidity position	Not released – institution-specific information prepared by PwC for the Financial Regulator
Sunday 28/09/2008 14.54	E-mail from NTMA to Department forwarding e-mail from PwC to NTMA re liquidity scenarios for banks	Not released – institution-specific information prepared by PwC for the Financial Regulator
Sunday 28/09/2008 15.04	E-mail from PwC to Department with attachment – summary of discussions on credit positions	Not released – institution-specific information prepared by PwC for the Financial Regulator
Monday 29/09/2008	Letter from Attorney to Minister re State Aid and Guarantee Issue	Not released – the document is subject to legal privilege as it contains advice received from the Attorney
Monday 29/09/2008 12.29	E-mail from Department to Office of the Attorney General with attachment re special share vs share transfer	Not released – the document is subject to legal privilege as it reveals AGO's advice
Monday 29/09/2008 15.00	E-mail from Arthur Cox to Department re powers of Central Bank	Not released – the document is subject to legal privilege as it was prepared by the Department's legal advisors legal privilege
Monday 29/09/2008 20.40	E-mail from PwC to Department, NTMA and Central Bank re liquidity positions	Not released – institution-specific information prepared by PwC for the Financial Regulator
Monday 29/09/2008 22.38	Draft contingency legislative provisions for Credit Institutions (Protection ) Bill	Not released – the document is subject to legal privilege as it was prepared by the Office of the Parliamentary Draftsman

The Central Bank provided a number of daily liquidity figures for the Irish institutions during September 2008. In addition, during September 2008 the Financial Regulator circulated 5 times per day deposit flow reports in relation to a particular institution. These were circulated in the Department but the individual e-mails have not been listed. They have not been released as they contain confidential institution-specific information from the Financial Regulator and the Central Bank.

Multiple earlier drafts of documents have generally not been listed.



**DSG meetings**

<b>No</b>	<b>Date of DSG meeting</b>	<b>Note of meeting</b>
1	DSG 03/07/2007	Released
2	DSG 31/8/2007	Part redacted
3	DSG 21/9/2007	Released
4	DSG 03/10/2007	Part redacted
5	DSG 02/11/2007	Part redacted
6	DSG 16/11/2007	Part redacted
7	DSG 03/12/2007	Part redacted
8	DSG 11/01/2008	Part redacted
9	DSG 08/02/2008	Part redacted
10	DSG 06/03/2008	Part redacted
11	DSG 17/04/2008	Part redacted
12	DSG 22/04/2008	Part redacted
13	DSG 26/05/2008.	Part redacted [An associated note on a particular issue not released]
14	DSG 18/06/2008	Part redacted
15	DSG 08/07/2008	Part redacted
16	DSG 23/7/2008.	Part redacted
17	DSG 17/09/2008	Released
18	DSG of 09/2/2009	Withheld from release
19	DSG of 27/2/2009	Withheld from release
20	DSG of 16/04/2009	Withheld from release
21	DSG of 06/10/2009	Withheld from release

No	Date of DSG meeting	Note of meeting
22	DSG 02/11/2009	No note of this meeting
23	DSG of 12/11/2009	Withheld from release

# CONFIDENTIAL

## Financial Stability Issues – Scoping Paper

### 1. Introduction

The purpose of this paper is to identify significant issues relating to the options available to the Irish authorities in the case of a systemic threat to financial stability, as well as consider any issues regarding the structures currently in place to oversee financial stability planning arrangements and also to manage a financial crisis. It examines the legal framework within which any crisis management operations must take place and any possible questions regarding the legal powers available to the Minister and the Central Bank and Financial Services Authority of Ireland (CBFSAI). The paper also includes some analysis of the recent difficulties in the UK financial system, following the experience of Northern Rock and any implications this may have for financial crisis management here. The paper examines these issues by reference to two key scenarios – a financial institution that is solvent but is experiencing liquidity problems and an institution that is insolvent or heading towards insolvency.

This paper focuses on the domestic framework for managing financial stability issues. Work is on-going at EU level on enhancing the effectiveness of the EU stability framework by clarifying the existing arrangements for resolving cross-border financial crises and their use, while stressing the primacy of private sector solutions and minimising moral hazards. Arising from EU requirements there are a number of work streams that need to be addressed by our Domestic Standing Group on Financial Stability (DSG). These include developing a national contingency plan and carrying out a crisis simulation exercise. Ecofin Ministers recently adopted conclusions setting out further steps, at both EU and national levels, for the development of financial stability arrangements. The conclusions include common principles for cross-border financial crisis management and a roadmap for enhancing cooperation and preparedness and for reviewing the tools for crisis prevention, management and resolution. A new EU level MoU between supervisors, central banks and finance ministries will include a common analytical framework for the assessment of systemic implications of a potential crisis to ensure the use of common terminology in assessing the systemic implications of a cross-border financial crisis by relevant authorities and common practical guidelines for crisis management to reflect a common understanding of the steps and procedures that need to be taken in a cross-border crisis situation.

### 2. Overall approach to crisis management – spectrum from constructive ambiguity to transparency

At the outset it is important to draw attention to variety of approaches that can be taken by the authorities to financial stability planning and contingency planning arrangements for crisis management on a spectrum from constructive ambiguity to complete transparency. A policy of constructive ambiguity towards financial stability planning involves not sharing full information about public authorities' likely actions in a financial crisis, in order to minimise moral hazard. In such circumstances a financial institutions cannot be sure in what circumstances the CBFSAI will intervene and so they are encouraged to monitor and manage risks that might otherwise be ignored if an institution was confident that the CBFSAI would definitely intervene. Transparency regarding the preparations and preparedness of authorities for a financial crisis may help support public confidence in the event of a crisis but it may also constrain authorities' actions in any given crisis due to

expectations of their actions. It may also condition or influence public perceptions of the likelihood of a financial stability event.

The authorities in Ireland have practiced constructive ambiguity regarding financial stability planning to date. For the future it would seem appropriate to maintain this approach. However, the existence and ongoing development of the EU framework for crisis management on a cross-border basis provides an opportunity to communicate, as appropriate, the existence of financial stability planning structures in Ireland in line with EU requirements in the interests of greater openness and transparency.

### **3. Scenario 1 – An institution that is illiquid but solvent**

If an institution is experiencing liquidity difficulties<sup>1</sup> and has exhausted any opportunities for accessing liquidity in the wholesale market the first step should be for it to seek liquidity from the European Central Bank (ECB) in normal operations. This liquidity would of course require eligible collateral. In Ireland, a large proportion of banks' balance sheets can be used as collateral for liquidity provision; through for example the use of mortgage backed promissory notes. Intensive use of eligible assets for liquidity under "normal" Eurosystem conditions is likely to be noticed by the market. If this liquidity is not sufficient to restore liquidity to the institution, the institution may approach the CBFSAI for emergency liquidity assistance (ELA). The view of the CBFSAI is that the requirement for the ELA provision to an Irish bank would signify the existence of a serious threat to the long-term sustainability of the financial institution in question because of the 'stigma' that would attach to it. It is important to highlight, therefore, that ELA provision would be an interim measure while urgent consideration was given by all parties to the available options for rescuing the bank.

#### **3.1 CBFSAI role in this situation**

The authority responsible for the provision of ELA to an illiquid institution is the CBFSAI. The CBFSAI is preparing a paper outlining the basis, legal powers and other considerations relating to the provision of ELA and this will form an appendix to this paper when completed. On account of the CBFSAI's statutory independence for monetary operations, on behalf of the ESCB, emergency lending would be at a national central bank's own risk and the CBFSAI would therefore advise the Department before providing such assistance. This would take place through, for example, the DSG or other official channels. As the CBFSAI is a member of the ECB, provision of ELA must be reported to the ECB, either *ex post*, or in advance if it exceeds €500mn. The ECB could prohibit the ELA provision if it is deemed to interfere with the single monetary policy. It is very important to note that the CBFSAI is prohibited from providing ELA to an insolvent institution. Therefore if there is any concern that a financial institution seeking ELA is insolvent, the CBFSAI would not be in a position to provide liquidity support without the question of some guarantee arising from the Exchequer. However, it is recognised that this type of assessment is very difficult in a situation of financial stress. The issues that arose in relation to the performance of the Bank of England's Lender of Last Resort function in the case of Northern Rock highlight a number of important issues requiring consideration in the context of the scope for ELA support. These are discussed at Section 3.6 of this paper below.

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<sup>1</sup> For the purposes of this paper, illiquid/illiquidity is taken to be a situation where a financial institution is unable to convert its assets into negotiable instruments that can be used to meet its obligations. Also for the purposes of this paper, insolvent is taken to be a situation whereby an institution has insufficient assets to meet its obligations.



While it is not necessary to make public immediately the provision of ELA, the support would appear on the CBFSAI's balance sheet without referring to the recipient and could therefore prompt unhelpful market speculation, which could exacerbate the financial situation of the individual institution or the market generally. In addition, it seems unlikely that information that an Irish bank was in receipt of ELA would not come into the public domain in any event. The requirement for a PLC to make a disclosure to this effect under Stock Exchange rules also needs examination.

### **3.2 Department/Minister's role in this situation**

Traditionally, it would be considered that the Minister for Finance does not have a specific role when an institution is illiquid but solvent and there is no legal role for the Minister in such an event. However, following the impact of the provision of ELA to Northern Rock in the UK on public confidence in that institution and the financial system generally (see below), it is likely that if the provision of ELA came into the public domain the Minister and the Department would in practical terms very quickly become involved in terms of the management of the potential broader financial stability issue.

Therefore the Minister and Government could quickly find itself in a situation where there was pressure to give assurances that the State was prepared to support the bank in difficulty or provide guarantees to its depositors. Other guarantees which the Minister might consider giving include guarantee to banks regarding interbank lending to pre-empt overall withdrawal of market liquidity and guarantee to CBFSAI regarding losses that may occur on ELA. The broader issue of communication and maintaining confidence in the financial system raises the issue of whether the CBFSAI or the Minister / Government should take the lead communications on financial stability concerns. Consideration needs to be given to the requirement to communicate with the public but also with the international financial community whose assessment of overall financial stability conditions would be expected to be critical to the broader systemic impact of difficulties in any individual financial institution.

The important question also arises in this context what options may be available to the authorities to initiate actions to address its emerging concerns about the bank's liquidity, solvency or stability in advance of a crisis situation emerging into the public domain.

### **3.3 Impact of ELA provision on confidence in the institution**

As the recent liquidity difficulties at Northern Rock have shown, while an institution may be illiquid but solvent, the public perception of a requirement for ELA is that the institution is in trouble and at risk of collapse. The announcement that Northern Rock would receive ELA from the Bank of England triggered a bank run which was only stemmed by the Chancellor's announcement of a 100% guarantee for deposits in Northern Rock. It may be the case that the question of such a guarantee would now arise in any similar situation in Ireland in the future to prevent depositors withdrawing their money once any ELA provision is disclosed to the market.

In circumstances that there may be specific concerns regarding the position of the financial system as a whole in Ireland, on account, for example, of its dependence on property related lending, a further effect of ELA provision on confidence in the financial sector may take place in international wholesale markets, as other banks lose confidence in an

institution and are no longer willing to lend to it. This could lead to a general decline in confidence in the Irish financial sector as a whole – depending on the reasons for the ELA provision in the first place – and has the potential to cause a systemic issue even if the initial institution is still solvent and the position of the Irish financial sector is in objective terms sound. As summarised above, in current market conditions, any difficulty in a significant individual Irish bank could be expected to raise very serious concerns regarding the stability of the Irish financial system overall. It is imperative therefore, that a successful resolution is secured at the earliest possible stage in the development of the crisis., and that, as much as possible any guarantee or interbank lending required would be in place in advance of any public knowledge of ELA provision.

### **3.4 Importance of communication and media management strategy (Department and CBFSAI)**

The “Northern Rock effect” demonstrated that communications re any ELA provisions and the deposit protection scheme in place would be vital in the case of a crisis. Statements by the FSA, the Bank of England and the Chancellor that the bank was solvent did not prevent depositors losing confidence in Northern Rock and large queues forming as depositors queued to withdraw their deposits, worsening the liquidity position of Northern Rock even further. The evolution of the Northern Rock crisis in the UK and the information that has subsequently emerged regarding conflicts between the authorities on the resolution of crisis, highlight the case for a swift pre-emptive response to difficulties at the earliest possible stage. The longer the crisis continues the greater the risk of contagion.

A formal crisis communications procedure between the press offices of the three authorities should be established as part of the overall package of crisis management procedures to enhance the effective of public communications. A set of generic “Questions and Answers” documents and templates for media communication could be developed in advance to enhance any pre-emptive response.

### **3.5 Actions undertaken by the UK authorities following Northern Rock’s difficulties**

Since Northern Rock difficulties began the UK authorities have taken a number of actions in order to maintain financial stability. These are:

- The Bank of England provided ELA to Northern Rock and also announced that it would provide ELA at the same terms to any other institutions who ran into similar difficulties
- Following the run on Northern Rock deposits the Chancellor announced that all current deposits in Northern Rock would be 100% guaranteed and it was clarified with the UK Treasury that the guarantee extended to Irish depositors and wholesale deposits.
- The level of deposit protection was increased to 100% of the first €35,000 in any account
- The Treasury guarantee was extended to all new deposits, including wholesale deposits, placed in Northern Rock
- Northern Rock customers who withdrew from ISAs in Northern Rock were allowed to keep their tax benefits providing the money was redeposited in an ISA ( in Northern Rock or another institution)
- The guarantee was extended to a variety of existing and future unsubordinated wholesale obligations.

Arising from this legal advice is required from the Office of the Attorney General on the legal scope available to the Minister to provide an increased level of guarantee if required particularly at short notice (over and above DGS levels).

### **3.6 CBFSAI's assessment of issues raised by Bank of England that impeded its lender of last resort function**

The CBFSAI is currently examining the four legal issues identified by the Bank of England as impeding its lender of last resort function. These are:

- **The Takeover Code**  
This legislation forces takeover bids to be disclosed and sets out a long procedure for takeovers – the Governor of the Bank of England, Mr Mervyn King, said that this prevented him from organising a takeover and presenting it as a “done deal”
- **The Market Abuse Directive**  
This defines what behaviour is considered insider dealing and provides for disclosures to the market – Mr King said this meant that any lending operations to Northern Rock had to be disclosed.
- **The insolvency regime in the Enterprise Act 2002**  
This provides a framework for the winding up of companies -- for banks it means that depositors have their accounts frozen. Mr King said that this made it rational for people to queue for their deposits back
- **The Financial Services Compensation Scheme**  
This sets out the rules for the limited guarantees on UK banking deposits -- Mr King said that the fact that this only covered up to £35,000 made it more important for people to withdraw their money from Northern Rock.

The Department may need to seek its own legal advice from the Office of the Attorney General in relation to these matters and any potential implications for the Minister/Department, to identify issues and possible options in resolving a financial crisis.

### **4.Scenario 2: An institution that is insolvent (or approaching insolvency)**

If a period of illiquidity continues it is likely that an illiquidity institution will move closer to insolvency. As referred to above, it is important to note that, from the outset, any major financial institution drawing on ELA will be in very serious financial difficulty and is likely to be in need of rescue. A situation that commences as one where an institution has difficulty in converting assets into financial instruments (cash, credit instruments) can deteriorate quickly (e.g. withdrawal of deposits by depositors, reluctance of lenders to provide credit facilities, etc.). In circumstances that liquidity is not freely available, any sustained poorly managed mismatch between the short-term liabilities and the longer-term asset can quickly lead to a situation whereby an institution becomes unable to meet its obligations as they fall due, i.e. it becomes insolvent because of its illiquidity. Furthermore a perception that an institution is in difficulty can lead to the discounting of the value of its assets by the market such that the value of its assets falls below its liabilities. Where lending to the financial institution in question is secured over its assets, any deterioration in asset quality will give rise to increased financial demands from its creditors.

Given the importance of the principle of the precedence of private sector solutions, the first decision is whether the State should take any action to assist an institution at risk of insolvency. Responsibility for maintaining the solvency of an institution lies with its Directors and shareholders should try to ensure that any institution they invest in is solvent

and will remain so for the foreseeable future in order to realise profits from their investment. The costs of insolvency should not transfer to the State simply because the institution in question is a bank (or other financial institution). The role of the authorities is to maintain financial stability and not to bailout shareholders of insolvent institutions. Thus the preferred outcome for an insolvent institution may be its failure and subsequent orderly wind-down. However, it may be the case that an institution is considered systemically important, ie the failure of this institution is believed to be likely to have a serious effect on the financial system in general and may thus cause financial instability. An institution of this nature is also described as “too big to fail” (TBTF). If a financial institution is considered TBTF, in order to maintain financial stability overall, it is likely that the State will intervene in order to prevent the failure of that institution. The intervention may take the form of assisting the institution until a private sector buyer can be found (as is happening with Northern Rock) or consideration could be given to taking the institution, or elements of it, into public ownership (See also Appendix 2)

#### **4.1 Definition of systemically important institution (TBTF)**

A TBTF financial institution is defined as one whose failure is believed to be likely – both directly through its impact on the real economy and indirectly through the risk that contagion effects will threaten the stability of other financial institutions – to provoke a systemic failure of the financial sector overall. Formally defining an institution as TBTF in advance of any difficulties is not a viable strategy for two main reasons:

- i) It would cause moral hazard as the institution expects that the State will intervene and it will be rescued if it should run into difficulties.
- ii) The systemic impact of the failure of an institution may vary depending on a number of factors, for example public confidence in the system in general or general financial market conditions. If public confidence is low, the failure of any institution could cause systemic problems and so in this case any institution may be TBTF. Another reason an institution may be systemically important relates to the type of difficulties encountered by the institutions. If there is a perception that this type of difficulties (eg exposure to the property market) is likely to affect more than one institution this could also mean that its failure would have systemic consequences.

The failure of even a small bank which is not systemically important in itself may not be acceptable in certain circumstances because of fear of contagion at a time of market uncertainty or for political deposit protection reasons. Thus the decision to classify an institution as TBTF, indicating that the State is likely to intervene, should be taken on a pragmatic, case-by-case basis in light of prevailing economic and financial circumstances. The information provided by the CBFSAI to the Minister and the Government, assessing the nature and scale of a financial crisis and the importance of the institution in the financial system is of critical importance when designating a financial institution as TBTF. It also needs to be borne in mind that a further lesson from the Northern Rock situation is that the state of public confidence may be such that what, in objective terms, may not be a systemically important financial institution (i.e. one that is TBTF) may need to be treated as one on account of the potential impact of its collapse on public confidence in other financial institutions and the financial sector generally.

#### **4.2 Role of CBFSAI if an institution is insolvent**

It is important to note that the CBFSAI is legally prohibited from providing ELA to an insolvent institution. As referred to above, it will be difficult particularly in a crisis situation to differentiate clearly between an illiquid and an institution at risk of insolvency. In any event an illiquid institution can quickly become insolvent. It is therefore essential that



there is close co-operation, co-ordination and communication between the three institutions comprising the DSG to ensure that the tools available to manage a crisis situation are effectively deployed in a crisis situation.

The CBFSAI could continue to lend to an insolvent institution if it was given a guarantee or letter of comfort from the Minister / Government. The role of the CBFSAI in lending to an insolvent institution is thus defined by the actions of the Minister for Finance. There are, however, significant issues regarding the Minister's legal powers in this area (see below).

It is also important to note that under Company Law it is the responsibility of the Board to determine whether an institution is in a position to meet its obligations as they arise or not. While the CBFSAI, in discharging its role as lender of last resort, would clearly be involved in intensive monitoring of the financial status of the bank to which it was lending, a decision that the bank had become insolvent and ongoing support required State involvement would take place at the point that the bank was being placed in administration. This highlights the case that early action is required to respond to a situation of financial distress in a bank with a view to achieving a market-based resolution.

#### **4.3 Role/Legal powers of the Minister in this situation**

As outlined above, if an insolvent bank sought ELA, the CBFSAI would be legally prohibited from extending it. However, if the bank was systemically important and the Government agreed to extend a guarantee to its liabilities, then this would turn it from an insolvent bank into an illiquid but solvent one (with the State guarantee backing up its capital), so that the CBFSAI could inject liquidity to prevent contagion effects in the wider financial system.

In regard to guarantees, Public Financial Procedures (PFPs) provide that a guarantee may be issued only where there is specific statutory authority to issue such a guarantee. Statutory power to guarantee borrowing is provided under the State Guarantees Act, 1954 (which allows the Minister for Finance to guarantee borrowing by any body named in the Schedule to the Act or added to the Schedule by Government order) or under the specific legislation governing a particular body.

The statutory power to guarantee, whether under the State Guarantees Act, 1954 or other legislation is normally subject to a cash limit above which guarantees cannot be given in respect of a particular body. The use of the State Guarantees Act for guaranteeing borrowing has diminished and the practice now more usually adopted is to provide borrowing and guaranteeing powers in the particular legislation which relates to a specific State body.

"Letters of Comfort" is a somewhat loose term used to describe a form of written assurance to lending institutions or others in relation to borrowing or other financial commitments where there is no statutory power to guarantee or where guarantees up to the statutorily authorised level have already been given. PFPs state that such letters are objectionable as they may be interpreted as imposing a contingent liability on the Exchequer without Dail approval. Detailed instructions in relation to letters of comfort have been set out in Department of Finance Circular 4/84. The main principle contained in these instructions is that a letter which expressly, or by implication, gives a guarantee or undertaking not already authorised by legislation should not, in any circumstances, be issued. The CBFSAI's view is that a letter of comfort from the Minister to cover the CBFSAI's risks

would not be sufficient for the CBFSAI to lend to an insolvent institutions – a comprehensive guarantee would be necessary.

The discussion above would seem to suggest that in order for the Minister to provide the CBFSAI with the guarantee it requires to assist an insolvent institution legislation is required. However, if this legislation is passed in advance the advantages of constructive ambiguity may be lost as it will be clear that the State may “bailout” an insolvent institution. Legislation may also require that the circumstance in which such a letter of comfort be provided are laid out which could cause moral hazard, as institutions would know when and how the State would intervene if they were in difficulty. The existence of such powers in the Statute Book could also compel the Minister to act to save an institution that would otherwise not be saved and reduce the flexibility available to the Minister to deal with any particular institution. It may be the case therefore that the solution is to prepare legislation *ex ante* of a crisis but only enact it if required. The difficulty this raised is that the time frame for dealing with a crisis may be quite limited and the Dáil may not be in session when the legislation was required.

In line with what has taken place in other jurisdictions the existence of explicit legal powers may not be required providing the Minister / Government is in a position to announce the intention to provide the required guarantee / support with the appropriate approval of the Oireachtas in due course either in relation to legislation or through approval for a Vote. The CBFSAI’s view is that it would not be able to act on a “promise of a guarantee” given the prohibition on their lending to insolvent institutions.

If the State is to intervene to support an institution it may choose to assist the institution to remain a going concern while a buyer is found, which would require liquidity assistance and the guarantee outlined above. However, another option which may be available to the State is to nationalise the institution. In these circumstances, the State may simply takeover the entire institution or takeover the part of the institution that is in difficulty (creating in effect a “bad bank”). The nationalisation of a bank would be likely to be a temporary measure. If the entire institution was nationalised, it might be then be sold on, after it had recovered from its difficulties. If a “bad bank” was formed then this bad bank might be run off or put in examinership. Any form of nationalisation may require legislation. A number of important legal / constitutional points are likely to arise vis-à-vis shareholders’ rights under Company Law in respect of which legal advice is required.

#### **4.4 Principles guiding public intervention**

A paper prepared by the Department of Finance in 2005 identified the following as important principles which should guide State intervention to resolve a banking crisis:

- The support given is transparent and public
- The attractiveness and public funding needs of the programme shall be minimised. The economic responsibility of the owners of the bank receiving support should be realised as widely as possible - shareholders should not be protected against losses.
- The terms of the programme should support the efficiency of the banking system and contribute to necessary structural adjustment.
- The State should be afforded the opportunity to participate in any upturn in the fortunes of the rescued entity
- The State should seek value for money
- The State's contribution to the rescue should be remunerated on commercial terms at least

- State support should be conditional - opportunities for exerting leverage from the support should be fully exploited.
- The rescue plan must have a good prospect of success and have a high probability of returning to the State any funds provided over the longer term
- Prompt intervention should reduce the cost of intervention and will promote efficiency
- The impact of shareholder interests should be assessed.

There will of course be an inevitable tension between these desiderata and the risk (because of the delay associated) of failure to avert the crisis.

An Ad Hoc Working Group on Financial Stability (ADWG) was established in September 2006 by the ECOFIN Council to explore ways to further develop financial stability arrangements in the EU. The Final Report was presented to the ECOFIN Council. The core of their Final Report, which formed part of the Ecofin Council conclusion in October 2007, is a set of 13 policy recommendations, 9 principles and a detailed strategic roadmap for actions out to 2009 involving action mainly in two areas – extending the 2005 EU Memorandum of Understanding on cooperation in financial crisis situations and developing voluntary cross-border cooperation agreements. The principles, which are to be applied to cross-border financial crises, are listed below:

#### *Common Principles for cross-border financial crisis management*

1. The objective of crisis management is to protect the stability of the financial system in all countries involved and in the EU as a whole and to minimise potential harmful economic impacts at the lowest overall collective cost. The objective is not to prevent bank failures.
2. In a crisis situation, primacy will always be given to private sector solutions which as far as possible will build on the financial situation of a banking group as a whole. The management of an ailing institution will be held accountable, shareholders will not be bailed out and creditors and uninsured depositors should expect to face losses.
3. The use of public money to resolve a crisis can never be taken for granted and will only be considered to remedy a serious disturbance in the economy and when overall social benefits are assessed to exceed the cost of recapitalisation at public expense. The circumstances and the timing of a possible public intervention can not be set in advance. Strict and uniform conditions shall be applied to any use of public money.
4. Managing a cross-border crisis is a matter of common interest for all Member States affected. Where a bank group has significant cross-border activities in different Member States, authorities in these countries will carefully cooperate and prepare in normal times as much as possible for sharing a potential fiscal burden. If public resources are involved, direct budgetary net costs are shared among affected Member States on the basis of equitable and balanced criteria, which take into account the economic impact of the crisis in the countries affected and the framework of home and host countries' supervisory powers.
5. Arrangements and tools for cross-border crisis management will be designed flexibly to allow for adapting to the specific features of a crisis, individual institutions, balance sheet items and markets. Cross-border arrangements will build on effective national arrangements and cooperation between authorities of different countries. Competent authorities in the Member States affected by a crisis should be in a position to promptly

assess the systemic nature of the crisis and its cross-border implications based on common terminology and a common analytical framework.

6. Arrangements for crisis management and crisis resolution will be consistent with the arrangements for supervision and crisis prevention. This consistency particularly refers to the division of responsibilities between authorities and the coordinating role of home country supervisory authorities.
7. Full participation in management and resolution of a crisis will be ensured at an early stage for those Member States that may be affected through individual institutions or infrastructures, taking into account that quick actions may be needed to solve the crisis.
8. Policy actions in the context of crisis management will preserve a level playing field. Especially, any public intervention must comply with EU competition and state-aid rules.
9. The global dimension will be taken into account in financial stability arrangements whenever necessary. Authorities from third countries will be involved where appropriate.

While these type of guiding principles should clearly inform the decision making made in a crisis situation, it needs to be borne in mind that every crisis situation is different and that a rigid adherence to any one principle is unlikely to be consistent with effective and successful crisis management.

#### **4.5 Company Law provisions and the interaction of these provisions and financial stability objectives – difficulties, etc**

While it may be desirable to consider a special insolvency regime for dealing with banks this paper simply presents the three courses of action currently available under company law should an institution be insolvent or nearing insolvency.

The Department produced a summary of these provisions which is attached at Appendix I. These three mechanisms are summarised below. The Court Protection route seems to offer the most advantageous approach to dealing with a problem financial institution, if intervention at this level is to be considered.

##### ***Appointment of a receiver for all or part of the assets***

Receivers are usually appointed by creditors in respect of a charged asset once the conditions (default etc.) specified in the agreement creating the charge for the appointment occur. The receiver's main function is to realise the security for the benefit of the creditor. Appointment of a receiver to a financial institution would immediately erode confidence in its solvency, require supervisory intervention and probably precipitate a request for appointment of either a liquidator or examiner.

##### ***Appointment of a liquidator (under three forms of winding up);***

There are three form of winding up:

- The members (voluntary winding up of a solvent company)
- The creditors (voluntary winding up of an insolvent company)
- The Courts (compulsory winding up for insolvency or other reasons).

The functions of a liquidator are to wind up the affairs of the company and realise its assets for distribution. The appointment generally puts an end to the directors' powers

The CBFSAI may petition for the winding up of a bank on four grounds:

- that it may be unable to meet its obligations to creditors
- has failed to comply with a direction under S21 of the Central Bank Act (CBA) 1971
- has ceased to carry on banking



- in the interests of depositors.

Liquidation has a number of practical effects:

- It freezes the assets and the transactions of the company;
- It freezes all actions against the company;
- It terminates all contracts of employment;
- Payments to creditors etc. would generally not commence until the liquidator has established the true state of affairs of the company

The appointment of a liquidator is primarily intended to provide for an orderly winding up of a firm's affairs. However this would have serious implications for customers and other users of financial institutions, which are not contemplated in the normal framework for dealing with liquidation. There could be delay or uncertainty in relation to repayment of short term commercial deposits and settlement of other payment transactions. This would have knock on effects on liquidity for both in the payments system and commercial transactions (e.g. money held by solicitors and others towards the conclusion of contracts). Given the importance of confidence in the financial services sector, the appointment of a liquidator (or receiver) to one financial institution, would likely lead to financial stability concerns arising in the wider system.

### ***Appointment of an Examiner (Court Protection)***

The protection and examination procedure is designed to save all or part of the undertaking and to prevent it being wound up. Only the CBFSAI may apply to the Courts for examinership in the case of a credit institution which is supervised by it. Creditors' rights are restricted from the moment the petition is presented. An application to the Court should demonstrate that the company is insolvent or likely to become so (5 tests are provided) and satisfy the Court that there is a reasonable prospect of ensuring the survival of all or part of the undertaking. The immediate effect of court protection is to provide the company with extensive protection against creditors, claims, realization or repossession of assets against which security was given, liquidation and receivership, from the time of application. While this would freeze the company's transactions, the examiner can be given extensive powers to continue its operations pending the putting in place of the final rescue package. Examinership would mean the closure of the entity until a new owner or other solution is found. This could have serious implications for the overall payment system if the bank is a major clearing bank. To realise the benefits of examinership a guarantee of deposits may be required.

Where necessary, in order to secure the survival of the company, the examiner may certify liability in respect of certain transactions, thus making them an expense of the examination which would then have priority over other debts of the company. There also may be scope for using the Deposit Guarantee Scheme (DGS) to pay out deposits. It may be possible to maintain some essential banking services during examinership.

### ***Critical Banking Functions***

The failure of any bank could have negative impacts on critical banking services such as automated payments and direct debits that are now an integral part of payments systems on which the economy is reliant. It may be possible for certain critical functions to be taken on by another provider but this approach would of necessity be uncertain and ad hoc in nature. Mechanisms to maintain critical banking functions would be important from the point of view of protecting consumers and helping to maintain market and consumer confidence.

The recent UK discussion paper 'Banking reform – protecting depositors – indicates there different approaches to resolving bank difficulties in other countries. The US has a distinct insolvency regime for banks involving wide powers for special administrators appointed to

carry out resolutions. These special administrators are generally answerable to the banking regulator rather than the courts. Bridge Banks involves either the transfer of the assets and liabilities of the existing legal entity to a new legal entity or the transfer of the existing legal entity to new owners. The new (bridge) bank would then continue to provide the critical banking functions while either a recapitalisation or a permanent transfer of business to new owners was organised. Some European countries have special arrangements for banks in trouble including provisions for authorities to appoint special or provisional administrators with discretion over the initiation of measures, including the ability to apply them to banks before they are technically insolvent.

In looking to the case for the reform of deposit protection and banking stability systems in Ireland, recent developments in the UK and the subsequent assessment of how the Northern Rock situation might have been better handled, highlight a number of issues for review and examination as follows:

- Does Ireland need a new insolvency mechanism specifically for banks and other credit institutions?
- If it is decided to maintain the legal mechanisms currently available under Company Law are there any reforms that would be desirable?
- Is it clear that examinership is the best available winding down mechanism if the aim of the State is to “rescue” the bank?
- What mechanisms are available to ensure that essential banking services in circumstances that a retail financial institution is the subject of examinership or administration.

#### **4.6 Implications of State Aid rules for any actions undertaken to assist an insolvent institution**

The EU framework for competition is laid down in Articles 81-89 of the EC Treaty. Article 87(1) declares that “any aid granted by a Member State through State resources in any form whatsoever which distorts or threatens competition...shall...be incompatible with the common market.” The EU Commission is responsible for decisions on this issue and must be notified by a Member State of any State aid measures. The Commission’s assessment of whether an action is state aid is based on the ‘private investor test’ – a State measure is State aid if a private investor would not be willing to provide the aid under similar circumstances. Article 87(1) does apply to the banking sector. However, liquidity support for solvent institutions is not considered State Aid.

Article 87(3)(b) provides for a possible derogation for actions taken to “remedy a serious disturbance in the economy of a member state.” Thus if measures to deal with a systemic crisis support the whole national financial system and do not duly distort competition and are limited to what is strictly necessary then these measures could be declared compatible with EU competition law. However the Commission takes the view that a crisis at a large bank does not automatically entail derogation.

The conclusions of the Economic and Financial Affairs Council (ECOFIN) meeting 9 October 2007 invites the Commission to “endeavour to clarify when a major banking crisis could be considered by the Commission such as to provoke a ‘serious disturbance of the economy’ within the meaning of Article 87(3)(b) of the EC Treaty and state aid rules” and “to consider streamlining procedures focusing on how state aid enquires under such critical circumstances can be treated rapidly.” The outcome of the Commission’s work could have a major impact on the scope for Member States to take action to avert systemic crises.

### *State Aid and Northern Rock*

The European Commission is monitoring the situation regarding the provision of a State guarantee of Northern Rock deposits by the British government. In September a Commission spokesperson said it was too early to tell whether it has State aid implications. The spokesperson also said that the Commission is generally supportive of rescue efforts when there is a systemic risk of collapse and this type of support has a six-month limit and has to be granted on normal market terms so as not to distort competition with other financial institutions. If it lasts over six months, any official aid could not be considered as rescue support and would require a restructuring to be carried out.

On 25 October the UK Chancellor of the Exchequer told MPs that the European Commission had raised no objections to the facility provided to Northern Rock. That suggests it is not being treated as State aid under European rules.

The EU treatment of UK support for Northern Rock will be monitored closely to draw any lessons relating to the possible implications in the area of State aid for the provision of a government guarantee to the CBFSAI to support a financial institution in difficulty, to understand fully the extent to which the terms of any such guarantee are prescribed by the State aid rules and to assess the implications of any positions taken by the European Commission on the UK Government's guarantee of all Northern Rock deposits for any future measures undertaken in order to prevent a systemic crisis.

### **4.7 Deposit Guarantee Scheme:**

The UK public's reaction to the liquidity difficulties at Northern Rock and the UK Chancellor's provision of a 100% guarantee of all deposits in Northern Rock, which has subsequently been extended to include new deposits, has led to calls for a reassessment of the effectiveness of the deposit guarantee arrangements in the EU as a whole under the terms of the EU Deposit Protection Directive. The Ecofin Council, at its meeting on 9 October last, decided on a preliminary set of issues to be analysed and addressed following the recent market turbulence. These include reviewing possible enhancements of the deposit guarantee schemes in the EU. This review is to be undertaken by the Commission and the EU's Financial Services Committee on which Ireland is represented. This review is to report by mid-2008. The work carried out on this review and its conclusions will be important inputs to the process of ensuring that arrangements to safeguard financial stability in Ireland continue to conform to international standards.

The legislation governing the Deposit Guarantee Scheme (DGS) in Ireland is the Deposit Guarantee Directive Regulations which came into force in 1995. Ireland provided the minimum level of protection - €20,000 or 90% of the loss, whichever is the lesser. This is significantly less than the 100% of deposits up to £35,000 now provided in the UK. The UK Chancellor has also stated that he plans to increase this protection to £100,000. However, the UK banking industry has already voiced significant opposition to an increase in deposit protection to this level on account of the funding implications.

An issue arises as to how a payout of the scheme would be funded. Currently the DGS stands at €455 million. However it is likely that the requirement to compensate depositors would be greater than this figure. There is a requirement in the Deposit Guarantee Directive Regulations on the CBFSAI to pay all eligible depositors. The CBFSAI have therefore concluded that it is implied that if the DGS is not sufficient to meet the loss amount the CBFSAI must meet the balance. The Regulations allow the CBFSAI to go back out to credit institutions and seek additional contributions. It is considered though that these contributions are limited to the initial amount in the fund. It is unclear whether, if more than

twice the current value of the fund was required, the CBFSAI could or should cover the balance. The question also arises of the pace at which participating credit institutions would be in a position to replenish the DGS fund and the implications for maintaining the attractiveness of Ireland as an investment location for banks, since they can provide services from abroad on a broad basis.

The speed at which deposits can be repaid may be extremely important in maintaining consumer confidence in an institution and may be something that should be examined in the review.

The two possible uses of the DGS identified are:

- to assist illiquid and/or insolvent institutions ie could the deposit protection scheme be used to financially assist a (systemically important) institution?
- to service depositors during an examinership – as discussed above examinership may be the best insolvency proceedings option in the case of an insolvent bank. However, as all assets including deposits would be frozen, could the DGS be used to allow depositors to access (some of) their deposits during the examinership?

The Directive does not seem to explicitly prohibit a fund from having additional responsibilities, so long as it offers that minimum level of protection. However, such an option would have to be considered in the light of State aid rules if its was to be introduced now and would require primary legislation, if it was found feasible to define a purpose that did not conflict with State Aid rules. This issue will of course require further detailed examination.

In developing Ireland's position and contributing to the EU review, it will be necessary to examine what is the appropriate level of deposit protection in Ireland balancing 'moral hazard' and the requirement to maintain confidence in the stability of the financial system; the implications in the case of future financial stability events of the 100% guarantee of deposits in Northern Rock given by the UK Chancellor in order to restore confidence in an institution (or to prevent a 'bank run'); as well as the manner in which deposits are repaid, and particularly the speed at which customers receive their compensation. Consideration is also required of the scope for the DGS to be used to maintain financial stability in ways other than simply repaying deposits in an insolvent institution.

### **5. Scenario 3: Unclear whether institution is illiquid or insolvent**

This paper details two scenarios: (a) bank is illiquid but solvent (section 3), and (b) bank is unequivocally insolvent or unequivocally approaching insolvency (section 4). In periods of normal financial tranquillity, it may be fairly easy to distinguish between these two cases. A third case in which it is uncertain as to whether the bank is merely illiquid or is indeed insolvent may constitute a more realistic scenario. Banks are increasingly involved in financial markets activities either directly through proprietary dealing in financial markets, lending for the purpose of asset purchase by their borrowing clients or through off-balance sheet guarantees and underwriting for financial market participants. In a period of severe financial markets turmoil, it may be very difficult to determine the true worth of the bank's assets including its net contingent assets. A fortiori, it is much more difficult for a central bank or a financial regulator to know whether the bank is just illiquid or has become insolvent, especially in the light of the incentives a bank may have to disguise its true state of health from a central bank or financial regulator.



Given this uncertainty, the central bank may end up making one of the following two judgment calls. Firstly, it may lend to an institution which turns out to be insolvent. This is prohibited according to the general terms and conditions relating in the Documentation on Monetary Policy Instruments and Procedures (CBFSAI, 2005), which says that counterparties must be financially sound. However, the definition of soundness (i.e., subject to at least one form of EU/EEA harmonised supervision) is not especially precise or helpful. In any case, the risk associated with this judgment call may not be in any way damaging to the Bank since, in the case of bankruptcy of the counterparty, the Bank can always sell off the collateral. But the loss to the Bank is not the only consideration. An insolvent bank which succeeds in borrowing from the Bank will almost certainly be tempted to “gamble for resurrection” which could exacerbate the prevailing financial market turmoil and damage the banking system’s financial reputation.

The second potential risk consists of refusing to lend to a bank because it wrongly considers it to be insolvent when in reality it is merely illiquid. This is potentially much more serious. The refusal to lend may drive a sound bank into liquidation. This presumes that it cannot get liquidity in the private secondary money market (as many banks are currently finding it hard to do). If it is then unable to meet its obligations to its creditors then one or other of them could petition, successfully, for the winding up of the bank. So a bank could become insolvent under private company law when it is easily solvent under the total liabilities / total assets definition of insolvency relevant to the CBFSAI and IFSRA

#### **Urgent Next Steps**

- Seek legal advice from the Office of the Attorney General as a matter of urgency on the legal issues highlighted in this paper.
- Identify and discuss with the CBFSAI key issues that arise in dealing with the emergence of financial difficulties in a systemically significant Irish financial institution.
- Complete preparations for and participate in the DSG’s crisis management simulation exercise.
- Prepare crisis management manual for the Department in line with EU requirements.
- Review any specific issues arising to ensure that there is clarity as between the roles and responsibilities of all participants in the national DSG structure including in relation to communication.

### Company Law intervention Mechanisms

1 Company Law provides for three forms of external intervention in the running/affairs of an insolvent (or potentially insolvent) company. In ascending order of relevance to a financial institution these are:

- Appointment of a receiver for all or part of the assets;
- Appointment of a liquidator (under three forms of winding up);
- Appointment of an Examiner (Court Protection).

There are also various provisions for appointment of inspectors etc. but in the case of a financial institution, such an appointment would either follow or precipitate the intervention options above. Anyhow, the supervisory powers of the CBFSAI would probably be more relevant and confidential. Company and Banking Law also provide mechanisms for internal reorganisation, transfers of business and mergers, but these are either cumbersome or involve significant time lags. *The Court Protection route seems to offer the most advantageous approach to dealing with a problem financial institution, if intervention at this level is to be considered.*

#### **Appointment of a receiver**

2 Receivers are usually appointed by creditors in respect of a charged asset once the conditions (default etc.) specified in the agreement creating the charge for the appointment occur. The receiver's main function is to realise the security for the benefit of the creditor. Such appointments do not need court sanction although the courts also have an implicit power to appoint a receiver e.g. where the security is put in jeopardy or there is a winding up. Where the security relates to all of the assets of the company the receivers powers can extend to the running of the company and the salvage of its viable parts. Appointment of a receiver to a financial institution would immediately erode confidence in its solvency, require supervisory intervention and probably precipitate a request for appointment of either a liquidator or examiner. The CBFSAI does not seem to have explicit powers to appoint a receiver to a credit institution, but receivership per se would not seem to offer any benefits as a form of supervisory intervention. However, some of the powers enjoyed by a receiver might be looked at in the context of any proposal to extend the Bank's supervisory powers to intervene in the direction of a financial institution.

#### **Appointment of a liquidator**

3 A liquidator may be appointed for the winding up of a company by

- The members (voluntary winding up of a solvent company)
- The creditors (voluntary winding up of an insolvent company)
- The Courts (compulsory winding up for insolvency or other reasons).

The functions of a liquidator are to wind up the affairs of the company and realise its assets for distribution (S258 Companies Act (CA) 1963). The appointment generally puts an end to the directors' powers (completely so in the case of a Court appointment). The liquidator has considerable powers over the company's assets etc., but many, particularly in relation to settlement with creditors, must be exercised under supervision of the Company's members, creditors or the Court as appropriate. The winding up commences from the time the resolution is passed or the petition is presented to the court. All three forms of winding up are well publicised to creditors, public and authorities.

#### **Members and creditors voluntary winding up**

4 The members (shareholders) may by special resolution appoint a liquidator to wind up a company (S251 CA 1963). In the case of a solvent company the only further formalities

are a statement of solvency by the directors (independently verified), notification of the Registrar of Companies and a public notice. If the company is insolvent, an ordinary resolution is all that is required but there must be a publicly advertised creditors' meeting on the day the resolution is proposed to be voted or the following day. The creditors are entitled to appoint the liquidator and a committee of inspection to fix his remuneration and oversee the winding up. Neither course precludes application to the Court either on specific points of the liquidation or for a compulsory winding up. Ss 49 and 50 Of the Central Bank Act (CBA) 1989 provide that the CBFSAI is entitled to receive any documents etc. which are required to be sent to creditors and to be represented on any committee of inspection in any winding up of a license holder (i.e. bank) or former license holder. S 109 of the Building Societies Act (BSA) 1989 applies the company law and CBFSAI provisions to liquidation of Building Societies.

### **Compulsory winding up under a Court appointed liquidator**

5 The company, any creditor, the M/ETE (following an inspection report) and any member or contributory (a person liable to contribute to the assets in the event of its being wound up) may petition the Court for the winding up of a company (S215 CA 1983). The grounds on which the Court may order a winding up sets out in S213 CA 1983 but the most common reason is inability to pay its debts (e.g. Revenue cases). This status is deemed to exist if a judgment order is returned unsatisfied or if a creditor owed more than £1000 is unable to secure payment, security or compounding of the debt within 3 weeks (S 214 CA 1983).

6 The CBFSAI is entitled to prior notice and a hearing in relation to any petition to wind up a bank. The Bank may also petition for the winding up of a bank on four grounds i.e. that it may be unable to meet its obligations to creditors, has failed to comply with a direction under S21 of the CBA 1971, has ceased to carry on banking, or in the interests of depositors. Where a bank is being wound up voluntarily the Bank may also apply on these grounds to have it wound up by the Court (S48 CBA 1989). The Bank has similar powers in relation to Building Societies (S 109 BSA 1989).

7 The court has wide powers in relation to the appointment of a liquidator and may terminate or vary the appointment and appoint a provisional liquidator (to secure the assets pending liquidation). The official liquidator is an officer of the Court and has extensive powers (subject to Court control). Usually the Court directs him to call a creditors meeting and to set a timetable for various phases of the winding up process. The appointment does not prevent the appointment of a receiver in respect of charged assets but it restricts the receiver's powers to manage the business or enter into contracts binding the company.

8 From a practical point of view a liquidation has a number of important effects:

- It freezes the assets and the transactions of the company;
- It freezes all actions against the company;
- It terminates all contracts of employment;
- It invokes the fraudulent preference rule in relation to certain payments, floating charges and other securities and transactions effected in the previous 6 months.
- Payments to creditors etc. would generally not commence until the liquidator has established the true state of affairs of the company

9 In the case of a financial institution these practical difficulties would have important implications. There could be delay or uncertainty in relation to repayment of short term commercial deposits and settlement of other payment transactions. The liquidity of the institution would also be affected by the triggering of cross-default clauses in long term debt instruments which would render them immediately repayable, while it would be unable to raise

funds on any commercial basis, thus increasing the level of uncertainty for creditors. This would have knock on effects on liquidity both in the payments system and for commercial transactions (e.g. money held by solicitors and others towards the conclusion of contracts). The value and nature of assets (loans, securities derivatives etc.) and liabilities (e.g. debt instruments) could both be difficult to determine and adversely affected by the appointment of the liquidator. Termination of employment contracts could affect the availability of useful personnel to the liquidator (particularly in the areas of dealing with depositors and collection of assets/loan repayments from creditors).

10 While these adverse implications could be minimised by delaying liquidation until there had been an orderly run down of the business (deposit and lending bases) and/or its reliance on short term deposits, significant funding might have to be provided to replace the volatile commercial deposits. In those circumstances any transfer of property (or security given) in respect of that funding could be rendered void if this took place within the previous six months and the company was insolvent (i.e. unable to meet its liabilities as they arose) at the time (S286 CA 1963). The CBFSAI, as funder would then become an unsecured creditor, whose dividend would depend on the outcome of the winding up. Any decision to provide financial support (other than temporary liquidity to an otherwise very sound institution) would have to have regard to the likely outcome of a liquidation. *In the case of an institution with a strong retail deposit base would an intervention which effectively met 100 per cent of the liabilities of commercial depositors before liquidation either prejudice the use of the deposit protection scheme to meet the liabilities to small depositors, or give them grounds to claim unfair treatment?*

#### **Appointment of an Examiner (court protection)**

11 The protection and examination procedure is designed to save all or part of the undertaking and to prevent it being wound up. The Company, its directors, shareholders or creditors may apply to the Court to have an examiner appointed to the Company. However, only the CBFSAI may apply in the case of a credit institution which is supervised by it (this seems to exclude Building Societies). Creditors' rights are restricted from the moment the petition is presented. An application to the Court should:

- be in good faith and factually accurate;
- be supported by good reasons why the examiner should be appointed;
- be supported by a report of an independent accountant (although in exceptional cases the court may postpone this for up to 10 days);
- demonstrate that the company is insolvent or likely to become so (5 tests are provided);
- satisfy the Court that there is a reasonable prospect of ensuring the survival of all or part of the undertaking.

*The CBFSAI do not consider that their supervisory data would be detailed enough/suitable to establish viability or to support the independent accountant's report to support its application as it would not reflect the difficulties the institution is experiencing.*

12 The immediate effect of court protection is to provide the company with extensive protection against creditors, claims, realization or repossession of assets against which security was given, liquidation and receivership, from the time of application. Shareholders and directors may continue to exercise their rights and functions but the Court may give directions in relation to the conduct of the company's business, including restriction of the directors' powers. The granting of protection and the appointment of the examiner must be notified to the Companies Office and the creditors etc. and advertised within specified time limits.



13 The examiner has 2 principal functions:

- To examine the affairs of the company and to report back to the court (within 3 weeks of his appointment), and
- To seek to put together a scheme to ensure the company's survival to report back to the Court (within 6 weeks of his appointment).

The Court may extend the above time limits. Also the Court must be immediately informed of any irregularities in the company's affairs found by the examiner. If the conclusions of the initial report are adverse the Court may make such orders as it sees fit including a winding up order. If the conclusions are that all or part of the company can survive, that a scheme would facilitate this, and that to do so would be more advantageous than a winding up, the examiner prepares his proposed scheme for the survival of the company and presents it to the Court, and then to the various classes of creditors etc. Once the latter have agreed to the scheme the Court confirms it and it may be implemented.

14 In the case of a credit institution Court protection would offer a number of advantages. While it would freeze the company's transactions, the examiner can be given extensive powers to continue its operations pending the putting in place of the final rescue package. Where necessary, in order to secure the survival of the company, the examiner may certify liability in respect of certain transactions, thus making them an expense of the examination which would then have priority over other debts of the company. *These powers could presumably be granted immediately if the Bank's application were able to demonstrate the ultimate viability of the business, the availability of appropriate funding and measures to reduce or control the risks of prejudicing the position of other classes of creditor.* Holders of subordinated debt instruments or long term deposits would remain restricted in relation to demanding immediate repayment e.g. under cross default clauses in their agreements. This could allow the repayment of deposits and the settlement of payments as they fall when due, thus minimising the short term liquidity problems associated with a liquidation.

### **Appointment of Inspectors or intervention of the Director of Corporate Enforcement**

15 The Companies Acts provide for various powers of direct or Court ordered investigations into the affairs of a company. However, their scope is confined to investigation of breaches of Company Law. Obviously, an inspection of this nature could not be ruled out if breaches of Company Law came to light during other interventions to rescue a financial institution. An early intervention of this nature would have the effect of damaging confidence in the institution and offers less scope for dealing with its banking business than a direction by the Bank (under S 21 CBA 1971). Interventions of this nature would not help directly in a rescue or salvage of a credit institution, although it may be a necessary accompaniment if public funds were being committed.

### **Structural Changes to the Company**

16 The vast majority of structural changes to a company (e.g. reduction or issue of share capital, mergers, change of purpose and often sale of major assets require as a minimum the prior approval of the shareholders by special resolution. In the case of a credit institution which is a publicly quoted company the time scale for effecting such a change, and the need to obtain it to shareholder approval on both sides (or legislative authority in the case of the State), would to limit the scope for use of such mechanisms to restore confidence in its solvency, or to effect

urgent changes in its operations. Similarly, these requirements would seem to preclude an arrangement whereby rescue funding would be provided (by the State or another company) in exchange for share capital.

17 The situation in the case of an unquoted or subsidiary company would be slightly better. The directors or owners could presumably take some remedial actions before the need for them became public. In some circumstances this might require a direction from the CBFSAI. In the case of subsidiary company, sale to a third party could also be agreed if it were within the powers of both sides (i.e. directors of the companies involved) or in the expectation of subsequent shareholder sanction. This course would not be without risk to the survival/reputation of the parent company, particularly if a clean break were not possible or a liquidation by the new owners followed immediately. It would still be dependent on a clear plan for dealing with the problems of the affected institution, and a contingency plan to support the parent if it were a financial institution

18 The course outlined at par 17 was followed when the State acquired the insolvent ICI from AIB in 1985 and put it into administration under the Insurance Acts, with funding effectively provided by AIB and the banking system under parallel and subsequent agreements. (Shareholder and legislative cover was given retrospectively.) Similarly, the State acquired a share holding in Irish Life in 1939 by facilitating the merger of a number of insolvent life companies and making up the deficit on policyholders funds (The Insurance Act 1939 provided for the Minister's holding and confirmed the arrangement) However, the relevance of these models to a credit institution is limited. Insurance liabilities are generally long term while most credit institutions are heavily dependent on short term deposits. Also, unlike non-repayment of deposits, delays in or partial settlement of insurance claims would have little or no systematic effects on payment systems or liquidity in the banking system.

### **Stock Exchange considerations**

19 In the case of a listed institution, the Stock Exchange would have to be informed, by the affected company, of any development which would have a material impact on its share price. This greatly complicates any effort to rescue the institution from its difficulties. Any solvency or structural liquidity problems affecting the credit rating or borrowing terms of a credit institution would presumably have implications for the share price of the institution (or its parent in the case of a subsidiary) and would certainly have to be reported. While it is not clear if liquidity support alone would need to be reported, this is probably academic as the underlying problem (e.g. balance sheet exposure, management change) would still have to be reported. The 24 hours time limit for reporting these development would effectively set the time frame for putting in place support/remedial measures *While it might be possible to empower the CBFSAI to override or grant an exemption from this reporting requirement, this would seem undesirable. The side effects could include downgrading the overall standing of CBFSAI shares relative to other companies, placing the CBFSAI in an awkward position as supervisor of the Stock Exchange, and accusations of providing excessive comfort for credit institutions. The current position of leaving it to the company to balance the risk of not reporting against the risk of prejudicing remedial measures may be the lesser evil.*

### ***Some Tentative Assumptions and Conclusions***

- *Intervention should only be considered where difficulties for the banking and/or payment systems are foreseen arising from serious problems likely to affect the long term liquidity or the balance sheet of a credit institution.*

- *Where the institution is substantially viable (or has a significant "goodwill value") a market solution (takeover or merger) may be the preferred option or the target of any short term intervention.*
- *Company law intervention would of its nature only form part of any package to assist a troubled financial institution, and would probably accompany or follow measures to support its liquidity.*
- *The Court Protection (Examinership) procedure seems to offer the least difficulties and most advantages of all the procedures except possibly in the case of dire insolvency.*
- *If Court Protection is recognised as the most useful of the tools available there may be scope for fine tuning aspects of the legislation governing the initiation of the process (e.g. use of CBFSAI data) to render it more user friendly.*
- *It is doubtful if an effective form of support or supervisory action (intermediate between short term liquidity support and company law intervention) could be devised which would enable a credit institution to continue trading in a normal or near normal manner.*
- *There is a need to explore further the nature of deposits as liabilities of a credit institution and the related question of when or if a liquidity problem affecting their repayment on time would constitute insolvency ( as in unable to meet liabilities as they fall due).*

### **Goodhart approach to deposit protection**

Charles Goodhart, Emeritus Professor of Banking and Finance, LSE, has recently advocated an alternative approach to the protection of depositors than the deposit protection schemes currently in place in the US and elsewhere. He argues that on receipt of evidence that a bank cannot meet its due commitments, or can do so only by persistent recourse to the Bank of England for Lender of Last Resort support, and on receipt of a letter from the Governor of the Bank of England to the effect that failure of that bank would probably have contagious consequences, the Chancellor should have the power to nationalise the bank on a temporary basis (with a maximum horizon of perhaps two years).

Once it is nationalised, the Chancellor would be expected, but not obligated, to dismiss senior management. All deposits, irrespective of currency denomination, location or counterparty would be guaranteed but no dividends or interest on subordinated debt would be paid during the temporary nationalisation.

At, or before, the two-year horizon, the Chancellor would be required to hold an open auction to sell the bank back to the private sector, although some potential bidders might have to be prevented on competition grounds. With the auction proceeds, the Government would first be repaid for any losses in making good on the guarantees and then the remaining creditors, debt and equity holders would be paid off in strict order of seniority.

An advantage of this approach would be that no additional deposit insurance or extra regulation would be required. Crucially the scheme would penalise those who make the poor decisions: the bank managers and their shareholders. Professor Goodhart acknowledges the difficulty for governments in penalising shareholders for managerial errors, since they include charities, pensioners, voters and other worthy people.



# Overview of Financial Stability Resolution Issues

Department of Finance  
Friday, 8 February 2008  
**SECRET**

2008 8 February 2008

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# Context

- EU requirement for national contingency plans for crisis resolution
- Report-back due for April ECOFIN (report to FSC in March)
- CBFSAI 'Red Book' in place
- Work has commenced on DoF operational manual based on
  - Scoping paper & CBFSAI comments
  - legal advice from Office of the Attorney General
  - Lessons from Crisis Simulation Exercise (December 2007)
- Policy decisions required to finalise a number of key "resolution" issues highlighted by work of the DSG to date

# National Contingency Plans

- Integrated and consistent national approach essential
- Individual organisational plans will reflect different roles and responsibilities in effective crisis management and crisis resolution
- Must be soundly based on rigorous analysis and research on
  - Legal consideration governing crisis management
  - Preferred solutions (national policy objectives)

# Previous conventional wisdom

- Intervention only if institution considered TBTF
- Otherwise institution should be allowed to fail
- Request to CBFSAI for ELA provision from financial institution
  - inauguration of financial stability event
  - lead responsibility for crisis management during that phase residing with CBFSAI
- Department's direct involvement predicated on the emergence of 'solvency' as opposed to 'liquidity' issues

# Current viewpoint

- If confidence fragile then small institution could trigger systemic difficulties which suggests all institutions are TBTF (in current market environment)
- 'Market discipline' may not be useful tool as insolvency (let it fail) not practical owing to weaknesses in DGS
- Increasing consensus that a "support operation" likely to trigger wider systemic problem
- Also 'solvency assessment' could often be an abstract / contentious exercise reflecting such issues as information gaps and valuation uncertainties, shaped by strict accounting / legal definitions, influenced by market conditions and particular assumptions



# Current viewpoint continued...

- In identifying the way forward very important to differentiate between short- & medium- term actions / policy responses feasible
- Current contingency plans must be designed around what is currently permissible under the existing legislative framework and what might be changed over relatively short timeframe
- Unlikely that more fundamental structural reforms if concluded to be desirable (e.g. special insolvency regime for banks) could be achieved quickly

# Lessons from recent crisis management

- Every crisis has unique characteristics but has common themes
- There are risks from extrapolating too strongly from Northern Rock experience, but it would be prudent to examine particular lessons:
  - Announcement of BoE support operation triggered bank run in Northern Rock and risked systemic crisis
  - DGS did not maintain public confidence
  - Resulted in very substantial public exposure (BoE loans, HMT guarantees)
  - Highlighted the risk in those circumstances that to maintain financial stability the State is left with no option other than to provide open-ended 'guarantees'

# Lessons continued...

- **Key question – could Irish financial system accommodate crisis resolution approach adopted by UK for Northern Rock? (e.g. would the scale of lending / State "guarantees" required be credible)**
- With the benefit of hindsight, 'covert' private sector takeover presented as *fait-accompli* to market preferable approach
- Issue for financial stability planning in Ireland is whether covert takeover legally feasible
- If so, how financial stability planning can be designed to expedite / maximise the prospect of success



# Proposed framework for crisis resolution

- Overarching Principles
  - Earliest possible warning / identification of possible threats to financial stability and swift resolution critical<sup>1</sup>
  - Need for a number of options for early intervention

<sup>1</sup>CB/FR to have, on a continuous basis, all information for ongoing assessment of sustainability of financial institutions

# Proposed framework for crisis resolution cntd.

- Three primary options should ideally be available for consideration in advance of any financial stability issue coming into the public domain:
  - Orchestrated market-based solution (i.e. non-publicly organised private 'take-over' / re-capitalisation – depending on scale may require involve Irish banks, international banks, outside investors)
  - Examinership (may not be readily available – consideration of reform of DGS required to underpin credibility)
  - Nationalisation as a last resort but to pre-empt requirement for extended period of ELA support and attempted public rescue

# Framework for crisis resolution contd.

- The three primary options should ideally be available for consideration in advance of any financial stability issue coming into the public domain:
- **As a matter of public policy to protect the interests of taxpayers any requirement to provide open-ended / legally binding State guarantees which would expose the Exchequer to the risk of very significant costs are not regarded as part of the toolkit for successful crisis management and resolution**
- Legal advice obtained from the Office of the Attorney General on key aspects of the proposed framework
- In overall terms legal assessment favourable

# MAD & ELA provision

- A financial institution could postpone disclosing to the market information that prompts a negotiation for ELA, provided that:-
  - the failure to disclose would not be likely to mislead the public (key issue identified by the OAG) and
  - the financial institution was able to ensure the confidentiality of the information
- Requirement of a *legitimate interest* would probably be met in these circumstances
- Strict obligations of confidentiality would apply to CBFSAI and DoF
- CBFSAI would be under obligation to ensure that MAD obligations are complied with
- Definitive advice could only be given in a particular context having regard to the two conditions above
- Impact of ISE rules require further examination

# Takeover Rules

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- Public authorities could facilitate the non-public takeover of a distressed financial institution if the Takeover Panel granted a derogation from its Rules given the exceptional circumstances
- This waiver would also meet MAD requirements
- Competition clearance likely to be required from the EU Commission (or TCA)
- Takeover could be made conditional on such approval
- Early consultation with the EU Commission is recommended



# Nationalisation

- CBFSAI itself has express statutory power to purchase shares in a credit institution with the approval of the Minister for Finance
- Express statutory authority would have to be provided for the purchase of a credit institution in the name of the Minister or Government
- Existing legislative provision could not be relied on – draft Bill would need to be prepared
- Would have to provide for compensation for shareholders (possibly with level of compensation worked out subsequently)
- Nationalisation could probably not be effected if the institution was under the protection of the Courts

# State Guarantees

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- The Minister does not have statutory authority to issue a guarantee
- This would not prevent the Minister announcing his intention to give a guarantee or his intention to protect deposits and then putting in place the necessary legislative measures
- It would be more appropriate to have the necessary draft legislation for a guarantee in place in advance



# State Guarantees

- Clarity essential regarding different types of State 'guarantees' that may arise under financial stability event including
  - 'conditional' deposit guarantee as in the case of Northern Rock (may need to distinguish between retail and wholesale deposits)
  - guarantee in respect of CBFSAl liquidity support to distressed financial institution (e.g. in case of low-quality collateral)
  - State guarantee to underwrite a Bank's solvency position (could only be justified in circumstances that otherwise the entire financial system is at risk of collapse)

# Legal advice – CBFSAI ELA

- The Minister may request the CBFSAI to consult with him both with regard to the provision of an ELA and the terms and conditions on which it may be provided. The CBFSAI is obliged to comply with such a request
- Seeking to clarify the legal basis for the requirement [from CBFSAI Explanatory Memorandum on ELA] that in order for the CBFSAI to inject liquidity into an insolvent institution a Government guarantee of the institution's liabilities would be required

# State Aid

- CBFSAI Liquidity support on commercial terms probably not a State Aid
- Other financial assistance, including guarantees not provided on commercial terms likely to constitute State Aid
- Commission requirements for approving State Aid in such circumstances
- October 2007 Ecofin conclusions invite the Commission to clarify when a major banking crisis might be considered by the Commission as falling within Article 87(3)(b) 9 (“a serious disturbance of the economy”)

# Emerging Conclusions

- Primary objective is to safeguard public / international confidence in stability of Irish financial system
- It is in the interests of the public that the situation is solved before it enters the public domain in order to prevent contagion
- Whether dealing with 'Big Bang' (SocGen/'Alpha Bank') type scenario or 'Slow Burn' (Nordic countries 1990s)
- Legal advice confirms that proposed framework for crisis resolution is broadly legally feasible
- Review and any necessary reform of DGS a priority given the requirement to ensure that examinership is a credit resolution option
- It is essential that clear roles and responsibilities are identified and the systems are put in place for organising a non-public takeover of a distressed financial institution

# Main Policy Issues

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- Contact the Competition Authority and the Commission regarding competition implications of courses of action
- Engage with Commission regarding state aid implications
- Clarify crisis resolution responsibilities particularly roles regarding orchestrating a market-based solution
- Prepare draft legislation for enactment as required for:
  - the provision of Ministerial guarantees
  - the nationalisation of a financial institution
- Review of Deposit Guarantee Scheme



# Proposed Next Steps

- Department to finalise its proposed approach a paper on crisis resolution
- Seek the views of CB and FR through DSG
- Submit for consideration by MAC / top management
- Policy issues to be submitted for Ministerial consideration / approval
- Crisis manual to be prepared on the basis of policy decisions

# Conventional wisdom on crisis management

- Process viewed in a 'linear' way
  - Request to CBFSAI for Emergency Liquidity Assistance (ELA) provision from financial institution
  - Lead responsibility for crisis management during that phase residing with CBFSAI
  - Department's direct involvement predicated on the emergence of 'solvency' as opposed to 'liquidity' issues (i.e. need for public funds)

8 April 2008

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# Lessons learnt

- If confidence fragile then small institution could trigger systemic difficulties
- 'Market discipline' not a useful tool in current context
- Emergency Liquidity Assistance likely to trigger requirement for open ended State guarantees and possibly wider systemic problem
- Liquidity problem can quickly trigger solvency concerns

# Framework for crisis resolution

- Key Principles:-

- Earliest possible identification and communication to Department of possible threats to financial stability
- Need to maximise options for early intervention to pre-empt requirement for ELA (by which time banks' financial position is unlikely to be retrievable)
- Swift resolution presented as *fait-accompli* critical<sup>1</sup>
- Open-ended State guarantees exposing the Exchequer to the significant fiscal risk are not regarded as part of the toolkit for successful crisis management and resolution
- There are circumstances where such guarantees may be unavoidable to maintain confidence in the overall financial system

<sup>1</sup>CB/FR to have, on a continuous basis, all information for ongoing assessment of sustainability of financial institutions

# Main resolution options

- Market-based solution preferred option - depending on scale may require involve Irish banks, international banks, outside investors
- Nationalisation is sub-optimal, but may need to be considered as a last resort to pre-empt requirement for extended period of ELA support and attempted public 'market' rescue carried out in the public domain
- Examinership is a legal option under insolvency law but in present climate would be seen to reflect very negatively on entire banking system



# Legal assessment

- Legal advice obtained from the Office of the Attorney General on key aspects of the proposed framework
- In overall terms legal assessment is enabling, but will require a number of participants (outside the Dept's control) to agree/approve the resolution

# Market Abuse Directive/Takeover Rules/Nationalisation/Guarantees

- A financial institution could postpone disclosing to the market information that prompts a negotiation for ELA, provided that:-
  - The institution had a legitimate interest, not be likely to mislead the public (OAG) and able to ensure the confidentiality of the information
- Public authorities could facilitate the non-public takeover of a distressed financial institution **if** the Takeover Panel granted a derogation from its Rules given the exceptional circumstances
- CBFSAI itself has express statutory power to purchase shares in a credit institution with the approval of the Minister for Finance
- Statutory authority to issue a Ministerial guarantee would need to be examined.

# State Aid

- CBFSAI Liquidity support on commercial terms probably not a State Aid
- Other financial assistance, including guarantees not provided on commercial terms prima face likely constitute State Aid
- October 2007 Ecofin conclusions invite the Commission to clarify when a major banking crisis might be considered by the Commission as falling within Article 87(3)(b) 9 (“a serious disturbance of the economy”)

# State Aid Cntd.

- EU Commission view of State aid control
  - Pursue a legitimate public interest
  - Well designed to deliver on the objective of common interest
  - Distortion of competition is limited
- Rescue and Restructuring Guidelines Article 87(3)(c)
  - Emergency liquidity (Normally Loan guarantees/loans), limited time period (6 months)
  - Restore long term viability, Avoid undue distortion of competition, limited to the minimum
- Article 87(3)(b) Crisis affecting the economy as a whole "...banking crisis will normally not be found compatible on the basis of Article 87(3)(b)

# Conclusions

- Primary objective is to safeguard public / international confidence in stability of Irish financial system
- It is in the interests of the public that the situation is solved before it enters the public domain in order to prevent contagion
- Legal advice confirms that proposed framework for crisis resolution should be broadly legally feasible



**Note of Meeting with NTMA,  
3.00 pm, Thursday, 10 April, 2008**

**Present:** Dept of Finance; Mr. K. Cardiff, Mr. M. Manley  
National Treasury Management Agency (NTMA); Mr. O Whelan,  
Mr. B. Mc Donagh

The Dept briefly described the framework for financial stability planning (esp. the EU Memorandum of Understanding), explained work undertaken with the CBFSAI and outlined legal advice from the Office of the Attorney General in relation to key issues. Following from this, the Dept outlined the emerging framework for crisis resolution and preferred options; early identification and market based resolution.

The meeting discussed possible roles the NTMA could play having regard to its range of roles, including supporting the Dept to access specialist expertise.

NTMA set out the steps it has already undertaken to strengthen its capacity to play a positive role in relation to financial stability (preparation of contract documentation, gathering market intelligence, etc.) and outlined issues it had identified for consideration in supporting a financial institution threatened with financial crisis.

The meeting discussed the current state of financial markets and economic circumstances, recent very successful fundraising by the NTMA, funding activity by the Housing Finance Agency (HFA) and the potential for that organisation to assist in relation to financial crisis. The discussion focussed on measures that would facilitate support operations and options through which support could be best managed.

The NTMA explained the investment policy formulation process of the National Pensions Reserve Fund (NPRF) and steps being taken to strengthen its capacity to play a positive role in relation to financial stability.

It was agreed the meeting had played a useful role in facilitating an initial open and wide ranging discussion of a range of issues that arise in planning for financial stability. It was agreed the participants would reflect on the matters covered and meet again in 2 to 3 weeks, at which meeting there would be a greater focus on mapping specific steps.

10 April, 2008

From: Lonergan, Ciara  
Sent: 24 April 2008 17:43  
To: Manley, Michael; Nolan, Kevin  
Subject: State Guarantee Act 1954

Michael/Kevin

You asked me to examine the potential for amending the State Guarantee Act 1954 to allow the Minister to provide a guarantee to an financial institution or the CBFSAI should it be required.

The SGA 54 provides for the Minister to guarantee the borrowings of specified bodies. The bodies that the Minister can provide a guarantee to are listed in a Schedule to the Act. Section 9 gives the Minister the power to amend by order this Schedule by changing the maximum amount of the guarantee specified in the Schedule, by deleting a body from the Schedule, or by adding a body and its maximum guarantee to the Schedule.

SGA 54 - The State Guarantee Act 1954

There are a number of issues that arise if we wish to amend the SGA 54:

- The purpose of the SGA 54 is to provide for "guarantee by the Minister for Finance in respect of moneys borrowed by certain bodies". It specifies the maximum amount of any guarantee to specific bodies and **it does not provide the circumstances under which the Minister would undertake such a guarantee**. If we want to use this structure for a guarantee of a financial institution, following the McCreevy judgement, the principles and polices under which an Order that added this institution to the Schedule (thus making it eligible for a guarantee) was made would need to be stated in the Act. However, the principles and polices required for the type of guarantee the Minister might undertake to provide in order to manage financial stability would not necessarily be appropriate for other guarantees provided for in the Act as it currently stands.
- In additions the Act provides for the guarantee of borrowings, while the Minister might wish to guarantee the deposits of an institution in addition to its borrowings.
- The requirement to set out the maximum amount that be guaranteed could possibly restrict the types of guarantees that would be provided by requiring that a limit be set out in advance of the guarantee being entered into.

Given these concerns it may be easier and clearer to simply draft legislation to provide for the Minister to give guarantees which relate to financial stability management, outlining the possible circumstances in which such a guarantee could be considered, the criteria (non-exhaustive) that would apply to such a decision by the Minister, and the purpose that such a guarantee would be expected to fulfil. This could be inserted into existing legislation such as the Central Bank Act 1942, or it could be a stand alone piece of legislation.

Ciara

## Consultation Note

### Preparation of a draft nationalisation Bill for a financial institution

1

This paper provides a summary of the main approaches to nationalisation in (i) the recent UK legislation enacted to nationalise Northern Rock and (ii) Irish legislation. Overall it would appear that previous Irish legislative practice in this area has been based on 'agreed' takeover/rescue in contrast to the recent UK legislation which empowers State intervention whether or not the entity in difficulty agrees.

#### 2. (i) Nationalisation of Northern Rock

The nationalisation of Northern Rock is based upon two pieces of legislation:

- the *Banking (Special Provisions) Act 2008*, and
- the *Northern Rock plc Transfer Order 2008*

The **Banking (Special Provisions) Act 2008** gives the Treasury powers to transfer the ownership or business of UK authorised deposit-takers (which for these purposes are UK-incorporated banks and building societies). The Treasury may make an order to transfer the securities (including shares) or business of a particular deposit-taker either into public ownership, or to another body in the private sector. In relation to any such transfer, provision may be made to deal with supplementary issues concerning the deposit-taker (or the securities or property, rights and liabilities transferred). The Treasury may also, by order, transfer a deposit-taker, or all or some of the property, rights and liabilities, brought into public ownership back to the private sector. The Act also enables the Treasury, by order, to amend legislation so as to facilitate the giving of financial assistance by the Bank of England to building societies.

The outline of the Act is as follows:

*Where Treasury powers are executable* – sections 1 and 2 define the circumstances in which, and the purposes for which, the Treasury's powers to transfer the securities or property, rights and liabilities of a deposit-taker are exercisable and set out which institutions qualify for purposes of those powers;

These powers are exercisable only where it appears to the Treasury to be desirable for either or both of the following purposes:

- a) maintaining the stability of the UK financial system where the Treasury consider that there would be a serious threat to its stability if the power were not exercised;
- b) protecting the public interest in circumstances where financial assistance has been provided by the Treasury to the deposit-taker for the purpose of maintaining the stability of the UK financial system

Subsections (4) to (6) and (11) make further provision about the giving of notice, and the meaning of the guarantee arrangements referred to in subsection (3).

***Transfer of securities*** – sections 3 to 5 and Schedule 1 deal with the power to transfer shares and other securities to the Bank of England, the Treasury, a company owned by the Treasury or the Bank of England, or any other body corporate; provide powers for the Treasury to extinguish certain rights in relation to such securities; and require the Treasury to make provision, in an order, for determining the amount of any compensation or consideration payable to the holders of such securities and to those whose rights have been extinguished. An extensive definition of securities is provided in section 15.

The powers in sections 3 and 6 to transfer securities or property, rights and liabilities of a deposit-taker to the public or private sector may only be exercised in the period of one year from the date of Royal Assent [section 2(8)].

***Transfer of property, rights and liabilities*** – sections 6 and 7 and Schedule 2 deal with the power to transfer property, rights and liabilities of a deposit-taker to a company owned by the Bank of England, the Treasury or to any other body corporate; and require the Treasury to make provision, in an order, for determining the amount of any compensation or consideration payable to the deposit-taker.

***Further transfers following transfer to the public sector*** – section 8 provides powers for the onward transfer of securities or property etc transferred to the public sector by an order under section 3 or 6. This would enable the institution to be transferred back to the private sector (or within the public sector). Unlike the transfer powers in sections 3 and 6, the powers under this section do not cease to be exercisable one year after Royal Assent.

***Supplementary matters*** – section 9 contains supplementary provisions about:

- the manner in which compensation is to be assessed;
- the assessment to be made by an independent valuer appointed by the Treasury;
- the procedure for the assessment of compensation;
- enabling persons to apply to a tribunal to review the independent valuer's compensation decisions (which may be the Financial Services and Markets Tribunal or any other tribunal appointed by the Treasury);
- the remuneration and expenses of the valuer or of a tribunal appointed by the Treasury



*Tax consequences* – Section 10 gives the Treasury power to make regulations varying the way in which relevant taxes apply in consequence of orders transferring securities, property rights or liabilities or extinguishing rights. The purpose of this section is to give the Treasury the flexibility to minimise or to otherwise deal with the tax consequences of transfers made under such orders.

*Building societies* – Section 11 gives the Treasury a power to modify legislation to facilitate the giving of certain financial assistance by the Bank of England to building societies. It is understood the Treasury intend to use this power to modify the application of building society legislation generally, so the changes would apply to any building society which needed to seek financial assistance from the Bank of England.

*General* – sections 12 to 17 are general provisions concerning consequential and supplementary provision, orders and regulations made under the Act, interpretation, financial provision and extent; they include provision to modify primary and secondary legislation and make a limited form of retrospective provision.

**The Northern Rock plc Transfer Order 2008** provides for the transfer of shares in Northern Rock to the Treasury Solicitor, and the delisting of the shares, as well as enabling the Treasury to remove and appoint directors, and other modifications of the rules for holding meetings. In addition to providing for the transfer of Northern Rock shares, the Order also extinguishes the existing share options; converts Northern Rock Foundation shares to ordinary shares and terminates the existing Foundation deed.

The Order makes limited technical adjustments to the provisions of certain Tier 1 securities; provides for the rights or obligations of lenders, bondholders, swap counterparties or suppliers which would be triggered by the act of bringing Northern Rock into temporary public ownership not to be so triggered. The Order facilitates Northern Rock board changes; deals with the issue of liability of those directors appointed to or continuing on the board of Northern Rock while it is in public ownership; modifies the application of certain provisions of the Financial Services and Markets Act 2000 to the company; and disapplies shadow directorship provisions to specified public sector persons.

## **2. (ii) Irish nationalisation legislation**

In contrast to the above approach, much of the legislation enacted in Ireland to enable nationalisation of companies has taken a different form – the acquisition of shares in a specific company by the relevant Minister. The general form of nationalisation legislation is as follows.

The legislation generally provides for:

- the acquisition of shares in the company to be nationalised by the relevant Minister, including the advance of money from the Central Fund for the purchase of the shares
- the holding of shares in the company by the relevant Minister
- the exercise by the Minister concerned of the right or power exercisable by holders of shares of the company



- the restriction on the issue of shares of the company
- the payment of dividends, etc into the Exchequer
- issues regarding the appointment, etc of directors, chairman, managing directors of the company
- any required alteration of the memorandum and articles of association of the company
- the obligation to furnish balance sheets, etc to the Minister.
- the expenses of the Minister to be paid out of moneys provided by the Oireachtas

A number of the Acts involved also provide for a guarantee by the Minister of certain payments, loans, etc of the company.

Acts that conform to this template include:

- *Insurance (Miscellaneous Provisions) Act 1985*, which provides for the Minister for Industry, Trade and Employment to take up shares in Sealuchais Arachais Teoranta, a holding company for shares in the Insurance Company of Ireland, which were transferred to Sealuchais Arachais Teoranta from AIB. The Act also provides for the guarantee of certain payments by the Insurance Company of Ireland Limited by the Minister.
- *Air Companies Act 1966*, which provides for the transfer to the Minister for Finance of shares in Aer Lingus, Teoranta held by Aer Rianta, Teoranta. The Act also provides for the guaranteeing of sums borrowed by Aer Lingus, Teoranta. The Act also contains other provisions regarding Aer Lingus, Aer Linte and Aer Rianta.
- *British & Irish Steam Packet Company Limited (Acquisition) Act 1965*, which approves an agreement which provides for the purchase of all issued shares in the British & Irish Steam Packet Company Limited from Coast Lines Limited by the Minister for Finance. The agreement is contained in a Schedule to the Act.
- *Section 12 and 13 of the Insurance Act 1964*, which provides for the purchase and sale of shares of the Irish Life Insurance Company limited by the Minister for Finance.
- *Irish Steel Holdings Limited Act 1960*, which provides for the Minister for Finance to take up shares of Irish Steel Holdings Limited, and increases the share capital of the company. The Act also provides for the guarantee of borrowings of the company by the Minister

The *Gas (Amendment) Act 1987* provides for Bord Gais Eireann (BGE) to takeover the functions and duties of the Dublin Gas Company, following the company's entrance into receivership in 1987 and BGE's successful bid for the assets of the company. It does not conform to the template above as it does not transfer the shares to the Minister or to BGE, but instead amends the functions of BGE to allow it to carry out the functions of the Dublin Gas Company.

### **3. Applicability of alternative approaches to required draft nationalisation Bill for a financial institution in Ireland**

The approach taken to the nationalisation of the Dublin Gas Company would not seem to be easily transferable to the nationalisation of a financial institution, and it is unlikely to provide a useful framework for our draft nationalisation bill.

The UK approach provides a framework for nationalisation of any deposit taker if it is required to maintain stability or protect the public interest. It also provides a framework for the provision of compensation to shareholders. It does not provide a framework for the nationalisation of other financial services providers (eg insurance companies). This Bill was enacted in 2008, to suit the current circumstances in the UK, and forms part of an extensive re-examination of their framework for crisis management.

The approach adopted by most Irish nationalisation legislation provides for the acquisitions of shares in a specific company. This allows for the nationalisation of any particular company. However, none of the Irish Acts listed above contain a provision for compensation to shareholders, which would be required. In addition the most recent Act was enacted 23 years ago.

**Manley, Michael**

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**From:** Beausang, William  
**Sent:** 08 May 2008 09:35  
**To:** Manley, Michael  
**Cc:** Lonergan, Ciara; Nolan, Kevin  
**Subject:** Version submitted to KC - no changes other than key points added

**Attachments:** revised Briefing for Minister for Finance May 2008 rev1 (2).doc



revised Briefing for  
Minister ...

## **Briefing on Financial Stability Issues**

**7 May, 2008**

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.

The key points are as follows:-

### **International Position**

- Since last August, as a result of the “credit crunch” normal wholesale inter-bank lending and funding activities (e.g. securitisation) have at an international level seized up; in essence bank funding is either much more expensive or unavailable at the longer-term maturities that banks need
- While there have been some recent assessments suggesting the environment is set to improve, there are no clear indications that current difficulties will ease significantly for some time.
- Any further marked deterioration in economic conditions in the US or the EU will lead to a worsening of credit conditions.
- An extensive programme of actions is being put in place at EU level to improve financial market conditions and prepare for any risk to financial stability in the EU.
- International central banks, the US Federal Reserve and the ECB / Eurosystem have been very active in seeking to stabilise market conditions.

### **Situation in Ireland**

- The Irish banking system is sound and robust based on all key indicators of financial health (i.e. solvency, liquidity, asset quality, profitability)
- Irish banks have no meaningful exposure to the sub-prime securities which are at the root of the international liquidity crisis overall.
- International sentiment towards the Irish banks is very negative on account of the assessment that the pronounced downturn in the Irish market will undermine their financial position.
- Irish banks are therefore experiencing significant challenges in rolling-over their funding sources.
- In addition there has been intense speculation by hedge funds against specific Irish banks (i.e. Anglo-Irish and Irish Life and Permanent) which on occasion

has put very serious downward pressure on their share price which has increased the risk of a run on deposits on those banks.

- Irish banks have been working intensively to exploit any funding opportunities available internationally; as relatively small financial institutions by international standards they have not extensive options
- The Irish banks have build up large reserves of assets that are eligible to be used as collateral against lending by the ECB in circumstances that other funding sources are not available.
- In general, Irish banks are reluctant to access this funding owing to the risk that this will send a negative signal to the market and lead to the shutting down of other credit lines.
- A domestic shock (e.g. failure of a major property developer or very sharp further falls in property prices) would have a major negative effect on the financial position of the Irish banks on a systemic basis.

### **Contingency Planning**

- The Financial Regulator and the Central Bank have been working very closely with the banks to monitor their liquidity position on an ongoing basis and seek to identify risks to their sustainability at the earliest possible stage.
- The Department of Finance, Central Bank and Financial Regulator are in very close contact to exchange information on developments and advance contingency planning arrangements for dealing with the emergence of serious difficulties in any specific institutions or the banking system as a whole.

### **Primacy of market solutions**

- Responsibility for managing current issues affecting individual institutions and developing strategic options for responding to the market environment rests with the boards and senior managers of the institutions concerned.
- The CEO of the FR has been meeting with the boards / top management of some financial institutions to impress upon them the need to be prepared to examine all options to pre-empt the emergence of any difficulties.
- State intervention is only appropriate in circumstances that problems in an individual institution run the risk of creating systemic difficulties in the national financial system as a whole.

Detailed information note attached.



### **Irish Financial System**

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.

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.

### **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<sup>1</sup>, which had caused it to announce a special scheme to

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<sup>1</sup> 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

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.

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

## 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<sup>2</sup> duty specifies that "the Bank has ... the objective of contributing to the stability of the financial system"<sup>3</sup> 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).

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<sup>2</sup>Central Bank Act, 1942 (as amended), Section 6A(2)(a)

<sup>3</sup> 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) \$1 billion. 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 from 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.



1. Mr. Beausang
2. Second Secretary  
Mr. Cardiff

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Request for note on EU State Aids rules in relation to possible supports to assist a bank with liquidity difficulties refers:

### EU Treaty<sup>1</sup>

The EU Treaty, Article 87, sets out the basic proposition that State Assistance to any entity is not compatible with the EU treaties and is therefore not permitted, viz:

87 ...any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

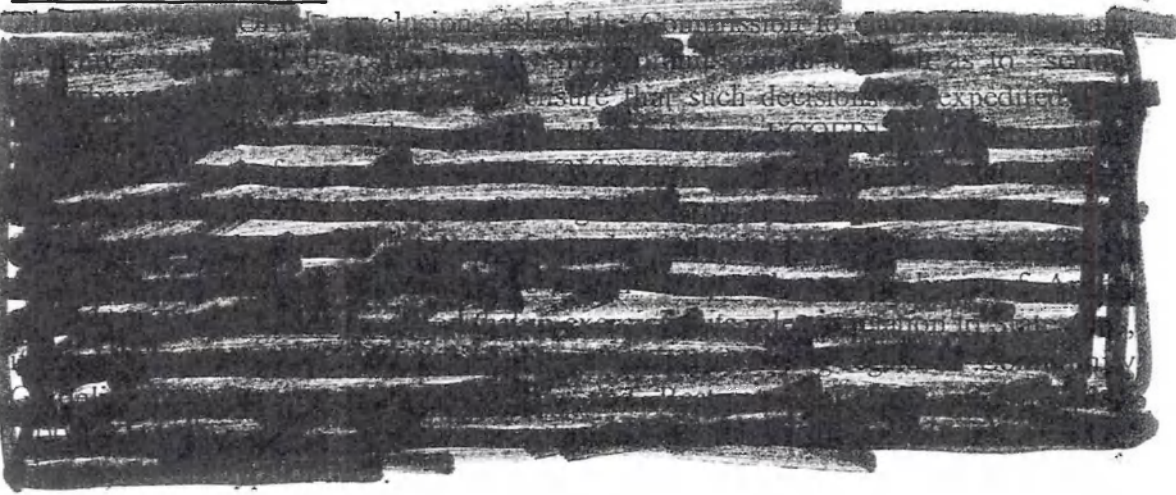
The Article continues by setting out 3 instances where State Aid shall be compatible with the common market; aid having a social character, to make good damage from natural disasters, aid to certain areas of the reunified Germany; and 5 instances where aids or may be regarded as compatible with the common market; e.g., aid targeted at economic development, EU sponsored projects, etc.

Article 87(3)(b) in dealing with aid that may be compatible with the common market provides for;

aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;

Article 88 (2) grants the Commission the primary role in deciding if Aids contravene Article 87 (The EU Court of Justice and Council also have roles) including power to "...decide that the State concerned shall abolish or alter such aid..." and (3) require "the Commission be informed in sufficient time... of any plans to grant or alter aid".

### Commission Guidance



<sup>1</sup> Articles 87 to 89 set out at Appendix 1, Tab 1

### Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty' (2004/C244/02)<sup>2</sup>

The guidelines apply to almost all sectors and firms<sup>3</sup> and are not specifically framed to meet the needs of the financial sector. It recognises that there is no Community definition of what constitutes a firm in difficulty, but states (2.1.- point 9) that "the Commission regards a firm as being in difficulty where it will almost certainly [go] ... out of business in the short or medium term" Points 10 & 11 elaborate further in an attempt to define firms in difficulty.

The Guidelines provide for a two phased process, initially Rescue Aid and subsequently Restructuring Aid

Rescue Aid, to be approved by the Commission must (3.1.1. – point 25)

- (a) consist of liquidity support in the form of loan guarantees or loans...
- (b) be warranted on the grounds of serious social difficulties and have no unduly adverse spillover effects on other Member States;
- (c) be accompanied, on notification, by an undertaking given by the Member State concerned to communicate to the Commission, not later than six months after the rescue aid measure has been authorised, a restructuring plan or a liquidation plan or proof that the loan has been reimbursed in full and/or that the guarantee has been terminated; in the case of non-notified aid the Member State must communicate, no later than six months after the first implementation of a rescue aid measure, a restructuring plan or a liquidation plan or proof that the loan has been reimbursed in full and /or that the guarantee has been terminated;
- (d) be restricted to the amount needed to keep the firm in business for the period during which the aid is authorised; (e) respect the condition set out in section 3.3 (one time, last time).

Provisions in relation to restructuring plans are far more detailed (points 31 to 71 of 3.2.1.) but are summarised in the Commission's notes to the February ECOFIN as requiring that the rescue plan must be feasible and coherent to address the *Restoration of long term viability, Avoidance of undue distortions of competition and Aid limited to the minimum.*

### Northern Rock<sup>4</sup>

The European Commission authorised, 5 December, 2007, under the EC Treaty's rules on state aid, the UK authorities' rescue package of measures to support Northern Rock, the UK mortgage bank. The Commission stated it had received full details of these measures on 26th November 2007 (also stating there had been substantial communication in advance). The Commission stated it had concluded that the measures comply with EU rules on rescue aid, but that this had no bearing on whether any future measures taken by the UK authorities to support a restructuring plan would be similarly approved.

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<sup>2</sup> Tab 3

<sup>3</sup> Except coal, steel, fisheries, aquaculture, agriculture, aviation

<sup>4</sup> Commission Memo of 5 December on Northern rock rescue decision set out at Tab 3

In a memo appended to the statement announcing the decision, the Commission stated that the initial provision of emergency liquidity assistance by the Bank of England on 14 September, which was provided against high quality collateral, bearing a premium interest rate and without a government indemnity, was not state aid. Later measures, i.e. the deposit guarantees granted by the Treasury and further assistance provided by the Bank of England with a Treasury indemnity did qualify as state aid. The Commission stated these measures have been found to be compatible because they comply with the relevant rules for rescue aid and summarised the conditions it considered in assessing aid as rescue aid to be:

- The beneficiary has to be a firm in difficulty and it should not have received any rescue or restructuring aid during the past 10 years.
- The aid should normally consist of liquidity support and should be restricted to the minimum necessary to keep the firm in business for the rescue period.
- The aid must be granted in the form of loans or guarantees.
- The aid must be limited to a period of not more than 6 months.

If the Member State communicates to the Commission within these 6 months a restructuring plan or liquidation plan, then the rescue aid can normally continue for the time needed by the Commission to decide on this plan.

#### Advice of the Attorney General

REDACTED

MATERIAL

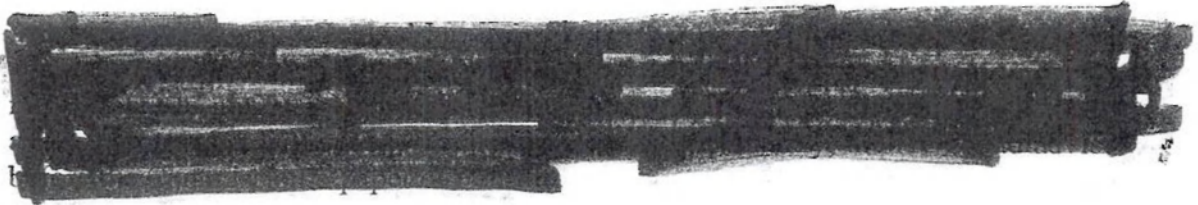
### Summary

The treaty draws a wide prohibition around any aid provided through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings, it confers on the Commission the primary role in determining if any aid is contrary to the common market and it requires the Commission be notified in advance of any proposed aid.

The Commission in its paper of Feb. '08 to the ECOFIN has made clear that it does not consider banking crises can be dealt with under Article 87(3)(b), but that it will consider any proposed support to a bank in difficulty under the terms of the Rescue and Restructuring provisions issued in 2004. This effectively requires the relevant authorities to formally invoke these procedures and submit proposals for assistance to the Commission for decision. As far as can be determined, commission decisions are published.

The terms of Article 88 and point 25 of the R&R Guidelines seem to countenance there are situations where aid is provided and the Commission informed and the R&R processes invoked afterwards – though presumably this is not the intended or desired approach.

In the case of Northern Rock, the Commission decided that the provision of liquidity assistance against good quality collateral and at commercial (penal) interest rates did not constitute State aid in the rescue phase. It remains to be seen how it will view liquidity assistance to be provided under the restructuring proposal.



Michael Manley  
16 May, 2007

**TITLE VI**  
**COMMON RULES ON COMPETITION, TAXATION AND**  
**APPROXIMATION OF LAWS**  
**CHAPTER 1**  
**RULES ON COMPETITION**  
**SECTION 2**  
**AIDS GRANTED BY STATES**

**Article 87**

1. Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.
2. The following shall be compatible with the common market:
  - (a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;
  - (b) aid to make good the damage caused by natural disasters or exceptional occurrences;
  - (c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division.
3. The following may be considered to be compatible with the common market:
  - (a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;
  - (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
  - (c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;
  - (d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest;
  - (e) such other categories of aid as may be specified by decision of the Council acting by a qualified majority on a proposal from the Commission.

**Article 88**

1. The Commission shall, in cooperation with Member States, keep under constant review all systems of aid existing in those States. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the common market.



2. If, after giving notice to the parties concerned to submit their comments, the Commission finds that aid granted by a State or through State resources is not compatible with the common market having regard to Article 87, or that such aid is being misused, it shall decide that the State concerned shall abolish or alter such aid within a period of time to be determined by the Commission.

If the State concerned does not comply with this decision within the prescribed time, the Commission or any other interested State may, in derogation from the provisions of Articles 226 and 227, refer the matter to the Court of Justice direct. On application by a Member State, the Council may, acting unanimously, decide that aid which that State is granting or intends to grant shall be considered to be compatible with the common market, in derogation from the provisions of Article 87 or from the regulations provided for in Article 89, if such a decision is justified by exceptional circumstances. If, as regards the aid in question, the Commission has already initiated the procedure provided for in the first subparagraph of this paragraph, the fact that the State concerned has made its application to the Council shall have the effect of suspending that procedure until the Council has made its attitude known. If, however, the Council has not made its attitude known within three months of the said application being made, the Commission shall give its decision on the case.

3. The Commission shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. If it considers that any such plan is not compatible with the common market having regard to Article 87, it shall without delay initiate the procedure provided for in paragraph 2. The Member State concerned shall not put its proposed measures into effect until this procedure has resulted in a final decision.

#### **Article 89**

The Council, acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament, may make any appropriate regulations for the application of Articles 87 and 88 and may in particular determine the conditions in which Article 88(3) shall apply and the categories of aid exempted from this procedure.

MEMO/07/545

Brussels, 5 December 2007

## **State aid: Commission approves UK rescue aid package for Northern Rock – frequently asked questions**

(see also IP/07/1859)

### **What were the measures on which the Commission took a decision?**

The Commission has taken a decision on all the measures which the UK authorities have taken since 14 September. As regards, the Bank of England's provision of emergency liquidity assistance on its own account, the Commission has decided that no state aid was involved. The guarantees to depositors provided during the period 17 to 20 September, and the revised and extended measures taken by the Bank of England on 9 October with the addition of a Treasury indemnity, are considered by the Commission to constitute state aid, but compatible with the rules on rescue aid.

### **Are the measures granted to Northern Rock state aid?**

The initial provision of emergency liquidity assistance by the Bank of England on 14 September, which was provided against high quality collateral, bearing a premium interest rate and without a government indemnity, was not state aid.

Later measures, i.e. the deposit guarantees granted by the Treasury and further assistance provided by the Bank of England with a Treasury indemnity did qualify as state aid.

However, these measures have been found to be compatible because they comply with the relevant rules for rescue aid.

### **Were the measures notified?**

The UK authorities provided detailed information on the measures in contacts beginning immediately after the measures were adopted. The full information about the measures was communicated formally on 26 November.

### **Has the UK provided all of the information which you require for your assessment?**

The Commission has received what it needs to authorise the rescue aid. The UK has undertaken to send by 17 March 2008 either a restructuring plan for the bank, or confirmation that the aid measures have been brought to an end. If the restructuring plan involved any state aid then this would be subject to separate Commission authorisation and full details would need to be notified to the Commission.

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### **What are the conditions to authorise rescue aid?**

The conditions to consider an aid as rescue aid can in general be summarised as follows:

- The beneficiary has to be a firm in difficulty and it should not have received any rescue or restructuring aid during the past 10 years.
- The aid should normally consist of liquidity support and should be restricted to the minimum necessary to keep the firm in business for the rescue period.
- The aid must be granted in the form of loans or guarantees.
- The aid must be limited to a period of not more than 6 months.
- If the Member State communicates to the Commission within these 6 months a restructuring plan or liquidation plan, then the rescue aid can normally continue

for the time needed by the Commission to decide on this plan.

**Are the conditions for rescue aid met in full in this case?**

Yes. The rules contain special technical provisions concerning the banking sector because of the need to fit with prudential rules. These special provisions apply in this case.

**Does this Commission decision give the green light for the takeover of Northern Rock by Virgin?**

This decision is about the measures taken by the UK authorities up to now to rescue the bank. As such it should provide legal security to all stakeholders including depositors, lenders and those developing long term plans for the company.

The Commission has not been informed officially of proposals for the bank's future. If state measures are involved we look forward to hearing from the UK authorities at the appropriate time. We do not of course have a view about the different possible bidders.

**What if the buyer doesn't pay back all the Government's lending to Northern Rock?**

The Commission will look at what is officially notified to the Commission. If there were state aid in the sale or restructuring of Northern Rock then this would be subject to separate authorisation as restructuring aid.

**What are the conditions to authorise restructuring aid?**

As regards the beneficiary, the conditions are the same as for rescue aid.

As regards the aid, unlike for rescue aid, a restructuring plan, capable of restoring the long term viability of the firm must be provided. The state aid must be limited to the minimum necessary in time and amount, and the beneficiary must significantly contribute to the cost of restructuring.

The aid must not distort competition to an extent contrary to the common interest. In this respect, the Commission may impose specific conditions and obligations on the beneficiary.

3

**How has the Commission been able to reach a conclusion in only 8 working days?**

Although the formal transmission of information took place on 26th November, the Commission and UK authorities were in close contact for some weeks before that. These prior contacts, combined with the completeness of the information given on 26th November, have helped to ensure that a rapid decision could be taken.

**Could there be competition consequences of the takeover? Would a takeover by Virgin fall under the merger regulation?**

It would be the responsibility of companies bidding for Northern Rock to verify whether they needed to notify the details under the terms of the EU Merger Regulation. If bids were notified under the Merger Regulation the Commission would have to verify whether there would be any adverse impact on effective competition.

**What is the status of other banking cases? Sachsen LB, IKB?**

The Commission is in close contact with the German authorities on these two cases.

**Strictly Confidential**

29

Meeting with Dr Somers 21 May – Financial Stability Planning Issues

**The key message we would wish to see communicated is that the NTMA and NPRF should continue its welcome engagement with the Department of Finance, Central Bank and Irish banks to help sustain financial stability.**

Context

1. The previous Minister wrote to the Dr Somers last December requesting his views on the role that the NTMA and NPRF might play in helping to maintain financial stability. In view of their financial resources and the commercial mandate, the NTMA / NPRF can play a very important role in helping to meeting the funding needs of the Irish banks in stressed financial market conditions.
2. Subsequently the NTMA / NPRF have participated in discussions with the Department of Finance and the Central Bank and Financial Services Authority of Ireland (CBFSAI) on planning arrangements for helping to maintain financial stability. The Agency has also stressed its openness to discuss commercial proposals for support from the Irish banks and has had a number of meetings with various financial institutions on this basis.

NTMA

3. The main potential role of the NTMA relates to the provision of liquidity in circumstances that Irish financial institutions cannot meet their funding requirements from the wholesale market.
4. The NTMA has placed some deposits with the main banks. While the amounts have been relatively small, it is an important signal to the banks of support from public authorities and demonstrated the potential for the NTMA to intervene to seek to pre-empt what might otherwise lead to a major funding crisis in an Irish bank.
5. The NTMA has indicated that it will maintain a floor to its liquidity in order to be in a position to supply emergency funding to the Irish banks if the need arose. It has also put arrangements in place in order to allow it to engage in collateralised lending to the Irish banks (i.e. providing loans secured on mortgage assets). This could act as a very important source of liquidity to the Irish banks in circumstances that they did not wish to rely excessively on ECB liquidity support on account of the risk of a negative market reaction.
6. The NTMA operates a strictly commercial mandate and has consistently highlighted the requirement for a Ministerial direction for the Agency in order for the Agency to engage in any of the above activities.

## NPRF

7. The legal framework for the National Pension Reserve Fund was specifically designed to safeguard its independence and its strictly commercial mandate.

8. The Fund has indicated its willingness to engage in discussions with financial institutions to help meeting their funding needs through support for Asset Covered Security (ACS) bond issuance on commercial terms (i.e. ACS are highly secure bonds issued under a specific statutory framework in Ireland). The Fund has also signalled its willingness to discuss participation in rolling over banks' regulatory capital requirements through investment in subordinate debt (i.e. Tier 2 capital).

## Conclusion

In summary both the Agency and the Fund have demonstrated a willingness to engage positively with the issues that have arisen and are open to proposals from the Irish financial sector.

There are important legislative and State aid constraints to their activities in this area, highlighting the importance of ensuring that any proposals from the financial sector have a firm commercial focus and that the assistance that the Agency / Fund is not treated by the financial sector as State support on preferential and non-commercial terms.



**HIGHLY CONFIDENTIAL****Outline Heads of a Bill to provide for the Irish Authorities (Minister for Finance) to take action in relation to an Irish financial institution to:**

- (i) take into public ownership of, and
- (ii) possible provision of a guarantee in respect of a distressed credit institution

**Purpose**

(Long Title?)

The purpose of the Bill is to give the Minister for Finance power to transfer the ownership of a particular distressed credit institution<sup>1</sup> authorised to operate in Ireland (the institution is referred to as 'Xfi' in these heads). The Bill should provide that the Minister may transfer the securities (including shares) [or business]<sup>2</sup> of a particular credit institution into public ownership, i.e. to the Minister for Finance.

[Questions:

- Should provision also be made to provide power to transfer ownership to another body in the public or private sector?
- Should provision be made to provide power to transfer ownership of a building society to a public/private body or Minister for the Environment, Local Government and Heritage (or Finance)?]

The Bill is also to provide that the Minister may also transfer a credit institution brought into public ownership back to the private sector. [Has the CBFSAI power to give financial assistance Irish registered building societies?].

The Bill may also need to provide for necessary or consequential provisions, i.e.:

- Delisting of shares in the Xfi as well as enabling the Minister to remove and appoint directors, and make other modifications of the rules for holding of meetings of the company.
- Extinguishing of the existing share options
- Providing for the any amendment necessary in consequence of the impact of transfer of ownership on rights or obligations of lenders, bondholders, swap counterparties or suppliers which would be triggered by the act of bringing the financial institution into temporary public ownership. (Apparent from UK NR legislation that a range of contractual arrangements that NR had previously entered into were impacted by the transfer of ownership and required provision in the legislation to address these issues/ensure these were not triggered – may have to be dealt with on a specific case by case basis)
- Resolution of pension issues.

<sup>1</sup> 'Credit institution' as defined in regulation 1 of the European Communities (Deposit Guarantee Scheme) Regulations 1995 [SI 168 of 1995] i.e. "... an undertaking other than a credit union or friendly society whose business it is to receive deposits or other repayable funds from the public and to grant credit on its own account. This definition encompasses both banks and building societies.

<sup>2</sup> The UK Banking (Special Provisions) Act 2008 refers to 'securities' of an institution and seems to differentiate these from the 'business' (e.g. property, rights and liabilities). However, the Northern Rock plc Transfer Order 2008 made under the Act is concerned with only the transfer of shares to the Treasury Solicitor. No order has yet been made under the UK Act in relation to transfer of property, rights and liabilities.

## **Head 1 - Circumstances in which powers under the Bill would be exercisable by the Minister for Finance**

Provide that the Minister for Finance may exercise powers under the Bill in relation to Xfi only where it appears to him to be necessary for any or all of the following purposes:

- maintaining the stability of the financial system in Ireland where the Minister [ , having consulted with the CBFSAI (in view of CB's statutory role in relation to financial stability)] considers that there would be a serious threat to its stability if the power were not exercised;
- protecting the public interest in circumstances where financial assistance or a guarantee has been provided by the Central Bank or Minister to Xfi for the purpose of maintaining the stability of the financial system in Ireland<sup>3</sup>.
- where the Minister has been notified by the Central Bank and Financial Services Authority of Ireland that it intends [following an assessment<sup>4</sup>] to use its powers under Section 3(2)(b) of the Companies Act 1990 to petition the Court to appoint an examiner, or under Section 48(1) of the Central Bank Act, 1989 to petition the Court to have the holder of a licence wound up. (Would it be necessary to amend both of these Acts to require the CBFSAI to give the Minister advance notice of its intention to use these provisions)

"Financial assistance" for the purposes of this Head would include

(i) any case where the CBFSAI has provided financial assistance to Xfi and the Minister assumed a liability in respect of that assistance but excluding ECB open market operations and other forms of liquidity support made available on the basis of the CBFSAI's own balance sheet without the need for it to seek an indemnity from the Minister for Finance [can the latter actually arise?],

"guarantee" for the purpose of this Head would include

(i) Any case where the Minister for Finance has announced that the Minister for Finance [the Department of Finance] (whether acting alone or with the CBFSAI) would if necessary put in place depositor guarantee arrangements in relation to Xfi.

(ii) A guarantee under head 7 of this Bill Act /or through an amendment of the Central Bank Act 1942 [Head 7 could be included as part of this Bill or be enacted separately with more general application depending on circumstances]

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<sup>3</sup> It needs to be clarified whether it is necessary to define "stability of the financial system" having regard to the convention in legal drafting that the purpose of a definition is to achieve clarity without needless repetition. It follows then that it is not necessary to define words that are used in their usual dictionary meaning. Financial Stability is not defined in the UK's Financial Services Management Act 2000 or it's Banking (Special Provisions) Act 2008.

<sup>4</sup> It is not clear that the CBFSAI is required to conduct an assessment before it uses its powers under Sn 3(2)(b) of the Companies Amendment Act 1990 or Sn 48 (1) of the Central Bank Act 1989.

## Head 2: Transfer of securities

Provide that by virtue of this head the securities [shares] in Xfi are transferred to the Minister for Finance [or his nominee, other public/private body] and that the securities shares are transferred

- free of any trusts, liabilities and encumbrances
- together with all the rights, benefits and privileges which relate to the shares transferred.
- The head should enable securities [shares] to be transferred to the CBFSAI, a nominee of the Minister, a company wholly owned by the CBFSAI or the Dept of Finance [can CB and Dept legally own a company?], or any other body public or private.

The head should provide that the transfer of securities will be effective notwithstanding;

- the absence of any consent otherwise required
- Any restriction otherwise applicable to the transfer
- [absence of the delivery of any instrument representing securities transferable by delivery (a "bearer instrument")]

The head should provide that any shares 'lent' or otherwise assigned, e.g. to a hedge fund, will on the transfer, transfer to the Minister or other public/private body

Securities [shares] for the purposes of this head may need to be defined widely having regard to the credit institution concerned but would be likely to include;

- shares and stock,
- debentures, including debenture stock,
- loan stock, bonds, certificates of deposit and other instruments creating or acknowledging indebtedness;
- warrants or other instruments entitling the holder to acquire such securities.

### Head 3: Registration of shares and issue of certificates

Provide that Xfi shall take all necessary steps to ensure that the Minister is registered as the holder of the shares and that he is to have all rights and advantages of a member of the company pending registration (i.e. even while not yet registered).

[Questions

- Is it necessary to make explicit provision to require that the Stock Exchange accept the Minister (etc.) as the registered owner of the securities?
- Are those elements that are to address provisions in Xfi's constitution/contractual arrangements that might otherwise frustrate the transfer more appropriate to this head or head 2?]

This head is required (?) to ensure the Minister (etc.) is clearly identified as the owner of Xfi.

#### Head 4: Extinguishing of subscription rights

If appropriate in relation to Xfi, provide for the extinguishing of

- share options or other rights held by persons to subscribe for, or otherwise acquire, securities of Xfi, or any of its subsidiaries.
- rights to shares arising from or in connection with a person's employment or office or provision of services with or to Xfi or one of its subsidiary [or connected entities]

This power might be necessary in a case where persons have an enforceable right to be issued with or otherwise acquire shares or other securities of Xfi or any of its subsidiaries. This power may be necessary depending on the financial institution involved as the existence of, and exercise of, such rights might frustrate the purposes of a transfer to the Minister or his nominee.



## **Compensation for securities transferred**

There may be at least two options to deal with the determination for compensation for securities transferred.

1. Defer making compensation arrangements
2. Set out detailed compensation determination rules/procedures in the Bill to nationalise the institution

1. The UK Banking (Special Provisions) Act 2008 provides that the Treasury will develop a compensation scheme up to three months after the transfer of securities. i.e. (Sn5) "...the Treasury must...make a scheme determining the amount of any compensation payable by the Treasury to persons who held the securities immediately before they were so transferred [and for subscription] rights extinguished...". Broadly similar provisions are provided in relation to transfer of property (Sn 7) supplemented by Sn 9, which sets out areas to be covered in compensation schemes – manner and procedure of assessment, appointment of independent valuer, appeals, expenses, etc. Generally under Sn 5 the UK authorities have 3 months within which to make a scheme of compensation in relation to the transfer of securities<sup>5</sup>.

This approach has the advantage that there may be issues specific to a particular institution that need examination/analysis before a specific compensation provision can be drafted. However the Oireachtas may be less willing to approve a transfer of assets without knowing the terms on which people will be compensated. There may also be constitutional issues.

2. An alternative approach would be to provide for payment of compensation to persons who held the securities immediately before they were transferred based on a valuation of the securities on the date falling before the day on which this Bill is passed.

Regardless of which approach is taken, subject in the case of option 1 to the addition of a text to state the compensation provisions will be brought forward at a later date, the substantive provisions are likely to have a broadly common format as set out at draft Head 5 following

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<sup>5</sup> Notwithstanding the provision to enable the separation by up to three months, the Northern Rock Plc Transfer Order was made on 21 February 2008 and the NR Plc Compensation Scheme Order on 12 March, 2008.

## Head 5: Compensation for securities transferred

[Provide that the Minister for Finance will bring forward within x months a compensation scheme for shareholders whose rights have been extinguished at heads 2 or 4.

(Note, it is envisaged that such a scheme would be part of a Bill (perhaps a "No.2 Bill") rather than a Statutory Instrument)]

Provide that compensation for securities transferred under head 2 or subscription rights extinguished under head 4, will be determined by a compensation scheme (depending on the financial institution concerned) which will make provision for:

- the appointment of an independent arbiter to assess [determine?] the amount of compensation to be paid by the Minister for Finance [and make provision as to the remuneration of the arbiter, the appointment of staff by him etc.].
- that the arbiter must, in assessing compensation payable by the Minister for Finance to any person in accordance with Sections 2 or 4, assess compensation on the basis that at the date of announcement of the transfer of securities Xfi —
  - (a) is unable to continue as a going concern,
  - (b) is in Examinership and being wound up
  - (c) that all financial assistance provided by the Minister for Finance to Xfi has been withdrawn (whether by the making of a demand for payment or otherwise), and
  - (d) that no financial assistance would in future be provided by the Minister for Finance to the deposit-taker in question (apart from ordinary market assistance offered by the CBFSAI subject to its usual terms)
  - (e) that any guarantee given under .... or in any case where the Minister for Finance has announced that the Minister for Finance would if necessary put in place depositor guarantee arrangements in relation to Xfi, that such a guarantee has been removed [revoked?].
- the arbiter to make such rules as to the procedure in relation to the determination of compensation as s/he considers appropriate,
- a system of review by the Arbiter of assessment of compensation at the request of the person who receives the assessment or the Minister (i.e. a system of internal review)
- a system of appeal whereby if a person in receipt of an assessment or revised assessment notice or the Minister are dissatisfied with the revised assessment notice they may make a reference to [the Investor Compensation Tribunal/ Financial Services Appeals Tribunal] for the notice to be reviewed.

## **Head 6: Further transfers**

Provide that where any securities of Xfi that have been transferred to the public sector under head 2, these may be transferred by the Minister to any person.

This would enable the institution to be transferred back to the private sector (or within the public sector). The securities issued by a company wholly owned by the CBFSAI or the Minister may also be transferred. This gives the Minister a legislative route for transferring all or part of Xfi back to the private sector, or for restructuring Xfi within the public sector.

## **Head 7: Guarantees in respect of credit institutions in distress**

Depending on circumstances, this head could be enacted separately to perhaps provide a general power to give guarantees in respect of distressed credit institutions or it could be directed at a particular credit institution. The text following is on the basis of a general power.

Amend the Central Bank 1942 (as amended) to provide as follows:

### **(a) Power of Minister**

Provide that the Minister for Finance may guarantee in such form and manner and on such terms and conditions as he sees fit, any or all of the following -

- (i) payment to the Central Bank of the principle of and any interest on, any moneys advanced by the Central Bank under the terms of a guarantee given by the Central Bank in respect of a credit institution
- (ii) the borrowings and liabilities of a credit institution
- (iii) deposits in a credit institution subject to appropriate interaction with the Deposit Protection Scheme under the Deposit Guarantee Schemes Directive 94/19 EC enacted here in the S.I. No. 168 of 1995 / European Communities (Deposit Guarantee Schemes) Regulations 1995 (as amended).

### **(b) Circumstances where power is exercisable**

Provide that the Minister may exercise the power at (a) above only in circumstances where it appears to him that it is necessary for any of the following purposes:

- (i) maintaining the stability of the financial system in Ireland where the Minister considers that there would be a serious threat to its stability if the power was not exercised;
- (ii) [protecting the public interest by] safeguarding depositors' funds in a credit institution where the Minister considers that such deposit funds would be under serious threat if the power was not exercised;
- (iii) providing the Board of a credit institution and its shareholders with an opportunity to find and consider potential private sector solutions where the Minister considers that this would be facilitated by the exercise of the power.

(c) Provide that a Guarantee under this Section will have effect from the date announced by the Minister as the date from which it will have effect, but not before the date of the announcement, regardless of whether that announcement is made before the passing of this Act.

(d) Provide that all moneys to be paid out by the Minister on foot of a guarantee provided by him under this section will be paid from the Central Fund or the growing produce thereof.

(e) Provide that moneys paid by the Minister to the Central Bank under a guarantee under this head are repayable to the Minister, with interest, as and when such moneys are recovered by the Central Bank. Moneys paid by the Central Bank to the Minister are to be paid into [or disposed of for the benefit of] the /Central Fund Exchequer [in such manner as the Minister thinks fit].

(f) Provide that the Minister and /or the Central Bank as appropriate will have a continuing obligation to use all reasonable means to recover amounts paid out under guarantees provided under this head.

(g) Provide that in the event that moneys paid out under a guarantee under this section are not recovered, the amount outstanding will be repaid to the Central Fund from moneys voted by the Oireachtas. This is designed to ensure sound accounting principles and provide transparency.

(h) Provide that the Minister is required to lay a statement before each House of the Oireachtas every year to fully inform members on the situation with any guarantees made under this Head<sup>6</sup>. The Minister's report to give particulars of each guarantee; where payments have been made by the Minister or the Central Bank, the amount of payment and the amount (if any ) repaid to the Minister on foot of the payment; and the amount of money covered by a guarantee that was outstanding at the end of that year.

**Explanatory Note:**

The nature, duration etc of a guarantee are important factors in the context of EU State Aid rules. It is envisaged that these factors would be encompassed in "... such terms and conditions ..." at (a) above. The criteria laid down in the EU Rescue and Restructuring Guidelines can be summarised as:

- the beneficiary has to be a firm in difficulty and may not have received rescue or restructuring aid during the past 10 years,
- the aid should normally consist of liquidity support and should be restricted to the minimum necessary to keep the firm in business for the rescue period,
- the aid must be granted in the form of loans or loan guarantees,
- the aid must be limited to a period of maximum 6 months,
- if the Member State communicates to the Commission within these 6 months a restructuring plan or liquidation plan, then the rescue aid can normally continue for the time needed by the Commission to examine this plan.

It should be noted that in moving to the restructuring phase the Commission have emphasised that aid must be the minimum necessary and there must be appropriate compensatory measures.

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<sup>6</sup> Part One of the annual Finance Accounts comprises financial statements of Exchequer receipts and issues and guaranteed liabilities.



In relation to (a)(i) of the head, the CBFSAI has power to grant Emergency Liquidity Assistance (ELA) under Section 5B(d) of the Central Bank Act 1942. This empowers the CBFSAI to *“provide loans and other kinds of financial accommodation to credit institutions and other persons on the security of such assets and on such terms and conditions as the Board considers appropriate”*. Advice from the Attorney General’s Office refers to the general supplementary powers of the CBFSAI under Section 5A (2) and (3) of the CBA 1942 to do all that is necessary or reasonably incidental to the performance of its functions in accordance with normal banking practice. The AG’s Office advice is that the terms and conditions of any assistance under 5B(d) are the subject of a wide discretion of the CBFSAI subject to the ESCB requirements. CBFSAI might also be asked to confirm this position is consistent with its own view, i.e. that it has sufficient legislative powers in relation to the giving of guarantees. Any deficiencies in this regard could be remedied in this head or an associated head.]

In regard to (b)(i) of the head, it may not be necessary to define “stability of the financial system” (see footnote 3).

The provision at (d) is required as otherwise it would be necessary for the Minister to arrange a Vote in the Department’s Estimate for the purpose or more likely a Supplementary Estimate which would be dependent on the Dáil being in session and would be subject to a possible vote thus not providing sufficient certainty as to the outcome of the process. The text is modelled on section 9(5) of the Bretton Woods (Amendment) Act 1999.

Subparagraph (e) is based on section 9(6) and (9) of the Bretton Woods (Amendment) Act 1999.

Subparagraph (f) is based on section 9(7) of the Bretton Woods (Amendment) Act 1999.

Subparagraph (g) is based on section 9(8) of the Bretton Woods (Amendment) Act 1999.

Subparagraph (h) is modelled on section 9(10) of the Bretton Woods (Amendment) Act 1999.

## **Head 8 - Definitions**

Provide as appropriate for necessary definitions (for example for terms such as 'credit institution', guarantee, etc.)

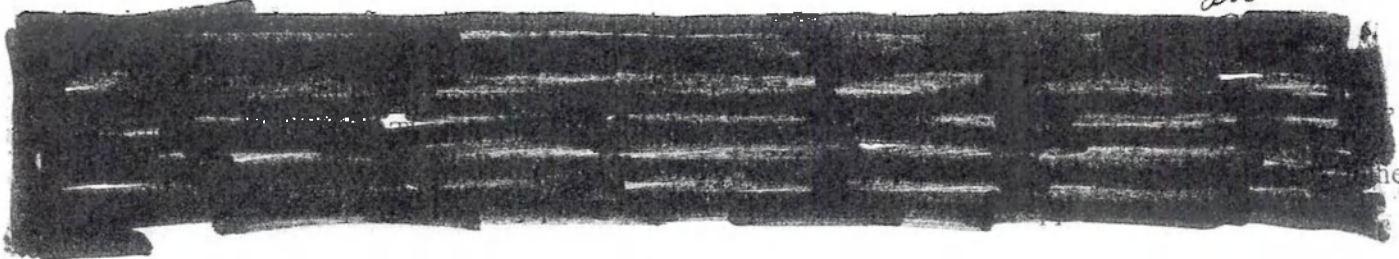
Manley, Michael

From: Manley, Michael  
Sent: 12 June 2008 17:49  
To: Doyle, David  
Cc: Beausang, William; Cardiff, Kevin

Secretary General

27

✓  
pl relate r  
add a copy of  
200's info  
action 9/2/16



The full text of Section 5B(b) and (c) state:

"Without limiting section 5A, the powers of the Bank include power to do all or any of the following: "  
section 5A sets out the functions of the Bank).

"(b) acquire, hold or dispose of shares in a bank or other institution formed wholly or mainly by banks that are the principal currency authority in their respective countries, but only with the approval of the Minister;"

(c) enter into, carry out, assign or accept the assignment of, vary or rescind, any contract, agreement or other obligation;

Section 5B was inserted by Section 5 of the CBFSAI Act 2003; in relation to subsection (b) the briefing for the Committee stage states this to be a restatement of Sn (7)(1)(d) of the 1942 Act (as amended in 1997). The power to acquire shares in a bank would therefore seem to be long standing, though it appears to be qualified to relate to a bank that is the principal currency authority for a particular country. This would suggest that the Bank can only acquire, etc., shares of banks (or other institutions) formed by central banks. Thus it would seem that this provision does not give the CBFSAI power to purchase shares of a financial institution experiencing difficulties as might be considered desirable in order to manage financial stability. Its not clear why the original provision was included in the CB Act ' 1942, a file search for the original brief is underway, though it may have been provided in anticipation of the Breton Woods agreement then in discussion. The full text of Sn 5B(b) presents a position at variance with that identified by the AGO and this is being taken up with that Office.

Michael

26  
Lonergan, Ciara

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From: Manley, Michael  
Sent: 19 June 2008 16:22  
To: Lonergan, Ciara  
Subject: FW:

For file

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From: Manley, Michael  
Sent: 19 June 2008 16:21  
To: 'Buttmore, Jonathan'  
Subject:

Jonathan,

Apologies for pursuing you on this, but I hope you have had an any opportunity to consider the material in relation to the outline nationalisation Bill. Overall, it is not considered practical or feasible that the broad range of powers provided in the UK – especially those exercised through secondary legislation - should be included in the legislation which it is proposed should be drafted to effect the nationalisation of an Irish bank. Our policy approach is to have legal powers available to the Minister to take an individual financial institution into public ownership in certain circumstances rather than as is the case in the UK to create a broad policy framework to support the resolution of financial stability issues as they may arise across the banking sector as a whole.

On account of the continued disruption of wholesale financial markets and the challenges this is creating for Irish banks in securing funding on an ongoing basis, it is considered essential as we previously discussed with you that draft emergency legislation is available to provide the Minister with the powers necessary to take, as a last resort, a distressed financial institution into public ownership to support the maintenance of financial stability in the State.

The disruption and its effects have gone on longer than anyone had forecast, with at least one commentator now suggesting it will extend well into 2009 and the scale of impact is now being talked of more than a trillions in terms of sub-prime alone. All of this lends both greater urgency and importance to what we are seeking to do and I would welcome an opportunity for an early meeting.

Regards,

Michael

Seen by Minister

25.6.08

add.

25

Minister,

See table below for the performance (over the last year and quarter) of the main Irish banking stocks vis-à-vis some of the weakest international performers -- graphs in respect of each comparison are also attached for information.

In terms of the performance of the overall sector, the ISE index of Irish financials has experienced a decline of -63% since February '07 as compared to -45% for the UK FTSE financial index and -51% for the US Dow Jones financial index (TAB A).

24 June 2008

cc Secretary-General

**Irish banks compared with HBOS, Royal Bank of Scotland and UBS**

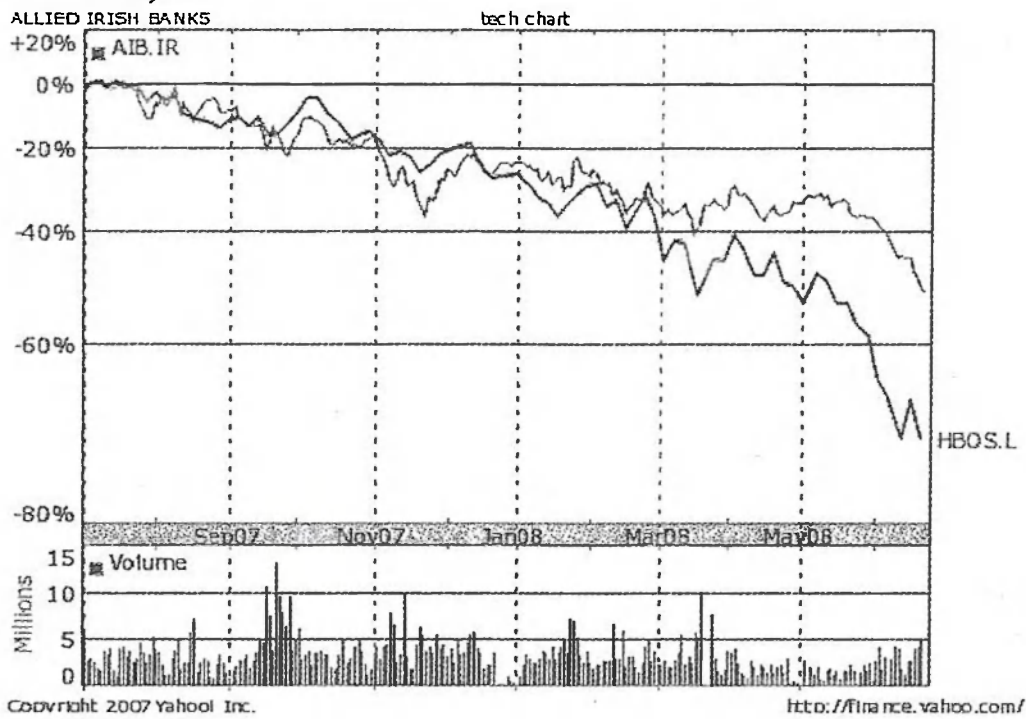
<b>Irish Banks</b>		
<b><u>Bank</u></b>	<b><u>Approximate % change</u> <u>1 year</u></b>	<b><u>Approximate % change</u> <u>3 months</u></b>
Allied Irish Bank	- 50	- 30
Bank of Ireland	- 60	- 38
Anglo Irish Bank	- 55	- 25
IL&P	- 50	- 31

<b>International Banks</b>		
<b><u>Bank</u></b>	<b><u>Approximate % change</u> <u>1 year</u></b>	<b><u>Approximate % change</u> <u>3 months</u></b>
HBOS	- 70	-50
RBS	- 65	- 36
UBS	- 65	- 27

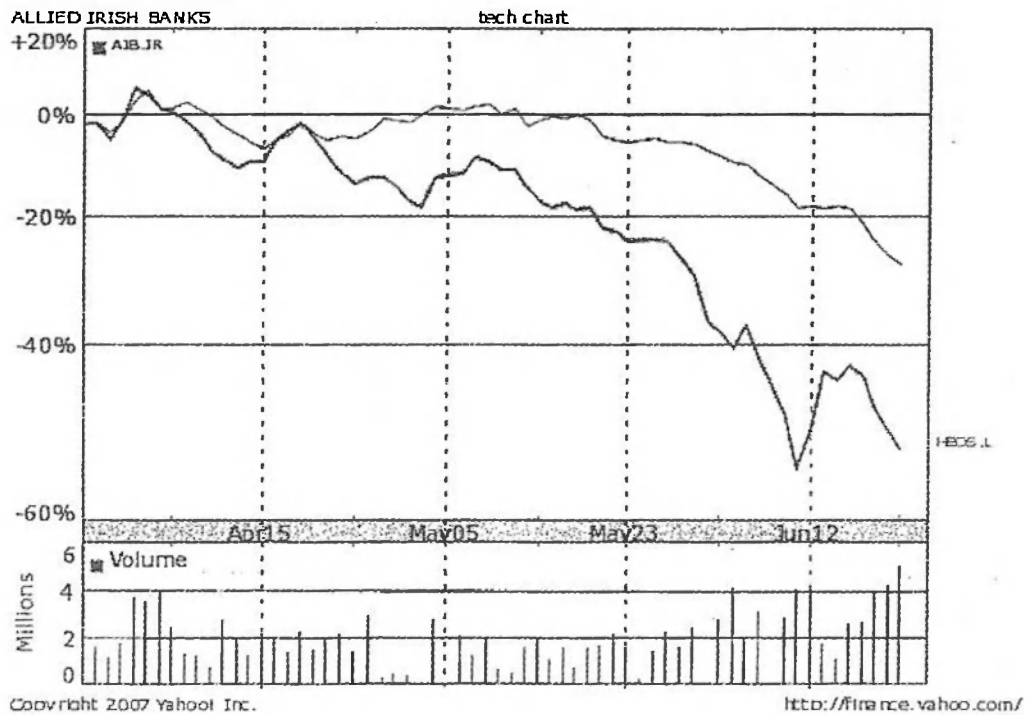


## Allied Irish Banks

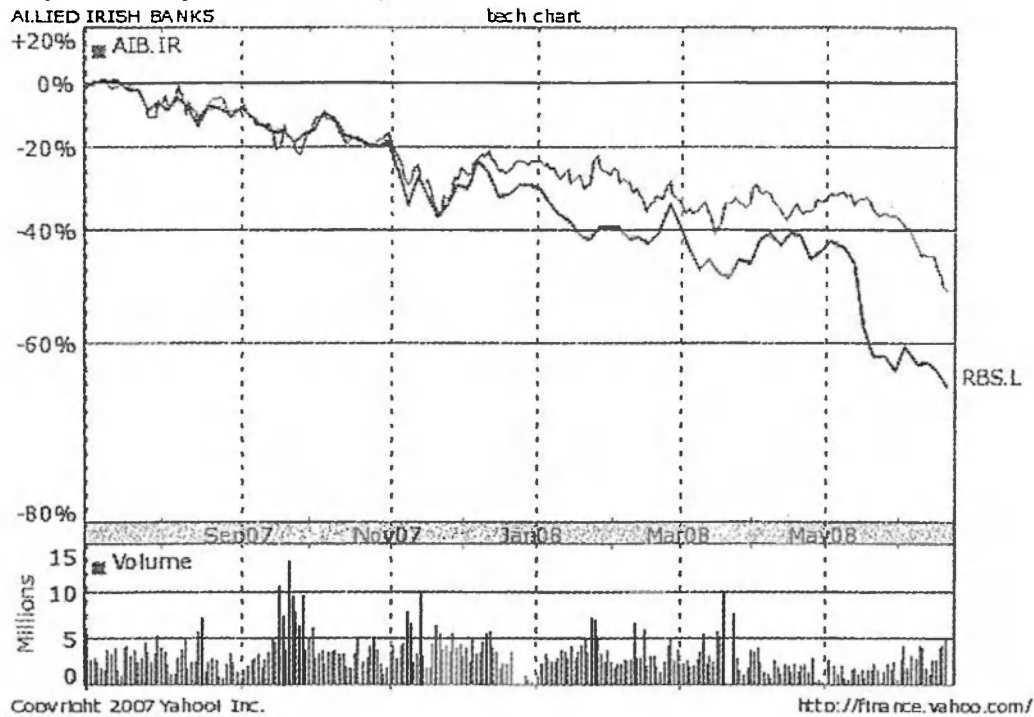
### HBOS - 1 year



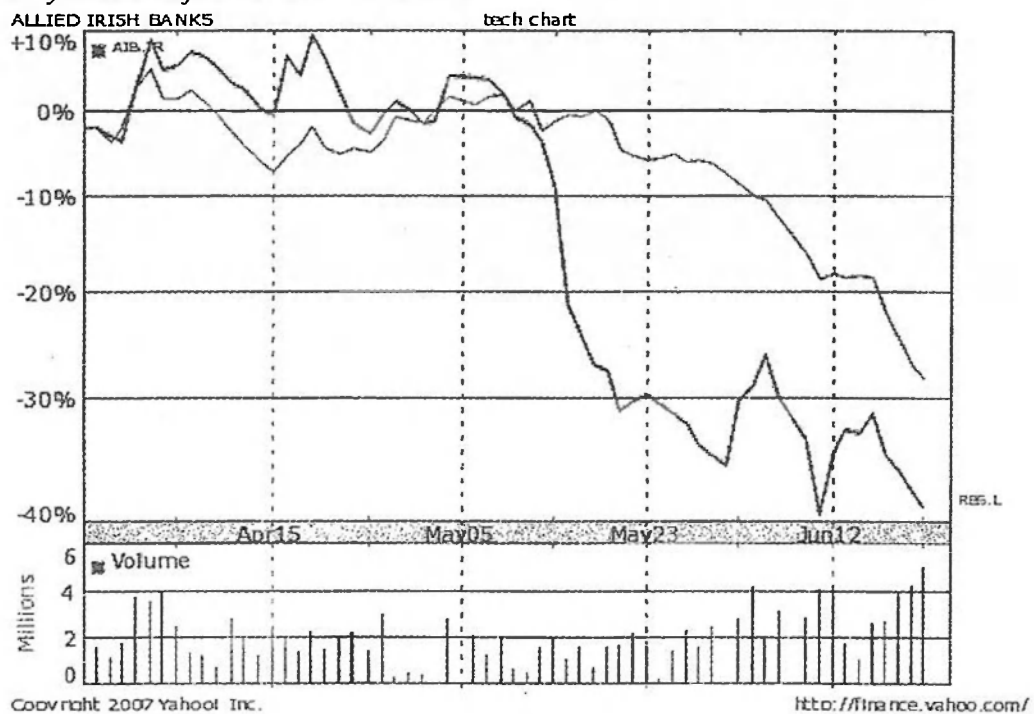
### HBOS - 3 month



### Royal Bank of Scotland – 1 year



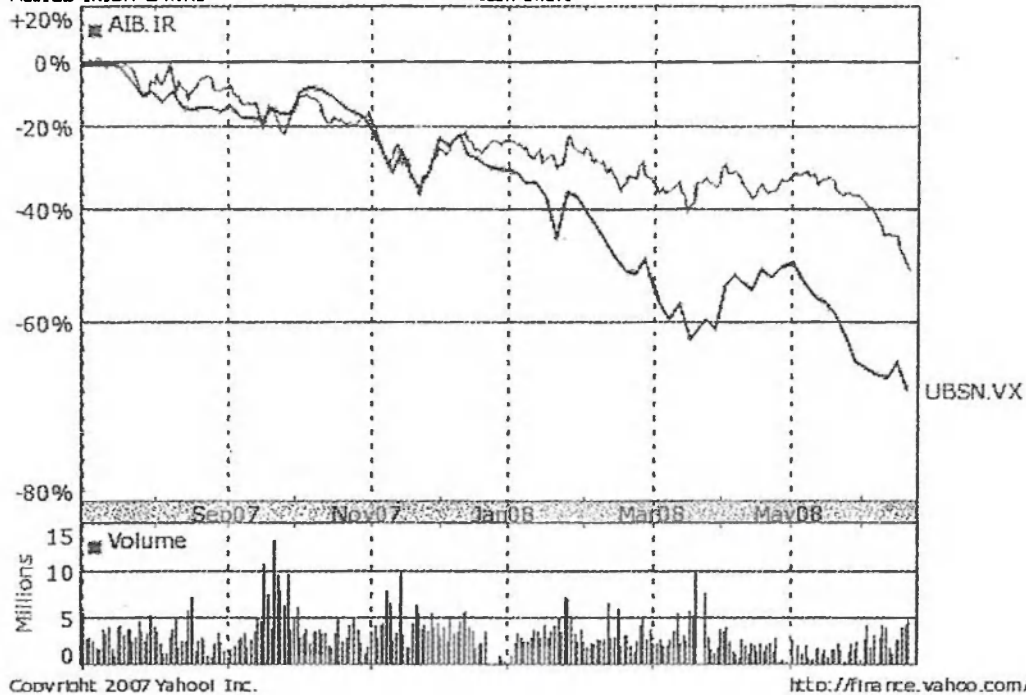
### Royal Bank of Scotland – 3 month



### UBS - 1 year

ALLIED IRISH BANKS

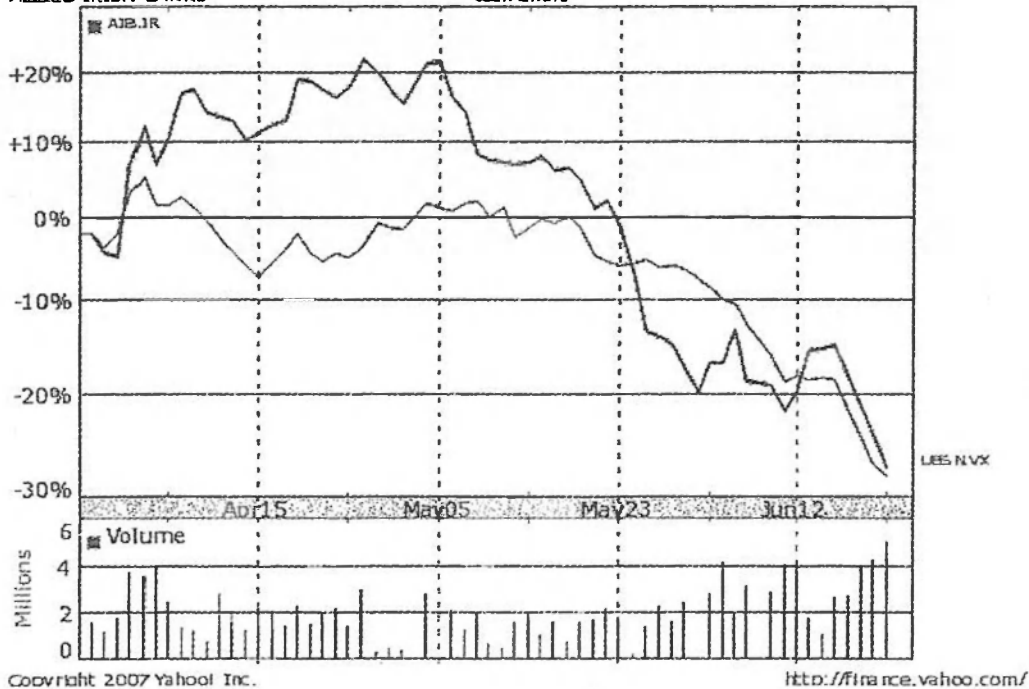
tech chart



### UBS - 3 months

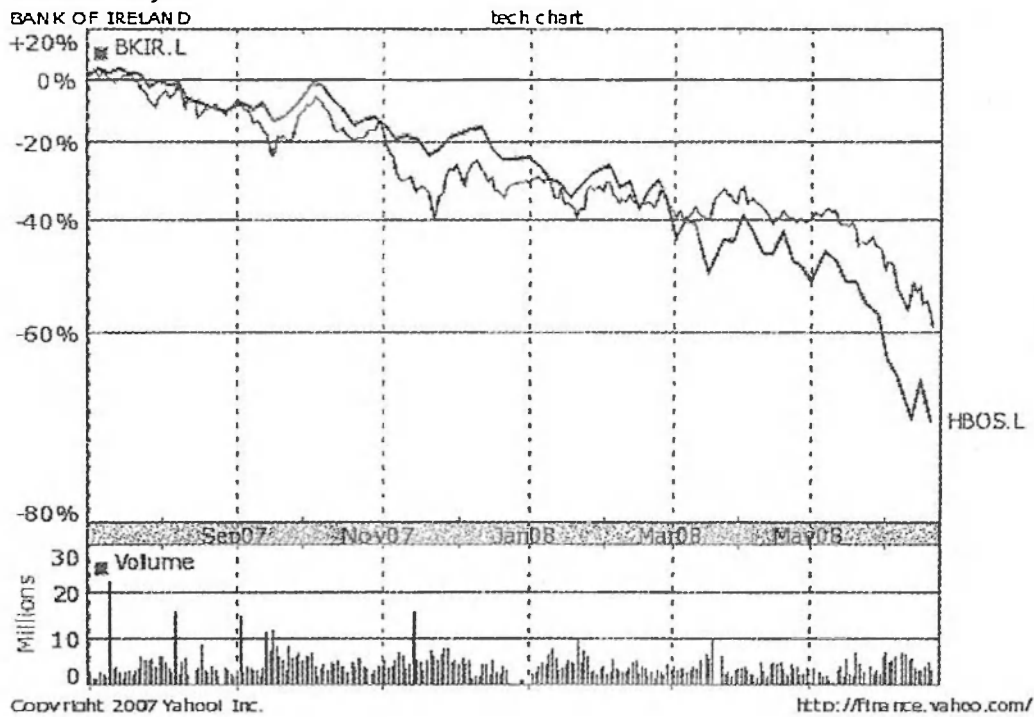
ALLIED IRISH BANKS

tech chart

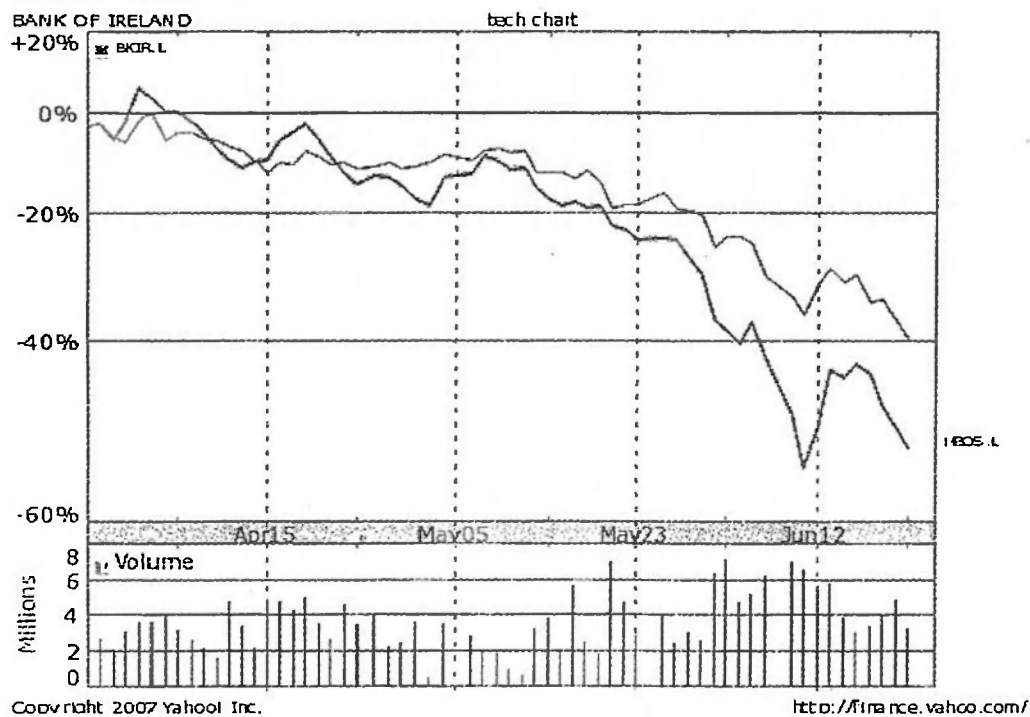


## Bank of Ireland

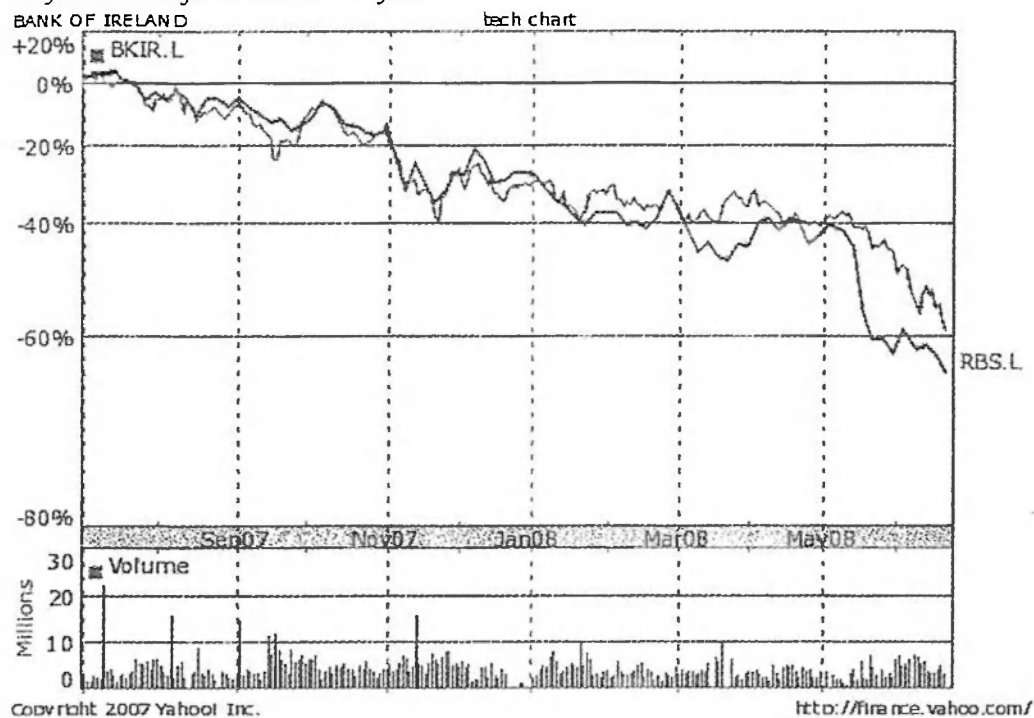
### HBOS - 1 year



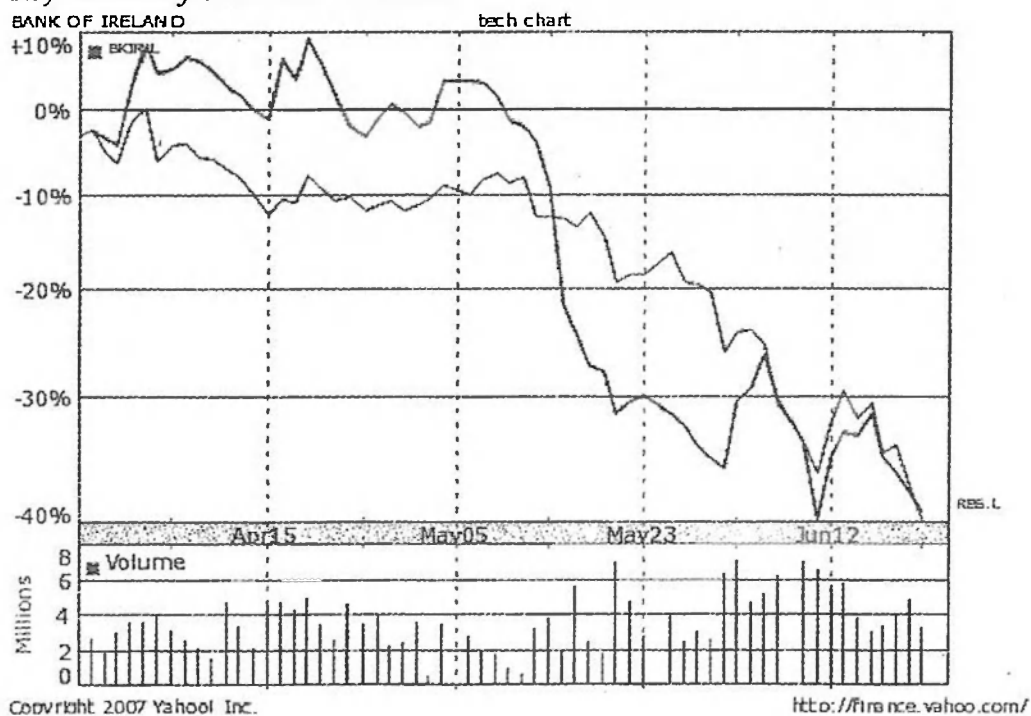
### HBOS - 3 months



# Royal Bank of Scotland – 1 year



# Royal Bank of Scotland – 3 month

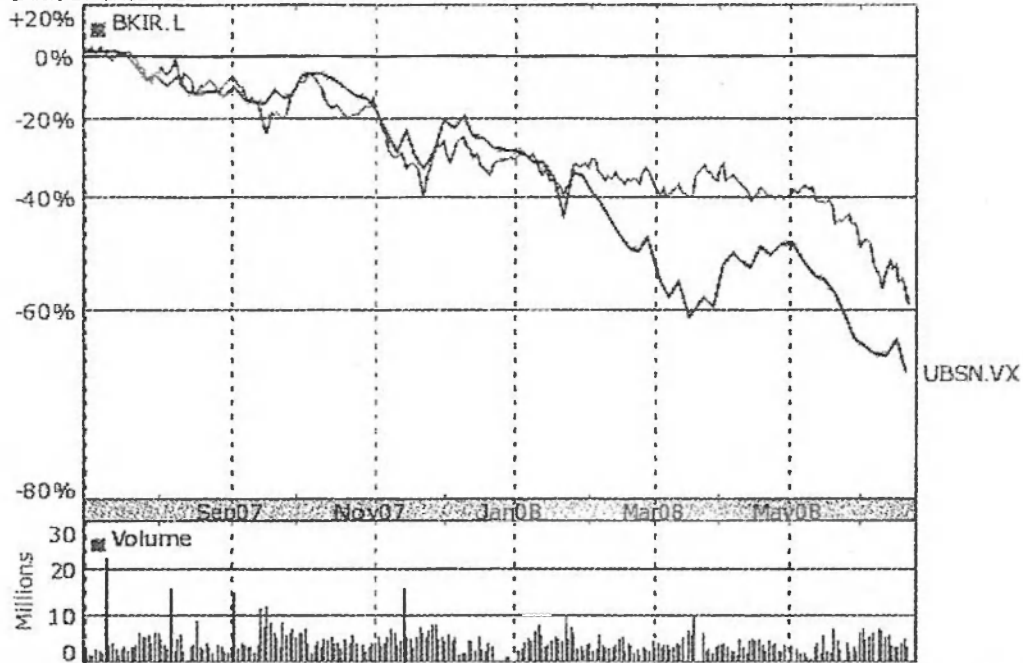




### UBS - 1 year

BANK OF IRELAND

tech chart



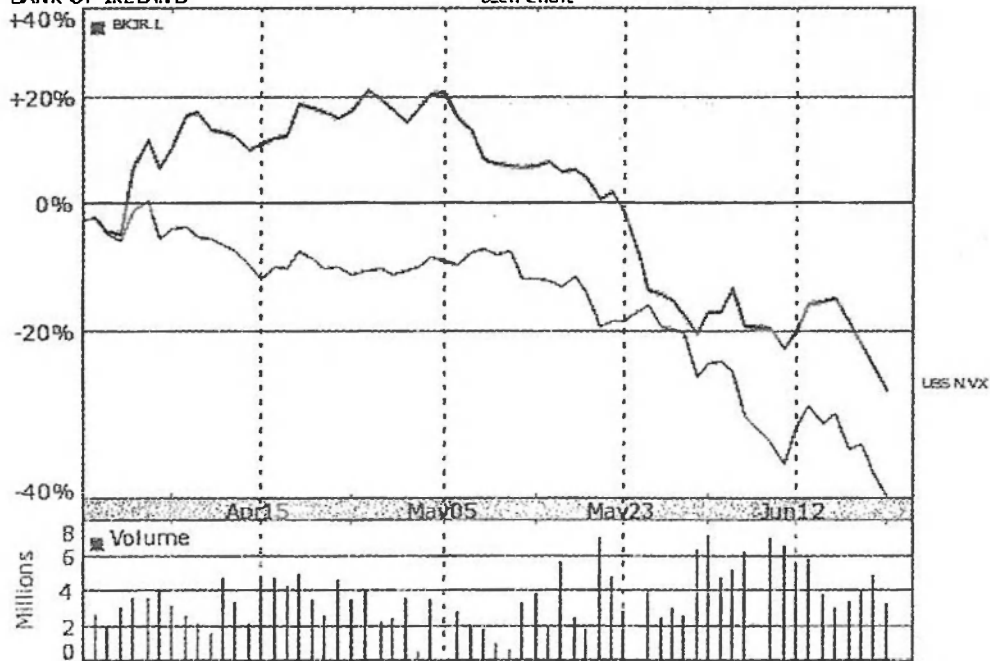
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### UBS - 3 months

BANK OF IRELAND

tech chart

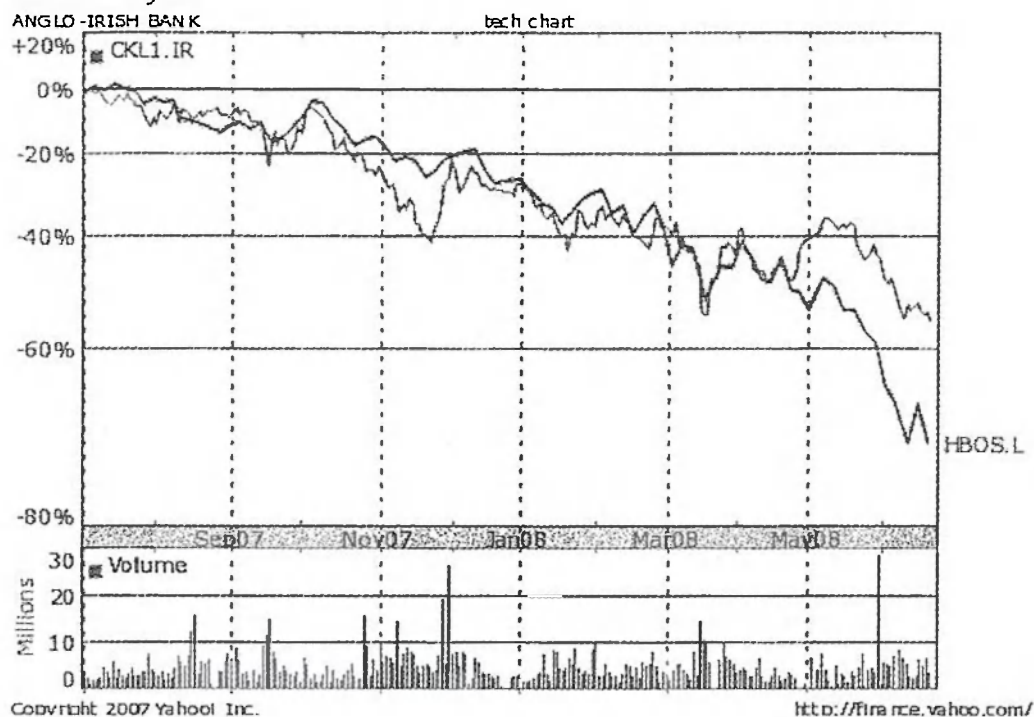


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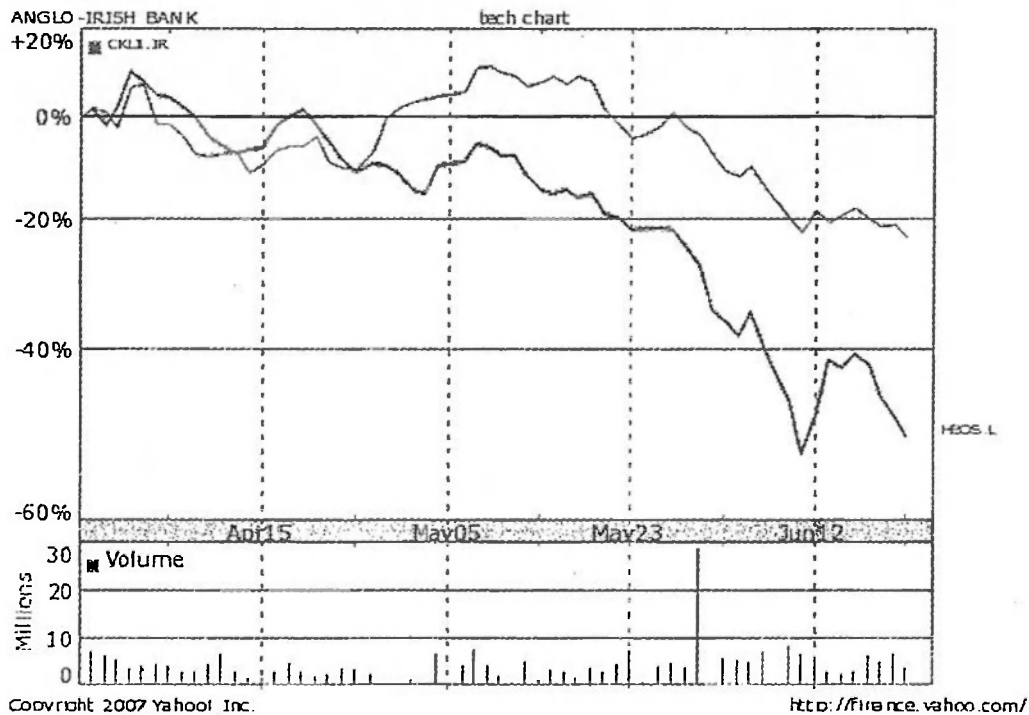
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## Anglo Irish Bank

### HBOS -- 1 year



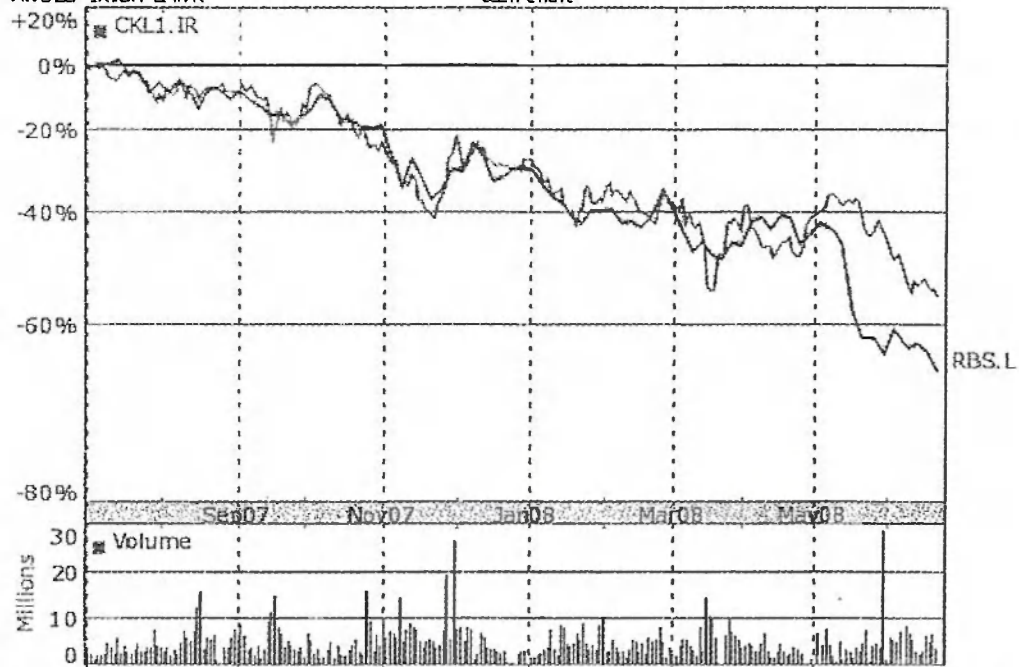
### HBOS -- 3 months



# Royal Bank of Scotland – 1 year

ANGLO-IRISH BANK

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## Royal Bank of Scotland – 3 month

ANGLO-IRISH BANK

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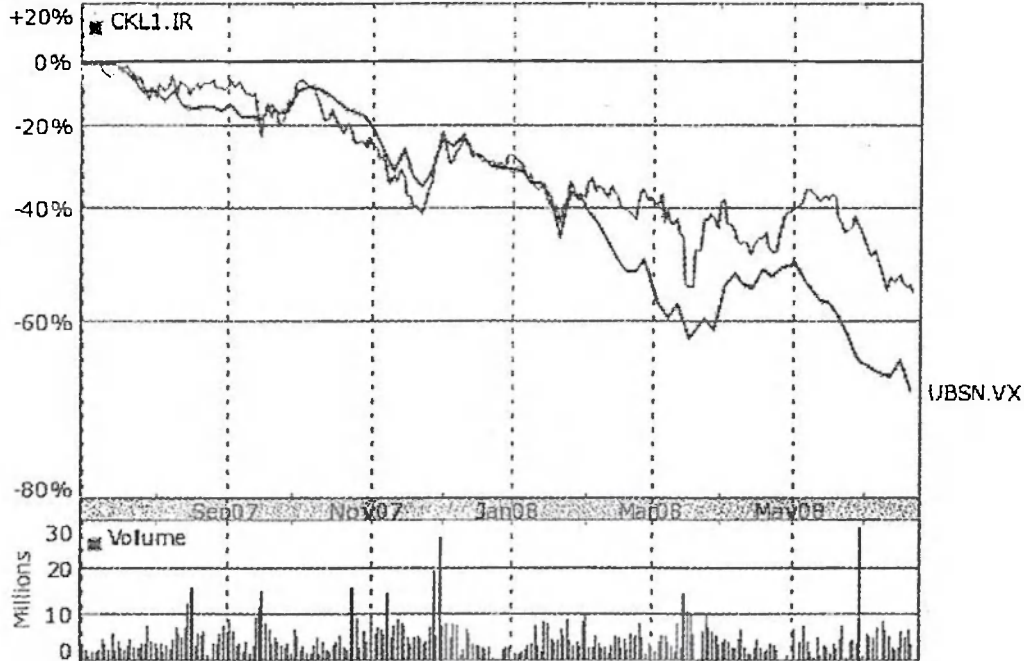
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# UBS - 1 year

ANGLO-IRISH BANK

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## UBS - 3 months

ANGLO-IRISH BANK

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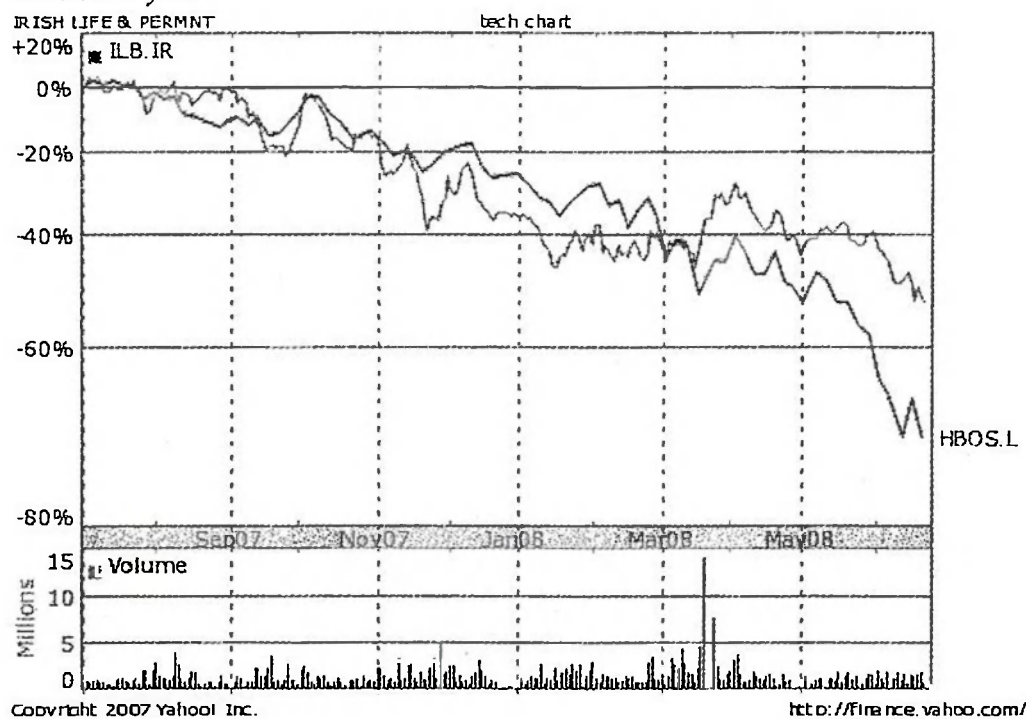


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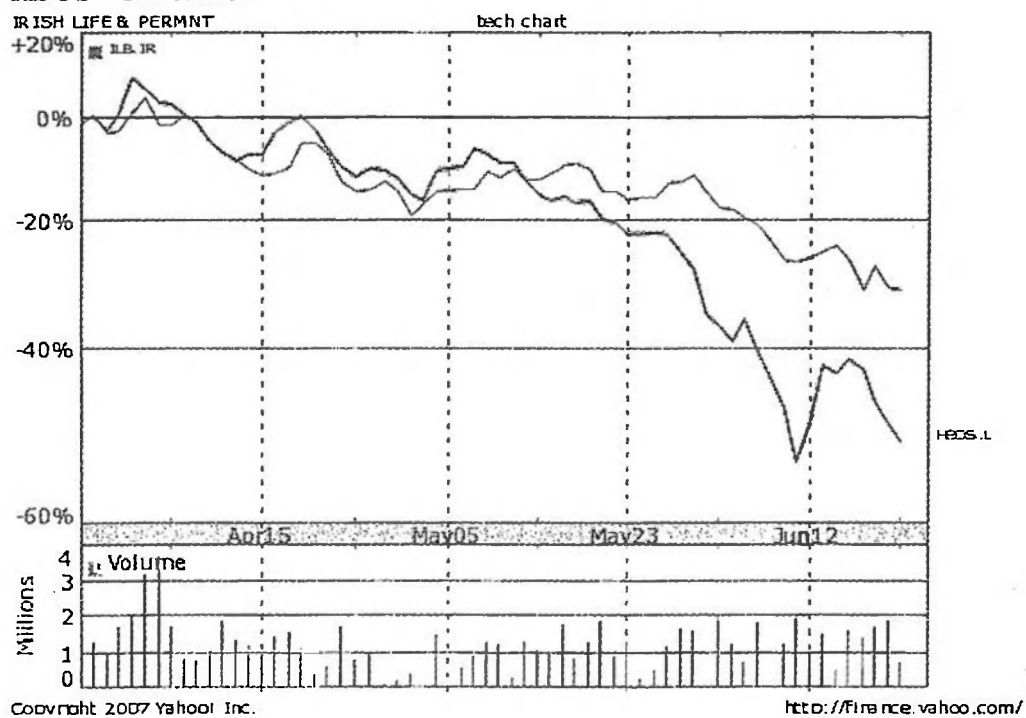
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## Irish Life and Permanent

### HBOS - 1 year

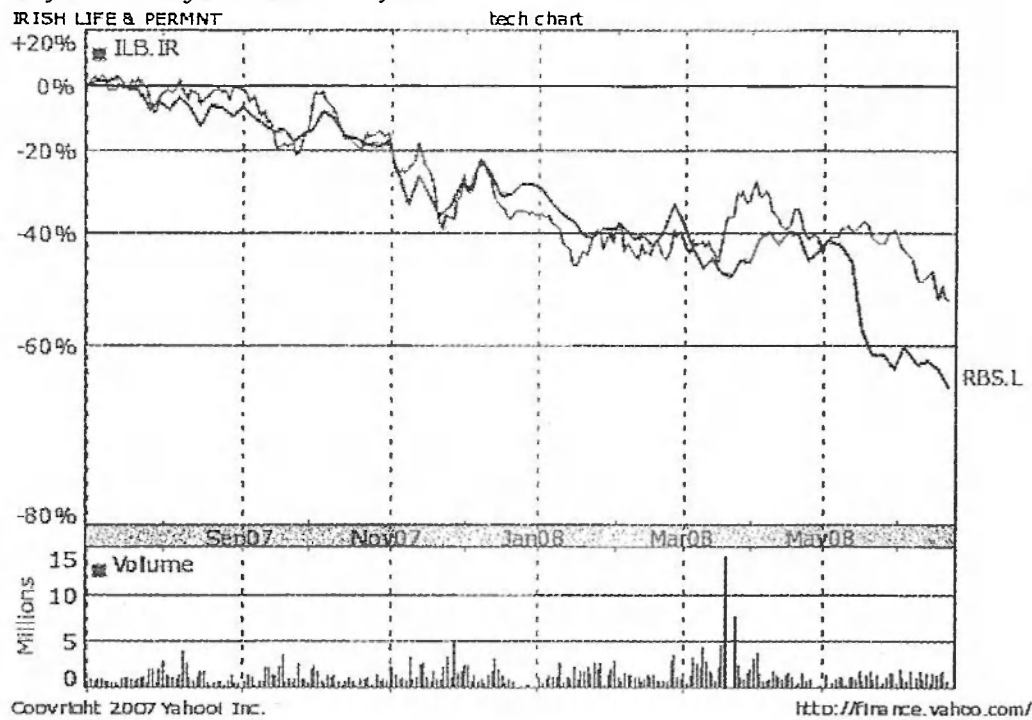


### HBOS - 3 months

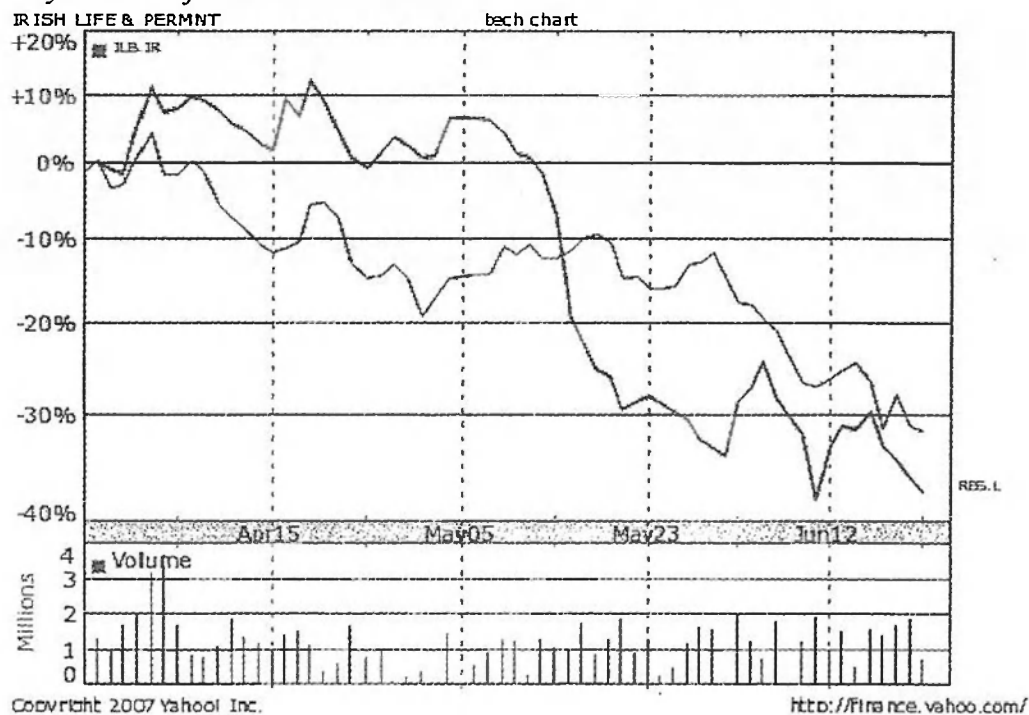




# Royal Bank of Scotland – 1 year



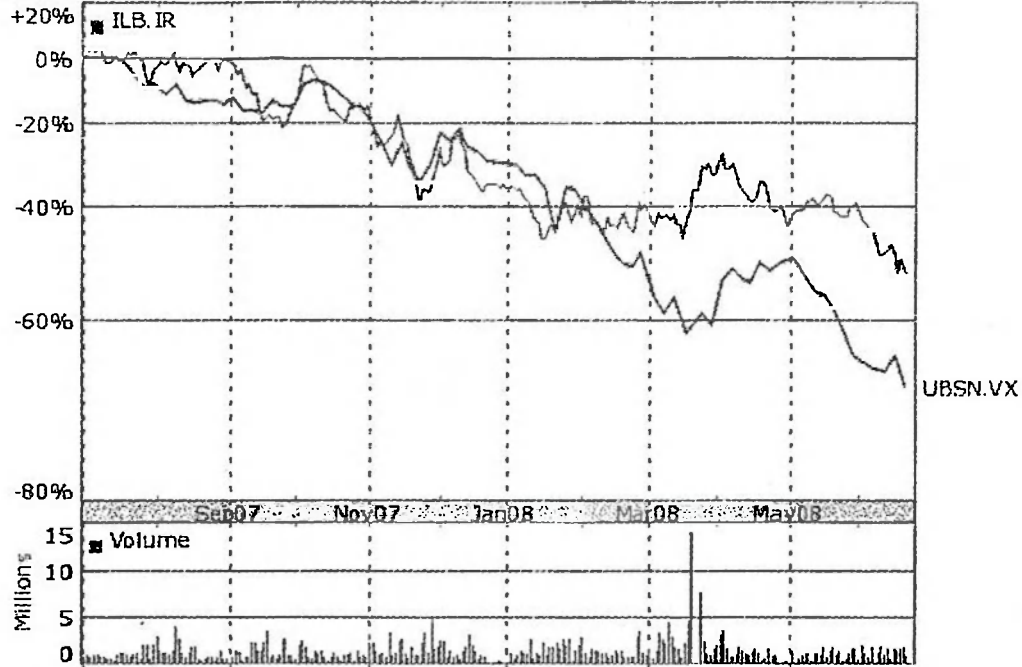
# Royal Bank of Scotland – 3 month



### UBS - 1 year

IRISH LIFE & PERMINT

tech chart



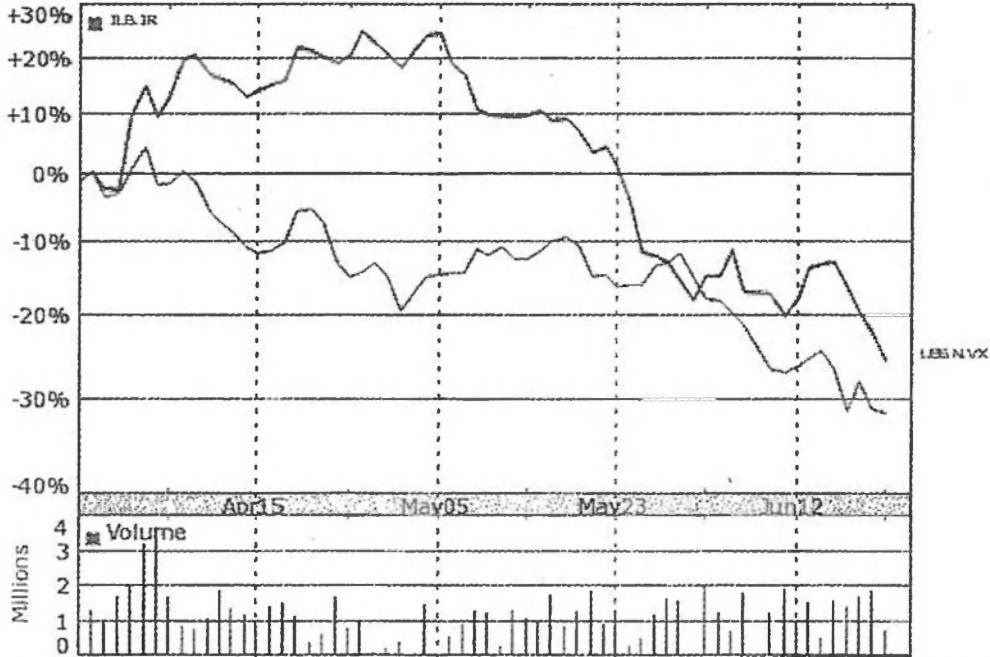
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### UBS - 3 months

IRISH LIFE & PERMINT

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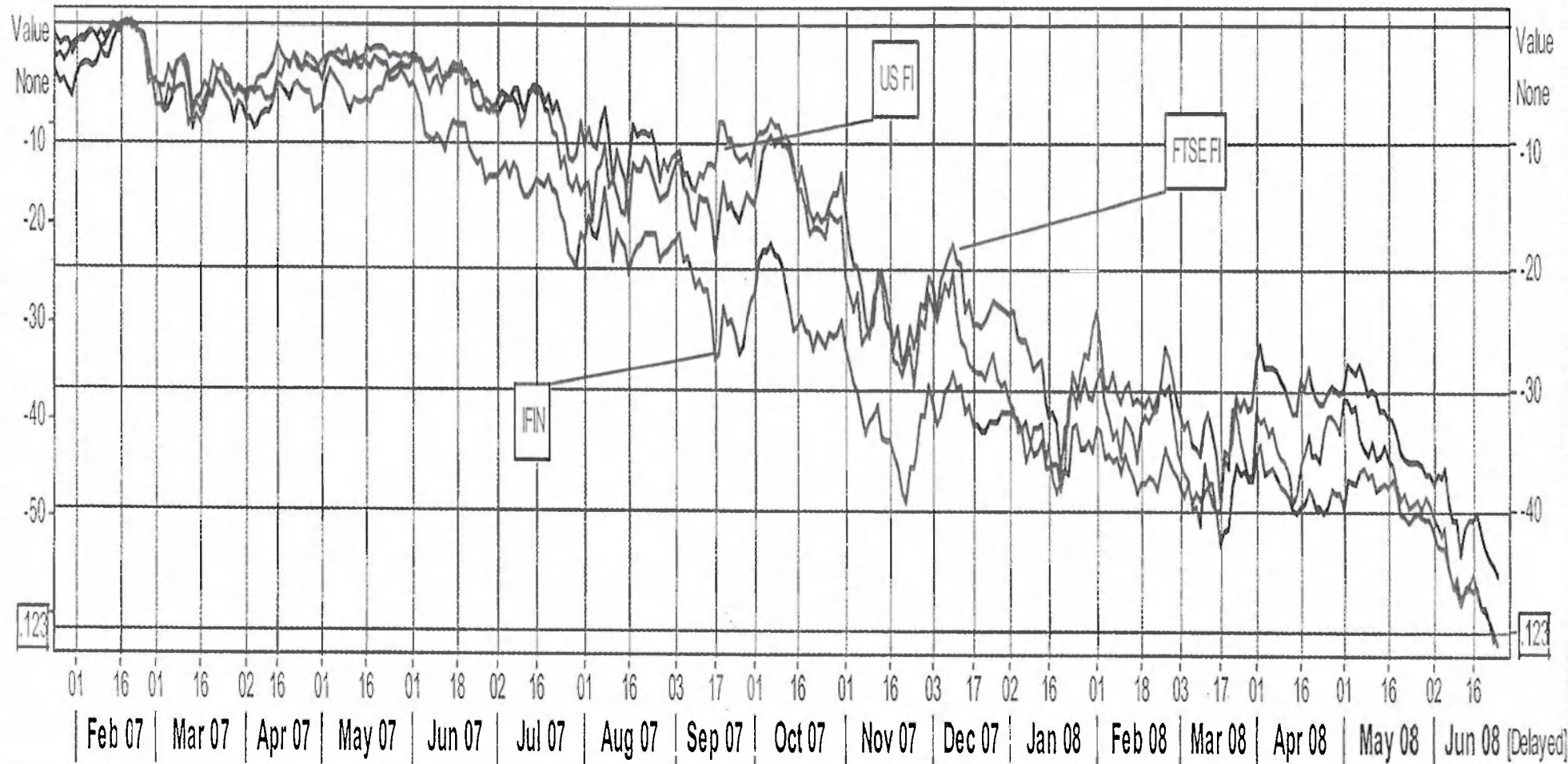
Percentage change in Financial Indices since February 2007:

Index	% change
ISEQ Financials IFIN	↓63%
FTSE 350 financials FTSE FI	↓45%
Dow Jones US Financials US FI	↓51%

Percentage change in Financial Indices from the highs of February 2007 LHS (IFIN ↓63%) RHS (FTSE FI ↓45%; US FI ↓51%)

Daily Q.FTUB8300, Q.DJUSBK, Q.IFIN

25/01/2007 - 27/06/2008 (LON)



24

Lonergan, Ciara

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From: Manley, Michael  
Sent: 01 July 2008 14:52  
To: Buttimore, Jonathan  
Cc: Lonergan, Ciara; Nolan, Kevin  
Subject: Contingency planning - competition

Attachments: Competiton issues AGO note.doc

Jonathan,

When we met on Thursday last in relation to contingency planning for financial stability, I outlined questions that had recently been identified in relation to competition policy issues and said I would follow-up with a note to clarify the issues, hence this email and attachment

A key issue we have identified is, where a market based solution is being orchestrated (acquisition, merger, etc.), whether the timeframe and framework for decision in relation to competition policy would generate uncertainty regarding the possible outcome that could undermine public confidence in the proposed takeover financial stability generally.

This issue has been discussed with the Central Bank and Financial Regulator and our assessment is that, ideally, in the case of a takeover of a distressed financial institution by another domestic market participant, the transaction would be announced with the approval of the Competition Authority already secured. This requires an examination of the competition issue to take place swiftly, taking full account that the takeover is motivated by the objective of pre-empting what would otherwise represent a very significant threat to financial stability in the State rather than giving rise to any competition concerns. However, the Competition Act does not provide for expedited decision making on this basis.

**As I indicated at the meeting, your advice is sought as to whether it would be possible to amend the Competition Authority Act, either;**

- To require the competition Authority of approve a proposed acquisition, merger, etc., where the CBFSAI confirms (in writing) that the proposed merger etc., is necessary to maintain financial stability**

**Or**

**To require the competition Authority to consider (have regard to, or some such formulation) a view by the CBFSAI that the proposed merger etc should be allowed to proceed to maintain financial stability.**

Obviously the first formulation offers the most straightforward resolution, ensuring the merger, etc., would have to be approved where necessary for maintenance of financial stability. However, if such direct provision is not possible (EU Treaty considerations?), it would be important that the second option provision be sufficiently strong to meet that which is required.

I appreciate you intend to forward your advice before going on Leave and if there is anything further we can do to assist, please let me know.

Regards,

Michael



Competiton issues  
AGO note.doc...



## Competition Law issues & the takeover of an Irish bank

Where a takeover, merger, etc., of a distressed financial institution arises, the question of competition approval may arise under EU or domestic law. If the annual turnover of the combined businesses exceeds specified thresholds in terms of global and European turnover the proposed merger must be notified to the European Commission, which must examine it. Below these thresholds, the national competition authorities in the EU Member States may review the merger. The threshold most likely to apply in the case for a takeover of a domestic financial institution is aggregate worldwide turnover of €5bn and Community turnover of €250m (unless each of the businesses achieves at least two-thirds of its turnover within the same Member State). In the case of financial institutions in place of 'turnover' a detailed income calculation is included in the EC Merger Control Regulations.

Notwithstanding that a proposed transaction exceeds the threshold criteria, the Commission may refer the matter back to the national competition authority of the Member State concerned where, for example, the proposal threatens to affect competition in a market within that Member State, which presents all the characteristics of a distinct market and which does not constitute a substantial part of the common market.

In Ireland, a takeover proposal that does not reach the EU thresholds, or which is referred to the Irish authorities by the EU Commission, would fall to be dealt with under the Competition Act. The Competition Authority is required to assess if the merger or acquisition will not be to substantially lessen competition. The emphasis is on the effect of competition within the State as distinct from the EU emphasis on the effective competition in the single market<sup>1</sup>.

Our initial assessment is therefore if a large foreign institution not currently active in the Irish market was taking over a mid-sized Irish bank, the decision on competition approval would fall to the European Commission. In those circumstances no significant competition issue would appear to arise within the single market or indeed Ireland, competition approval would seem straightforward and no question of referral of the transaction back to the Competition Authority should arise. While the Regulations do provide for a 25 working day time limit for decisions, this would not be expected to impact on the credibility of the transaction as it would be expected that any acquiring bank would be a major cross-border European bank.

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<sup>1</sup> The preamble to regulation 139/2004, states that completion of the internal market will [likely] result in economic reorganisation likely to lead to 'concentrations', which should be welcomed to the extent that they contribute to growth, raise living standards and are in line with increasing the competitiveness of EU industry. Regulation aims to prevent this reorganisation resulting in concentrations that may significantly impede effective competition in the common market or a substantial part of it, i.e. the emphasis is on the effective functioning of the common market.

In circumstances that a large domestic financial institution was proposing to takeover a small domestic financial institution, even if the turnover thresholds are met, the Commission is likely to form a view that domestic competition approval is necessary on account of the possible impact on competition in the national market and refer the transaction to the Competition Authority for approval.

There would seem to be a strong case that the takeover of a distressed bank in such circumstances should not be viewed as giving rise to any diminution of competition. Such action would preserve the functioning of a credit institution, reduce risk of contagion that could damage financial stability and maintain Ireland's standing as an attractive location for banking activity (incl. EU passporting provisions and Internet banking). However, there is a significant risk that uncertainty and speculation regarding the Competition Authority's decision or even the period of time it takes to arrive at a decision, could erode public confidence in the takeover going ahead and lead to financial uncertainty instability. The Competition Act allows the Authority a period of up to a month to decide to approve a notification which is not subject to full investigations (and this period can be extended to 45 days).

## European Merger Control Regulation - ECMR

Council Regulation 139/2004 of 20 Jan., 2004

### (Summary of key provisions)

- The regulations apply to proposed concentrations which have a community dimension, which is stated to arise where (Art. 1.2);
  - The combined aggregate worldwide 'turnover' of all the undertakings concerned is more than €5 Billion
  - The aggregate Community-wide 'turnover' of each of at least two of the undertakings concerned is more than €250m
  - Unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide 'turnover' within the same Member State
- Additional provision is made at Art 1.3 to apply the regulations to concentrations where;
  - The combined aggregate worldwide 'turnover' of all the undertakings concerned is more than €2.5bn
  - In each of at least three member States the aggregate turnover of the undertakings exceeds €100 million,
  - aggregate turnover of each of at least two undertakings exceeds €25 million and the aggregate turnover of at least two of the undertakings exceeds €100 million.
- Calculation of turnover is dealt with at Art 5, which provides that in the case of credit institutions the sum of the following is used in place of turnover (net of VAT and other taxes directly related to those items)
  - interest income and similar income
  - income from securities
  - commission receivable
  - net profit on financial operations
  - other operating income
- Takeover proposals must be notified to the Commission before they are implemented (Art. 4)
- Commission is the sole competent authority to determine takeover proposals (Art. 8)
  - Approve ( under Art. 81(3) disapply general prohibition at Art. 81.1)
  - Refuse to approve or approve with conditions
  - Revoke earlier approval.
- Commission may refer proposal to competent authorities in member states (Art. 9) at its own initiative or that of the Member State on the grounds that;
  - (a) a concentration threatens to affect significantly competition in a market within that Member State, which presents all the characteristics of a distinct market, or
  - (b) a concentration affects competition in a market within that Member State, which presents all the characteristics of a distinct market and which does not constitute a substantial part of the common market.

Competition Act 2002 (as amended 2006).

- The Act;
  - establishes the Competition Authority (CA) and
  - obliges notification of merges or acquisitions where the worldwide turnover of two or more of the businesses exceeds €40 million, each of the businesses conducts business in the State and at least one of them has a turnover in the State of more than €40 million.
- Section 21 requires the CA to decide
  - " [if] in its opinion, the result of the merger or acquisition will not be to substantively lessen competition in markets for goods or services in the State and, accordingly, that the merger or acquisition may be put in effect", or
  - if it decides to conduct an investigation to determine (Sn. 22) " the merger may be put in effect, may not be put in effect, or may be put in effect subject to conditions on the grounds the result... will or will not ...be to substantially lessen competition for goods or services in the State...".

HIGHLY CONFIDENTIAL

Head re Guarantees in respect of credit institutions in distress

Note

The text following is on the basis of a general power to give guarantees in respect of distressed credit institutions. 'Credit Institution' for purposes of this head to be as defined in Regulation 3(1) of the European Communities (Deposit Guarantee Scheme) Regulations 1995 (SI 168 of 1995)] except that it is to include credit unions as defined in section 2 of the Credit Union Act, 1997.

Head

Provide as follows:

(a) Power of Minister

Provide that the Minister for Finance may guarantee in such form and manner and on such terms and conditions as he sees fit, any or all of the following -

- (i) the borrowings and liabilities of a credit institution to the CBFSAI or any person
- (ii) deposits in a credit institution

(b) Circumstances where power is exercisable

Provide that the Minister may exercise the power at (a) above only in circumstances where it appears to him that it is necessary for any of the following purposes:

- (i) maintaining the stability of the financial system in Ireland or a credit institution where the Minister considers that there would be a serious threat to its stability if the power was not exercised;
- (ii) protecting the public interest by safeguarding depositors' funds in a credit institution where the Minister considers that such deposit funds would be under serious threat if the power was not exercised;

(c) Provide that a Guarantee under this Section will have effect from the date announced by the Minister as the date from which it will have effect, but not before the date of the announcement, regardless of whether that announcement is made before the passing of this Act.

(d) Provide that the Minister may withdraw or revoke a guarantee as he sees fit.

(e) Provide that all moneys to be paid out by the Minister on foot of a guarantee provided by him under this section will be paid from the Central Fund or the growing produce thereof.

(f) Provide that moneys paid by the Minister under a guarantee under this head are repayable to the Minister, with interest, as and when such moneys are available to Xfi. Moneys paid by Xfi to the Minister are to be paid into or disposed of for the benefit of the Exchequer in such manner as the Minister thinks fit.



(g) Provide that the Minister will have a continuing obligation to use all reasonable means to recover amounts paid out under guarantees provided under this head.

(h) Provide that in the event that moneys paid out under a guarantee under this section are not recovered, the amount outstanding will be repaid to the Central Fund from moneys voted by the Oireachtas. [Note: This is designed to ensure sound accounting principles and provide transparency.]

(i) Provide that the Minister is required to lay a statement before each House of the Oireachtas every year to fully inform members on the situation with any guarantees made under this Head. The Minister's report to give particulars of each guarantee; where payments have been made by the Minister, the amount of payment and the amount (if any) repaid to the Minister on foot of the payment; and the amount of money covered by a guarantee that was outstanding at the end of that year.

**Explanatory Note:**

The nature, duration etc of a guarantee are important factors in the context of EU State Aid rules. It is envisaged that these factors would be encompassed in "... *such terms and conditions* ..." at (a) above. The criteria laid down in the EU Rescue and Restructuring Guidelines can be summarised as:

- the beneficiary has to be a firm in difficulty and may not have received rescue or restructuring aid during the past 10 years,
- the aid should normally consist of liquidity support and should be restricted to the minimum necessary to keep the firm in business for the rescue period,
- the aid must be granted in the form of loans or loan guarantees,
- the aid must be limited to a period of maximum 6 months,
- if the Member State communicates to the Commission within these 6 months a restructuring plan or liquidation plan, then the rescue aid can normally continue for the time needed by the Commission to examine this plan.

It should be noted that in moving to the restructuring phase the Commission have emphasised that aid must be the minimum necessary and there must be appropriate compensatory measures.

The provision at (d) is required as otherwise it would be necessary for the Minister to arrange a Vote in the Department's Estimate for the purpose or more likely a Supplementary Estimate which would be dependent on the Dáil being in session and would be subject to a possible vote thus not providing sufficient certainty as to the outcome of the process. The text is modelled on section 9(5) of the Bretton Woods (Amendment) Act 1999.

Subparagraph (f) is based on section 9(6) and (9) of the Bretton Woods (Amendment) Act 1999.

Subparagraph (g) is based on section 9(7) of the Bretton Woods (Amendment) Act 1999.

Subparagraph (h) is based on section 9(8) of the Bretton Woods (Amendment) Act 1999.

Subparagraph (i) is modelled on section 9(10) of the Bretton Woods (Amendment) Act 1999.

## HIGHLY CONFIDENTIAL

### Outline Heads of a Bill to provide for the Irish Authorities (Minister for Finance) to take action in relation to an Irish credit institution by taking it into public ownership

#### Purpose

The purpose of the Bill is to give the Minister for Finance power to transfer into public ownership a particular distressed credit institution<sup>1</sup> authorised to operate in Ireland (the institution is referred to as 'Xfi' in these heads).

The Bill may also need to provide for necessary or consequential provisions as follows, but should in any event provide a specific power for the Minister for Finance

- to directly appoint and remove directors of Xfi so that he can ensure a level of control and influence over the operations of the company, consistent with the directors' statutory and fiduciary duties to the company;
- Enabling the Minister to remove and appoint directors including the Chairman, Chief Executive and other key executives as the Minister sees fit, and make other modifications of the rules for holding of meetings of the company without being constrained by the provisions of company law or memorandum and articles of association regarding the holding of meetings of shareholders.
- Extinguishing of the existing share options
- Providing for the any amendment necessary in consequence of the impact of transfer of ownership on rights or obligations of lenders, bondholders, swap counterparties or suppliers which would be triggered by the act of bringing the financial institution into temporary public ownership. (Apparent from UK NR legislation that a range of contractual arrangements that NR had previously entered into were impacted by the transfer of ownership and required provision in the legislation to address these issues/ensure these were not triggered – may have to be dealt with on a specific case by case basis)
- Resolution of pension issues.

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<sup>1</sup> 'Credit institution' as defined in regulation 1 of the European Communities (Deposit Guarantee Scheme) Regulations 1995 [SI 168 of 1995] i.e. "... an undertaking other than a credit union or friendly society whose business it is to receive deposits or other repayable funds from the public and to grant credit on its own account". This definition encompasses both banks and building societies. The definition should be amended for the purposes of these Heads to include credit unions as defined in section 2 of the Credit Union Act, 1997.

## Head 1 - Circumstances in which powers under the Bill would be exercisable by the Minister for Finance

Provide that the Minister for Finance may exercise powers under the Bill in relation to Xfi only where it appears to him to be necessary for any or all of the following purposes:

- maintaining the stability of the financial system in Ireland or a credit institution where the Minister considers that there would be a serious threat to its stability if the power were not exercised;
- protecting the public interest in circumstances where financial assistance or a guarantee has been provided by the Minister to Xfi for the purpose of maintaining the stability of the financial system in Ireland<sup>2</sup>.
- where the Minister has been notified by the Central Bank and Financial Services Authority of Ireland that it intends to use its powers under Section 3(2)(b) of the Companies Act 1990 to petition the Court to appoint an examiner, or under Section 48(1) of the Central Bank Act, 1989 to petition the Court to have the holder of a licence wound up. Provide that the CBFSAI must give advance notice to the Minister for Finance of any decision to petition the Court

"Financial assistance" for the purposes of this Head would include any case where another person has provided financial assistance to Xfi and the Minister assumed a liability in respect of that assistance .

"guarantee" for the purpose of this Head would include

(i) Any case where the Minister for Finance has announced that the Minister for Finance would if necessary put in place depositor guarantee arrangements in relation to Xfi, and

(ii) A guarantee under section x of ANOTHER Act 200X (See separate Head 'Guarantees in respect of credit institutions in distress')

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<sup>2</sup> Advice from the AG's Office is that it would not seem necessary at present to provide a definition of financial stability which is self evident from the ordinary meaning of the word.

## Head 2: Transfer of securities

Provide that by virtue of this head the securities [shares] in Xfi are transferred to the Minister for Finance and that the securities shares are transferred

- free of any trusts, liabilities and encumbrances
- together with all the rights, benefits and privileges which relate to the shares transferred.

Provide the securities [shares] may be transferred to a nominee of the Minister, a company wholly owned by Minister for Finance or any other body public or private.

Provide that the transfer of securities will be effective notwithstanding;

- the absence of any consent otherwise required
- Any restriction otherwise applicable to the transfer

Provide that any shares 'lent' or otherwise assigned, e.g. to a hedge fund, will on the transfer, transfer to the Minister or other public/private body.

Provide that Xfi shall take all necessary steps to ensure that the Minister is registered as the holder of the shares and that he is to have all rights and advantages of a member of the company pending registration (i.e. even while not yet registered).

Securities [shares] for the purposes of this head may need to be defined widely having regard to the credit institution concerned but would be likely to include;

- shares and stock,
- debentures, including debenture stock,
- loan stock, bonds, certificates of deposit and other instruments creating or acknowledging indebtedness;
- warrants or other instruments entitling the holder to acquire such securities.



### Head 3: Extinguishing of subscription rights

Provide in relation to Xfi, for the extinguishing of

- share options or other rights held by persons to subscribe for, or otherwise acquire, securities of Xfi, or any of its subsidiaries.
- rights to shares arising from or in connection with a person's employment or office or provision of services with or to Xfi or one of its subsidiary or connected entities

#### Note

This power is thought likely to be necessary to deal with a case where persons have an enforceable right to be issued with or otherwise acquire shares or other securities of Xfi or any of its subsidiaries. This power may be necessary depending on the financial institution involved as the existence of, and exercise of, such rights might frustrate the purposes of a transfer to the Minister or his nominee.

## Compensation for securities transferred

### Note

1. The UK Banking (Special Provisions) Act 2008 provides that the Treasury will develop a compensation scheme up to three months after the transfer of securities. i.e. (Sn5) "...the Treasury must...make a scheme determining the amount of any compensation payable by the Treasury to persons who held the securities immediately before they were so transferred [and for subscription] rights extinguished...". Broadly similar provisions are provided in relation to transfer of property (Sn 7) supplemented by Sn 9, which sets out areas to be covered in compensation schemes -- manner and procedure of assessment, appointment of independent assessor, appeals, expenses, etc. Generally under Sn 5 the UK authorities have 3 months within which to make a scheme of compensation in relation to the transfer of securities<sup>3</sup>.

This approach has the advantage that there may be issues specific to a particular institution that need examination/analysis before a specific compensation provision can be drafted. However the Oireachtas may be less willing to approve a transfer of assets without knowing the terms on which people will be compensated. There may also be constitutional issues.

2. The approach in Head 4 which follows is to provide for payment of compensation to persons who held securities in Xfi immediately before they were transferred based on a valuation of the securities on the date falling before the day on which this Bill is passed. Advisory Counsel has advised of the importance of making express provision for compensation in the Bill to balance the interference with property rights stating " Heads providing for compensation must be included in the draft heads of the Bill ...".

An extensive provision is set out in the draft Head following, but it may be that a short provision stating the intention to make a compensation scheme and the principles for determining compensation would suffice.

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<sup>3</sup> Notwithstanding the provision to enable the separation by up to three months, the Northern Rock Plc Transfer Order was made on 21 February 2008 and the NR Plc Compensation Scheme Order on 12 March, 2008.

#### Head 4: Compensation for securities transferred

Provide that the Minister for Finance will by Order made under this Bill make within x months a compensation scheme for shareholders whose rights have been extinguished at heads 2 or 3.

Provide that compensation for securities transferred under head 2 or subscription rights extinguished under head 3 will be determined by a compensation scheme which will make provision:

- for the appointment by the Minister for Finance of an independent assessor to determine the amount of compensation to be paid by the Minister and make provision as to the remuneration of the assessor, etc.

- that the assessor must, in assessing compensation payable by the Minister for Finance to any person in accordance with Heads 2 or 3, assess compensation on the basis that at the date of announcement of the transfer of securities, Xfi ---

- (a) is unable to continue as a going concern,

- (b) is in Examinership and being wound up

- (c) that all financial assistance provided by the Minister for Finance to Xfi has been withdrawn (whether by the making of a demand for payment or otherwise), and

- (d) that no financial assistance would in future be provided by the Minister for Finance to the deposit-taker in question (apart from ordinary market assistance offered by the CBFSAI subject to its usual terms)

- (e) that any guarantee given under law or in any case where the Minister for Finance has announced that he would if necessary put in place depositor guarantee arrangements in relation to Xfi, that such a guarantee has been revoked.

Provide that the assessor is required to determine the amount of any compensation payable by the Minister in accordance with the compensation scheme and communicate his determinations by means of "notices of assessment" which must include the reasons for the assessor's decision.

Provide that where the Minister or any person affected by the determination of the amount of any compensation which is contained in a notice of assessment is dissatisfied with the assessment, they may require the assessor to reconsider his determination. Where the assessor is required to reconsider his determination he is required to issue a revised notice of assessment setting out,

- (a) the date on which the notice is issued;

- (b) either notification that the assessor has upheld the assessment; or notification that the assessor has varied the assessment;

- (c) the amount of any compensation determined by the assessor as being payable; and
- (d) the reasons for the assessor's decision.

The assessor shall send a copy of the revised assessment notice to the Minister.

Provide that where the Minister or any person affected by a determination of the amount of any compensation which is contained in a revised notice of assessment is dissatisfied with the revised assessment, they may refer the matter to the Irish Financial Services Appeals Tribunal for the assessment to be appealed. The assessor in these circumstances acts as a respondent in the Tribunal proceedings.

Provide that where the Tribunal concludes that the decision as to the amount of any compensation shown in the revised notice of assessment was not reasonable, the Tribunal must remit the matter to the assessor for reconsideration in accordance with such directions (if any) as the Tribunal considers appropriate. The assessor must then reconsider his determination in accordance with any such directions.

#### *Payment of compensation*

Provide that the Minister will pay the amount of compensation determined by the assessor to be payable to a person in respect of a class or description of shares /securities. The Minister will not be required to make a payment in accordance with the foregoing until he has received a copy of the notice of assessment or revised notice of assessment or in the case of a reference to the Tribunal that the matter has been disposed of.

#### *Compensation assessment procedures*

Provide that the assessor may make such procedural rules in relation to the assessment of any compensation (including the procedure for the reconsideration of any decisions relating to the assessment of compensation) as he considers appropriate but that the procedure followed by the assessor must be fair. Provide that the procedures shall be approved by the Minister for Finance before being used.

The drawing up of the procedural rules will be a matter for the assessor in the first instance but must cover such matters as communications between the assessor and interested parties, the handling of evidence, deadlines etc. The assessor will also act as the respondent in any proceedings before the Tribunal. The assessor will be expected to act so as to facilitate the smooth operation of the appeals process.

#### *Remuneration of Assessor*

Provide that the assessor will be paid such remuneration and reimbursed such expenses as the Minister may determine.

### **Criteria for appointment as assessor**

Provide that persons to be appointed as assessor should be able to satisfy the following criteria:

#### *Potential conflicts of interest:*

To be eligible for appointment as assessor persons must be able to confirm

- they have no actual or potential conflict between any personal or business interests and functions as an assessor that could influence, or be reasonably perceived to influence, their judgement in performing functions as an assessor in respect of Xfi.
- will not engage any staffs who, to the best of their knowledge having made reasonable enquiries, have any such actual or potential conflict.
- they will take appropriate steps to ensure that, if appointed, neither they nor any staff are placed in a position where there is any actual or potential conflict between any personal or business interests and their or their functions that could influence, or be reasonably perceived to influence, them or their judgements in performing their functions as assessor.
- that they will disclose to former shareholders, the Minister and other interested parties full particulars of any such actual or potential conflict of interest that may arise.

#### *Knowledge and Experience*

To be eligible for appointment to the position of assessor persons should

- (a) have extensive professional financial company valuation skills. In order to be able draw on a range of professional expertise, including accountancy, investment banking and legal, the assessor should have a high standing and credibility in their profession.
- (b) be able to demonstrate that they have the capacity and resources to undertake the task of assessing any compensation payable and managing a compensation scheme in a timely and efficient manner;

#### *Termination of office*

The Minister may terminate the appointment of an assessor by notice in writing with immediate effect on the grounds of incapacity or serious misbehaviour. Where an appointment is terminated or vacated (howsoever arising) the assessor must provide free of charge such assistance as may reasonably be requested by any person appointed to the position of assessor to facilitate an effective and timely handover of all work then in progress.

If an assessor vacates office other than in circumstances outside his control he will reimburse the Minister such amount as is reasonably required to provide for any additional costs arising out of the change of assessor. For the avoidance of doubt, an assessor moving to another firm, the identity of which, by reason of its involvement with Xfi or otherwise, prevents his continuing as assessor, will not be treated as circumstances outside his control.



**Head 5: Removal from/ Appointments to (i) membership of the Board of Xfi and (ii) senior executive positions within Xfi.**

Provide that as sole shareholder in Xfi the Minister may remove persons from and appoint persons to:

(a) the Board of Xfi including to/from the position of Chairman of the Board.

(b) the positions of Chief Executive and Chief Finance Officer of Xfi:

Provide that the directors of Xfi will hold office for such duration and upon such terms and conditions as the Minister may determine.

Note

Other key executive positions might be included depending on the staff structure of the particular credit institution involved. It may also be appropriate to include the position of Deputy Chairman again depending on the particular institution concerned.

## Head 6 - Definitions

Provide as appropriate for necessary definitions (for example for terms such as 'credit institution', guarantee, etc.)

## Head re amendment of the Competition Act 2002

### Purpose

The purpose of this Head is to allow in certain circumstances for a declaration by the Minister for Finance that a proposed merger or acquisition of a credit institution\* is approved for purposes of the Competition Act having regard to the need to maintain the stability of the financial system in Ireland. [*\* as defined in Regulation 1 of the European Communities (Deposit Guarantee Scheme) Regulations 1995 (SI 168 of 1995) but to include a credit union as defined in section 2 of the Credit Union Act 1997.*]

### Head

Provide in relation to a merger or acquisition within the meaning of section 16 of the Competition Act 2002 that involves a credit institution which does not affect trade between EU Member States, that the Minister for Finance may declare that the proposed merger or acquisition is necessary to maintain the stability of the financial system in Ireland and the effect of such declaration will be to remove the power of the Competition Authority to make a determination as to whether the merger or acquisition would be in breach of the prohibition on anti-competitive agreements, decisions and concerted practices in sections 4 and 5 of the Competition Act 2002.

Provide that the power of the Minister to make such declaration may be exercised only where it appears to him to be necessary for any or all of the following purposes:

- maintaining the stability of the financial system in Ireland where the Minister considers that there would be a serious threat to its stability if the power were not exercised;
- protecting the public interest in circumstances where financial assistance or a guarantee has been provided by the Minister to a credit institution involved in the merger or acquisition in question for the purpose of maintaining the stability of the financial system in Ireland.

### Note

Section 4 of the 2002 Act contains the general prohibition on anti-competitive agreements, decisions and concerted practices. Section 5 prohibits the abuse of dominant position. Subsection 5(3) exempts from the prohibition mergers for which provision is made in Part 3 of the Act.

Where the takeover, merger, etc of a distressed financial institution arises, the question of competition approval may arise under EU or domestic law. If the annual turnover of the combined business exceeds specified thresholds in terms of global and European turnover, the proposed merger must be notified to the European Commission which must examine it. Below these thresholds, the national competition authorities in the EU Member States may review the merger. The threshold most likely to apply in the case of a takeover of a domestic financial institution is aggregate worldwide turnover of 5bn and Community turnover of €250m (unless each of the businesses achieves at least two-thirds of its turnover within the same Member State).

CONFIDENTIAL

22

1. Mr. Beausang ✓
2. Secretary General ✓ 319 2/9
3. Minister

From Michael Manley

Re: Information Note [REDACTED] of 3 September 2008 on current financial market conditions and outlook

The attached note has been prepared [REDACTED] to provide briefing, if required, on current financial market conditions and outlook.

*M Manley*  
2 September 2008

cc Mr Cardiff, Ms Herbert

## Note for the Minister's Information on financial market developments 3 September 2008

### Purpose of Note

This note provides an update on current financial market conditions. An overview of the international and domestic situation is presented in the main note. A more detailed background note is attached as an appendix.

### International Situation

- Financial market conditions remain extremely difficult and the international financial sector remains under considerable stress with credit availability restricted, the cost of funds elevated and no near term prospect of credit markets returning to their pre-crisis levels of activity.
- There are few real indications that any sustained improvement will be achieved in international financial market conditions for some time. The more optimistic commentaries characterise the current position as 'the end of the beginning'.
- The concerns that led to the international credit markets seizing-up last August persist and there is evidence that in the US the delinquency problems that affected sub prime loans are spreading to the wider economy, reflecting the broader slowdown in economic activity.
- Major financial institutions continue to disclose major write-downs and the IMF has estimated eventual losses at \$1 trillion.
- International initiatives and in particular the activities of the US Federal Reserve and the ECB/Eurosystem have helped to stabilise financial market conditions at particular junctures. However recent comments suggesting a tightening of the availability of liquidity from the ECB and the prospect of major international banks having to roll-over an estimated \$800bn in funding finance over the next few months have added to the negative picture.
- International efforts to resolve the crisis (e.g. by promoting increased transparency or new valuation approaches) are ongoing but will in any event take some time to bear fruit in terms of contributing to a sustained improvement in financial market conditions.

### Irish Financial System

- Irish banks continue to meet all the conventional measures of relatively robust financial health – solvency, liquidity, profitability, asset quality. However, not surprisingly profit projections are down somewhat.
- Though having very limited direct exposure to US sub-prime lending, the domestic Irish banks are subject to the funding pressures and weakness in investor confidence that is adversely affecting the international financial system.
- 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 their exposure to a declining residential property market in Ireland and weak commercial property market internationally.
- Increased costs and reduced availability of wholesale funding on international credit markets, particularly for longer-terms has led Irish banks to tighten lending standards coinciding with the downturn in the real economy, driven by the necessary adjustment of the construction sector.



- There is little international investor appetite for investment in Irish financial institutions, which are perceived to be vulnerable to the real economy impacts of the credit crisis and correction in construction activity. The resulting very significant fall in the share prices of Irish financials has outpaced those in other countries. The decline in the ISEQ financial index since Q2 2007 is 69% as against falls of 44% in the UK FTSE and 47% in the US Dow Jones financial indices.
- As mid-sized banks by international standards, Irish banks are disadvantaged in terms of their credit ratings and access to and cost of wholesale funding; the financial position of some Irish financial institutions is particularly sensitive to the risk of credit ratings downgrades.
- While international investors are clearly differentiating between the financial position of Irish banks (e.g. as demonstrated by Credit Default Swap (CDS) rates), it is likely to be the case that a problem in any domestic financial institution or an event such as the collapse of a major property developer would be likely to give rise to a systemic difficulty in the Irish financial system affecting all the Irish banks.
- Another important indicator of investors' negative view of Ireland is that the yield spread of Irish Government Bonds over German Government Bonds now stands at 47bps whereas before the financial market turmoil Ireland was normally at the low end of a 5 to 10bp range over Germany.

### Conclusion

The **international financial market background** is one of major losses from sub-prime mortgage products, the collapse/rescue of major banks and the prospect of further difficulties. Irish banks have weathered international developments and the correction in domestic construction activity and property prices, but are under ongoing pressure. Wholesale funding continues to be constrained and costly as compared to pre-crisis levels, putting pressure on institutions to fund their lending activities with varying degrees of challenge in different institutions.

\* The national picture is that the **Irish banks continue to stress that they are "open for business"** notwithstanding the tightening in standards / increased cost of credit that has taken place and the reduced appetite for borrowing in the economy. The case that lending is continuing is borne out by the available statistics. Private Sector Credit annual rate of increase in July was 13.3%. The recent IBF/PwC mortgage lending figures to mid-year also demonstrate the resilience of mortgage lending despite the adjustment to more sustainable levels of activity in the housing market overall. The Irish Banking Federation (IBF) is reported as stating the Government did not need to act to re-invigorate the mortgage market at this time. However, the supply of credit could be seriously disrupted by any significant financial shocks in the future. This would intensify the downturn in domestic economic activity and could potentially lead to financial stability issues.

Key to sustaining the position of Irish banks this far has been the **maintenance of confidence and overall financial stability** despite the year long international credit crunch and negative investor sentiment. The endorsement of the financial health of the Irish banks by the Central Bank, OECD and international credit rating agencies to date has been important. However the maintenance of confidence will be challenging

in face of continuing stress in international credit markets, the sharp downturn in domestic economic activity and, in particular, the property market..

The foregoing summary assessment underlines the importance of the Government's role in maintaining confidence in the financial system and sustainable fiscal policy.

The CBFSAI continues to monitor developments closely and the Domestic Standing Group (DSG) on Financial Stability is continuing to meet to coordinate information exchanges between the Central Bank, the Financial Regulator and the Department.

A more detailed note is attached.

## Financial Market Developments

### International

International financial markets remain depressed reflected in very significant falls in bank share prices, little investor interest in financial markets and continuing elevated interest rates in the euro area and constrained liquidity. The generally held expectation is that the dislocation in financial markets, which has already spilled over into the real economy, will continue for at least another year. Over the last twelve months markets have received a succession of bad news:

- **US Sub-Prime** crisis is now estimated by the IMF to be likely to reach \$1 trillion in losses (approx \$500 billion already written off) which has massively impacted major international financial institutions which have had to bring these losses to book (e.g. UBS, Citibank, Lehmans, etc.).
- Standard & Poor reported on 22 August that that **mortgage delinquency rates** on many better quality US mortgages in July outpaced those on the sub prime loans that helped to spark the housing crisis. Total delinquencies on two categories of prime loans rose at rates of 7% and 9% from June while the rate for sub prime loans rose by 7%.
- In the US, **Fannie Mae and Freddie Mac**<sup>1</sup>, which together own or guarantee \$5.3 trillion in US mortgages (almost half of the US mortgage market) have been badly damaged by increased mortgage default. Because of the losses from the worsening situation in the US housing market both companies have sought to raise funds but investors fear they may not be able to raise enough to cover liabilities as they have to pay out if homeowners cannot meet their mortgage repayments. This led to recent heightened speculation that Freddie & Fannie would be nationalised. In light of the Bear Stearns events in March, the market is waiting to see how they will be recapitalised and how this might impact on their share holders. The US Treasury Secretary announced in mid July that the US Government's primary focus was supporting the two firms in their current form, but continuing deterioration in underlying mortgages is focusing speculation that both will have to be rescued by the Federal authorities (re-nationalisation).
- In Europe, **collapse in the value of certain banks**, leading to the nationalisation of Northern Rock in the UK, rescue of SachsenLB and IKB in Germany by other German banks and most recently the takeover of Roskilde bank in Denmark by a combination of the Central Bank and other Danish banks have left investors with little appetite for the financial sector.
- **Euribor rates** - The interest rates in the interbank money market remain elevated, with the Euribor 3-month rate 0.711% above the ECB base rate of 4.25% at 4.961%. The spread between the Euribor rate and the Eonia rate indicates how much of the spread of the Euribor above the ECB base rate is due to the market

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<sup>1</sup> Federal Home Loan Mortgage Corporation (Freddie Mac) and Federal National Mortgage Association (Fannie Mae) - originally established as Federal authorities to ensure funding to mortgage lenders through the secondary mortgage market, but subsequently privatised.

turmoil. This spread was approximately 0.6% at the start of August 2008. This is lower than its peak of 0.9% during this market dislocation, but far higher than the spread of only 0.07% before the onset of the turmoil in August 2007.

Against the background of persistent bad news, markets have recently been contemplating two prospective concerns:

- A key stabilising influence over the last twelve months has been **additional liquidity** made available by international central banks (ECB, Federal Reserve, Bank of England and Swiss Central Bank). However, recent public comments by the President and members of the ECB that banks must make greater efforts to return financial markets to some form of normality has led to speculation that such liquidity will become less available as the ECB tightens its lending criteria<sup>2</sup>. This would lead to greater pressure on banks, particularly smaller banks where these are perceived to be otherwise vulnerable (e.g. exposed to property markets) to find finance at an acceptable price.
- **Banks' funding requirements:** It is estimated that financial institutions will have to pay off almost \$800 billion in floating-rate notes (securities used to borrow money) and other medium-term obligations before the end of 2009, i.e. either find replacement funding in this amount or realise assets to pay off these moneys. By the end of this year, large banks and investment houses such as Goldman Sachs Group Inc., Merrill Lynch & Co, Morgan Stanley, Wachovia Corp., and HBOS PLC must each redeem more than \$5 billion in floating-rate notes. As banks compete for funds to pay off their borrowings, or sell assets to raise cash, these actions could exacerbate strains in financial markets. Banks that turn to shorter-term loans will have to renew their borrowings more frequently, increasing the risk that they won't be able to get money when they need it.

The effects of past and anticipated events are reflected in major falls in share price indices across international markets especially banks (see graph at appendix 1), increased prices for Credit Default Swaps (CDS, i.e. the price at which a guarantee of repayment of loan in the event of default by a borrower can be bought –see graph at appendix 2) and spill-over into real economies with decline in consumer confidence and economic growth.

### **Ireland**

Irish banks had little or no direct exposure to the US sub-prime crises. However, original hopes that the consequences of those problems could be avoided if the crisis was short lived and spill-over into real economies avoided have not been realised. In the context of a general loss of confidence in the financial sector, the perceived vulnerabilities of the Irish domestic financial sector to high levels of exposure to the property and construction sector have come into sharp focus, amplified by the correction now underway in construction activity.

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<sup>2</sup> Media reports point to increasing creativity of Banks in order to benefit from the ECB regime. The UK's Nationwide Building Society for example has announced plans to expand into Ireland to make use of the eurozone's funding opportunities. Spanish banks are reported to have scaled up their use of mortgage-backed securities to obtain funding from the ECB as they cannot find investors for these securities. All of these have been unhelpful.

- As a small banking market significantly involved in property lending particularly in the commercial sector, Irish banks have been hit hard by negative investor sentiment. The decline in the ISEQ financial index since Q2 2007 is 69% as against falls of 44% in the UK FTSE and 47% in the US Dow Jones financial indices.
- A further indicator of investors' negative sentiment towards Ireland is that the yield spread of Irish Government Bonds over German Government Bonds now stands at 47bps whereas before the financial market turmoil Ireland was normally at the low end of a 5 to 10bp range over Germany.
- The share prices of individual financial institutions have been highly volatile, in general the share prices of individual banks are worth about 1/3 of their price at the start of 2007, but have fallen precipitously at different times over the last year.
- Irish banks are under pressure to maintain dividends, with media reports pointing to IL&P declaring a dividend of 22 cents per share for H1 2008 on an income of 12 cents per share in the same period.
- Domestic Irish banks continue to state they are open for business and are interested in proposals that offer real opportunity for added value. However, there has been a decline in growth in lending; new mortgage lending has declined from €16.542 billion in the first six months of 2007 to €13,832 billion in the same period in 2008, a decline of 16%, and most banks have radically altered their loan product line and required increased equity input from prospective borrowers.

Against this background there is little international investor appetite for investment in Irish financial institutions. Goldman Sachs recently issued a report pointing to likely increased impairment of loans by Irish banks, expecting Irish lenders to write off 3pc of loans to property developers next year alone and reducing by 34pc their earnings estimates for the sector between 2008 and 2010. While the extent of write-offs is significant, it is close to the forecasts by the individual institutions and Goldman Sachs expects the three main banks Allied Irish Banks, Bank of Ireland and Anglo Irish Bank to remain profitable. All of the Irish banks have stressed they are working closely with key borrowers to monitor developments and manage financing needs. Nonetheless, the overall assessment reinforces investor reluctance to support Irish banks.

In the context of international concerns of growth in dependence by banks on liquidity from Central Banks, it should be noted that while the overall level of ECB funding availed of by banks in Ireland has increased from €39.5 bn to €44 bn, domestic banks accounting for €15bn of the total. However this figure fluctuates over time.

#### **Financial Stability Report 2008**

The CBFSAI's Financial Stability Report (FSR) for 2008 will be published in mid November. This arises from our membership of the European System of Central Banks which requires the ECB and national Central Banks to foster financial stability in the euro zone. The objective of the Report is to set out the CBFSAI's overall assessment of the stability of the domestic financial system; it does not relate to monetary policy matters. The FSR provides the CBFSAI's view on the economic

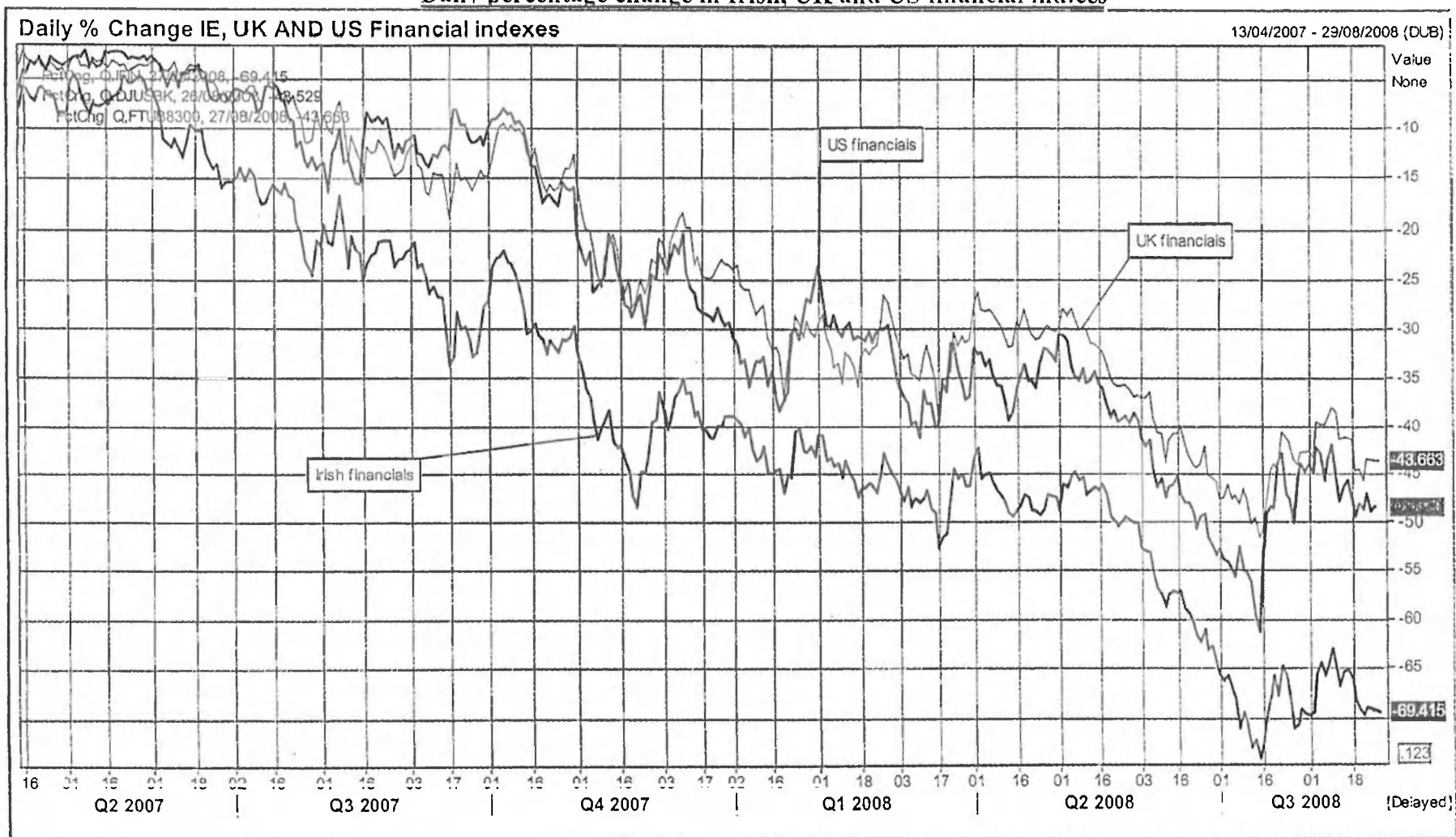


outlook generally and macroeconomic risks arising. It focuses on issues for the Domestic Financial System and its overall health. The overall conclusion of the FSR for 2007 was that the shock-absorption capacity of the banking system left it well placed to withstand pressures from possible adverse economic and sectoral developments. Clearly the extended period of dislocation in financial markets, spillover into the global economy and correction in the construction sector will be reflected in the FSR 2008. While it is too early yet to anticipate the content of the CBFSAI's report for 2008, the Department will liaise closely with the CBFSAI to identify key issues.

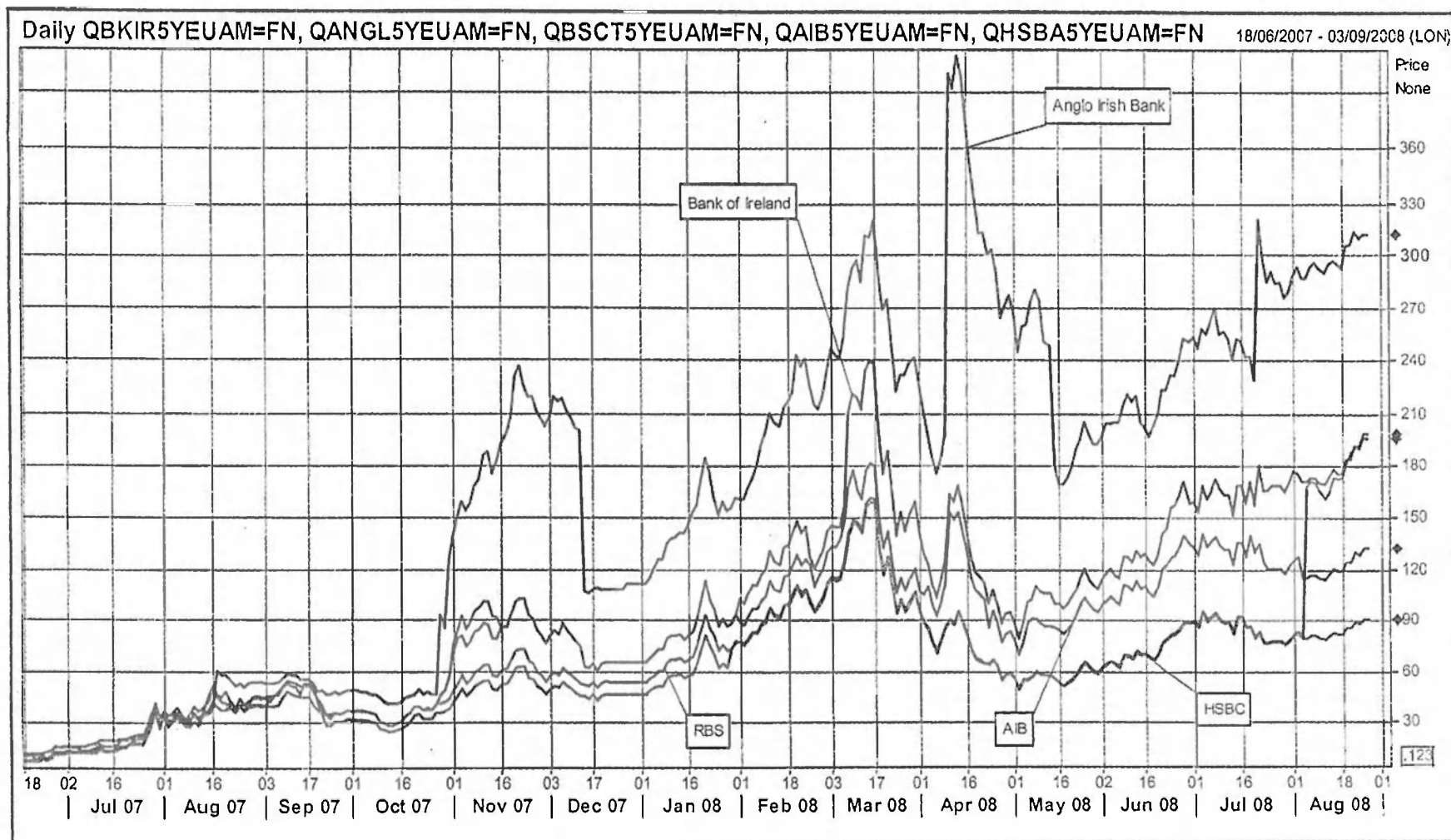
September 2008

cc Secretary General, Mr Cardiff, Ms Herbert

### Daily percentage change in Irish, UK and US financial indices



CDS spreads for AIB, Bank of Ireland, Anglo Irish Bank and HSBC and RBS



**SECRET**

Minister

(21)  
This is not good news for INBS as  
while INBS is currently financially  
stable with high levels of liquid  
assets, there is a clear potential  
for future difficulties if further

1. William Beausang
2. Minister

Subject: Note for the Minister's information:

Ratings agency (Moody's) downgrade of Irish National Building Society. W Beausang  
5 Sept. 2009

Key message

Moody's, the international rating agency has announced a downgrade of its rating of Irish Nationwide Building Society (INBS) including for long-term bank deposits and senior debt from A3 to Baal – which we understand to be a 'two-notch' reduction in the rating which is considered a significant negative development by the Financial Regulator. All INBS's ratings remain on review for further downgrade. The report indicates the downgrade would probably be greater except that Moody's anticipate there is moderate probability of systemic support to INBS in the event of financial crisis. (Copy Moody's release attached)

Reasons for downgrade

According to Moody's the downgrades reflect:-

- increasing exposure to commercial property and development (which now accounts for 80% of its loan book)
- the rapid deterioration in land and property values in Ireland and the UK
- the Agency's expectation of weakening asset quality as the economic environment in Ireland and the US deteriorates.

Moody's also note important concentration risks to its largest 20 borrowers.

Implications of downgrade

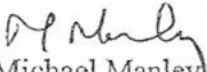
The downgrade will have implications for INBS's funding costs and will also cause difficulty for it in retaining corporate deposits in its Isle of Man subsidiary. INBS expects outflows of €200m on account of the downgrade in due course, which according to the Financial Regulator is considered manageable by INBS. Savings in INBS are tied up in term deposits, depositors would need to decide to break the terms of the account and suffer penalties to withdraw if they had significant concerns.

Context

INBS is one of only two remaining building societies in Ireland. INBS has grown by engaging in substantial commercial lending. Its 2007 Balance Sheet shows it having assets of €16bn making it one of the smallest of the 'big six' domestic financial institutions, with loans to the non-financial sector of €12.3bn (of which €9.7bn are commercial mortgages and €2.6bn are residential). INBS has been seeking to sell itself and de-mutualise for some time without success; in the current climate and with its inherent vulnerabilities, there is little prospect of this being realised any time soon.

Monitoring and Next Steps

The Financial Regulator is monitoring the INBS's position very closely and will continue to keep the Department informed of developments, particularly if there is any indication that outflows are significantly greater than expected. The position of the INBS and other smaller more exposed domestic financial institutions in the ongoing stressed financial market conditions will be reviewed at the next meeting of the joint Department-CBFSAI Domestic Standing Group (DSG).

  
Michael Manley  
5 September, 2008

cc Mr. Kevin Cardiff, Secretary General, Ms. C. Herbert



1. Mr. Beausang
2. Minister

**SECRET**

**Subject: Note for the Minister's information:  
Ratings agency (Moody's) downgrade of Irish National Building Society.**

**Key message**

Moody's Investors Service is issuing a downgrade of its rating of Irish Nationwide Building Society (INBS). It has downgraded:

- the long-term bank deposit rating and the senior debt rating of to Baa1 from A3 and
- its subordinated debt to Baa2.

The bank's financial strength rating (BFSR) was confirmed at C-, however Moody's believes that the bank is now more weakly placed within this rating category, and so has lowered the baseline credit assessment to Baa2 from Baa1. The short term debt and deposit ratings were affirmed at Prime-2. All these ratings remain on review for further downgrade. The report indicates the downgrade would probably be greater except that Moody's anticipate there is moderate probability of systemic support to INBS in the event of financial crisis. (Copy Moody's release attached)

**Context**

INBS is one of only two remaining building societies, most of the others (e.g. Irish Permanent) having de-mutualised in recent years to become part of mainstream banking. INBS, while continuing to provide residential mortgages, has grown by engaging in substantial commercial lending. Its 2007 Balance sheet shows it having assets of €16 Billion, making it one of the smallest of the 'big six' financial institutions, with loans amounting to €14.45 Bn. Customer deposits, amounted to €7.25 Bn. INBS is vulnerable on two fronts:

- its funding is very heavily reliant on financial instruments (circa €7 bn at end 2007), making it vulnerable to the dislocation in financial markets,
- it is reported to have lent heavily to the commercial property/development sector, making it vulnerable to the downturn in economic and commercial activity.

While noting that INBS has managed to contain operating costs, Moody's emphasise their ratings downgrade to reflect the significant risk inherent in INBS's commercial real estate portfolio (noting an important concentration risks to its largest 20 borrowers).

**Summary**

INBS (CEO: Michael Fingleton) has been seeking to sell itself and de-mutualise for some time without success; in the current climate and with its inherent vulnerabilities, there is little prospect of this being realised any time soon.

INBS, in advising the Financial Regulator of the downgrade expressed surprise, indicating they hadn't expected this news for some weeks (October), but the fact remains it will enter the public domain during the day. Outflows of up to €200m are expected on account of the downgrade, which is considered manageable by INBS. A lot of savings are tied up in term deposits in Isle of Man accounts, so savers would need to decide to break the terms to withdraw if they had significant concerns.

The Financial Regulator is monitoring the position very closely.

Michael Manley

5 September, 2008

CC Mr. Kevin Cardiff, Secretary General, Ms. C. Herbert



Moody's Investors Service

Global Credit Research

Rating Action

4 SEP 2008

Rating Action: Irish Nationwide Building Society

Moody's downgrades Irish Nationwide to Baa1, ratings placed on review for downgrade

London, 04 September 2008 – Moody's Investors Service has today downgraded the long-term bank deposit rating and the senior debt rating of Irish Nationwide Building Society (INBS) to Baa1 from A3. The society's subordinated debt has been downgraded to Baa2. The bank financial strength rating (BFSR) was confirmed at C-, however Moody's believes that the bank is now more weakly placed within this rating category, and so has lowered the baseline credit assessment to Baa2 from Baa1. The short term debt and deposit ratings were affirmed at Prime-2. All these ratings are placed on review for further downgrade.

Moody's said that the downgrade reflects:

- (i) the increasing exposure to commercial property and development which now accounts for 80% of the society's loan book;
- (ii) the rapid deterioration in land and property values in Ireland and the UK which is exacerbating the already high loan-to-value ratios on the commercial property and development loan book;
- (iii) Moody's expectation of weakening asset quality as the economic environment in both Ireland and the UK deteriorates.

The C- BFSR rating reflects the society's niche position as a commercial real estate lender in Ireland and the UK and to a declining extent its role as a residential mortgage loan provider, primarily in the Republic of Ireland. The rating also takes into account INBS's good earnings and high efficiency as it continues to operate with a low cost base despite a relatively large branch network. At the same time, the rating recognises INBS's high dependence on the higher risk commercial development business, as well as its growing dependence on wholesale funding resources.

The decision to place the ratings under review for possible downgrade reflects the significant risk inherent in INBS's commercial real estate portfolio, including important concentration risks to its largest 20 borrowers, while being exposed to a rapidly deteriorating operating environment which could put further pressure on the bank's credit profile. The review will focus on the measures that the bank is taking to manage and potentially reduce these risks.

INBS has been actively attempting to sell itself. Moody's believes that this is unlikely in the current environment and therefore an important part of the review will be the society's future strategic direction. Moody's noted that were a sale to take place then this would have future rating implications depending on the potential acquirers risk profile and strategy for the institution.

The Baa1 deposit and debt ratings of INBS reflect Moody's view that the probability of systemic support for INBS in the event of a financial crisis is moderate and this results in a one notch uplift in the deposit and debt ratings from the Baa2 Baseline Credit Assessment.

Due to the downgrade of INBS's senior debt rating to Baa1, Moody's also downgrades INBS's Mortgage Backed Promissory Notes to A2, on review for further downgrade. The ratings of the Mortgage Backed Promissory Notes benefits from a two notch uplift from the issuer's senior debt rating. Please refer to the "Framework Agreement in Respect of the issue of Mortgage Backed Promissory Notes" on [www.moody's.com](http://www.moody's.com).

Irish Nationwide Building Society, headquartered in Dublin, Ireland, had total assets of EUR16.1 billion at year-end 2007.

London  
Johannes Wassenberg  
Managing Director  
Financial Institutions Group  
Moody's Investors Service Ltd.  
JOURNALISTS: 44 20 7772 5456  
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20

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Patrick Neary  
Chief Executive

Mr Kevin Cardiff  
Second Secretary General  
Department of Finance  
Upper Merrion Street  
Dublin 2

10 September 2008

Dear Kevin

I refer to our meeting this morning and your request for a formal report from the Financial Regulator on current liquidity conditions under the DSG Framework.

The attached report reflects our assessment and possible policy response.

Yours sincerely

## **OUTLOOK FOR LIQUIDITY**

### **IRISH DOMESTIC INSTITUTIONS**

Banking Supervision Department

10 September 2008

## 1. Introduction

This paper summarises the current liquidity position for the six indigenous Irish credit institutions ('banks') and the outlook for three of the six. The paper starts by recalling the current state of play for Irish institutions with regard to the turmoil in financial markets. It then focuses on how the situation has evolved. In Section 3, it focuses on three of the indigenous institutions and assesses the liquidity position of each one in greater detail. Section 4 highlights the outlook for these three institutions and a number of specific external factors which impact on their funding. The paper concludes with Section 5 providing an overview of the Financial Regulator's regulatory engagement to date.

## 2. Background

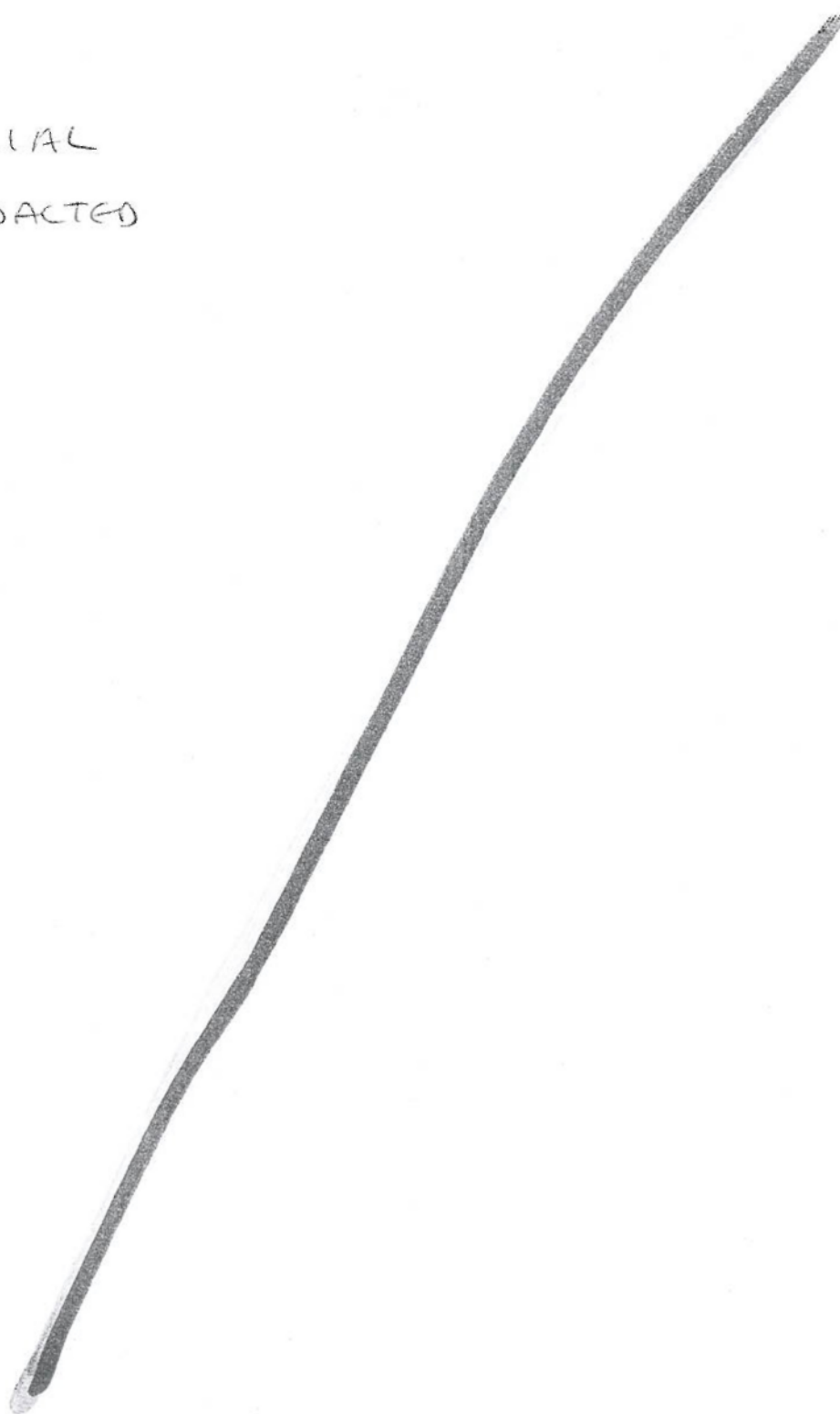
At the core of liquidity risk in banking is the maturity transformation function of banks (lending long and borrowing short). The Financial Regulator's liquidity requirements ('the Requirements') seek to address this risk by requiring banks hold enough liquidity to match inflows and outflows in the first time band (0-8 days) and seeking 90% coverage of outflows in the second time band (8 to 30 days).

The turmoil in markets, which is the most prolonged (approximately 14 months) and widespread since the Second World War, has made banks' management of the maturity gap between assets and liabilities much more difficult. Bank assets (loans) duration has remained relatively unchanged. However, the duration of liabilities has shortened considerably as banks cannot issue medium and longer term funding instruments. Intense competition in the retail deposit market has made it difficult to grow the deposit base. Banks are also seeing the maturity of funding sources such as corporate deposits continuously shortening. The above trends are marked for Irish and UK banks that are perceived by international investors as having large exposures to property lending in economies that have gone into deep and rapid declines.

The challenging funding conditions have been present since August 2007 and, as a result, many banks have adapted to the challenging markets and have amended their funding *modus operandi*. The table below shows the end-month liquidity ratios for the first two time bands, as per the Requirements, for the six indigenous banks for the last six months.

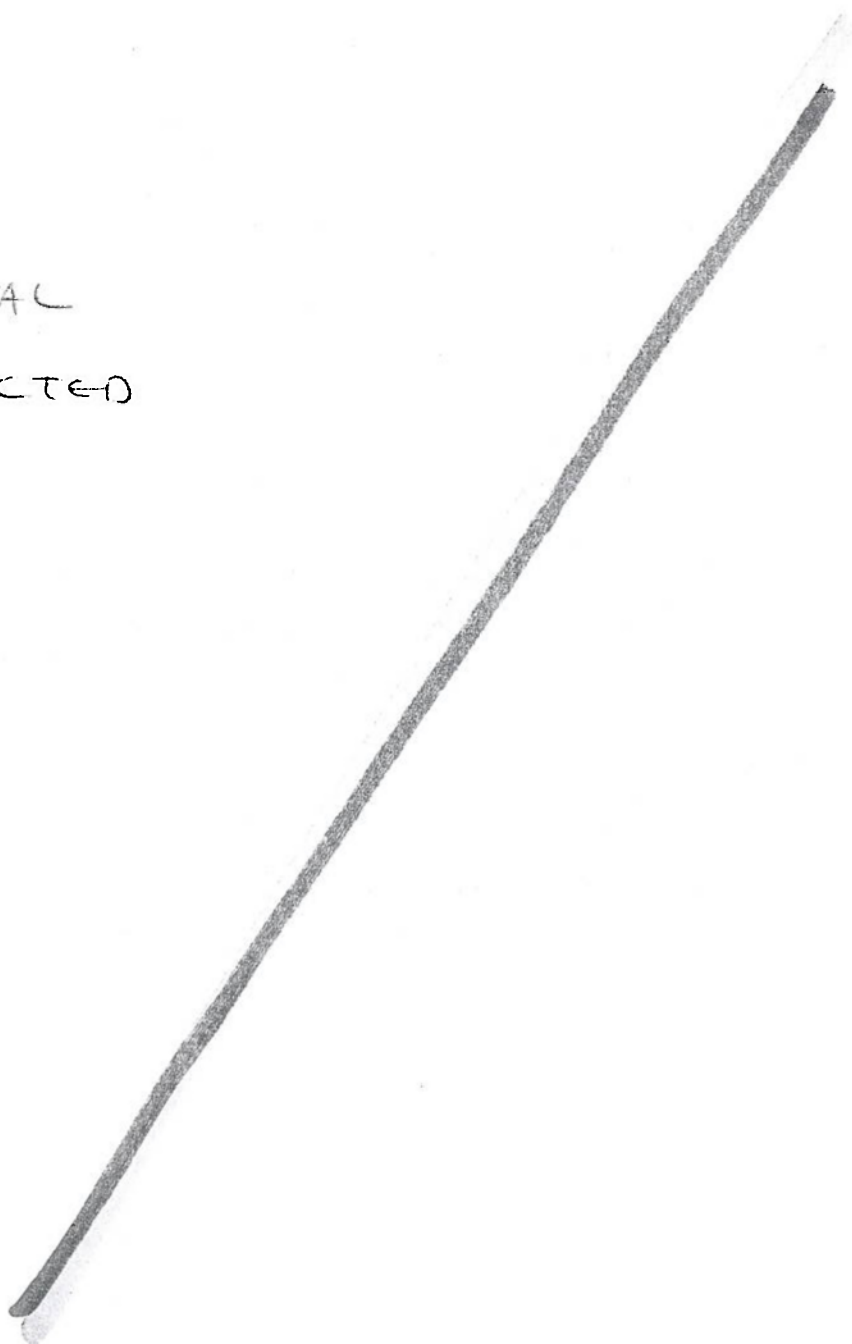


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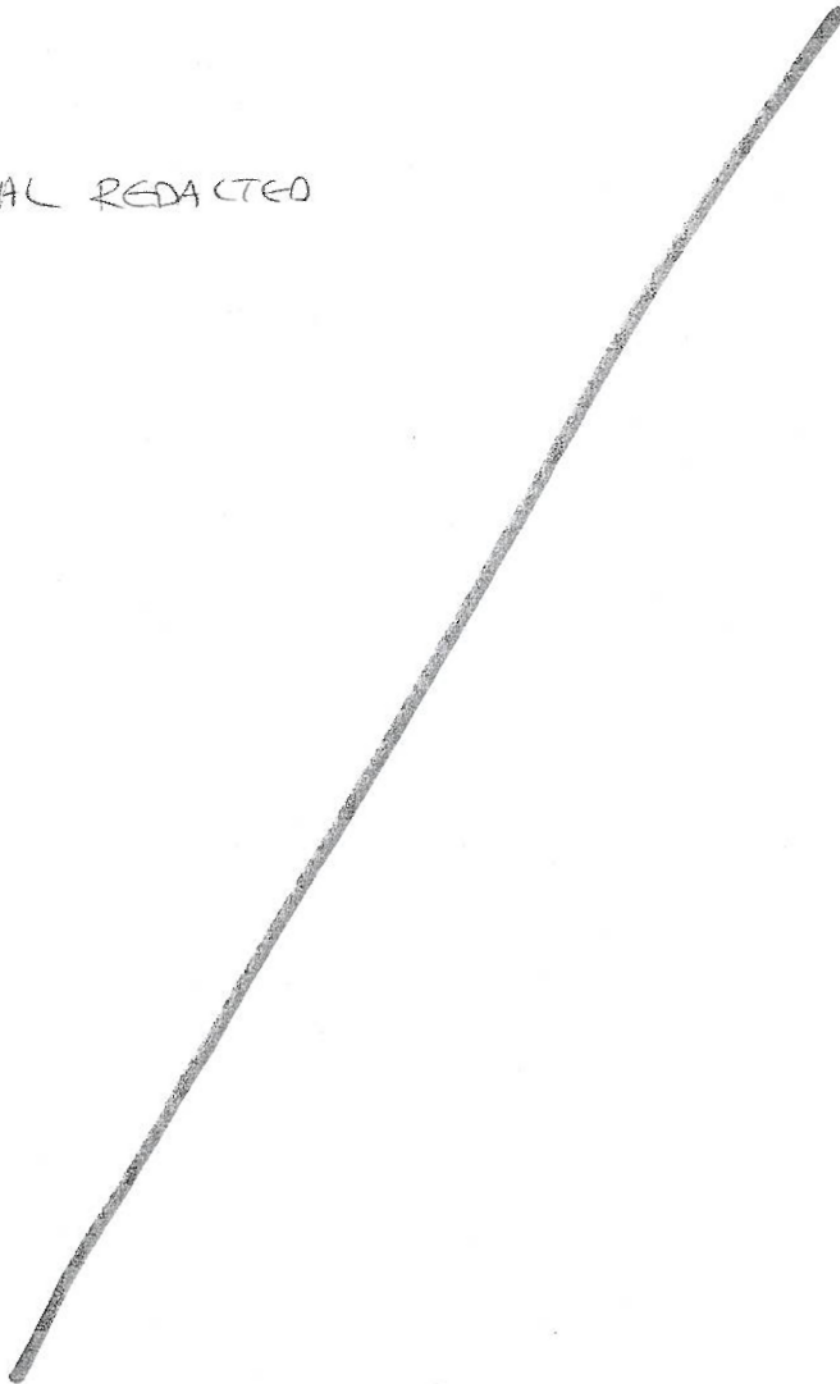


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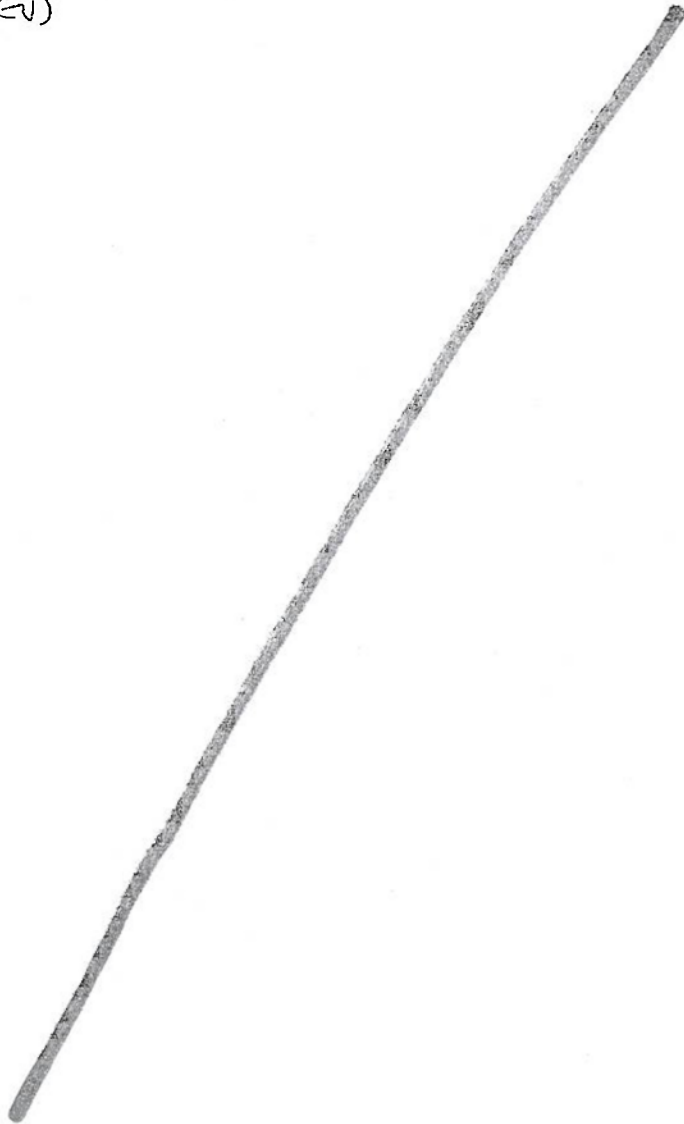


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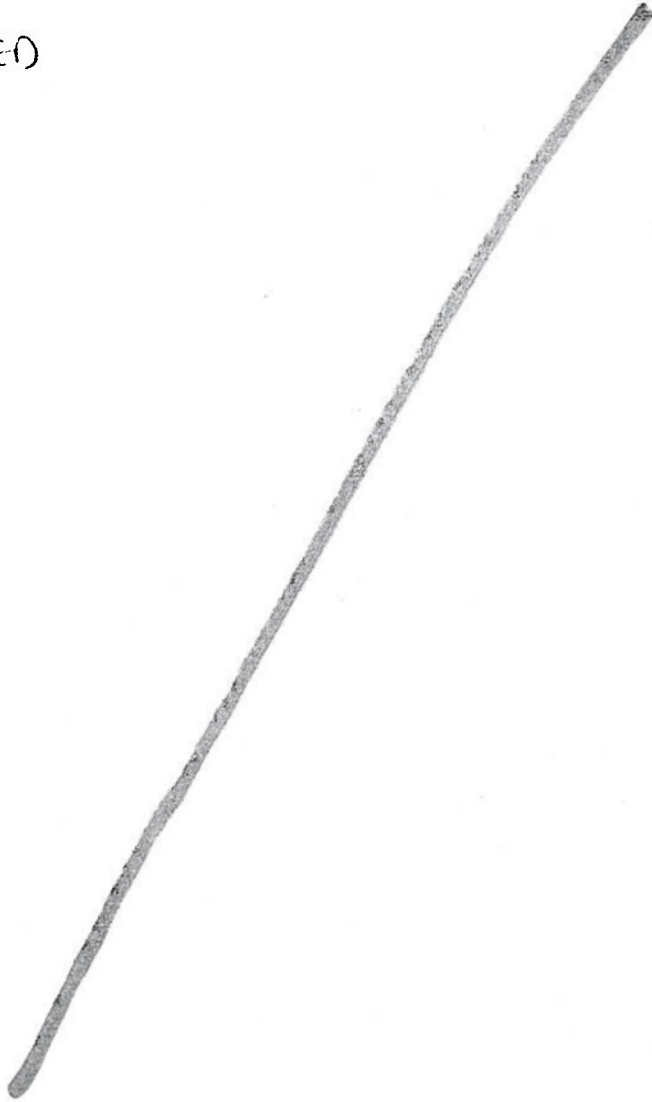


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REDACTED



MATERIAL

REDACTED



## 5. Regulatory Engagement

### *Industry Wide*

The Financial Regulator's concern regarding banks exposure to property led it to introduce increased capital requirements for 100% LTV mortgages in May 2006. In December 2006, in the context of exercising national discretions under the Capital Requirements Directive, the Financial Regulator introduced higher capital requirements than other EU Member States for non-owner occupied residential property, higher LTV residential mortgages and speculative commercial property exposures. These initiatives recognised the higher risk associated with these exposures and required banks to hold additional capital against them. Market commentary and rating agencies assessments are that Irish banks are adequately capitalised. Interestingly, Moodys commented in a recent meeting with the Financial Regulator that they did not believe that a bank would fail because of capital. Liquidity, not capital, is the main issue in the current crisis.

The Financial Regulator's revised liquidity requirements were imposed with full effect from July 2007. In October 2007, the Financial Regulator formally put all Irish licensed banks on a weekly liquidity reporting cycle to facilitate closer monitoring of liquidity positions. In the case of the six indigenous banks we have formal oral briefings on their liquidity position, movements, strategies and market conditions on at least a weekly basis. In the context of reinforcing the need for institutions to consider strategic direction and initiatives, senior management of the Financial Regulator, jointly with the Governor of the Central Bank, has had meetings with the CEOs of these banks and with the boards of directors.

### *Future Options*

Given that the Financial Regulator "toolbox" does not include the ability to increase the availability of funding, an approach that restricts outflows must be considered.

Banks have recognised the need to curtail lending given current market conditions. However, in order to conserve liquidity the Financial Regulator could go further and require banks to curtail lending significantly. While this would have serious broader economic consequences we do not at this stage see other options to protect banks'



liquidity positions. Given the potential for increased negative perceptions of Irish banks if such a requirement came into the public domain, the manner of its imposition would need to be carefully managed. In addition, such action would limit, if not remove, the ability of banks to work with any significant borrowers who may need additional support to work through the current market conditions. Any such action would need to be considered in a wider financial stability context and in consultation with the Central Bank. However, as stated above, in terms of tools available to the Financial Regulator we have very limited options.

**Banking Supervision Department**  
**10 September 2008**

## SCENARIO

"PROTECTION"

CONTROL

GOING CONCERN BASIS

PROPERTY RIGHTS ADDRESSED

## LEGISLATION REQUIRED

RECALL DAIL AND SEANAD

3 STAGES DAIL

SAME SEANAD

URGENCY MOTION

PRES SIGNS

Interim stage.

CAN BE FAST, BUT THERE IS A TIME FRAME

## PHASES OF ACTION

need for ECA - dipping point  
what cash level - bigger?

### DISTRESS PHASE 1 DAY ---- ?

pressure on liquidity

on mgt

preparatory activity

ACTION ON LIQUIDITY

ACTION ON COMMS

ACTION WITH MGT\STAFF

ACTION\PREP RE OTHER INSTITUTIONS

WORK ON OTHER\BETTER OUTCOMES

### "RED BUTTON" PHASE (E.G FRI ---- MONDAY)

DECISION TO GO — Minister, Government, CBFSA, NTMA.

INVOKE PLANS AND ADJUST AS REQ.

TAKE CONTROL INCL. Subs. — need enough control to cover risk.

START LEG PROCESS (incl recall Dail, Seanad)

COMMUNICATE DECISIONS

↓

- public
- depositors
- corporate and interbank
- mgt and staff
- EU bodies
- MOU counterparts

- need statement of intention for  
Minister before mkt open.

- 5 'c's — message needs to be
- coherent

- can't trade if known to be insolvent.

Can we provide

need to  
be worried about bank  
value in other institution

- comprehensive
- credible
- consistent
- coming from all rescue parties - FR bank Min GIS Taois NTMA and, v. important, INBS *consistent with everyone else's message*
- internet
- mass media
- PR firms
- usual investor channels
- direct contact - phones, branches email *v. important*

significant risk  
to public fund  
both ways

### REGULATOR CONTROL PHASE -- DAYS?

Cbfsai POWER AND INFLUENCE DIRECT ALL ACTIVITY THROUGH A TEAM  
PUT IN AND DIRECTLY (exp if resistance) *what powers available?*

ACTION CONTINUES ON COMMS AND LIQUIDITY

ACTION TO PROTECT ASSETS IF NEEDED - business as usual but don't want to lose assets

ACTION TO REASSURE MGT AND STAFF

LEG PROCESS IN TRAIN

NEED TO PLAN ALSO AGAINST CONTAGION - other institutions implication

### MINISTERIAL PROTECTION PHASE STARTS

TEAM ALREADY IN SITU - put in place by RUCB - same team as by minister

VERY CLOSE COOPERATION WITH CB/FR/NTMA/IN

COMMS/LIQUIDITY/REASSURANCE CONTINUES

ANTI-CONTAGION ACTIVITY

EXAMINATION OF STATUS/STOCKTAKING

CONSOLIDATE AND DIG-IN AGAINST "BACKLASH"

KEEP MESSAGES POSITIVE

could legislation be  
easily adapted to this?

### CHECKLIST

GROUPS

WORKPLAN

REPORT BACK

- bullet points then details

- contagion → priority of bank digger → contagion  
→ could be positive contagion if do well.

guarantee on  
of deposits  
↓  
will have to  
able to equal

- equity reason to keep money in will be fine  
liquidity needs will have to account of this

Timing critical - need triggers

need map

Workstreams for Nationalisation Contingency



1. Legislation	2. Governance	3. Press/PR/Consumer	4. Market and Investor Relations	5. ECB and EU	6. Liquidity	7. Supervision post nationalisation
<p>Advise on drafting of legislation</p> <p>How will the legislation be triggered?</p> <p>How will compensation (if any) be determined?</p>	<p>Identify potential candidates to chair inst</p> <p>With Chair, identify management needed and potential candidates</p> <p>Identify any changes required in existing management arrangements</p>	<p>Prepare Statements and Information packs for media &amp; Consumers</p> <p>Handle calls</p> <p>Design media strategy</p>	<p>Identify external advisors on how to present to market</p> <p>Identify key information to be made available on request.</p> <p>Identify market expectations of information to be provided/covenants to be addressed</p>	<p>Identify potential areas of EU law that need to be addressed</p> <p>Identify obligations in respect of ECB</p>	<p>Identify liquidity requirements for initial business plan</p> <p>Identify sources of contingent liquidity to provide support as required</p> <p>What expertise is required within the institution to manage liquidity?</p> <p>What collateral can be generated for market transactions?</p>	<p>Identify which supervisory requirements should be applied to nationalised entity</p> <p>Identify any legislative amendments required</p> <p>Identify any administrative notices affected/directions required</p> <p>Identify any foreign supervisors that would need to be informed</p>

Each team will be shadowed by an Authority Director

Each stream will require administrative support for file searching, typing and photocopying/faxing

## Checklist

- What is / who is the 1st of Mon management??*  
*Control of INBS: who's the*
- operational* 1. Legislation in place
2. Deposit maturity profile - *daily*
3. Debt Maturity Profile - *daily*
- not gives away / so let them* 4. Take full possession of *all* assets - *J.V. 5 + non-true companies*  
*First says does not have right control of bank*  
*subsidiaries*
5. Press Statement to cover
- Management - new CEO *→ informed by Bill*
  - New Board (s)
  - Depositors
  - Debt holders
  - Future of INBS
  - State Guarantee of INBS Liabilities
  - Nationalisation *Protection*
  - Profit/Losses - sharing of risk
  - Legal Advisors
  - Staff of INBS
  - IFSRA/Central Bank
  - Setup Hotline and arrange PR Agency
6. Contact major depositors in advance of media announcement?
7. Accountants KPMG - *what he may know*
8. Credit Ratings of INBS - advise CRA's
9. Credit Ratings of Ireland - advise CRA's
10. Appoint Corporate Finance Advisors
- x* 11. Power of Attorney & appoint Legal advisors *? extension*  
*U. I.*
12. Analysis of Assets & Liabilities
13. Overseas subsidiaries/ trusts - can we access all assets/liabilities and information *check subsidiary definition. (question)*
14. Use of Loan Book as collateral with Central Bank
15. Refinancing
16. Cash available at Branches
17. Impact on other Financial Institutions, get them to also issue press releases

- 
18. INBS staff – who knows what?
  19. Cooperation of current INBS Senior Management
  20. Contact ECB
  21. Contact European Commission
  22. Central Bank support of other Financial Institutions -- cash/assurance
  23. Role of Central Bank/IFRSA
  24. DOF role
  25. NTMA role
- 
- 
- 



## Xfi Protection Bill

12 September, 2008

## XFI Protection Bill

- Protection of depositors and lenders by taking Xfi into public ownership.
- Maintain Xfi as a going concern
- State as owner to have to have all the powers, rights and obligations of ownership
- Relevant prudential rules and requirements applied by the Financial Regulator to continue to apply
- Ensure that State's capacity to manage isn't inappropriately constrained by procedural rules
- Provision of fair compensation (if any)
- Minister enabled to provide guarantee/loan
- Misc - expenses

## XFI Protection Bill

- Head 1
  - Minister given functions under the Bill (after consultation with Governor) where the Minister is of the opinion that
    - There is or would be a serious threat to the stability of the Society if these functions are not exercised and
    - The exercise of those functions is necessary, in the public interest, for maintaining financial stability in the State
  - CBFSAI's functions in relation to the Society continued

## XFI Protection Bill

- Head 2
  - Existing shareholdings to become deposits
  - Existing membership rights to be extinguished
  - Minister to become sole member
  - Rights (of lenders or borrower) to acquire shareholding extinguished
  - Procedural aspects of BS Act '89 (as amended) disappplied.
  - Existing Society rules disappplied
  - Ensure sufficient power of BS Act '89 (as amended) are maintained to ensure ordinary business can be carried on post transfer
  - Provide power to amend, repeal rules of the

## XFI Protection Bill

- Head 3
  - Power to remove/appoint
    - Directors
    - Chairman
    - CEO
    - Employees
  - Nominees to comply with Ministerial request
- Head 3B
  - Directors to hold office for such duration and on such terms as minister may determine.

## XFI Protection Bill

- Head 4
  - Extinguishment of rights to acquire shares (by virtue of being an employee, director, etc.) at a future date
  - Extinguishment of rights to dividend arising out of any shareholding

### XFI Protection Bill

- Head 5
  - Appointment of Assessor
  - Minister required to appoint assessor within X months to determine compensation (if any) payable in respect of membership/extinguished rights
  - Assessor to be independent
  - Assessor to be paid such remuneration etc as the Minister shall determine

### XFI Protection Bill

- Head 6
  - Determination of compensation as if
    - Society cannot continue as a going concern (to be wound up)
    - No assistance/guarantee by the State
  - Further criteria for determination of fair and reasonable compensation
  - Process for consultation with Minister/those affected
  - Process for advising of outcome

### XFI Protection Bill

- Head 7
- Scheme of compensation
  - Calculation of amount payable
  - Process of payment
  - Principles/policies of scheme (Assumptions to be made, rules of procedure)
- Scheme to be laid before Houses of Oireachtas for approval; permanent unless motion annulling passed within 21 days

### XFI Protection Bill

- Head 8
  - Power for Minister to make Guarantee/loan (incl. to do so on commercial terms/fee)
  - Provision for recovery, charging to Central Fund, reporting to Oireachtas

### XFI Protection Bill

- Head 9
  - Misc
    - Power for the minister to incur expenses

### XFI Protection Bill

- Schedule
  - Powers of Assessor
  - To require giving of evidence and production of documents
  - Conduct of proceedings
  - Proceedings in private
  - Offence of failing to appear
  - Offence of refusing to answer
  - Protection of those appearing before Assessor

## GOVERNANCE GROUP



### Framework for Action

#### Issues for Clarification as soon as possible:

- Current Goldman work – to examine any loan agreements for clauses in covenants that have a bearing in possible circumstances
- Goldman also to examine Isle of Man structure to ensure no barriers to proposed action
- Goldman to examine book for any potential very large difficulties
- Advice from liquidation experts to ensure that all necessary actions have been listed (see in particular Directions below)
- Check powers to give Directions (see Directions below) and check language of Directions
- Consider and reach view as to what action is necessary from State Aids point of view and what longer term implications there may be
- Communications to external parties:
  - MOUs (check with whom and what obligations)
  - UK Treasury
- Communicate message politically:
  - DFA
  - IFSC Banks
  - Any others?

#### Agree trigger points:

- For approach to Government for decision and for approach to Chair
- For initiation of legislation

#### If first trigger point is reached:

- Department of Finance go to government for decision
- Department of Finance approach a potential Chair (list has been drawn up)

- Department of Finance, in consultation with new Chair, approach individuals (from list?) to fill the following positions:
  - COO plus
  - 3 directors, one to be a direct representative of the Minister of Finance
- If second trigger point is reached, Department of Finance arrange for legislation to be introduced
- At the same time, Directions are issued to the firm (see below).
- MDY  
12 members of existing Board are retained as advisers

**Directions to Board**  
(To be checked by legal expert)

**Under the powers conferred on the Financial Regulator by ...., the Board of the Firm is hereby directed:**

- A. To appoint immediately on receipt of this Direction xx and xx as members of the management team of the firm and to co-opt them to the Board.
- B. To provide all assistance required by xx and xx to enable them to perform any duties that the Financial Regulator may require of them, to cede all necessary authority to them, to cooperate with them in every way, to provide them with all information sought and to provide them with access to all information sought
- C. To make no major contractual decisions, to sequester no assets, make no changes to the status of any agreements or covenants that the firm or its Directors or managers is party to without the prior approval of the Financial Regulator which should be sought through the Chair.
- D. To continue the business of the firm as usual and to honour all contracts
- E. To make no amendments to employment contracts of the Directors, Officers, management or staff of the firm without the prior agreement of the Financial Regulator
- F. To make no payments of redundancy or severance of any kind in favour of any Director, Officer, member of the management or staff of the firm without the permission of the FR.

- G. To take all measures to ensure that no documents, whether held in paper or electronic format, are deleted or removed.
- H. To ensure that Directors, officers, members of management and staff, including those in branches and agents will comply with all of the foregoing requirements.

## Xfi Strategy Document

### 1. – Customer Access Point with Financial Regulator Helpline

The Department has been asked to provide officials to assist in the manning of the overall Xfi Helpline, whose operation will be overseen by the CBFSAI. A list of Department officials who have worked in the Financial Services Division has been drawn up to play such a role.

### 2. – Customer Access Points with Department

The three forms of communications for which the Department must be prepared to deal with are:

- Website
- Telephone
- Walk-in

#### Website

A special website capable of handling millions of hits can be set up by CMOD within a number of hours. This website could be linked to the Department website's and could also be linked with the other relevant parties; including the Financial Regulator, the Central Bank, and Xfi.

The material on the website would include the Minister's Statement, Questions and Answer material, Deposit Protection Scheme (if relevant), and additional material on issues as they develop; i.e. proposed legislation, Dáil speeches.

#### Tasks

Setup of Website – CMOD in consultation with Press Office

Material for Website – Taxation and Financial Services Division and Press Office

Management of Website – Press Office

#### Telephone

CMOD can put in place telephones, some computers (8 or 9 initially) and a call queuing and monitoring system in a number of rooms in Lansdowne House. Much of this infrastructure is from the REACH system. These rooms could cater for up to 30 officials to man the Department mainline or alternatively a separate telephone line could be set up. CMOD will require a full day to set up the phone lines and infrastructure.

A list of officials to man the telephone centre is being drawn up. As far as possible, the officials will be drawn from areas with minimal involvement in the Budget.

Also a query sheet is being drawn up which will allow the tracking of basic statistics related to inquiries:

- number of inquiries received,
- the questions being asked by customers,



- are the inquiries related to other financial institutions (if volunteered), and
- general reaction of customers. (see Appendix 2)

#### Tasks

Setup of Telephone lines, Computers, and Telephone queuing and monitoring - CMOD

Selection of officials to man telephone lines - Press Office in consultation with CSD

Briefing of officials in advance of lines opening - Taxation and Financial Services Division and Press Office

Draw up phone query sheet - Press Office

#### **Walk-in Customers**

Walk-in customers should be discouraged from coming into the Department.

However if this occurs, it is essential that a queue does not form outside the Department. A possibility is to use the atrium of the new Finance building as a waiting area with some of the offices to the side as meeting rooms.

Required staff to carry out this task could be drawn from the list of officials tasked with manning the helpline.

#### Tasks

Preparation of waiting area and interview rooms - CSD

Preparation of staff to meet public - Financial Services Division and Press Office

## Appendix 1

### Department Officials to Staff Phonelines

Attached is a list of officials who could staff a Department Helpline. They are primarily drawn from sections with limited involvement with the Budget.

The second list contains officials who have experience of the Financial Services Division and could be seconded to the Financial Regulator helpline.

The key points that should be conveyed on the Department Helpline are the principal points conveyed in the Minister's statement:

- The decision taken and its effects;
- What does this mean for the company's customers;
- Reason why this decision was taken; and
- The remainder of the financial system is strong and people should retain confidence in their financial institutions.

### Introduction to Phoneline Officials

Administration issues:

- Many thanks for your willingness to assist in this urgent and critical task
- Importance that calm prevails, therefore:
  - Your involvement in this Group should be treated with confidentiality so as not to encourage panic;
  - Constantly reinforce the need for calm actions by people;
  - Only mention Xfi, draw a distinction between Xfi and the remainder of the Irish Banking system;
- Please fill out the draft questionnaire as far as possible. It has been divided into two parts: Firstly, questions that you should ask if the conversation goes that way, and secondly, questions that you should not ask directly but fill in the answers if the information is made available.
- If questions are asked to which no answer is listed please forward the question to the Team leader who will seek out an answer from the policy section.

Key messages:

- The decision taken and its effects;
- What does this mean for the company's customers;
- Reason why this decision was taken; and
- The remainder of the financial system is strong and people should retain confidence in their financial institutions.

Role of Team leader:

- Ensure that officials have sufficient information to deal with queries received.
- When new queries arise, seek out an answer from Financial Services Division.
- Overall management of staff resources within the call centre.

## Appendix 2

### Draft Query Sheet

Is the person a customer with Xfi? Yes / No

Has the person already contacted the Financial Regulator's helpline? Yes / No

If not, why? Was it taking too long to get through?

Principal Questions (please tick if asked):

Question	Yes
What does the action mean?	
Is my money safe?	
Why was this action required?	
There were rumours about the status of this financial institution; were they correct?	
Should I withdraw my deposits?	

Do not ask the questions below but please complete if the information is volunteered.

What financial institution is the customer concerned about?

Will they be withdrawing cash?

How satisfied does the customer appear to be?

On a scale of 1-5:

- 1 – completely dissatisfied and withdrawing cash
- 2 – dissatisfied and considering withdrawing cash
- 3 – remain unsure of what course of action they will adopt
- 4 – relatively satisfied and unlikely to withdraw cash
- 5 – satisfied and will not be withdrawing cash

## Draft Contingency Public Communications Plan

The scope of this part of the plan deals with communications with the general public including customers of Xfi and customers of other entities. There are two key parts to this plan – (i) the initial phase where it is important a clear message is delivered across all channels and (ii) dealing with the reaction from the public and having sufficient resources in place to deal with this.

### 1. Statement from Minister (Outline draft attached in Appendix 1)

A comprehensive clear statement to be issued by the Minister to address the following:

- What exactly will be happening – taking over ~~ownership~~ *control*
- Why is this happening -- to safeguard the interests of the members/customers, to ensure that it is business as usual and to safeguard the wider banking and financial system.
- Clear view on the cost associated with the takeover and the impact on taxpayers (indicating how taxpayers will be protected).
- What are the implications for customers – to confirm that all customers money is safe because it will be owned by the Government and that it is business as usual.
- What brought this about – market conditions, lack of liquidity available. Need to be clear why Xfi is different from other entities.
- What are the implications for other institutions and the system – need to be clear what the view is on other depositor takers including credit unions and that people should have confidence because this action demonstrates that Government will act where there is a potential problem.
- What are the Government plans for Xfi after takeover.
- How long will the Government guarantee last for?

Linked statement from Governor and Chair of Financial Regulator

- Need for a clear linked statement to back up what the Minister is saying and to confirm regarding the soundness of the system and other entities.

### Media Briefing

Just prior to the release of the statements key journalists from RTE and print media to be briefed to explain what is happening and why.

*(Responsibility – Press Offices of D of Finance and CBFSAI)*

### 2. Communications with Customers of Xfi

It is proposed to establish a **Joint Communications Group (JCG)** consisting of Press Officers from D of Finance and CBFSAI, Government Information Service (GIS), Consumer area of Financial Regulator as well as Xfi representatives. This group will need to coordinate messages and set out who is responsible for delivering

the message and how. It will also be responsible for reviewing and monitoring ongoing communications.

*(Responsibility -- Press Offices)*

It is important that the new Chair and CEO of the Xfi commit to putting resources into communication with the customers including the possible appointment of a PR agency.

*(Responsibility – Xfi)*

A Questions & Answers Document (Q&A) (draft in Appendix 2) will be prepared to deal with specific queries which may or may not be covered by the statements. This will have to be issued at the same time as the statements. This Q&A will have to be updated at regular intervals as new issues arise.

*(Responsibility – Press Offices and Consumer Information Dept of Financial Regulator/GIS)*

#### Communications by Xfi

A key channel for communication with the customers of Xfi will be through the Xfi itself. The effectiveness of this should help to reduce the volume of queries coming to the Department and CBFSAI.

- Staff of Xfi to be fully briefed as soon as possible on the overall plan and what customers need to be told. Ideally this should happen just before the release of the statements and preferably by direct contact with them from Xfi.
- A customer communication needs to be issued directly to each customer in writing.
- A customer communication needs to be put on the website of Xfi and in the branch network.

*(Responsibility – Xfi with oversight by JCG)*

#### Communications by D of Finance

- A copy of the statements to be put up on website immediately.
- A copy of any Q&A to be put on website immediately.
- Consideration needs to be given as to how customers can contact the Department with queries on the nationalisation.
- A public notice will be published in all national daily newspapers outlining what is happening and why and critically where customers can go for further information i.e. initially they should talk to the Xfi branches or helpline, consult the websites of D of Finance and Financial Regulator for info and any dedicated helpline established by Financial Regulator for customers seeking clarification. This public/consumer notice to be prepared jointly between the Department and Financial Regulator with the Financial Regulator placing the notices which can be done through the normal media buying channel of the Consumer Information Department.

*(Responsibility – D of Finance Press Office)*

### Communications by Financial Regulator/Central Bank

- A copy of the statements to be put up on website immediately.
- A copy of any Q&A to be put on website immediately.
- Setting up a dedicated helpline with support from the Department to deal with queries.

*(Responsibility – Financial Regulator Press Office and Consumer Information)*

### **3. Proactive Communication with the Public/Consumers**

The public will have many concerns about the announcement particularly in relation to their own financial institutions. Key information will need to be made available to address these concerns through the following channels:

- Media interviews to be given by senior personnel from D of Finance, Central Bank and Financial Regulator.
- Websites of D of Finance, Central Bank and Financial Regulator.
- Setting up of a dedicated single helpline resourced by CBFSAI.
- Direct lines to D of Finance and CBFSAI.
- Financial Regulator Information Centre.
- Reception areas of Central Bank and D of Finance.

*(Responsibility – D of Finance, CBFSAI, Financial Regulator including Press Offices, Consumer Information and GIS)*

### **4. Dealing with response from the Public/Consumers**

It is important that we do not underestimate the level of queries from the public which will arise. The effectiveness with which we deal with the volume of queries will help determine the overall success of the project. All channels and services will come under serious pressure and resources from throughout the CBFSAI and D of Finance will have to be reallocated to deal with the volume. Approx 60 staff will need to be identified across the organisation to be seconded to deal with potential high volumes of contacts (mainly calls).

Xfi has over 190,000 depositors and if even 10% of these decide to contact the CBFSAI (within the first few days) the various contact points which will come under extreme pressure and could potentially be overwhelmed.

The scale of contacts and our ability to manage it will depend on two key factors:

- How well the messages are communicated via the various channels and in particular the media; and



- How clear the question 'is my money safe' is answered by the Minister's statement and other communications.

It is far from certain as to how customers and consumer will react. It needs to be reiterated that any perception that there is a chance people could lose money risks precipitating a run. Northern Rock will be the frame of reference against which people will determine how to react. We will need to be able to answer the question is this guarantee the same. The issue of An Post Guarantee Savings and how this compares with the new scenario will also determine how customers react.

- Websites of D of Finance, Central Bank and Financial Regulator
  - IT capability will need to be available to deal with problems arising.
  - All information will need to be kept up-to-date by a dedicated resource.
- A dedicated Helpline will need to be put in place to be resourced by CBFSAI.
  - The existing call centre service in the Financial Regulator will be expanded to cater for this.
  - Resources from CBFSAI will need to be briefed to deal with calls.
  - Resource to be available from the Department and CBFSAI to provide a support structure to deal with queries not covered in the Q&A.
- D of Finance and Central Bank to put resources in place to deal with calls to their main phone numbers.
- Reception areas in both the Department and Central Bank need to be fully trained and resourced.
- Press Offices in both Department and CBFSAI to be fully resourced with possible outside PR agency assistance.

*(Responsibility – GIS/Consumer Information/Services Areas in Department and Central Bank)*

## ~~5. Communications with other stakeholders~~

Other key stakeholders will need to be briefed as they will also be asked for public comment. They include:

- Politicians
- Industry and Consumer Panels
- National Consumer Agency
- Financial Services Ombudsman
- Industry Rep Bodies

*(Responsibility – Shared re Politicians, otherwise Financial Regulator for others)*

Appendix 1

Minister DRAFT Statement

certainty in relation to the supply  
of deposits with a risk-based  
financial institution - Xfi

The Government has taken a decision today to introduce legislation that will take Xfi into public ownership.

This decision has been taken in close consultation with the Central Bank and Financial Services Authority of Ireland.

The decision was taken to safeguard the interest of the members and customers of Xfi and in the broader interest of the taxpayer.

~~It is important to stress that Xfi is solvent and is subject to normal ongoing regulatory requirements. Due to the current international market turmoil, Xfi has encountered temporary liquidity constraints. This means that in the short term it has been unable to raise sufficient funds in the market. This ~~pre-emptive~~ <sup>will</sup> ~~has been~~ <sup>is</sup> taken to give certainty to customers and the market about the underlying strength of Xfi.~~

~~The Minister will introduce legislation to have complete control of Xfi. The legislation will ensure that all the liabilities of Xfi and will operate as a normal company.~~  
The decision means that Xfi continues to operate as normal. All customers of Xfi can be assured that the full amount of their deposits and savings are fully safeguarded by this action. They can also be assured that they can and should continue transacting with Xfi as normal.

Customers of all financial institutions can have confidence that the wider financial system in Ireland remains strong, well capitalised, liquid and profitable. The Government's decision relates only to Xfi and was taken only in the context of the specific short-term difficulties at that institution.

The Government has prepared legislation to put this decision into effect. This will be presented at the next Dail sitting/tomorrow/Dail recalled.

~~While Xfi has sufficient cash to meet all its obligations, the Government has decided to take steps to ensure that Xfi can continue to operate as a normal company.~~  
There is no need for depositors or creditors of Xfi to take any steps at this moment. Moreover,

The Government intends to appoint XX as Chairman of Xfi. He will lead a new management team, which is already in place. Xfi will remain in public ownership while the current market difficulties persist.

I would again stress that this Government decision safeguards the future of Xfi. The bank will operate as normal and customers should continue to transact as normal.

All customers of Xfi will be communicated with directly by the bank.

The Government and Financial Regulator have established a telephone helpline to answer any queries or questions that people may have. This helpline will be open from tomorrow morning. All information is also available on the websites of the Government, Central Bank, Financial Regulator and Xfi.

*If any person deposits  
has difficulties in contacts*

*Even if there is any difficulty  
Xfi, they can rely on the Central Bank  
-ends- assured that the Government action is being taken  
action for the authorities is being taken to safeguard  
their position - this money is, therefore, safe.*

*Xfi remains a going concern -*

*Borrowers must, of course, continue to pay their  
loans on the basis of some commercial basis as identified.*

*→ move this report.*

## APPENDIX 2

Draft Q & A for Nationalisation Scenario:

13 Sept 2008

Q: What is the Government doing?

A: The Government is taking X into state <sup>control</sup> ownership. This means that it is the Government and ~~not the members that own the society~~ and it will appoint people to run X and to continue business as normal.

Q: Why did the Government need to do this?

A: Global problems in relation to how banks and building societies are funded have lead to some difficulties in X. While X is solvent the Government decided to act now to protect the customers of X and to make sure that the society can continue in business as normal. Its nationalisation means that the State now owns X and will appoint someone to manage its business.

[issue - nationalisation does not rule out the possibility of a run on X]

Q: What does it mean for me?

A: This development will make no difference to how you interact with Irish Nationwide and you can expect your business to be handled as normal. X branches will be open as normal (POLICY) and the staff there will continue to assist you with your banking requirements. If you have a mortgage or other loan you should continue to make your repayments as at present.

Q: Is my money safe? POLICY – THIS ANSWER NEEDS TO BE CLEAR AND UNAMBIGUOUS.

A: The Government has taken over X and will appoint people to operate it. Your savings will be protected under the terms of the Deposit Protection Scheme (see website for details) OR

*(So as to ensure that deposits are protected)*  
A. The Government has taken over X and will appoint people to operate it. Your savings will be guaranteed by the state. ~~one safer~~ *one being safeguarded by the State and whatever is necessary will be done to ensure this.*

Q: Who is X regulated by?

A. X remains regulated by the Financial Regulator and it will continue to be subject to the normal prudential and consumer protection rules. The Financial Regulator will work closely with the Department of Finance and the new management of X with regard to the running of the business.

*(Suggested Xfi was in discussion about replacing)*  
Q. There were recent media reports ~~that questioned the solvency of X~~ – were these correct? *Deposits*

A. No these were not correct. *But these reports did not help many have reduced confidence in the institution*

Q. The Financial Regulator stated that there was no basis to the Reuters report. Was this correct?

A. Yes -- the Financial Regulators statement was correct.

**Q: So what changed?**

**A:** It is important to re-iterate that X remains solvent and is in business as normal. The Government decision to act now was taken in light of continuing global problems that were impacting on the ability of X to raise funds and public speculation about X that exacerbated the issue for X. *(NEEDS TO BE CLEARED / expanded on to make a clear distinction between this case and other institutions).*

**Q: Is my money safe forever or is there a time limit to the Government ownership / state guarantee?**

**A:** Government ownership is temporary and is intended to steer the society through this period and ensure that the needs of its customers are met. ???? Is there a minimum length of time? When will this be reviewed??? **POLICY**

**A:** The deposit guarantee scheme will apply (NOW?) after the period of Government ownership ends

**Q: Are there similar issues with other institutions?**

**A:** X has faced very specific problems in recent times. **NEED SOMETHING ON WHY THIS IS UNIQUE.**

**Q: How was this allowed to happen?**

**A:** **NEED AN ANSWER...**

**Q: Did X's business model put it in greater risk?**

**A:**

**Q: Does the deposit guarantee scheme apply to all customers – retail and corporate?**

**If the DGS applies:**

**A:** The Deposit Protection Scheme, where the limit is 90% or €20,000, applies to members; ordinary customers and some others - see website for full details on who is covered.

**If there is a state guarantee:**

**A: All deposits in X come under the state guarantee**

**Q: Can I withdraw my money immediately?**

**A:** You can continue to bank as usual with X under the normal terms and conditions of your accounts. **POLICY Will there be a handover closure for a period?**

**Q: Will Xs branches remain open in the normal way?**

**A:** Yes – normal branch opening hours will apply and it will be 'business as usual' from customers perspective. **POLICY**

**Q: Will X be there to answer my calls and tell me what is going on?**

**A:** Yes. The staff of X have been kept fully informed of the changes and they should be able to answer all of your questions.

**Q: I have a mortgage, how will it be affected?**

**A:** You should continue to make your mortgage repayments to X in the normal way. There will be no change to your mortgage terms and conditions.

**Q: X is trying to repossess my home – what will happen now?**

**A:** The Government will appoint people to take over the day-to-day operations of X and manage its assets and liabilities. Most processes in train are likely to continue as normal and X staff will continue to process transactions and business such as arrears and repossessions. You can continue to deal with your issues directly with X.

**Q: I am in legal action with X over a loan – what will happen now?**

**A:** The Government will appoint people to take over the day to day operations of X and manage its assets and liabilities. Most processes in train are likely to continue as normal and X staff will continue to process transactions and business such as arrears and repossessions.

**Q: If I leave my money there will it still earn interest?**

**A:** It will be business as usual and the terms and conditions of your accounts will be the same

**Q: If I lodge more money to my account is it safe/is it guaranteed?**

**A:** Depends on the nationalisation scheme and also the limits in the Deposit Protection Scheme. **POLICY**

**Q: I am a member of the building society, how does this affect my membership?**

**A:** Under a nationalisation plan the members of a mutual society who currently own their society will no longer own the society....the Department of Finance will appoint an assessor the value of any compensation that may be due for their loss of ownership??

**Q: I am a member of the building society, are my funds covered under the DPS?**

**A:** Yes – they are

**Q: I am a member of the building society, will I get compensation and if so when?**

**A:** Department of Finance will appoint an assessor the value of any compensation that may be due for their loss of ownership?? This may take some time.

**Q: I work at X. What does this mean for me?**

**A:** The Government sets out in its nationalisation plan.....

**Q: I am a UK resident (any other non Irish resident), does the guarantee apply to my savings?**

**A:** There is no new guarantee covering savings with XX. Savings are covered under the Deposit Protection Scheme as set out above....

**Other Possible Questions:**

**For BSD/Finance:**



**Q: Is my money safe in the other financial institutions?**

**For Finance:**

**How much will it cost?**

**Does Government have the money to fund it?**

**Will taxpayer have to fund this?**

**Will Government put in people to run XX?**

**Will Government put in people to run the main banks?**

**List of XX Stakeholders:**

Members,

Depositors,

Mortgage Holders

Other borrowers including commercials borrowers,

Lenders to XX including institutions,

Staff

Pensioners – retired staff

Service Providers

## Appendix 1

### Minister DRAFT Statement

The Government has taken a decision today to introduce legislation that will take Xfi into public control. The decision was taken to safeguard the interest of the customers of Xfi and in the broader public interest. It will ensure the safety of deposits held in Xfi / an Irish financial institution.

This decision has been taken in close consultation with the Central Bank and Financial Regulator.

It is important to stress that Xfi remains solvent and continues to be subject to ongoing regulatory requirements.

Xfi has encountered particular liquidity difficulties. This means that in the short term it has been unable to raise sufficient funds in the market to meet its obligations. This action by the authorities has been taken to give certainty to customers and the market. It enables Xfi to operate as a going concern and to continue to transact business in the normal way.

All customers of Xfi can be assured that the full amount of their deposits and savings are fully safeguarded by this action. They can also be assured that they can and should continue transacting with Xfi as normal and there is no need for customers to take any particular steps as a result of this announcement. All customers will be communicated with directly by Xfi in the coming days.

The Government and Financial Regulator have established a telephone helpline to answer any queries or questions that people may have. This helpline will be open from tomorrow morning. All information is also available on the websites of the Department of Finance, Central Bank, Financial Regulator and Xfi.

Customers of all financial institutions can have confidence that the wider financial system in Ireland remains well capitalised and liquid and that the Irish authorities will be proactive to ensure that their interests are protected and their deposits are secure. The Government's decision relates only to Xfi and was taken only in the context of the specific short-term difficulties at that institution. [note: need for this last sentence?]

The Government has prepared legislation to put this decision into effect. This will be presented at the next Dail sitting/tomorrow/Dail recalled.

The Government intends to appoint XX as Chairman of Xfi. He will lead a new management team, which is already in place. Xfi will remain in public ownership while the current market difficulties persist.

I would again stress that this Government decision safeguards the interests of the customers of Xfi and their deposits and savings. The bank will continue to operate as normal and customers should continue to transact as normal.

-ends-

Fennell Jac (GSD)

---

From: Beausang, William [William.Beausang@finance.gov.ie]  
Sent: 14 September 2008 08:51  
To: Fennell Jac (GSD)  
Cc: Manley, Michael  
Subject: FW: Niall Brady Press Query - DGS

Jac

*Could you include this update in the papers for review by the group today.*

*thanks*

---

From: Beausang, William  
Sent: Fri 12/09/2008 19:15  
To: niall.brady@Sunday-times.ie  
Cc: Meenan, Brian; Taggart, Michael  
Subject: FW: Niall Brady Press Query - DGS

*Niall - sorry for the delay in responding to you on this. Brian Meenan asked me to send it on to you.*

*regards*

*William Beausang*

*Update on progress in review of EU Deposit Guarantee Scheme*

*- EU Finance Ministers agreed in October 2007 to consider possible enhancements to the EU Deposit Guarantee Directive.*

*- Ireland is participating in the EU review, which includes a consideration of the level of savings guarantee but also focus on wider policy areas such as improving the speed of payouts, depositor information and cross-border interoperability. It is expected that the conclusions of this EU review will be reached by end-year.*

*- The conclusions of the review will inform any changes required in the Irish Deposit Guarantee Scheme to ensure that savers in Ireland benefit from safeguards in line with EU best practice.*

*- The recent OECD Economic Survey of Ireland stated that Ireland's current deposit protection level is in the mainstream of European law and practice and should be sufficient to provide protection to the vast majority of depositors.*

#####

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# LIQUIDITY WORKSTREAM

## Steps ahead of protection

### **Outflows:**

- Closely monitor outflows: FR receives 4 liquidity reports daily
- Action threshold: When the aggregate outflows reach €1bln

### **Approval to act:**

- Internal authority: Governor/Board
- Government guarantee: needed for liquidity action e.g., letter of comfort

### **Amount of liquidity provision:**

- Worst-case estimate of deposit withdrawals: €4bln

### **Form of assistance:**

#### *Bank:*

- Bilateral asset swap:
  - o euro-area government bonds provided in exchange for legal charge over mortgage book
  - o written declaration from counterparty that charge<sup>1</sup> enforceable
  - o Haircut of 30% and 50% on residential and commercial mortgage loans respectively
  - o term of swap – 6 months (max)
  - o interest rate -- differential between GC repo (~~where we~~ borrow cash against lending euro area government bonds) and ~~unsecured~~ cash rate
- YFI/ZFI to provide cash to XFI against receipt of euro area government bonds (because not useable by XFI with ECB or in market)

#### *NTMA:*

- cash secured in same way (charge, declaration, haircuts)

---

<sup>1</sup> Floating charge must be registered within x days?

## LIQUIDITY WORKSTREAM

### External contact (outside of group)

#### a. Goldman's

- quality/enforceability of loan book?
- check bond documentation for events of default, e.g., following rating change and change of ownership
- investor relations role (extent of role dependant on clarity of statement from Minister)

#### b. XFI

- sign Deed of Charge
- written declaration from XFI on enforceability of charge
- list of qualifying assets

*- CONFIRMATION OF SOLVENCY FROM XFI BOA*

#### c. YFI and ZFI – re asset swap (and agreement to be put in place with XFI)

#### d. ECB?

*2*



## LIQUIDITY SCENARIOS

*at Letter of Credit for loan  
to amount of withdrawal possibility.*

### Scenario 1: Most Benign

Bank X has cash of €3.3 billion as at close of business Friday, 12 September 2008. It suffers withdrawals of €0.5 billion on Monday 15 September and €0.5 billion on Tuesday 16 September 2008. Bank X Noteholders take no action.

Action: CB does a €2 billion asset swap with Bank X on Tuesday 16 September 2008 whereby CBK takes a charge on €4 billion of Bank X's commercial mortgages and CBK gives Bank X €2 billion of sovereign bonds. Bank X then uses these sovereign bonds with Bank A and Bank B to get €2 billion of cash.

At close of business Tuesday 16 September 2008 Bank X has €4.3 billion of cash. Assuming withdrawals step up and €1 billion is withdrawn on Wednesday, Thursday and Friday, this would give the Steering Group time to finalise the inevitable solution over the weekend.

### Scenario 2: Probable but Manageable

Bank X has cash of €3.3 billion as at close of business Friday, 12 September 2008. It suffers withdrawals of €1 billion on Monday 15 September and €1 billion on Tuesday 16 September 2008. Bank X Noteholders take no action.

Action: CB does a €2 billion asset swap with Bank X on Tuesday 16 September 2008 whereby CBK takes a charge on €4 billion of Bank X's commercial mortgages and CBK gives Bank X €2 billion of sovereign bonds. Bank X then uses these sovereign bonds with Bank A and Bank B to get €2 billion of cash.

At close of business Tuesday 16 September 2008 Bank X has €3.3 billion of cash. Assuming withdrawals tail off Bank X has sufficient liquidity.

### Scenario 3: Worst Case

Bank X has cash of €3.3 billion as at close of business Friday, 12 September 2008. It suffers withdrawals of €2 billion on Monday 15 September and €2 billion on Tuesday 16 September 2008. Bank X Noteholders take no action.

Action: CB does a €2 billion asset swap with Bank X on Tuesday 16 September 2008 whereby CBK takes a charge on €4 billion of Bank X's commercial mortgages and CBK

gives Bank X €2 billion of sovereign bonds. Bank X then uses these sovereign bonds with Bank A and Bank B to get €2 billion of cash.

At close of business Tuesday 16 September 2008 Bank X has €1.3 billion cash.

Action:

Steering Group has to get government to recall Dail and pass legislation. Minister for Finance has to instruct NTMA to advance money as required for daily operations to Bank X probably unsecured to keep Bank X operational until legislation is passed.

The question arises as to how much cash NTMA will have to provide just to cover deposit withdrawals, maybe €3 billion.

NB: Each of the above scenarios changes dramatically if the Noteholders take any action to try and get their loan notes repaid. This amount is €6 billion and depending on what action the Minister for Finance takes or does not take it could trigger an additional drawdown from the Exchequer for all €6 billion or part thereof. ie. The Exchequer could be called on to provide €7-€10 billion unless Noteholders can get assurance that their loans are secured.

## OVERVIEW OF SUPERVISORY REQUIREMENTS for Xfi POST “PROTECTION BILL”

1. **Building Societies Act, 1989 (‘the Act’) (as amended)**  
Xfi remains authorised under the Act and will be required to comply with its provisions except to the extent that they are disapplied by the “Protection Bill”.

2. **Prudential Supervisory Requirements**

In the event that the Xfi is owned by the State, it would continue to be an authorised credit institution licensed and supervised by the Financial Regulator. The following identifies the key prudential supervision requirements under which Xfi would operate:

### 2.1 Capital Requirements Directive

EU directives 2006/48 /EC and 2006/49 EC, collectively known as the Capital Requirements Directive<sup>1</sup>, are the directives relating to the calculation of the solvency requirements for credit institutions in the EU. XFI would be required to operate in compliance with the CRD and any associated Notices issued by the Financial Regulator.

#### *Solvency*

The directives require that the credit institutions should hold a minimum solvency ratio of 8% in respect of its credit risk and also hold sufficient capital to meet its market risk and operational risk capital charges. Xfi is currently required by the Financial Regulator to maintain a minimum solvency requirement equivalent to 11%. Xfi is currently in excess of its current solvency requirements.

Should Xfi be brought under State protection, and given the change in ownership of the entity to that of a state owned entity, it would proposed that the current solvency requirement in respect of credit risk is reduced to the minimum requirement under the CRD of 8%. Xfi would be required to comply with this requirement on an ongoing basis. Should the value of the owns funds of Xfi decline with the result that Xfi is not

---

<sup>1</sup> SI 660 and SI 661 2006 transpose CRD into Irish law.

in compliance comply with its solvency requirements, it would be in breach of the CRD and would be required to take the necessary actions or steps at an early stage to address the situation.

### *Large Exposures Requirements*

EU directives 2006/48 and 2006/49 also outline the limits on large exposure which a credit institution can incur to a single person or group of connected persons. The current limit is 25%. The CRD does not permit a general exemption from these requirements. If Xfi exceeded this limit this would represent a breach of the directive and the directive provided that Xfi would be permitted a limited period of time in which to comply with the limits. Discretion rests with the Financial Regulator as to the period of time involved and the acceptability of any plan to bring Xfi back in compliance with the CRD.

## **2.2 Liquidity Requirements**

The Financial Regulator has imposed its requirements for Management of Liquidity Risk ('the Requirements') as a condition on the licence of all Irish licensed credit institutions. They are imposed on Xfi under Section 17 of the Building Societies Act, 1989. The Requirements are based a maturity mismatch approach and include both qualitative and quantitative requirements. They also impose obligations to report to the Financial Regulator; since October 2007 the frequency of such reporting has been increased to weekly.

The quantitative requirements of the maturity mismatch approach involve credit institutions assigning their cash inflows and outflows to various time bands based on their contractual residual maturity. Assets are to be assigned based on the latest possible date of receipt and liabilities based on the earliest occurrence of the obligation. A net mismatch figure is obtained by subtracting the outflows from the inflows. Mismatches are assessed on a net cumulative basis. Limits are set in the first two time bands; in the first time band of sight to 8 days, cash inflows plus allowable discounted liquid assets are required to be greater than or equal 100 per cent of cash outflows. In the second time band of over 8 days to 1 month, cash inflows including any net positive cash flow carried forward from the first time band, must equal at least 90 per cent of cash outflows.

On the basis that Xfi is State owned but operating on a going concern basis it is proposed that the Requirements remain as a condition on its licence. To remove this condition could create an unfair advantage for Xfi compared to the other credit institutions authorised in the State. In the event of a plan to wind-up Xfi the Financial Regulator could consider whether the condition remained. In any event, in the event of a breach of the Requirements were to occur it would be at the discretion of the Financial Regulator as to what action, if any, it took.

### **2.3 Impairment Requirements**

The Financial Regulator has imposed its Impairment Provisions for Credit Exposures ('Impairment Requirements') as a condition on the license of all licensed credit institutions. They are imposed on Xfi under Section 17 of the Building Societies Act, 1989. The Impairment Requirements set out the Financial Regulator's requirements with regard to the policies to be adopted by credit institutions for credit loss provisioning. They contain qualitative requirements on credit risk management and impairment provisioning and quantitative criteria, based on the IFRS 'incurred loss' approach, and quarterly reporting requirements. It is proposed to maintain these as a condition on the licence of Xfi.

### **2.4 Licensing and Supervision Standards**

The Licensing and Supervision Requirements and Standards for Credit Institutions ('the Standards') are non-statutory and are applied by the Financial Regulator as a supplement to the statutory requirements contained in or imposed under the Building Societies Act, 1989. The standards include, inter alia, high-level requirements regarding:

- 2.5 Acquisitions of and by credit institutions;
- 2.6 Board and management of credit institutions;
- 2.7 Internal controls;
- 2.8 Funding;
- 2.9 Lending.

---

The Standards will continue to apply to Xfi post enactment of the "Protection Bill".

### **3. Consumer Protection Requirements**

#### **3.1 Consumer Protection Code**

The Consumer Protection Code which sets out requirements for Xfi's interactions with its customers. In the interest of consumer protection these will continue to apply to Xfi

#### **3.2 Minimum Competency Standards**

The standards set out the minimum qualifications and experience required by the staff of institutions which offer financial services to consumers. In the interest of consumer protection, these will continue to apply to Xfi.

### **4.0 Other Applicable Legislation**

- 4.1 Deposit Guarantee Scheme - SI No 168 of 1995  
SI No 468 of 1999  
SI No 104 of 2002  
Central Bank Act 1997

#### **4.2 Investor Compensation Act, 1995**

#### **4.3 Criminal Justice Act, 1994**

### **5.0 Conclusion**

The above list represents the key legislative, prudential and consumer requirements that are currently apply to Xfi and identifies those that Xfi will be expected to remain in compliance with post enactment of the "Protection Bill". It does not purport to represent a complete list of all requirements and legislation that Xfi and other credit institutions may have to comply with on an ongoing basis. It is the responsibility of the board of Xfi to ensure that it operates in compliance with any regulatory or legislative requirements are in Ireland and in other jurisdictions in which it operates.



Fennell Jac (GSD)

---

From: Beausang, William [William.Beausang@finance.gov.ie]  
Sent: 14 September 2008 10:20  
To: Fennell Jac (GSD); Whoriskey Neil  
Cc: Manley, Michael; Cardiff, Kevin  
Subject: EU Workstream URGENT / CONFIDENTIAL



EU and  
international workstream  
Jac

*This is one of the chapters for incorporation into the document you are preparing for review by the group at 11am.*

*I'm v sorry for the late submission.*

*I would be grateful if you could acknowledge receipt so that I know you have it.*

*Ar... probs please ring me at 086 173 1649*

*many thanks*

*William Beausang*

#####

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## EU / international workstream (includes State Aid issue)

### – 14 September 2008

#### Scope

This workstream relates to contact with the European Commission, EU Member States (MS) (and other jurisdictions as appropriate) at finance ministry, central bank and regulator level as well as contacts with other relevant international bodies

#### Overview

These are key communication channels to maintain international confidence in the Irish banking system

Communication will 'cascade' through these channels to the international political and financial system generally

Critical balance must be struck between providing information and insight into events in Ireland and not exacerbating concerns regarding the robustness of the banking system (and the state of the economy and public finances overall)

In designing message and trying to get it across important to be aware that level of 'interest' will differ between stakeholders and 'attention span' will in many instances be limited

There is overlap with the communications and investor relations streams but clearly differentiated message required, in contrast to depositors, bondholders, etc. there is no direct financial interest involved.

Information conveyed to key international stakeholders will be assessed sceptically to shape international views on prospects for maintenance of financial stability in Ireland. These people are likely to already have their own views on the situation here and will very quickly decide how what they are hearing fits into that framework.

#### Key questions – what would we want to know if roles were reversed?

- What is the problem?
- What steps have been taken to resolve it?
- Are these measures expected to be successful?
- Is this the only rescue that will be needed?
- What are the possible knock-ons? (to possible worst case scenarios)

- 
- What are authorities doing to manage these risks?

Communication must be timely, clear, focused and realistic & must work through all possible follow-on issues in particular stability of the Irish financial system overall

#### Practical issues

- Differentiate between comprehensive briefings provided to key players internationally and that circulated 'for information' to EU e-mail contact lists (e.g. EFC, FSC, CEBS, ECSB etc)
- All communication must contain comprehensive contact list specifying who can provide information on what issues
- Website communication (IDoF, CB and FR) most effective way of informing broader international stakeholders

#### Competition Law

- No issue arises under protection regime (& no notifications required?)

#### State Aid – this is a key issue

- selective (i.e. not available to all) State-backed loans and guarantees fall under EU State Aid rules
- Commission draw distinction between rescue aid and restructuring aid
- Rescue aid is temporary (6 month limit) and reversible assistance to keep ailing bank afloat for the time needed to work out a restructuring or liquidation plan but it can be extended if necessary on presentation of a restructuring plan
- Rescue Aid must be limited to liquidity support and can normally only be granted in the form of loan guarantees or loans
- Restructuring aid encompasses structural financial measures, for example, capital injections, debt reductions etc) but must be based on a feasible, coherent and far-reaching plan to restore a firm's long-term viability.
- The restructuring plan must be submitted to the Commission within six months (otherwise the rescue aid has to be paid back) and must be compatible with (i) restoration of long-term viability (ii) avoidance of undue distortions of competition (iii) aid limited to the minimum
- Cion will look for supports to be provided as much as possible on 'commercial' basis
- MS are expected to contact the Commission as early as possible where rescue aid package arises but in practice other MS appear to have notified after the announcement of assistance

### Actions Required

1. Explore full implications of the above in context of Xfi case. Requires detailed assessment of the state of the loan book – earliest possible briefing for DoF by GS essential (contact details)
2. Establish who we will need to contact in Cion and what we will need to be able to tell them on the basis that we will contact immediately after / before? announcement
3. Be prepared to commence preparation of notification of rescue aid immediately and project in place to notify restructuring plan

### **EU**

Detailed briefing ready for Commissioner (McCreevy) & Cabinet (Power & Murray) – **need to decide who we would contact and brief in advance and what we need them to do / what do we need to know?**

Also Cion (Internal Markt – David Wright) & other key Irish EU personnel in the Commission (e.g. Catherine Day)

### **High level EU Committees - FSC / EFC etc**

- Case might be made for circulating information to members post-announcement? Against that should try to avoid drawing excessive attention to the measure. Germany, UK did not circulate any information following problems in their banking systems. Denmark mentioned Roskilde at FSC but didn't circulate anything. **Would same or different considerations inform interaction with CEBS and ECB / ESCB? – need advice from CB and FR on this.**

### **Department of Foreign Affairs**

- Role of DFA crucial in informing and communicating approach internationally and to Dublin embassies (particularly in the EU MS and the US given links between Irish financial system and US). **SG of DFA should be briefed early.**

- Ambassador to EU (Bobby McDonagh) and Permanent Representation including in particular Financial Services Attache are critical to effective communication of measure. **Ambassador should be briefed early.**

### **IFSC**

- International banks based in Dublin could have important role in communicating information in informal way to their HQs – we need to try to ensure that the message is as positive as it can be in the

circumstances. Who should liaise with them to help manage the message -- FIBI, FSI?

#### **Banks and representative bodies**

- Key role played by banks themselves and representative body IBF in communicating message internationally (as well as domestically) but need to decide how this process should be co-ordinated.

#### **MoU on crisis management**

- We are required to advise under MoS other MS of cross-border financial stability issues
- Xfi not systemic in UK – but has significant commercial loan book in the UK
- Important to advise HMT, BoE and FSA (and Isle of Man Regulator) at appropriate time particularly because of possible knock-on consequences
- **Is planning required with UK of contingency where larger institutions in Ireland (and the UK) are seriously affected by the announcement?**

#### **EU Crisis Management List**

- Have contact list to hand & briefing prepared to respond to queries from other MS

#### **Deposit Guarantee Scheme (DGS)**

- Need to be able to explain how protection has pre-empted activation of DGS
- However, announcement will generate strong focus on DGS
- Need be able to give update on reform of DGS domestically
- Key message is however this is not a DGS issue because there is no liquidation

Don't forget EFDI-FDIC Conference (22 September 2008) – also overlap with Ecofin other international major speaking engagements

#### **Other public international stakeholders**

- IMF (Stephen O'Sullivan is Irish Executive Director – is there a case for bringing SOS in early so that he can act as contact point for US banks / stakeholders?)
- DoF is Minister's representative on a number of international institutions (e.g. EIB, ADB) -- officials attending meetings should be prepared to provide appropriate information
- CB / FR international roles?

## **ECB / ECSB**

- when? how? who?



Lonergan, Ciara

---

(17)

From: Beausang, William  
Sent: 16 September 2008 08:55  
To: Manley, Michael  
Subject: Please see comments on this - could we discuss please

Attachments: Annotated Business plan Bills.doc



Annotated Business  
plan Bills...

## Business Plan

Two strands

**A - Finalise BS Protection Bill**

**B - Advance complementary Bank Protection Bill (+Guarantee Bill? – our next step is bank bill. We need to discuss how to expedite this.)**

**A - Finalise BS Protection Bill**

### Text of Bill

- Finalise text of already agreed provisions - DoF lead, but include OPC/AGO/TR/CB [we have final drafting changes...but CK from the FR should review draft afresh and input into these]
- Clarify/resolve outstanding requirements
  - o Year end (accounts/CRD) provision [you saw my email to MB...we are awaiting clarification of the position on this from her]
  - o Power of Minister to authorise/direct NTMA to restructure financing of society [NTMA have undertaken to come back to us on this]
  - o Formal confirmation from the FR that the articles and memo of association of the IoM sub do not contain any provisions that would frustrate the transfer under the Bill (FR is to either check this directly – this is my understanding or get their advisors GS to check this).
  - o Formal confirmation from the FR that their advisors GS McCann Fitzgeralds have checked the terms of the covenants associated with Xfi's wholesale borrowings to check what is the effect of any change of ownership and to check that they do not contain any unusual terms [I am liaising with FR and NTMA on this. FR has raised questions on how this can be done]

Once text agreed – seek high level clearance (in so far as this is possible at this stage) within CB / FR / NTMA of Bill before going to Govt? [As I understand it a trigger level of withdrawals has been agreed for going to Government on this]

### Bill processes

Prepare text of Explanatory Memo and Govt Memo – DoF lead with AGO/OPC input/clearance [Explanatory Memo and Govt Memo need to be ready to go – could we discuss logistics please]

Explanatory Memo – Key requirement, clarifying what the Bill sets out to do

Memo for Govt – Format as set out on Cabinet procedures – essentially

- Reason for Bill
- Summary of what Bill sets out to do
- Reason for urgency (might be covered at first point)
- Need draft assessment from FR/CB for insertion – co ordinate with other strands)

Practical arrangements for processing Bill through the Oireachtas (K Cullen preparing paper) [could you give me an update on this]

- Printing arrangements/procedures: (Separate checklist for these)
- Contact with Bills Office (Whips Office?) - latest time this can happen?
- Speeches (Will vary depending on decisions in relation to how Bill is taken through, esp. 1 day or several days)
- Committee Stage brief vital (will need to liaise closely with CB/FR)

If Dáil and Seanad to be recalled this will require a request to the Cean Comhairle to issue recall notice (probably desirable to have ready a note from the Minister to Taoiseach on this) procedures

Early Signing Motion - Check recent BUBA/Quinn direct motions (+ 1985 Special provisions Act)

### **Briefings**

- Government ?
- Opposition Leaders -- FR/CB involvement?
- Media -- link with FR/CB briefings to industry

Question - extent of FR/CB/NTMA involvement

### **B - Advance complementary Bank Protection Bill (+Guarantee Bill?) – PLEASE DISCUSS**

**Text of Bill** ( Significant input from Colm Breslin's side)

- Recommence drafting of text based on original outline and matters learned from BS Bill - DoF lead, but again include OPC/AGO/FR/CB
- Identify any additional issues
  - o matters for disapplication?
  - o Identify if there are Stock Exchange, Market abuse, takeover etc. issues?

Once text agreed -- seek high level clearance (in so far as this is possible at this stage) within CB / FR / NTMA of Bill before going to Govt?

### **Bill processes**

Same as BS Bill?

### **Briefings**

Same as BS Bill but greater attention to issues arising in share markets

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Minister

**RE : Background note for the Minister for Finance [REDACTED] on  
Financial Market Developments to 17 September, 2008**

Note attached setting out background [REDACTED] on Financial Market  
Developments to 17 September, 2008.

Michael Manley  
16 September, 2008

Background note for the Minister for Finance ON  
Financial Market Developments to 17 September, 2008

### **Events in the USA**

Major events over the last ten days have seriously impacted international equity and financial markets:

- On Sunday 14 September, Lehman Bros, filed for Chapter 11 protection (essentially a form of examinership in a situation of bankruptcy - reported exposures of \$600 billion)
- Merrill Lynch sold itself to Bank of America in an all-share deal (i.e. no new equity injected)
- 8 September - US took Fannie Mae and Freddie Mac into conservatorship, promising to pump in \$billions, and with the likely loss of \$10.8 billion in shareholders, stake

These events reflect the working through US markets of problems with underlying sub-prime mortgages. Their scale is virtually without precedent (some commentators likening these to the 1929 crash), and have given rise to serious falls in world equity markets, a flight to quality (Govt. bonds) further tightening in credit availability (lenders even more reluctant to lend) and rises in interest rates.

While difficulties in the banking sector have long been signalled, the sudden and unexpected approach to the Federal Reserve by the insurer American International Group (AIG) seeking \$40 billion in short-term financing to stave off rating downgrades and shore up the capital of its holding company, has raised new fears. The most recent reports indicate the US authorities have appointed JP Morgan to lead efforts to have major financial institutions provide a market-based solution and of New York State permitting AIG to access up to \$20 bn in its assets (insurance companies are usually strongly prevented from accessing their assets).

### **Impact on Ireland**

Events on this scale would inevitably extend to Ireland; largely in further tightening of the availability and cost of funding to banks and directly in employment and activity in institutions with operations in the IFSC (e.g. Merrill Lynch 650 employees; Bank of America 1,000 employees in a subsidiary MBNA).

Irish banks have repeatedly stressed they have little or no exposure to the problems with US sub-prime mortgages. However, since February 2007,

- Irish Stock Exchange index has lost almost 50% of its value, considerably outstripping US (Dow -18%) and UK (FTSW -18%) indices; with the Irish financial index falling 11% since 12 Sept as compared to 8% for UK and EU indices
- Individual banks have seen very significant falls in this period AIB -70%, BoI -75% and Anglo -74%. All Irish financial institutions saw major falls in their share prices in the last two days, e.g. AIB -15 % and Anglo -20 % up to mid morning 16 Sept.
- Credit Default Swaps (CDS) for Irish banks (i.e. the cost of a counterparty insuring lending to an Irish bank) has risen 30-37% since Friday, 12 Sept

The Governor of the Central Bank and CEO of the Financial Regulator have stressed on many occasions that Irish financial institutions are coping well with the ongoing dislocation in international financial markets. Irish banks are well capitalised, are highly liquid and have built up good financial buffers over a number of years of strong financial performance. However, we have been advised by the Financial Regulator that recent developments have led to a marked deterioration in the financing environment for Irish banks.

Investors and commentators perceive Irish financial institutions to be vulnerable to changes in property prices/adjustment in construction activity with ratings agencies adjusting downwards their ratings of Irish financials over the last year and generally indicating a negative outlook in terms of bad debts.

## **EU**

The ECB and other major Central Banks (UK, Swiss) provided additional liquidity to markets on Monday, 15 Sept. and the Informal Ecofin at the weekend reiterated the necessity to progress steps to restore confidence and maintain stability in global financial markets (i.e. implementation of the Roadmap dealing with transparency, progress on valuation standards, strengthened prudential standards and enhanced supervision of cross-border financial groups). However, additional liquidity provides temporary relief, while implementation of the Roadmap will only have effect over an extended time period.

## **Summary**

The vulnerability to adjustments in the property sector and further tightening in the availability and cost of credit internationally has put Irish banks under increased pressure. This is impacting individual institutions differently, but all are under pressure, especially the smaller ones.

Recent events in the US may be viewed as a necessary 'shake out', but it is generally accepted that markets will not begin to return to normal until property values in the US stabilise – no one has indicated this is likely to happen any time soon. International difficulties are therefore amplifying pressures in the domestic banking system.

cc Secretary-General, Kevin Cardiff, Cathy Herbert



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# **ANGLO IRISH BANK**

***Strictly Confidential***  
***Presentation to Department of Finance***

**ANGLO  
IRISH  
BANK**



**18 September 2008**

**[www.angloirishbank.com](http://www.angloirishbank.com)**

## ***Business Overview***

- **A simple business model**

- Lending**

- Senior secured term lending, emphasis on cash flow
    - Relationship based
    - Central approval of every loan

- Funding**

- Mostly customer funded
    - Wide franchise – 16 geographic markets

- **Highly capital accretive**

***Balance sheet lender - "old-fashioned banking"***



## ***Evolution of Anglo – 3 Decades***



***Three core markets – centrally controlled***





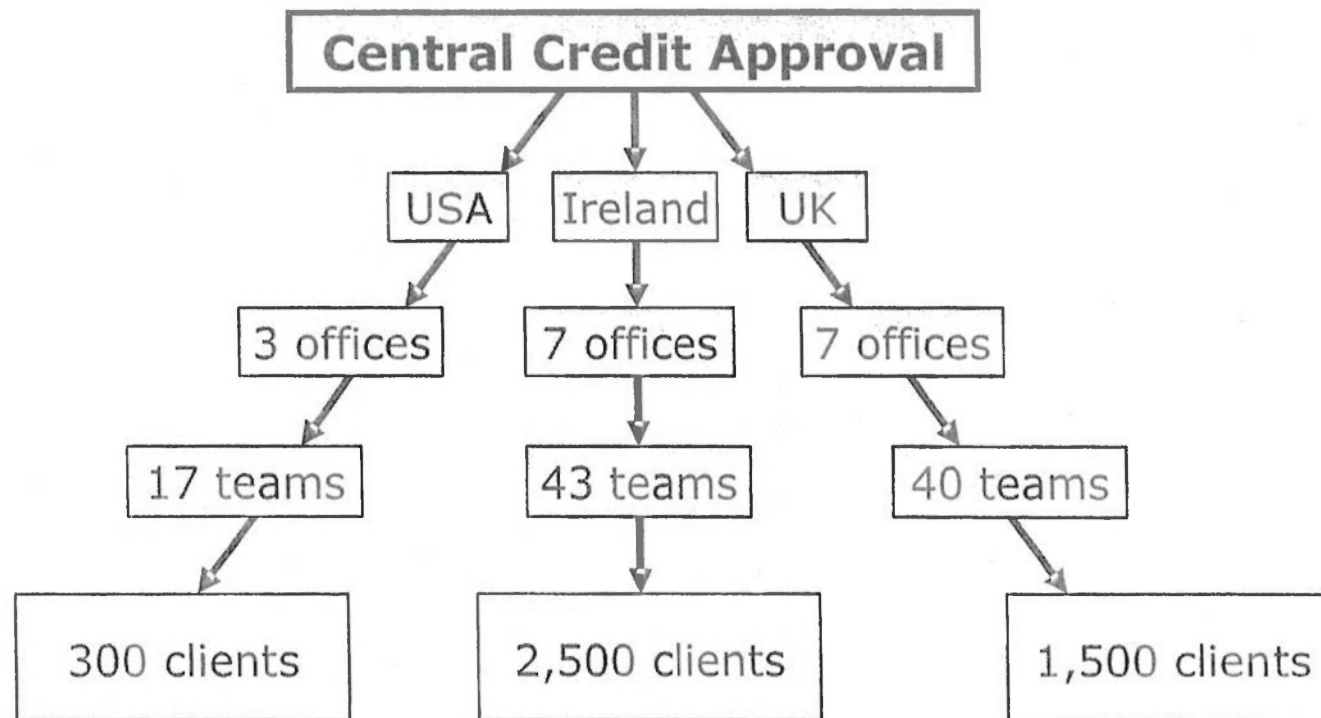
## ***Lending Underwriting Model***

- Traditional Balance Sheet lender – no transactional or 'bought' loans
- Strict focus on cash flows
- Professional experienced well capitalised client base
- All lending secured, cross collateralised with personal recourse

***We lend against cashflows not asset values***



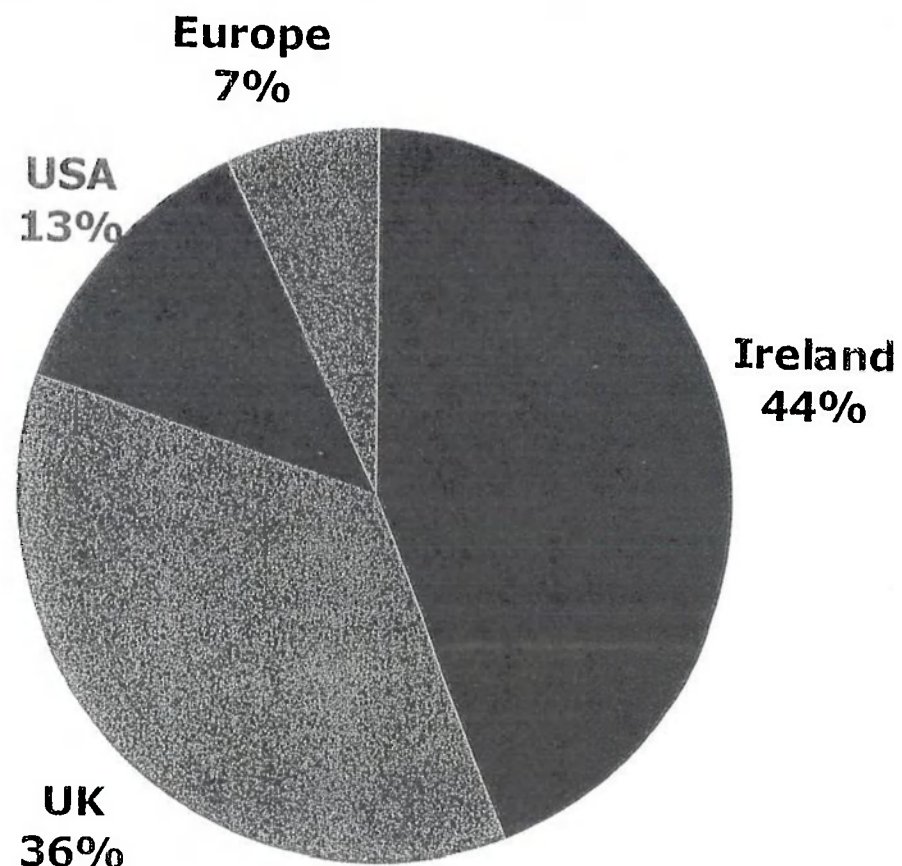
## ***Lending Organisation Structure***



***Consistent 'Private Banking' approach across all geographies***



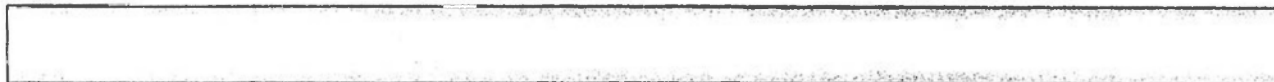
## ***Geographical Diversification : Location of Assets***





## ***Customers***

<b>Lending</b>	<b>7,000</b>	<b>(IRL; UK; USA)</b>
<b>Retail (IRL)</b>	<b>120,000</b>	
<b>Retail (UK)</b>	<b>140,000</b>	
<b>Corporate</b>	<b>10,000</b>	<b>(IRL; UK; Europe; USA)</b>



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## ***Peer Comparison***



## Peer Comparison – Balance Sheet




			
Total assets - €bn	101	197	178
Customer Funded	62%	54%	53%
Loan to deposit	125%	157%	157%

## Peer Comparison – Profitability

		Bank of Ireland 	
PBT - €m	1,400	1,933	2,508
Employees	1,850	16,026	23,797
Annualised profit per employee - €k	750	121	105
Cost to income - %	19	51	52
ROE - %	26	21	22
Market Cap - €bn	7.1	8.4	11.8



## Peer Comparison – Capital Position

		Bank of Ireland 	
Tier 1 capital - €bn	7.1	9.4	10.5
Core equity	5.6%	5.7%	5.6%
Tier 1	8.7%	8.1%	7.5%
Total capital	11.9%	11.1%	10.1%

## ***Current Market Issues***

- Asset Quality
- Funding
- Capital



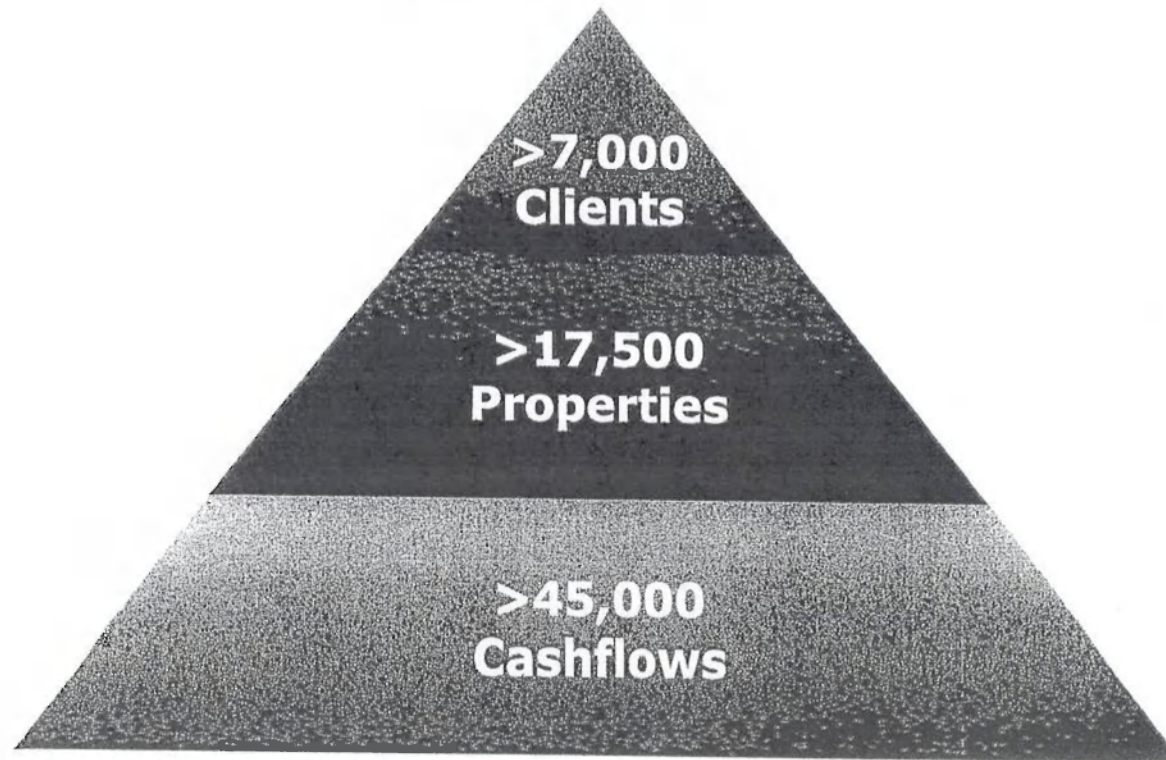


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## ***Asset Quality***



***Strength and Diversity of Cashflows & Security***



***Diverse cashflows from service economy***



## ***Group Loan Book Metrics***

Average LTV	73%
Debt service cover	1.34x
Interest rate hedging	57%

- LTVs indexed to current market
- Continuing strong cashflows
- Hedging provides certainty

***Loan book remains strong***



## ***Irish Banks – Wholesale Funding***


€'bn

	<b>Anglo</b>	<b>BOI</b>	<b>AIB</b>	<b>ILP</b>	<b>INBS</b>	<b>Total</b>
Total assets	101	197	183	76	16	573
Total funding	98	175	173	42	16	504
Wholesale funding	39	83	76	25	7	230
Wholesale funding -%	40%	47%	44%	59%	45%	46%



## Lending Asset Quality

31 March 2008

Total loans - €bn	69.0	<b>€273m Provision</b>	
Impaired loans - €m	358	47%	
Impaired loans as a % of total loans	0.52		
Total provisions - €m	273	53%	
Coverage	76%		

**Strong coverage notwithstanding strength of security held**



## ***Asset Quality Outlook***

- Maintaining strong asset quality is at the core of our underwriting model
- Impairment charges will increase in 2009 reflecting the weaker economic environment
- 2009 consensus impairment charge 0.7% - a 4-5 fold increase on the forecasts 2008 charge
- Even at this level the Bank continues to be highly profitable and Capital Accretive





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## ***Funding***



## ***Funding***

- Longer term funding markets continue to be dislocated
- Back to basics
- Focus on protecting the balance sheet



## Simple Balance Sheet – 31 March 2008

Assets	€bn	Liabilities	€bn
Customer Lending	69	Customer Deposits	55
		Term Debt	16
		Capital / Sub Debt	9
Customer Lending	69	Permanent Funding	80
Treasury Assets	28	CP / Money Market	18
Other	4	Other	3
<b>Total</b>	<b>101</b>	<b>Total</b>	<b>101</b>

***Customer deposits plus term market funding = 116% of customer loans***



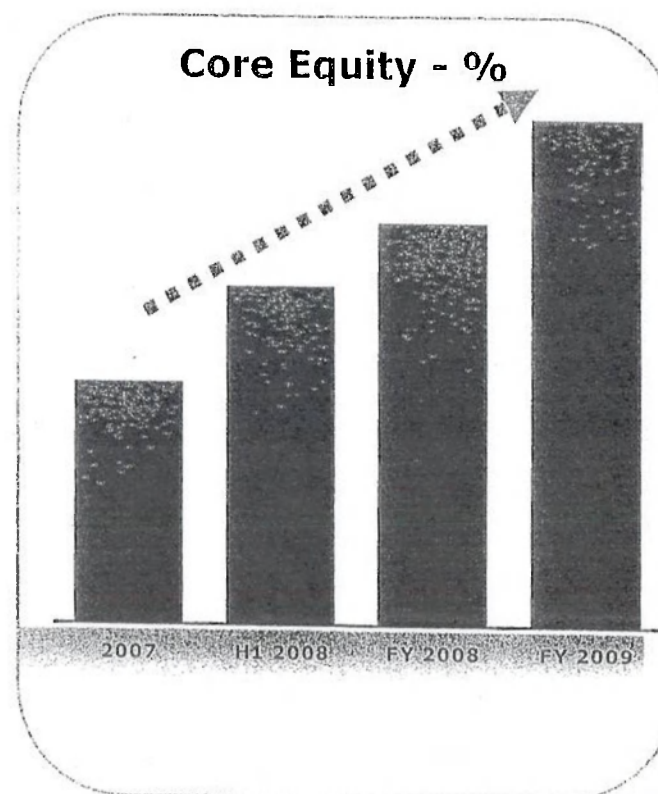
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***Capital***



## Capital

- Strong internal capital generation
- FY 2008 retentions c.€1bn
- Sep 2008 core equity c.6%



***No requirement for external equity capital***



## ***Capital Ratios***

### **Core Tier One:**

<b>Anglo</b>	<b>6%</b>	<b>(Sept 2008)</b>
<b>BOI</b>	<b>5.6%</b>	<b>(March 2008)</b>
<b>AIB</b>	<b>5.7%</b>	<b>(June 2008)</b>
<b>Euro Sector Av.</b>	<b>6.8%</b>	

***All About Asset Quality***





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## ***Outlook***



## Profits

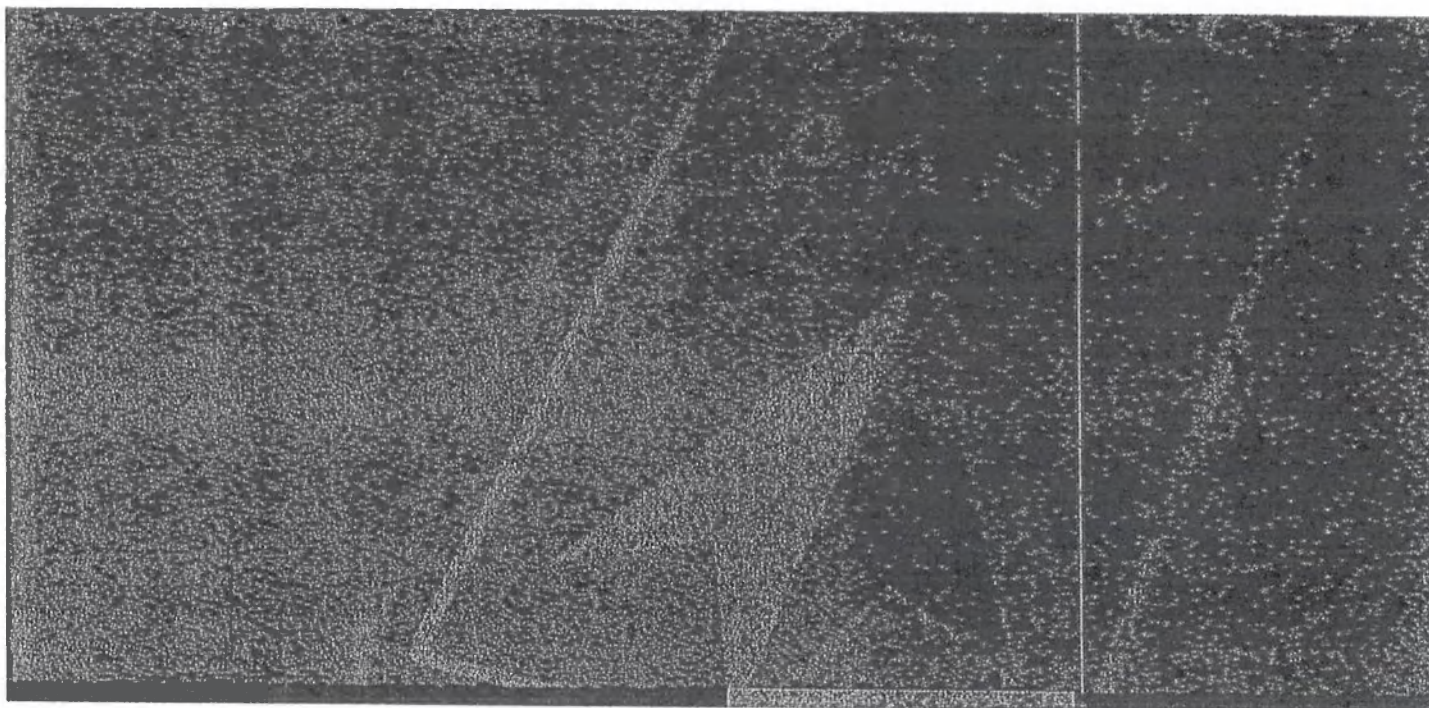
	<u>2008</u>	<u>2009</u>
<b>Underlying Profits</b>	<b>€1.7 bn</b>	<b>€1.8 bn</b>
<b>Exceptional Charges</b>	<b>(€0.2 bn)</b>	<b>-</b>
	<u><b>€1.5 bn</b></u>	<u><b>€1.8 bn</b></u>
<b>Bad Debts - Anglo</b>	<b>(€0.1bn)</b>	<b>(€0.3 bn)</b>
<b>- Analysts+</b>	<b>-</b>	<b>(€0.2 bn)</b>
<b>2009 Higher Funding Costs</b>	<b>-</b>	<b>(€0.2bn)</b>
<b>Reported Pre-Tax Profits</b>	<u><b>€1.4 bn</b></u>	<u><b>€1.1bn</b></u>

## ***Compelling Medium and Long Term Opportunity***

- Significant market shift to "Balance Sheet lenders"
- Changed competitive landscape – exit of non-bank lenders
- 25 years of performance through cycles – strong asset quality culture
- Franchise strength with huge organic potential in existing markets
- Long established management team

***Consistent delivery for shareholders***





There is a  
Difference



Minister  
NTMA Michael Somers, John Corrigan, B McDonagh  
D/Finance Kevin Cardiff\*, David Doyle  
CBFSAI John Hurley, Tony Grimes, Brian Halpin  
FR Jim Farrell, Patrick Neary\*

\*for part

John Hurley gave a report – liquidity under great strain – potentially serious crisis considerations (a) what can we do now? (b) specific bodies to focus on in next few days?

Re (a)

- Said Minister's reassuring statements had helped
- Needs to be something quickly on deposit guarantees and a further reassuring statement on the financial sector
- An 'all deposits' guarantee may be counterproductive. CB/FR not suggesting that now.
- Proposal
  - DGS to increase to 100k
  - Additional statement from Minister
  - Liquidity provision structures to provide immediate liquidity may be required (with letter of comfort from Minister) -- a €10 billion emergency fund should be available for a pressure scenario.

Re (b)

• [REDACTED]

re Anglo, John Hurley said options if trouble continues include (a) nationalising (b) support it but take equity share as a price for that -- then work it out over a period of time -- State should give itself potential for upside.

His conclusion (a) put liquidity facility in place asap and (b) look at how to deal with broader issues over next week or so.

Jim Farrell stressed DGS should also apply to credit unions.

[REDACTED]

Michael Somers outlined the Exchequer funding position; noted that a CU was seeking a facility to deposit with NTMA; raising large amounts of money takes time.

Minister asked that Kevin Cardiff, Pat Neary and Brian Halpin draft a statement re DGS immediately.

[I understand that the remainder of meeting was principally stock taking -- not actions points -- KC]





## **Government of Ireland - Department of Finance**

### **Government Increases Deposit Guarantee Limit to €100,000 per depositor**

**20<sup>th</sup> September 2008**

The Government has decided to increase the statutory limit for the deposit guarantee scheme for banks and building societies from €20,000 to €100,000 per depositor per institution. The cover will apply to 100% of each individual's deposit. This guarantee level will also apply to credit union savers.

Announcing the decision, the Minister for Finance, Brian Lenihan TD, said "I want it to be known that the Government is confident about the strength and resilience of the Irish financial system. The Government is committed to the stability of our financial system, so that money placed with an Irish credit institution would not be at risk. As I said yesterday, the Irish Government wants to protect the whole financial system, secure its stability and ensure that all deposits in Irish financial institutions are safe."

The Minister added "the Central Bank and Financial Regulator have stressed the soundness and stability of the Irish financial system. This measure provides additional reassurance to depositors in Ireland that their savings are safe. The new guarantee level is now among the highest in the EU."

The Minister also commented that notwithstanding the uncertainty caused by the turbulence in international financial markets over the last week, it is encouraging that the banks have retained the confidence of their customers.

This measure has been under consideration for some time, and the Minister believes that this is the appropriate time to make the announcement.

Ends



## Notes for Editors

### Legal basis to the Deposit Protection Scheme

The legal basis for the Deposit Protection Scheme in Ireland is the European Communities (Deposit Guarantee Schemes) Regulations, 1995. These Regulations implemented the European Union Directive on Deposit Guarantee Schemes (94/19/EC). The Irish regulations were amended in 1999 to provide for a maximum compensation of €20,000.

### Legislation

Legislation will be introduced shortly by the Minister to implement the new guarantee level but this new level will have affect from today following the Government's decision.

### EU Guarantee Levels

The single largest number of EU Member States currently have guarantee thresholds of €20,000 – Austria, Belgium, Cyprus, Germany, Greece, Ireland, Luxembourg, Malta, Slovakia, Spain. Other States have thresholds variously in excess of this – e.g. Finland and Portugal €25,000, Netherlands €38,000, Denmark €40,300, UK €48,500 euro equivalent of £35,000) and Italy €103,000.

### EU Review

Ireland is participating in the ongoing review of the EU Deposit Guarantee Schemes Directive. This review includes consideration of the minimum level of the EU guarantee but also focus on wider policy areas such as co-insurance requirements (under which depositors bore 10% of losses which is being abolished for the Irish scheme) improving the speed of payouts, better depositor information, the case for gross rather than net compensation (as at present) and cross-border interoperability of schemes. It is expected that the conclusions of this review will be reached by end-year. In the context of the conclusions of the EU review, any further changes required in the Irish Deposit Guarantee Scheme will be progressed to ensure that savers in Ireland benefit from safeguards in line with EU best practice.

### Funding of the Deposit Guarantee Scheme

The level of contribution required from each credit institution is 0.2% of eligible deposits held at all branches of the credit institution in the EEA, including deposits on current accounts and share accounts with a building society, but excluding interbank deposits and deposits represented by negotiable certificates of deposit. A minimum contribution of €25,400 is required. Each contribution is maintained in a Deposit Protection Account at the CBFSAI. As of 2007, the total amount held in Deposit Protection Accounts was €526 million.

Appropriate, mechanisms will also be put in place, in consultation with the financial institutions to increase the level of funds in the Deposit Protection Accounts over time but in the interim, the existing system provides for the availability of additional funds from the CBFSAI if required.

### Coverage of the Deposit Protection Scheme

The Deposit Protection Scheme currently covers:

- current accounts;
- demand deposit accounts;
- term deposit accounts; and
- share accounts with building societies (other than shares which fall within the definition of own funds)

held with banks, building societies and other types of deposit-taking institutions (other than credit unions) regulated by the Financial Regulator. It is now being extended to include share and deposit accounts in credit unions.

#### EU Branches

Deposits with credit institutions authorised in another European Economic Area (EEA) country and operating in Ireland on a branch basis are covered under that country's system.

#### Credit Unions

The Irish League of Credit Unions (ILCU) has since 1989, operated on an all-island basis a savings protection scheme (SPS) for credit unions. The SPS has, to date, operated by providing financial support to credit unions that get into difficulty and it has never been necessary to make savings protection payments to individual credit union members. Under the SPS regime no credit union has become insolvent and no member of a credit union has experienced any loss of shares or deposits. The Registrar of Credit Unions in the Financial Regulator is working closely with ILCU to approve a reform to SPS. It is expected that these discussions would conclude shortly.

It is intended that the guarantee that has now been announced for credit institution savers would act as a backstop to an approved SPS scheme for credit unions.

#### Operation of the DGS

The Deposit Protection Scheme in Ireland is administered by the Central Bank and Financial Services Authority of Ireland (CBFSAI).

#### Other compensation schemes

The Minister will be requesting the views of consumer interests, industry and other stakeholders regarding the implications of the announcement for investor compensation levels and the case for introducing an insurance guarantee scheme for the life sector.

#### Further Information

Further information on the Deposit Protection Scheme in Ireland can be found at the Financial Regulators consumer information website [www.itsyourmoney.ie](http://www.itsyourmoney.ie).

Any further queries should be addressed to the Department of Finance Press Office at 01-6767571 or Eoin Dorgan.

Briefing for Council meeting 20 September 2008

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**What is your assessment of the Irish Financial situation?**

- There have been dramatic events in international financial markets over the past fortnight as illustrated by recent stock market volatility; and the unprecedented developments on Wall Street over the last week
- Swift actions by international central banks, including the ECB, to provide major injections of liquidity and the US authorities' plan to rid US banks of troubled assets and shore up US financial institutions has helped stabilise markets internationally
- The US financial institutions in the headlines are investment banks operating largely in wholesale markets and are very different to Irish retail banks
- Irish financial institutions have no material exposure to the sub-prime securities which have created major losses for large investment banks
- The Governor of the Central Bank and the Financial Regulator have stressed repeatedly that Irish financial institutions are well capitalised and liquid with good quality assets.
- They have proved resilient in dealing with challenging market conditions
- Their access to liquidity from the European Central Bank on account of Ireland's membership of the euro zone is a major benefit and had proved a real strength in helping the Irish financial system to weather difficult financial conditions over the last year
- Depositors in Irish financial institutions can be confident that their deposits are safe and secure.

**Should Irish Depositors be concerned?**

- The Financial Regulator has made clear that our banks have ready access to cash from the European Central Bank, that there are no difficulties in ensuring that our banks have adequate funds for depositors and that depositors can be confident that their deposits are safe and secure.
- The Minister for Finance has said that the Government will take whatever steps are necessary to ensure the stability of Ireland's banking system.
- The message that I am giving this morning couldn't be clearer:- the Government puts the highest priority on ensuring the stability of our financial system and the safety and security of savings in all our financial institutions.

**Financial Regulator's decision on short selling?**

- I welcome the move by the Financial Regulator to prevent short selling.
- It is essential to act in tandem with our international partners, namely the US and British authorities, so as to ensure that our financial market is not subject to destabilising financial speculation
- Short-sellers have sought to gain from undermining confidence in our financial institutions

## **Will the Government be increasing the level of the Deposit Protection Scheme?**

- The Government has agreed to increase the existing statutory limit for the deposit guarantee scheme for banks and building societies to €100,000 per depositor.
  - The Government has also decided that 100% of each individual's deposit will be covered up to that limit.
  - It has also been decided that this guarantee level will apply to credit union savers.
  - The decision will require legislation, which will be backdated to today.
- 
- Given recent comments by Fine Gael and Labour I am sure they will be fully supportive of this decision.

## **Why is the decision occurring now?**

- In line with normal arrangements for such decisions, it was made public outside of normal financial institution opening hours. This will allow people to digest and fully understand the importance of this decision in terms of providing a further reassurance to depositors who may have been concerned by developments in financial markets and Wall Street earlier this week.
- The Government has always kept the Deposit Protection Scheme under review, participating in the EU review of the Deposit Guarantee Directive. Ill informed and misleading speculation about the stability of the banks and the guarantee scheme has caused concern to savers. This decision is being taken to stress that savers can be confident that their savings are safeguarded and guaranteed.
- It is always quite difficult to choose the right time for this decision to ensure that the reasons for it are fully understood. In light of recent developments and the uncertainty in the financial world, I believe the Government has acted at the appropriate time.
- The key point is that the Government wants to protect the whole financial sector, and secure its stability. The Regulator has confirmed that deposits in Irish banks are safe.

## **Has this decision been taken in reaction to public panic?**

- No, this decision has been made in light of the ongoing review of the deposit protection scheme. Obviously, the recent turbulence has highlighted the need to bring consideration of this specific issue to an end and take the decision on what is the appropriate level of guarantee to emphasise the Government's commitment to looking after the interests of savers.
- Indeed the Government has been impressed at the informed calm which the vast majority of customers have kept over the past fortnight.

- The key point is that the Government wants to protect the whole financial sector, and secure its stability. The Regulator has confirmed that deposits in Irish banks are safe.

**Are the Irish Banks in difficulty?**

- The US financial institutions that have been the headlines today are wholesale investment banks and are very different to the retail banks in Ireland.
- Irish banks have no material exposure to sub-prime securities
- As the Governor of the Central Bank has stressed, they are well capitalised and liquid with good quality assets.
- Their strong performance over recent years has provided them with strong buffers to deal with the current market environment.
- Ireland's membership of the eurozone and its access to ECB liquidity is a real strength
- They have proved resilient and are weathering well current difficult financial market conditions.
- Irish banks are continuing to go about their normal business in the challenging environment in which they find themselves and are working through the issues that they face.

**Will you comment on the rumours of takeovers?**

- I do not want to comment on any particular institution in the current climate as that would be unhelpful.

Irish Life & Permanent

# Discussion Materials

20 September 2008

Morgan Stanley





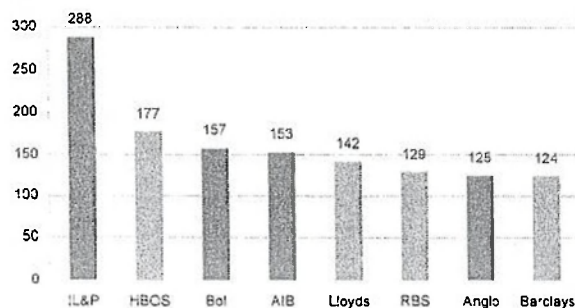
- IL&P has the highest loan / deposit ratio of any Irish or UK bank (absent Northern Rock)

## IL&P Balance Sheet Overview

### UK and Irish Banks Loan to Deposit Ratio

Latest Available

%

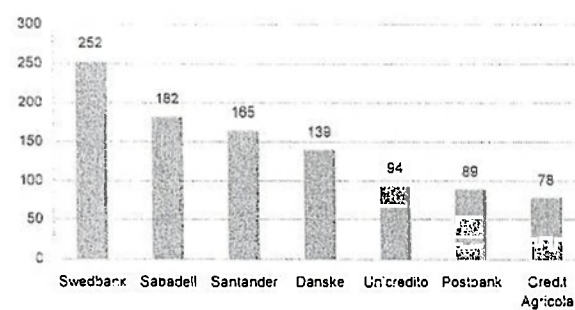


Source: Company Reports

### European Banks Loan to Deposit Ratio

Latest Available

%



Source: Company Reports

### IL&P Balance Sheet Overview

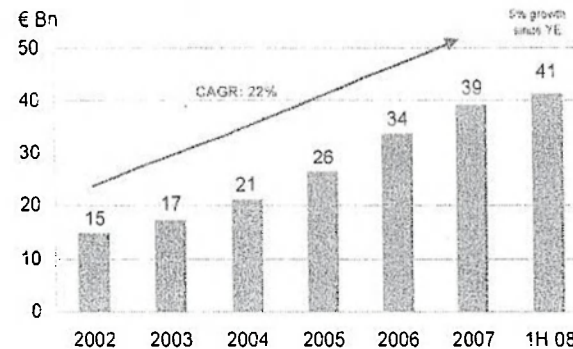
€ MM

	1H07	2007	1H08
Bank Loans & Deposits	4,041	2,528	2,358
Customer Loans	36,724	39,120	41,005
Cash Balances	256	253	141
Value in-Force	696	717	696
Other Assets	36,691	37,444	31,930
<b>Total Assets</b>	<b>78,408</b>	<b>80,062</b>	<b>76,130</b>
Bank Deposits	2,018	10,011	11,801
<i>o/w ECB</i>	-	5,333	3,900
<i>o/w "Real" Deposits</i>	<i>n/a</i>	2,322	<i>n/a</i>
Customer Deposits	14,429	13,576	14,597
Non-Recourse	3,534	3,090	2,820
Subordinated Liabilities	1,650	1,599	1,661
Other Liabilities	54,287	49,143	42,597
<b>Total Liabilities</b>	<b>75,918</b>	<b>77,419</b>	<b>73,476</b>
Equity	2,477	2,630	2,639
Minority Interests	13	13	15

## Banking – Loan Portfolio

- Loan book at IL&P viewed as generally low risk, due to predominantly secured nature of lending activity, but areas of greater concern include:
  - 2006 vintage mortgage lending (first time buyer and buy-to-let) due to lending criteria in force and subsequent house price declines
  - Tracker mortgages portfolio, due to inability to reprice unprofitable lending
  - CHL / UK specialist mortgages
  - Commercial lending portfolio, given vintages and more limited track record
- Despite contained development in impairments, provisioning likely to deteriorate considerably
  - Management assumes 8 bps for FY 08E and cumulative 60-80 bps over three years as a stress scenario
  - Avg. brokers assume peak provisions of 39 bps in 2010
- Suspension of higher risk lending, with UK new business suspended since March and withdrawal from Irish BTL and commercial lending
  - But reduced churn / refinancing levels offset funding benefits

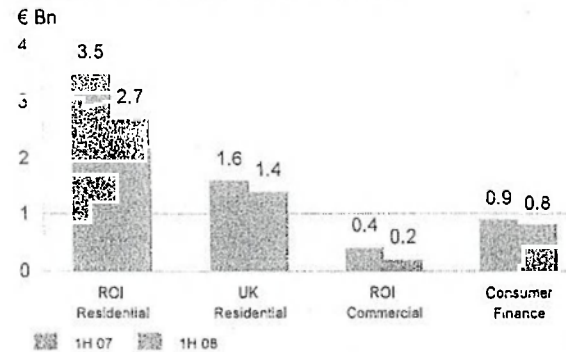
### Loan Book Growth



Source: Company Information

### Bank New Lending

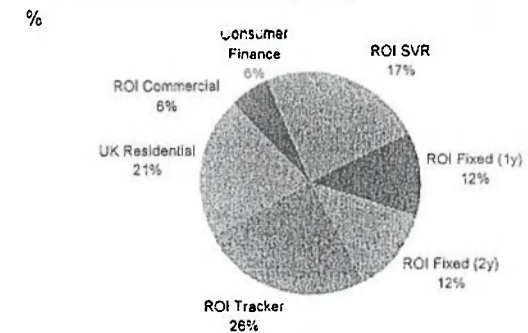
Total New Lending: €5.1 Bn (1H 07: €6.3 Bn)



Source: Company Information

### Loan Book Split

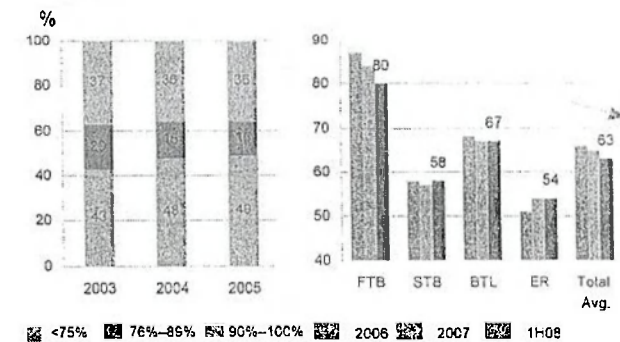
Total Loan Balance: €41.2 Bn (1H 08)



Source: Company Information

### ROI Residential New Lending

Avg. LTV



Source: Company Information, Broker reports

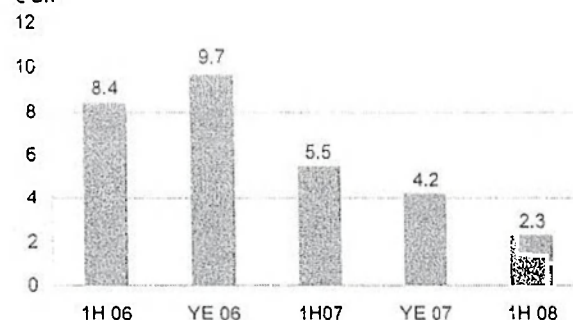
- Bank liquidity portfolio size decreased from €4.2 Bn at year-end to €2.3 Bn as of 1H 08 due to disposal of gilt investment portfolio
  - Reducing funding needs in same period by €1.9 Bn
  - Reduction from end 2006 to 1H07 primarily due to new liquidity regime introduced by IFSRA
- Ability to reduce liquidity portfolio further significantly constrained by requirement to maintain regulatory liquidity levels
  - Any relaxation of these would also be counterproductive
  - And as funding becomes increasingly short-term in nature liquidity requirements will increase
- Remaining liquidity portfolio consists mainly of Bank FRNs/ Corporate bonds and prime RMBS securities
  - No exposure to US subprime or other 'toxic assets'

## Banking – Liquidity Portfolio

### Development of Liquidity Portfolio

Bank Liquidity Portfolio

€ Bn

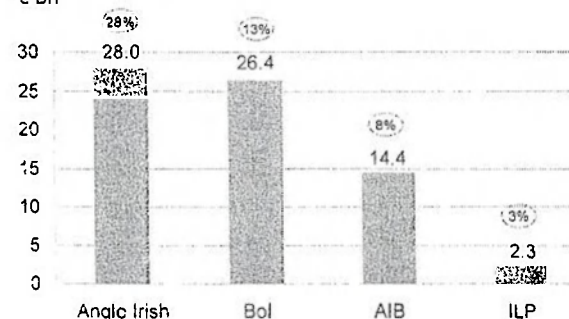


Source: Company Information

### Benchmarking vs. Peers <sup>(1)</sup>

Liquidity Portfolios Across Peers (1H 08) (% of Total Assets)

€ Bn



Source: Company Information

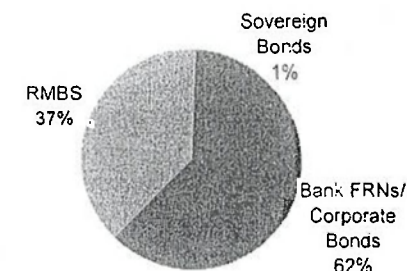
Note

1. Includes liquid treasury assets for Anglo, Treasury assets in the trading and AFS portfolio for AIB and AFS liquid assets for Bol as per company presentations

### Liquidity Portfolio by Type

Total: €2.3 Bn

%

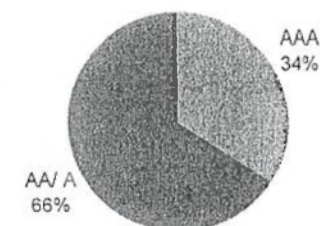


Source: Company Information

### Liquidity Portfolio by Rating

Total: €2.3 Bn

%



Source: Company Information



# Ratings Sensitivity

Main issues concerning rating agencies

- Both rating agencies have ILP's ratings on negative outlook
- Main driver is IL&P's constrained funding position and its impact on profitability
- Asset quality also a potential concern, but so far resilient
- After deduction of insurance capital, S&P sees bank capital as low
- We see a key short-term risk as increased asset encumbrance driven by increased reliance on secured funding, either ECB or bilateral

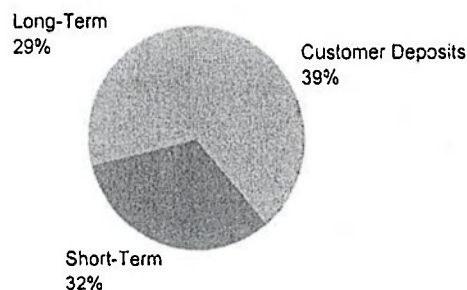
## Summary of Main Rating Agency Concerns

Area of Concern	S&P A/Negative/A-1	Moody's Aa3/Negative/P-1
Funding and Liquidity	<ul style="list-style-type: none"> <li>• Constrained funding profile is main driver of negative outlook</li> <li>• High loan/deposit ratio of 281% (6/08)</li> <li>• Disruption to unsecured funding has led to a reliance on secured funding and an increasing encumbrance of assets</li> <li>• Shortening maturity profile</li> </ul>	<ul style="list-style-type: none"> <li>• High reliance on market funding is main driver of negative outlook</li> <li>• Significant eligible collateral for ECB</li> <li>• Relatively high use of ECB repo (12% of total funding)</li> <li>• Liquidity ratio weakened to 23% at YE07</li> <li>• Low liquidity score of 'D+' in scorecard</li> </ul>
Profitability	<ul style="list-style-type: none"> <li>• Profitability under pressure as a result of higher funding costs</li> <li>• 2008 expected to deliver a low NIM of &lt;100bps</li> <li>• Increasing provisioning will also constrain profitability</li> </ul>	<ul style="list-style-type: none"> <li>• High reliance on market funds expected to lead to a lower level of profitability</li> </ul>
Asset Quality	<ul style="list-style-type: none"> <li>• Irish mortgages so far resilient, although recent vintage high LTVs a potential issue</li> <li>• Concerns over CHL and Irish consumer finance books</li> </ul>	<ul style="list-style-type: none"> <li>• Relatively high exposure to BTL sector in UK and Ireland</li> <li>• Deteriorating environment in Ireland</li> <li>• Lending at high LTVs up to mid-2007</li> </ul>
Capital	<ul style="list-style-type: none"> <li>• Strongly capitalised on a stand-alone basis, but S&amp;P looks at ratios will 100% and 50% deductions of insurance capital</li> <li>• On this basis, capital looks low</li> </ul>	<ul style="list-style-type: none"> <li>• Moody's does not adjust for insurance capital and therefore sees capital as acceptable</li> </ul>

- As at 30<sup>th</sup> June Irish Life & Permanent's funding profile consisted of 39% customer deposits, with the remaining 61% wholesale funding
  - Although a significant proportion, c. 60%, of customer deposits are corporate
- Within the last year debt securities in issue has decreased significantly (-42%). Consequently IL&P has increased deposits by banks by more than five times
- *"In respect of margins, higher funding costs will impact the full year net interest margin in the bank with an expected outcome for the full year of between 98 bps and 100 bps."* IL&P 2008 Interim Report

## IL&P Funding Overview

**Funding Mix**  
30 June 2008



Source: Company 2008 Interim Report

**Excerpts From Balance Sheet Liabilities**

€ MM

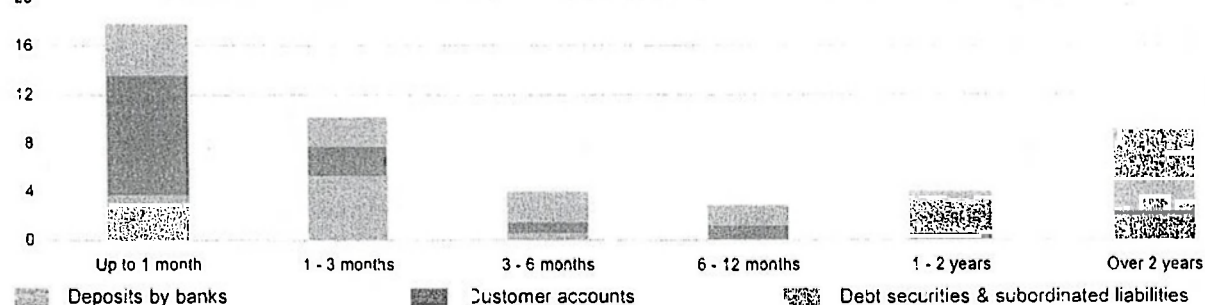
	30-Jun-2008	31-Dec-2007	Change	30-Jun-2007	Change
Deposits by banks	11,801	10,011	+17%	2,018	+585%
Customer accounts	14,597	13,376	+9%	14,429	+1%
Debt securities in issue	11,744	15,371	-24%	20,233	-42%
Subordinated liabilities	1,661	1,599	+4%	1,650	+1%

Source: Company Annual Report

**Irish Life & Permanent Liquidity Position**

YE 2007

€ Bn



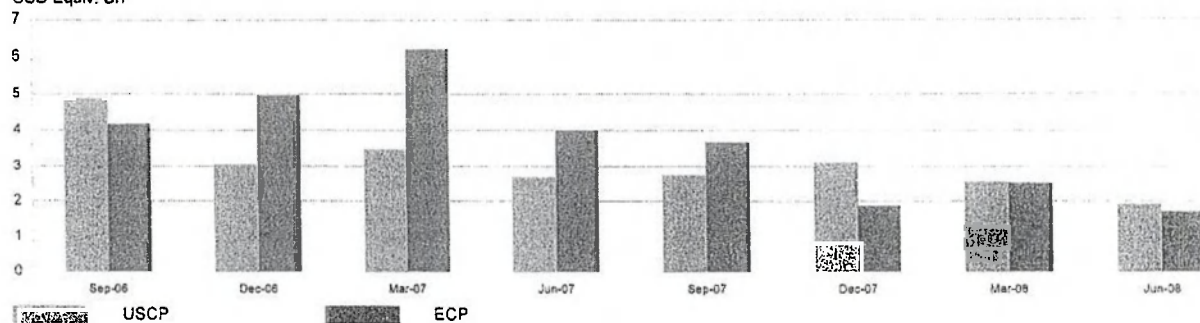
Source: Company Annual Report

- IL&P's US CP and ECP volumes have progressively decreased throughout the year (note that data beyond June-08 is unavailable from public sources)
- IL&P's US CP roll dates are unavailable from public sources, but a table of the ECP outstandings is shown to the right
  - IL&P's total ECP outstandings according to the database 'CPWare' are \$1.74 Bn
  - the weighted average maturity of IL&P's ECP outstandings is currently 50 days

## IL&P Commercial Paper Volumes

### CP Volumes Outstanding

USD Equiv. Bn



Source: Moody's

### Current ECP Outstandings for IL&P

Issue Date	Currency	Nominal Amount, MM	USD Equiv., MM	Maturity Date	ISIN
06-Mar-08	GBP	4.0	7.1	22-Sep-08	XS0351874218
08-Sep-08	USD	12.0	12.0	22-Sep-08	XS0387278855
28-Aug-08	EUR	15.0	21.3	22-Sep-08	XS0385556260
04-Aug-08	EUR	50.0	70.9	24-Sep-08	XS0381760130
31-Jul-08	EUR	48.0	68.0	26-Sep-08	XS0381248979
30-Jul-08	JPY	6,500.0	60.6	29-Sep-08	XS0380285709
22-Jul-08	EUR	30.5	43.2	29-Sep-08	XS0378800196
21-Apr-08	EUR	12.5	17.7	30-Sep-08	XS0359913950
17-Jul-08	EUR	27.5	39.9	01-Oct-08	XS0378029721
11-Sep-08	EUR	150.0	212.6	06-Oct-08	XS0387958308
11-Jul-08	JPY	6,000.0	55.9	07-Oct-08	XS0376583240
08-Aug-08	EUR	15.0	21.3	11-Oct-08	XS0382585833
07-Jul-08	EUR	14.0	19.8	14-Oct-08	XS0375400487
03-Jul-08	USD	11.0	11.0	14-Oct-08	XS0374355203
01-Sep-08	GBP	33.0	58.9	21-Oct-08	XS0386005754
30-Jun-08	CHF	35.0	30.9	21-Oct-08	XS0373976108
29-Aug-08	EUR	200.0	283.5	22-Oct-08	XS0385578827
15-Aug-08	EUR	25.0	35.4	30-Oct-08	XS0383773883
26-Aug-08	EUR	150.0	212.6	31-Oct-08	XS0385078182
10-Sep-08	USD	30.0	30.0	04-Nov-08	XS0387857294
21-Aug-08	EUR	200.0	283.5	28-Nov-08	XS0384664610
20-Aug-08	EUR	20.0	28.3	08-Dec-08	XS0384359146
22-Aug-08	GBP	67.0	119.6	05-Mar-09	XS0384827936
		Total	1,743.35	Weighted Average Maturity	50 days

Source: CPWare, Dealogic



- Based on public information it is quite challenging to ascertain the weekly redemption profile of IL&P
- However the ECP and term debt redemptions that are publicly disclosed indicate that last week was particularly significant

## IL&P Current Redemptions

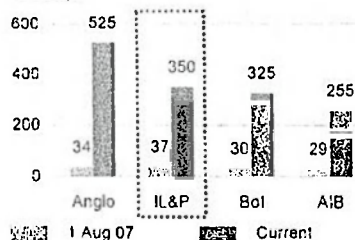
### Irish Life & Permanent Current Redemptions

Maturity Date	Market	Issue Date	Currency	Amount (Local Currency, MM)
Last Week (Week Commencing 15 <sup>th</sup> September)				
19 <sup>th</sup> September	Term Debt	27-Aug-2004	USD	268.0
19 <sup>th</sup> September	Term Debt	18-Mar-2007	EUR	75.0
19 <sup>th</sup> September	Term Debt	30-Nov-2005	USD	760.0
This Week (Week Commencing 22 <sup>nd</sup> September)				
22 <sup>nd</sup> September	Term Debt	22-Mar-2007	EUR	175.0
22 <sup>nd</sup> September	ECP	06-Mar-2008	GBP	4.0
22 <sup>nd</sup> September	ECP	08-Sep-2008	USD	12.0
22 <sup>nd</sup> September	ECP	28-Aug-2008	EUR	15.0
24 <sup>th</sup> September	ECP	04-Aug-2008	EUR	50.0
26 <sup>th</sup> September	Term Debt	23-Mar-2004	USD	5.9
26 <sup>th</sup> September	ECP	31-Jul-2008	EUR	48.0
Week Commencing 29 <sup>th</sup> September				
29 <sup>th</sup> September	ECP	30-Jul-2008	JPY	6,500.0
29 <sup>th</sup> September	ECP	22-Jul-2008	EUR	30.5
30 <sup>th</sup> September	Term Debt	29-Mar-2007	JPY	10,000.0
30 <sup>th</sup> September	ECP	21-Apr-2008	EUR	12.5
1 <sup>st</sup> October	ECP	17-Jul-2008	EUR	27.5
2 <sup>nd</sup> October	Term Debt	02-Oct-2006	EUR	50.0
Week Commencing 6 <sup>th</sup> October				
6 <sup>th</sup> October	ECP	11-Sep-2008	EUR	150.0
7 <sup>th</sup> October	ECP	11-Jul-2008	JPY	55.9
9 <sup>th</sup> October	Term Debt	07-Oct-2003	USD	6.3
11 <sup>th</sup> October	ECP	08-Aug-2008	EUR	15.0

- We anticipate that term funding markets for banks rated below AA will remain dislocated with periods of significant volatility and continued high spreads in the coming months
- IL&P's senior CDS has widened considerably in recent months and is currently quoted at 330/370 in 5 years
- IL&P has a €15 Bn Euro Medium Term Note Programme, but unlike the other large Irish banks it does not have access to the US markets for term debt via a debt shelf

#### Irish Banks CDS Spreads

5-Year Senior Unsecured  
Mid, bps



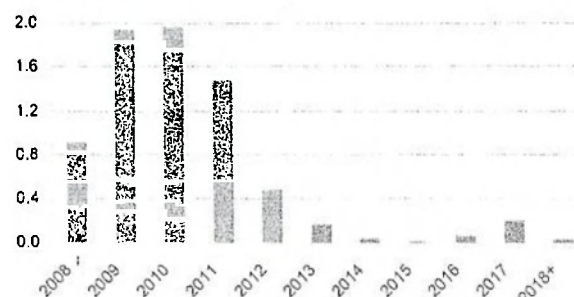
Source: Morgan Stanley as of 19 September 2008

Morgan Stanley

## IL&P Term Funding

### Irish Life & Permanent Term Debt Redemptions

EUR Equiv., Bn

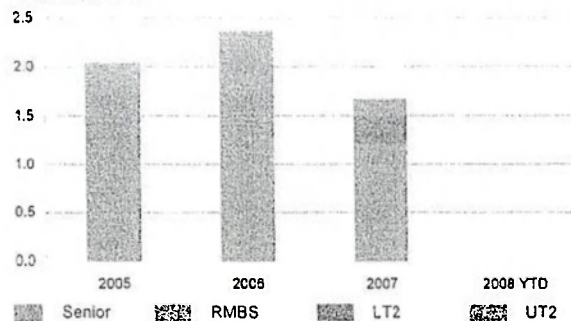


Term debt maturities

Notes: Bloomberg, Securitisations are not included

### Irish Life & Permanent Public Term Debt Issuance

EUR Equiv., Bn



Source: Morgan Stanley, Dealogic

Notes

1. 2008 redemptions remaining as at 20th September

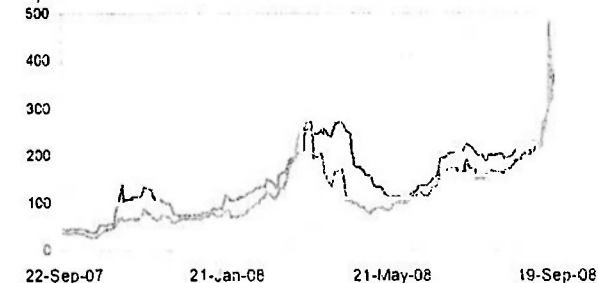
2. USD 250mm equivalent or greater

3. IL&P CDS data from Markit, adjusted per Morgan Stanley Trading data as of 19 September 2008

### IL&P CDS Performance

Last 12 Months

Bps



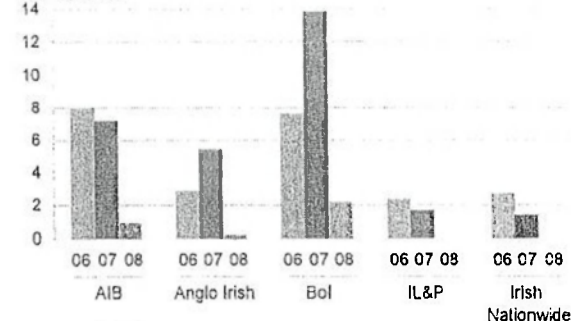
IL&P HBOS

Source: Markit as of 19 September 2008, Morgan Stanley Trading

### Irish Financial Institutions' Historical Debt Issuance Volumes

2005-2008 YTD

EUR Equiv., Bn



Source: Dealogic

- In late August we received detailed investor feedback on Irish bank names from the Morgan Stanley sales team
- Whilst some investors would be able to look at the larger institutions, in general there is limited appetite for new issues from Irish banks

## Debt Investor Commentary

### European Term Debt Investor Feedback on Irish Banks

As of 22<sup>nd</sup> August

[REDACTED]	<ul style="list-style-type: none"> <li>• No lines for Irish banks.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• Highly sceptical on Irish banks.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• No to Irish banks.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• OK on Irish names, but only for small size portfolio diversification. Only in fixed rate Euros.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• No interest in Irish names.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• Have a line for several Irish names, but have a natural bias towards AA rated issuers. Prefers 3 - 7 year maturity and EUR but can look at GBP.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• Full on Irish banks.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• No interest in Irish banks.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• Generally interested in AA rated names. Have a line for AIB/BOI. Anglo Irish / IL&amp;P rating too low.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• No interest in Irish banks.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• Will look at Irish banks on a name by name basis. Have a line for AIB, but are full on BOI. Main interest in 2 year Euro FRNs.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• No interest in Irish names unless spreads are very attractive. Generally look at 2 year Euro FRNS.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• Bought the Bank of Ireland 2yr Euro FRN, but the bond underperformed.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• Not fully opposed to Irish names, but not buying short dated senior currently.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• Negative on Ireland.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• Doesn't like Irish names.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• Name specific. No interest in Anglo Irish, AIB and BOI - no interest right now but there will be a time when they will look at them again.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• Not keen on Irish names.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• Not keen on Irish names. Doesn't envision not getting money back, but their credit department probably won't approve for time being.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• No lines for Irish banks.</li> </ul>
[REDACTED]	<ul style="list-style-type: none"> <li>• No to Irish banks.</li> </ul>

Source: Morgan Stanley Sales

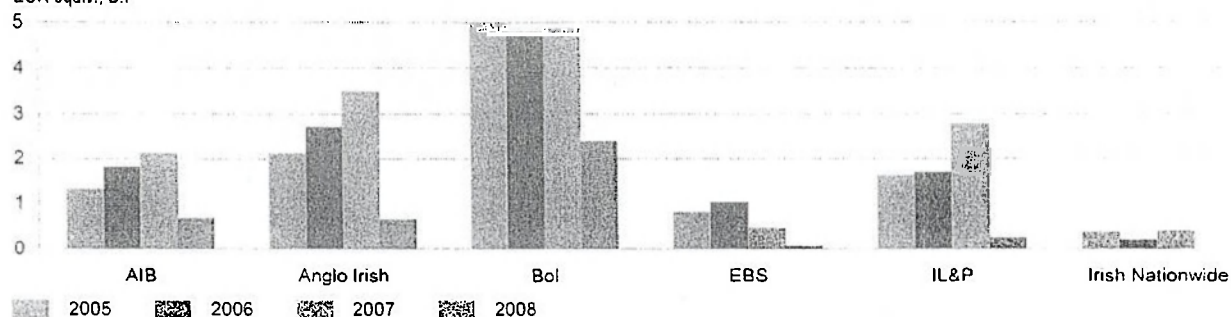
- 2008 YTD has seen significantly reduced private placement volumes across all of the Irish banks
  - Demand for structured notes in the market generally is significantly reduced
  - Vanilla private placements are being issued at spreads similar to the public markets
- Even though IL&P is highly flexible in the kinds of structures it can issue in MTN format, unfortunately due to reduced credit appetite and an inability to issue covered bond private placements 2008 volumes have significantly reduced

## Private Placement Market

### Irish Banks' Total Private Placement Issuance Levels

2005 – 2008 YTD

EUR equiv., Bn



Source: MTN Ware, Dealogic as at 19<sup>th</sup> September

### Irish Life & Permanent's Ability to Issue Private Placements

- Irish Life & Permanent is the most flexible private placement issuer in Ireland in terms of size, structure and maturity and has in the past been able to raise a large proportion of their annual funding needs through structured notes. However, in the recent market dislocation investors have become much more aware of counterparty risk and have been less willing to invest in Irish credits, particularly those with weaker ratings.
- Other Irish issuers have counteracted the fall in senior unsecured private placements through short-dated covered bond private placements to some extent. Irish Life & Permanent does not have a covered bond programme and could therefore not compensate for the shortfall in senior unsecured through covered bond issuance.
- Generally, the conditions for private placements given the current market environment have deteriorated as investors are less inclined to buy illiquid paper. Investors only consider private placements 1) if the issuer pays a generous new issue premium to secondaries or 2) if the particular maturity is not available in the public markets (e.g. 1yr paper) or 3) if they want a tailor-made currency / structure.



- IL&P currently has 8 RMBS transactions outstanding under its two securitisation programmes
- The deals are each structured as stand-alone transactions and IL&P's ongoing obligations are clearly defined
  - For example, in most structures, IL&P performs various functions (including swap provider) which are subject to ratings downgrade triggers
- Bonds which have been issued since the onset of the market dislocation have been retained and can be used as collateral for the ECB facility if required
- From February 2009, the terms applicable to the ECB Repo Facility will become more onerous
  - Will require third party involvement to utilise UK mortgages under cross-currency / close association rules

Morgan Stanley

## Existing IL&P Securitisations

### Irish Life & Permanent

#### Existing Securitisations

Vehicle	Principal Amount	Expected Maturity	Publicly Issued	Retained for ECB
Auburn Securities 3 plc.	£400 MM	November 2009	Yes	No
Auburn Securities 4 plc.	£1,000 MM	October 2009	Yes	No
Auburn Securities 5 plc.	£450 MM	November 2010	Yes	No
Auburn Securities 6 plc.	€4,150 MM	November 2010	No	Yes
Auburn Securities 7 plc.	€2,360 MM	August 2045 <sup>(1)</sup>	No	Yes
Fastnet Securities 2 plc	€2,150 MM	June 2012	Yes	No
Fastnet Securities 3 Ltd	€8,000 MM	November 2049 <sup>(1)</sup>	No	Yes
Fastnet Securities 4 Ltd	€6,500 MM	June 2013	No	Yes

#### Notes

1. No coupon step-up

# Securitisation Funding

## Considerations

- IL&P has already securitised a large portion of its mortgage book and is holding the bonds in reserve
- This may help to address immediate liquidity concerns in the short term
- However, ECB funding is available for a maximum of 6 months only and must be rolled on maturity with pricing set by way of auction
- Existing deals will be subject to the new regime which applies from February 2009
- At present we estimate that IL&P has up to c. €26 Bn of ECB eligible collateral, and the potential to create an additional c. €6 Bn
  - Of this we believe that approx. €11 Bn has been utilised, excluding increased ECB drawings since 1H08
    - As domestic, non-clearing institutions increased their drawings by 25% or €5 Bn in July alone, we expect IL&P to have used some of this capacity
- The securitisation market remains largely closed to new issuance. Accordingly, IL&P would need to access either the ECB Refinancing Facility or market counterparty repos in order to fund their residential mortgage assets
- The terms attaching to market repos have become increasingly onerous since the onset of the credit crunch. On this basis, we would expect IL&P to continue to lean towards the ECB Facility
- At 31 December 2007, IL&P had available to it ECB Eligible Collateral of €17.2Bn (€20Bn nominal collateralised asset pool) against which drawings of €5.3Bn had been made (reduced to €3.9 Bn at 1H08)
  - IL&P has since issued and retained a further €8.9Bn of ECB Eligible Collateral
  - On this basis, and assuming that the residential mortgage book balance is €36.5Bn, we estimate that IL&P has an unencumbered residential mortgage loan book of approx. €6.5Bn against which it should be possible to raise in the region of €4.5-5Bn of ECB Eligible Bonds
- IL&P also has a commercial loan book of approx €2Bn; we estimate that it may be possible to raise a further €1-1.5Bn of ECB Eligible Collateral against these assets (assuming a rating of less than AAA)
- Offset against this is the extent to which assets have been pledged by IL&P in relation to its announced €3 Bn term funding issuance in June / July – potentially c. €4 Bn
- It is important to note that, with effect from February 2009, the eligibility criteria applicable to the ECB Refinancing Facility will become more restrictive:
  - IL&P will not be able to act as cross currency swap counterparty on a securitisation of its own Sterling denominated UK Loans and would need to appoint a third party swap provider (making funding more expensive)
  - The applicable haircuts will increase significantly (up to a maximum of 16.4% from c. 2%)
- Although the changes will enter into force on 1 February 2009, there is no reference to existing arrangements being grandfathered and so, while it is not clear, it appears that the changes will apply to all collateral and counterparties (existing and new) as of the effective date

Source IL&P investor Reports; ECB Eligibility Handbook



## Key Funding / Liquidity Pressure Points

### Key Pressure Points

Instrument / Source	Amount / Data Point	Risk / Issue
Bank Deposits (ex. ECB etc.)	€2.3 Bn at FY07	<ul style="list-style-type: none"> <li>Stripping out ECB and secured repo funding from bank deposits, IL&amp;P suffered a €1.76 Bn outflow in bank deposits in 2007</li> <li>With IL&amp;P's credit rating downgrade since then, this funding source is vulnerable</li> </ul>
Other "Bank" Deposits	€2.4 Bn non-ECB secured at FY07 €3.9 Bn ECB at 1H08 (€5.3 Bn at FY07)	<ul style="list-style-type: none"> <li>This secured funding is relatively secure, with the ECB funding dependent on continuing provision of existing facilities and non-ECB secured funding primarily a function of price (at least €2 Bn term secured in 1H08, at 115bps spread)</li> <li>The pressure arising from this funding source is the reduced position of unsecured creditors, which has been commented on by rating agencies in a number of previous situations (e.g. B&amp;B downgrades)</li> </ul>
Customer Deposits	€14.6 Bn at 1H08	<ul style="list-style-type: none"> <li>IL&amp;P increased customer deposits by €1.0 Bn in 1H08, but signalled that this was achieved with significantly stronger growth in corporate deposits than retail deposits</li> <li>Corporate deposits, based on UK experience, are highly sensitive to ratings actions / other events due to internal treasury policies etc., and typically short-notice (e.g. B&amp;B lost c. 30% of non-retail deposits in 1H08)</li> <li>Retail deposits are typically more resilient, but can still react suddenly to negative newsflow, with direct access (i.e. internet and telephone) accounts most vulnerable</li> </ul>
Debt Securities	€11.7 Bn at 1H08	<ul style="list-style-type: none"> <li>This has reduced from €20.2 Bn at YE07</li> </ul>
Term Funding	c. €9 Bn at 1H08	<ul style="list-style-type: none"> <li>2H08 is a period of significant pressure for IL&amp;P's term funding, with c. €1.95 Bn of maturities, and minimal issuance possible</li> <li>Late September is an exceptionally challenging period, with c. €1.15 Bn of maturities from 12 September to 22 September</li> </ul>
Commercial Paper	c. €2.5 Bn at 1H08	<ul style="list-style-type: none"> <li>IL&amp;P's CP access, both USCP and ECP, has been contracting steadily since the onset of the credit crunch, and the maturity has been shortening</li> </ul>

- In the event of IL&P encountering difficulties, there are a range of possible actions that the Government could undertake to lend support
- These would have to be measured against the capacities and objectives of the Government, e.g.
  - Sector stability requirements
  - EU state support rules
  - Financial capacity of State
  - Precedents
  - Moral hazard

## Potential Options Available

### Potential Options

Action	Description	Advantages	Issues
Provision of Equity Capital	Underwriting of rights issue by State	<ul style="list-style-type: none"> <li>• Explicit support for institution / sector</li> <li>• Primary responsibility remains with existing shareholders</li> <li>• Relatively small commitment</li> </ul>	<ul style="list-style-type: none"> <li>• Does it address liquidity / funding challenges?</li> <li>• Issue of State support / involvement may alter behaviour</li> </ul>
Acquire Loan Books	Purchase mortgage assets direct from IL&P	<ul style="list-style-type: none"> <li>• Addresses loans to deposits ratio and reduces funding pressure</li> <li>• Also underpins confidence in house prices</li> </ul>	<ul style="list-style-type: none"> <li>• State takes on credit risk</li> <li>• Acquisition of book at a discount may exacerbate concerns / capital impacts</li> <li>• Equal treatment calls from other institutions</li> </ul>
Specific Instrument Guarantee	Guarantee new funding to market, e.g. covered bond	<ul style="list-style-type: none"> <li>• Funding comes from market, not State</li> <li>• Underlines State support and confidence</li> </ul>	<ul style="list-style-type: none"> <li>• State takes on credit risk</li> <li>• Does it prejudice other instruments?</li> <li>• Precedent for other institutions</li> </ul>
Funding Guarantee	Explicit promise by State to provide all necessary funding for a period (e.g. 2 yrs)	<ul style="list-style-type: none"> <li>• Removes immediate liquidity risks</li> <li>• Provides breathing space for restructuring</li> </ul>	<ul style="list-style-type: none"> <li>• Will funding be available for term longer than guarantee?</li> <li>• Does State bear credit risk first, or subordinate existing funding?</li> </ul>
Merge Banks	State support, funding or equity, for bank mergers (e.g. Anglo)	<ul style="list-style-type: none"> <li>• Creation of stronger institutions better positioned to address current environment</li> <li>• Leaves issues primarily with private sector</li> </ul>	<ul style="list-style-type: none"> <li>• Risks of cross-contamination within sector</li> <li>• Will merged entities address funding challenges?</li> </ul>
Good Bank / Bad Bank	Statewide institution to acquire problem assets	<ul style="list-style-type: none"> <li>• Provides clarity for sector / institutions</li> <li>• Allows normal lending to resume in economy</li> </ul>	<ul style="list-style-type: none"> <li>• State bears credit risks</li> <li>• Asset acquisition prices may create capital issues</li> </ul>

Appendix A

# Supporting Materials

- Equity analysts less worried about IL&P's ability to fund than the margin implications, but recognise significant structural issues difficult to address

## SUPPORTING MATERIALS

### Broker Views (1/3)

#### Funding...

"Around a third of ILP's funding or €14bn (32% of total funding) rolls on average every two months in wholesale funding markets. With the 3M Euribor currently at 496bps and ILP's 5 year CDS trading at 221bps, we continue to take a cautious stance."

(KBW 29 Aug 08)

"Concerns for the availability of funding centre on: Reliance on the ECB at the short-end, The capacity to roll over the medium term funding as it falls due. [...] There may be a need to re-jig the collateral placed with the ECB [...] but we see little risk to the availability and price of this funding."

(Citi 12 Sep 08)

"Irish Life is unlikely to suffer a direct liquidity problem, in our view, given the group's substantial book of mortgages [...]. Note also that €2bn of term debt has been rolled this month notwithstanding the credit crunch. Nevertheless, in the medium to longer term, we believe the requirement to rollover the €10bn of wholesale term debt (23% of total funding FY07A) will continue to heighten perceived liquidity risk until either: i) the credit crunch eases, ii) the customer deposit base (€14bn, 34% of total funding FY07A) grows sufficiently to replace a significant portion of the term debt, or iii) assets are reduced through maturity or asset sales."

(RBS 23 Jul 08)

"A major concern, in our view, for much of 2Q08 has been the bank's ability to refinance €3bn of short-term, inter-bank debt that needed to be in place for 3Q08. This was unwise because two things were, or should have been clear. First, the new short-term funding would be more expensive than the money it replaced. Second, there really was no question of new funding not being available. It seemed to us that some market participants believed that the funding could not be rolled over and replaced."

(ING Aug 08)

#### Margin

"The group is facing significant margin pressure over the near term in the bank. Much of this pricing pressure comes from the structure of the balance sheet. 37% of the bank's lending is based on tracker products. [...] The group is borrowing off the Euribor rate while lending on the base rate and is incurring a mismatch which is hurting margins."

"The net interest margin fell to 108bp in 1H, however the group is pointing to a full year margin of 98bp. This implies a 20% fall in the margin in the second half alone. We are now forecasting the bank to be loss making from 2H09. We believe the key area of pressure going forward is likely to be the increased cost of deposits."

(UBS 29 Aug 08)

"The group's loan book is heavily biased to mortgage lending. [...] Unless the group is able to re-price its book, there is little scope to raise the yield on the loan portfolio. Changes in the mix of the portfolio, particularly as some of the two year fixed term deals in the Irish residential market roll off in 2009, may lift the portfolio yield marginally (3bps)."

(Citi 12 Sep 08)



- Capital position and asset quality not viewed as major challenge by brokers, although dividend cuts are being forecast
- Significant comfort taken from Basel II introduction, which will reduce RWAs

## SUPPORTING MATERIALS

### Broker Views (2/3)

#### Capital

"Looking at the group's capital position on a 'comparable basis' we find that under our base-case earnings scenario, the group has entirely adequate levels of capital with an adjusted TCE in excess of 8.3% (Basel 2) every year from FY07-FY10F. In our bear case, (which includes a 33% dividend cut), this adjusted TCE would drop to 6.9% FY10F, which we think would still be sufficient given the economic recovery we would expect to be underway by then. In addition, if required, we believe the group has the ability to create €50-€100m of solvency capital annually via new business funding within the Life business (equivalent to 0.2%-0.4% of RWAs)." *(RBS 23 Jul 08)*

"On our base case, the group should be able to self fund itself to the end of 2010. With a relatively low risk mortgage portfolio and the capacity to release up to €525m of capital from the life company, ILP should not have to re-capitalise even under a 'worst case' impairment scenario." *(Citi 12 Sep 08)*

"Going forward, the group's organic capital ratios are clearly dependent on reported earnings, balance sheet growth, dividends and the impact of Basel 2. We are assuming a 20% reduction in RWAs in 2008 due to Basel 2." *(RBS 23 Jul 08)*

"[...] One might point to the substantial medium term capital releases possible from Basel II (an additional €250 million) and Solvency II (€1 billion)." *(Citi 12 Sep 08)*

"As of December 2007, IPM was solidly capitalised with an equity tier 1 ratio of 10.4% (Base: 1) as measured by the Irish Regulator. We estimate the adjusted equity tier 1 ratio was a respectable 7.0% FY07A (Basel 1). These ratios are consistent with Moody's recent BFSR 'A' rating for capital" *(RBS 23 Jul 08)*

#### Asset Quality

"For the full year 2008, the group predicts 6bps of loan loss provisioning through the P&L account. However this is a fast moving and fluid situation and there is likely to be material deterioration in the next three years. [...] Whatever one's view of the quality of the book, the arrears position looks set to deteriorate and this will most likely end up in significantly higher P&L charges for bad debts." *(Citi 12 Sep 08)*

"One can see a slightly more aggressive lending stance taken through the period up to 2006 — on the prime book, average LTVs rose from 67% to 72% before being reined back to 68% in 1H08. The more aggressive stance is also reflected in a three point rise in market share (from 19% to 22%) of new lending in 2006, a share that the group held onto in 2007. Unfortunately the group has not given the spread of LTVs post 2005. Nevertheless, we would be surprised if more than 40% of the book was lent on LTVs above 90% in 2006 and 2007 and would expect that this type of lending has been reined in this year. The generally conservative underwriting stance is reflected in a low rate of arrears. Indexed to current house prices, the LTV on the book stands at 43% — house prices have to fall materially for the equity to be threatened." *(Citi 12 Sep 08)*

"The company has not seen credit quality problems yet, although it expects bad debts to rise. Our suspicion is that it would not expect them to rise as much as our estimate; we view this as very conservative. In this regard, we believe it is a critical differentiating factor for Irish Life & Permanent that 88% of its bank lending is residential mortgages and 98% of all of its loans are secured." *ING (13 Aug 08)*

- Brokers forecast increasing impairments that are more comparable to company stress test of cumulative 60-80 bps
- Severe stress analysis more in line with 90s UK experience would imply on avg. 136 bps or €564 MM impairment charge for 'worst case year'

## Broker Pre-Provision Profit

bps	2008	2009	2010
Citi	262	431	443
KBW	311	538	576
UBS	304	431	417
RBS	265	524	584
Average	286	481	505

Morgan Stanley

## SUPPORTING MATERIALS

## Broker Views (3/3)

## Impairments:

"On our base case, we are forecasting aggregate impairments equivalent to 110bps of loans (over 2009-11), materially higher than the 60-80bps range postulated by the company. This gives rise to pre-tax losses of €458 million over the three years (€400 million net of tax). This is equivalent to 1.6% of risk weighted assets."

"Our 'worst' case year is informed by UK experience in the early 1990s. This could throw up losses of 7.0% of loans on the commercial mortgage portfolio and 5.0% on the consumer book. On the residential mortgage portfolios, we have the impairment data for around 45% of the industry stretching from 1990 to 1996. This shows a peak year of 62bp of impairments and aggregate impairments over the three worst years of 138bps. On the basis of our 'worst' case year, the group could suffer impairments of €564 million pre-tax (€494 million net), equivalent to 2.0% of risk weighted assets." (Citi, 12 Sep 08)

"We estimate that peak net write-offs on mortgages will be 30bps in our base case. We add on an additional 7-10bps of credit loss reserve rebuild. Accounting for the other 12% of the loan book gives a base case peak impairment charge of 40bps."

"We estimate that peak net write-offs on mortgages will be 50bps in our bear case. We add on an additional 7-10bps of credit loss reserve rebuild. Accounting for the other 12% of the loan book gives a bear case peak impairment charge of 70bps" (RBS, 23 Jul 08)

"We have significantly increased our impairment assumptions for Irish Life. The group stated that when stress testing its book it used a 60-80bp cumulative charge for impairments over three years. Given recent moves in house prices in Ireland and deteriorating arrears rates in UK Buy to Let portfolios we believe this is a sensible approach. As a result we have impairments peaking at 40bp in FY10. This results in the bank making a loss in FY10 of €81 million." (UBS, 29 Aug 08)

"In its Irish residential mortgage book, we are pencilling in [18]bps for 200[9] and 25bps in 2010 noting that a more conservative stance could be warranted given the adverse developments in the Irish housing market." (KBW, 29 Aug 08)

Broker Impairment Charges<sup>(1)</sup>

bps	2008	2009	2010	2011E	Cumulative 2008-10	2009-11E
Base	100	24	39	24	72	86
Citi	8	30	50	30	88	110
KBW	9	18	25	18	52	61
UBS	10	20	40	20	70	80
RBS	12	27	40	27	79	94
Bear					137	137
Citi					138	
RBS	13	53	70		136	

## 'Worst Case Year'

	Loans € Bn	Impairments bps	€ MM
ROI Resi	27.7	66	183
ROI Commercial	2.4	700	168
ROI Consumer	2.5	500	125
UK Resi	8.8	100	88
Total	41.4	136	564

Source: RBS Broker estimate

## Note

1. 2011 impairment charge estimated based on 2009 reported (except for Citi who provides 2011 estimate)



Note of Meeting with Goldman Sachs, 21 September 2008 (Sunday)

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DSG KC, CH, BO'H, MO'D (for part), PN (for part)

Goldman Sachs: Geoghegan + 1

Basic points

- Have examined INBS top 30 loans Ireland and top 30 loans UK
- Lot of reassurance in those that there is real value there
- But based on management discussions
- Some of book could be securitised for liquidity purposes, but slow job, even with advisers – would need new specialist staff of their own in house
- Riskiest part is not UK but Irish book
- Very few loans above 250m. Irish bank well diversified
- Will be difficult to get 100% recoveries for some loans. UK book – profit sharing ventures in reality -- some profit shares will pay this year
- KPMG are looking through a worst case scenario
- So far, could see hits eat through capital, but nothing to suggest it would go further than that
- To provide greater analysis would need a real estate, legal and accounting person
- Auditors do not see performance here being worst than anywhere else
- Management's central case assumption is loss of a few 100m
- Essential to retain knowledge of management.
- Liquidity a big issue – at current rates reaches limits in 11 days, but real danger of acceleration. Loans are assignable (per McCanns) but would take time to package them -- work on assets continues
- Convinced help from authorities will be required – soon
- Suggested range of options for discussion with pros and cons (1) Nationalisation (2) Stand alone with liquidity support (3) Break up
- Mark to market value right now maybe 50/60% but lot of value in loans if worked through

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Note of Meeting, 22 September 2008

NTMA            Oliver Whelan, John Corrigan  
D/Finance      Kevin Cardiff, William Beausang  
CBFSAI        Tony Grimes

Subject: Liquidity and how to provide a 'war chest'

Tony Grimes

Considerable outflows continuing [REDACTED] with danger that each will need the ECB marginal facility today (later phone call said this was averted).

Strong view at CBFSAI Board on 21/9 that liquidity pool of authorities needs to be bigger and we need to look again at this - Anglo already requesting 7bn facilities, and want to activate a swap with CB, who will not do so unless absolutely necessary -- could be in next day or so.

Oliver Whelan

Advice is not to go into bond market at present -- simply no appetite  
Would do a bond issue if it could be done, meanwhile issuing CP as long-dated as possible.

Conclusions:

(A) Liquidity 'available' is as follows:

<u>Cash</u>		<u>Portfolio Bonds</u>
Exchequer	8 billion	CB 9 billion
SIF	3.3 billion	NPRF 2.5 billion
NPRF	1.5 billion	

Allowing for holding back 2bn for day to day needs, this totals about 18 billion excluding NPRF where legal issues greater.

- (B) Legal advice to be sought re S. 157 powers of NTMA
- (C) CB to show floating charge documentation to NTMA
- (D) Consideration required as to whether possible to tranche Government bonds for direct swap with institutions if required.

FROM WALSH TO D.D.

14/11/08

22/9

## INBS Options

There are four options available in relation to the INBS. These are:-

1. Do nothing.
2. Ensure an orderly run-off of INBS
3. Break-up of INBS
4. Merge INBS with another institution.

### 1. Do Nothing.

Prior to the current issues INBS was seeking to undertake an orderly run-off so as to realise maximum value for its members in the changed market circumstances. INBS was seeking to generate sufficient liquidity through the reduction of the loan book. In a normal environment many of INBS's loans would typically be refinanced by other institutions – frequently HBOS or Anglo – within a period of circa 30 months. Because of the liquidity crisis and the problems that that has caused for banks and the property market, most institutions will not refinance the loans of another institution and consequently the redemption rate is much slower.

As a result, assuming current market conditions prevail the do nothing option will inevitably result in the collapse of INBS. Continuous downgrades from the rating agencies will reduce the availability of retail deposits, the capital markets have been closed to INBS since the advent of the credit crunch, and for the reasons described above the redemption rate on the loan book is much slower than previously.

A collapse of INBS would have implications for the circa 180,000 depositors and result in a distressed sale of the loan books. Given the high level of property related lending in all financial institutions this could have serious consequences as valuations in all institutions might then have to be set to reflect distressed levels. The rating agencies in particular are likely to use any benchmarks set in their appraisals.

In the absence of action there will be severe outflows of capital from Ireland. INBS has circa €2.3 billion of overseas deposits which will leave Ireland, the debt securities in issue of €5.9 billion are sourced overseas and many of the Irish depositors withdrawing money are putting it with Northern Rock as it is deemed to be the UK Government.

While it is evident to everyone that there is a serious financial problem in Ireland – emanating from the impact of the credit crunch on the economy and the dependence of the economy at all levels on property – inaction leading to collapse will be seen as a lack of leadership and confirm the international perception that Ireland does not know how to deal with its problems.

## 2. Ensure an Orderly Run-off of INBS

As previously mentioned, prior to the current issues INBS was seeking to undertake an orderly run-off so as to realise maximum value for its members in the changed market circumstances. The focus was on repayments, with lending confined to pre-existing commitments and to existing borrowers when funding was required to bring projects to a certain stage. As of August 31<sup>st</sup> there was a net reduction in the loan book of circa €600 million.

In the absence of support, in the current market conditions, it is unlikely that INBS will have sufficient funding to get the time to have an orderly run-off.

The immediate issue of INBS could be avoided in a number of ways:-

- a) Provision of liquidity on a covert basis
- b) Provision of liquidity on an overt basis
- c) Nationalisation
- d) Amalgamation with another institution
- e) Guarantee Deposits

Any solution which does not provide confidence to the depositors will ultimately cost more in cash terms as the State will have to replace the deposits or other funds which leave due to that lack of confidence.

### *(a) Covert Funding:*

If covert funding was provided to INBS to meet its liquidity needs, INBS could survive and continue an orderly run-off. The timing required to do this will depend very much on when the lending markets in the UK return to normality and whether they remain frozen in relation to property.

Covert funding will not protect INBS from further downgrades. Downgrades are likely due to the uncertainty in relation to INBS's ability to meet repayments on its Debt securities. The rating agencies will not take cognisance a funding source which is unexplained and uncertain. Ongoing downgrades are likely to result in a continuous outflow of deposits – with the overseas deposits likely to go very quickly.

There is also a need to consider what public announcements would be required due to Listing requirements depending on the funding being required.

Utilising covert funding is likely to require much more money from the State than would be required if public confidence was restored.

### *(b) Overt Funding*

Overt funding with the appropriate supporting statement is beneficial to both INBS and the market. As is evident from the UK, overt funding with the wrong message can amplify difficulties.



Overt funding which is focussed on a single institution will inevitably raise questions on other institutions. At its simplest if one knows one institution is safe but one is uncertain about the others then inevitably one will put one's money with the safe institution.

*(c) Nationalisation*

At first glance this looks like the easy way to deal with the current issues. This, however, ignores the fact that the problems are market wide and will inevitably bring into focus whether other institutions may be nationalised.

The threat of nationalisation of institutions is effectively a threat to wipe out the equity in those institutions. In such a position no rational investor is going to provide equity or near equity to an institution which might be nationalised.

Nationalising a single institution, in the absence of guaranteeing the deposits with the others will inevitably exacerbate the problems with the others.

*(d) Amalgamation with another institution*

The issues associated with this are discussed later as Option 4, in the context mainly of Anglo Irish Bank.

*(e) Guarantee Deposits*

The easiest way to facilitate an orderly run-off of INBS is for the State to publicly give comfort that no depositor or equivalent is at risk.

*Advantages:*

This is the least disruptive option from a national perspective. It gives a clear signal from the State that it is not prepared to countenance failure and that no creditor of an Irish financial institution is at risk.

*Risks:*

Any ambiguity in the statement of comfort could precipitate problems.

*Wider Implications:*

With the State giving public comfort on the security of funds with INBS (as the smallest institution) this will inevitably imply that the State will provide similar comfort to larger institutions. Most analysts already assume this is the case for the two main institutions. However confining the Guarantee to INBS may leave Anglo with a problem as its Irish depositor base is much smaller.

The admission that INBS requires such support will raise issues in relation to other institutions. However, these same issues are brought even more into focus if a collapse occurred.

(Note: In the absence of the comfort being absolutely public this solution would not work as the rating agencies would continue the downgrades. This would result in continuous outflows increasing the magnitude of the funding problem. Goldmans have advised that in the Bradford and Bingley situation that the rating agencies would not take account of implied support.)

### 3. Break-up of INBS

A break-up of INBS would probably involve an attempt to:

- a) sell the deposit book, the branch system and the 180,000 customers.
- b) sell the mortgage book
- c) sell the developer book in one or two components – potentially separating the UK and Irish elements.

In effect there is no difference, other than timing, between Option 3 (Break up of INBS) and Option 2 (providing sufficient support to enable an orderly run-off). Following Option 3 on an accelerated basis results in greater value destruction and almost certainly causes wider market problems.

While in theory this is an option the implementation might prove difficult as it would not necessarily be possible to do it on an overnight basis. In the current market circumstances the sale of the developer loan book is likely to be at a substantial discount as the only likely buyers are private equity funds looking to buy from forced sellers. Such a forced sale valuation would provide a very negative cross read to other Irish banks with property exposures.

The only way to avoid a heavily discounted sale of the loan books would be for the State to underwrite the losses or for the State to take over the book at face value and to pay another institution to manage the book on its behalf.

In normal market circumstances the sale of the deposit book would be likely to generate a substantial premium, however given the current period where the retail market has become much more rate sensitive the premium is probably substantially reduced. Depending on the buyer the customers and branch system may be of value. Clearly they would have no value to the main banks who already have a full branch system and probably the same customer base.



#### 4. Merge INBS into another Institution

The only institution which has indicated a willingness to consider a solution is Anglo.

##### *Advantages:*

1. Anglo is best positioned to manage the developer loan book. It will have many customers in common. It understands the relevant markets in great detail and it has the experience of working with people in more challenging times.
2. Relative to a straight runoff where customers have no need for long term loyalty the management of the book by someone with overlapping clients is likely to generate a better result. Against this must be balanced the inherent conflict of interest if the deal structure results in the same person managing two overlapping loan books – one where you have all of the downside and the other where you have none.
3. A solution focussed on Anglo avoids further concentration in the banking market. Anglo would get an initial customer group of circa 180,000 and a branch network of 50 outlets. There would be no branch closures as a result.

##### *Solution:*

Any solution must be one that can be executed very quickly. In any takeover of INBS, Anglo have indicated that they would require –

- a) To be seen as the State's preferred solution provider. Given the initial meetings between the FSR and AIB/BOI there is clearly a risk to this.
- b) Anglo must be seen to be insulated from any downside that may exist in the developer book.
- c) Anglo would have to be protected against any severe outflow of funds following an acquisition.

##### *Outline Anglo Proposal*

1. Anglo takes full control of the business with a view to:
  - (a) managing out lending assets to maximise value.
  - (b) effect synergies where possible.
2. The acquisition to be effected through a bankruptcy remote SPV, which will not be consolidated with Anglo for capital purposes.
3. Government underwrites the SPV as to any:
  - (a) deficit in net assets.
  - (b) funding and liquidity support provided with funding secured on SPV asset.
4. Consideration to be in shares and on a basis to be agreed, but largely based on realised net assets.

*Risks:*

Merging INBS into any bank will be publicly seen as a bailout. Clearly this will bring focus onto the Irish market and the share price of the entity INBS is merged into is likely to fall. This can only be counteracted by very significant support for the entity into which INBS is merged.

The State needs to be very careful not to compound its risks. Anglo is already seen to be a property focussed bank and in the absence of very clear support this solution would not work. While INBS's loan book is less than 10% of the level of those in AIB/BOI, Anglo's is over 50%.

In effect the State will have to guarantee Anglo at the same time -- it may not be sufficient to guarantee the liquidity and assets of the SPV.

The other major institutions may be strongly opposed to such a "sweetheart deal" for one of its competitors.

The State will be seen to be taking on a much bigger and more complicated problem than was necessary.

*Conclusion:*

There is a real danger that the market will not accept this as a solution unless there is an unequivocal statement from the State that it will provide whatever support is necessary to Anglo. The international market may react with cynicism and put the focus on the loan books of the two major institutions. The September 10<sup>th</sup> JP Morgan report on the Irish Banks noted that "75% of accumulated lending since 1999 has been collateralized with property assets and 50% of lending originated in the last 3 years".

Options:

INBS, EBS, and ILP brought together <i>State guarantee on INBS book, + Liquidity Support</i>  <b>Anglo Liquidity Support</b>  <b>BoI and AIB as now</b>	INBS broken up <b>EBS, ILP and INBS retail go together</b> <b>INBS - commercial property nationalised</b> <i>Financing required for INBS commercial</i>  <b>Anglo Liquidity Support</b>  <b>BoI and AIB as now</b>	INBS taken by Anglo <i>State guarantee on INBS book, + Liquidity Support for whole</i>  <b>ILP Liquidity Support</b>  <b>BoI, EBS and AIB as now</b>	INBS taken by EBS <i>State guarantee on INBS book, + Liquidity Support for whole</i>  <b>Anglo Liquidity Support</b>  <b>ILP Liquidity Support</b>  <b>BoI, EBS and AIB as now</b>	No mergers, nationalisations or take-overs  <b>INBS Liquidity support</b>  <b>Anglo Liquidity Support</b>  <b>ILP Liquidity Support</b>  <b>BoI, EBS and AIB as now</b>	Badbank approach  <b>INBS</b> <i>Assets put aside, Liquidity Support if needed</i>  <b>Anglo</b> <i>Assets put aside, Liquidity Support if needed</i>  <b>ILP</b> <i>Liquidity Support</i>  <b>BoI, EBS and AIB as now</b>	Combined Asset Swap and Badbank approach  <b>INBS</b> <i>Swap Ir-Govtbonds for INBS assets at book value, but require INBS to swap out assets that do not perform – but with a maximum pace for doing so.</i>  <b>Anglo</b> <i>Same as for INBS</i>  <b>ILP</b> <i>Liquidity Support</i>  <b>BoI, EBS and AIB as now</b>
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Other possibilities:

AIB and Bank could be brought together

EBS in appropriate combination with others could seek external taker

ILP could seek external taker

DATE? - 25/9/08

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.

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Meeting of 26 September 2008

Merrill Lynch presented a number of options -- see document of 26 September 2008

Attendance:

ML X3 = Prasath, Baldock, Andreas Orcelli  
Bob O'Hara  
Con Horan  
K Cardiff  
D Doyle  
Minister

ML points

- Worst credit crisis ever
- Need break a bad cycle
- French Government has indicated it will guarantee deposits
- However, number of situations where blanket guarantee may not add up having regard to numbers
- Liquidity is moving very very quickly
- Ireland is not an isolated case -- other Governments also seeking ML advice, for example
- Management teams tend to try to play out to the end, because Government intervention tends to change the team, the advisers etc -- their incentive therefore is to be over optimistic
- But it can create difficulties to go in without being asked in.

Presented a central scenario as follows

- (a) provide liquidity on 'penal' terms -- must not be easy money
- (b) intervention

Difficulties -- scale of intervention required.

Dangers with blanket guarantee -- credibility and prolonging of weak institutions

Question of who should be protected in interventions -- at least depositors in serious debt -- possibly dated subordinate debt.

Big question is how to navigate between intervening early to protect deposits and minimise costs and giving time to markets and management to realise there is a problem and adjust to that reality (can happen in days). But corporate deposits can exit very quickly in the meantime.

On a blanket guarantee for all banks -- ML felt could be a mistake and hit national rating and allow poorer banks to continue.

Liquidation -- ML said this was the worst thing that could be done -- accelerating trouble for all other institutions.

More generally, institutions should be encouraged to sell assets and get equity.

Next week is likely to be a very bad one in markets: Fortis, B&B, Dexia all having difficulties - EU will have to look at some more generalised action.

Minister asked that the options be articulated clearly over weekend so as to be ready to present to Government.

The Minister left and there was a discussion on allocation of work. To recommence at NTMA Sunday morning.



## Draft Preliminary Analysis



Presentation to

**National Treasury Management Agency**

26 September, 2008



**Merrill Lynch**

Global Markets & Investment Banking Group

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## 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	<ul style="list-style-type: none"> <li>■ Converts non ECB-eligible collateral into liquidity</li> <li>■ Deals with immediate liquidity problem / buys time</li> <li>■ Leaves Irish Nationwide / Anglo Irish temporarily as going concerns</li> <li>■ Benefits the whole financial system</li> <li>■ "Positive" for Ireland Inc. from outsiders' point of view</li> </ul>	<ul style="list-style-type: none"> <li>■ Deals with the most problematic assets causing headline risk</li> <li>■ Will help restore confidence and help banks carry on business</li> <li>■ Promotes orderly unwind / minimises asset deflation</li> </ul>	<ul style="list-style-type: none"> <li>■ Deals decisively with the most problematic institutions</li> <li>■ Demonstrates Implicit commitment to Irish banks as a whole</li> <li>■ Interim step before formal guarantee if needed</li> <li>■ Protects senior / subordinated creditors</li> <li>■ Deposit guarantee will stem outflows and may result in inflows</li> </ul>	<ul style="list-style-type: none"> <li>■ Best / most decisive / most impactful from market perspective</li> <li>■ Deposit guarantee will stem outflows and may result in inflows</li> <li>■ Protects senior and subordinated creditors</li> </ul>	<ul style="list-style-type: none"> <li>■ Does not have an immediate cost to the Exchequer, but likely to be longer term implications</li> </ul>
Cons	<ul style="list-style-type: none"> <li>■ Does not deal with problem that monoline / lowly rated business are unlikely to work</li> <li>■ 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</li> </ul>	<ul style="list-style-type: none"> <li>■ No critical mass remaining at Irish Nationwide / Anglo Irish</li> <li>■ Most complex option for Government – will require more time               <ul style="list-style-type: none"> <li>■ Capital / liquidity hits (€80bn++)</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>■ Government ends up funding combined balance sheet</li> <li>■ Irish tax payer exposed beyond shareholders' equity</li> <li>■ Potential negative impact on share price of Bank of Ireland / Allied Irish Banks / ILP</li> </ul>	<ul style="list-style-type: none"> <li>■ Will market find it credible given scale (€500bn+)?</li> <li>■ Can Ireland afford it?</li> <li>■ Ratings impact?</li> <li>■ Will it pass the test with other EU countries given broader implications?</li> <li>■ How long will it last?</li> </ul>	<ul style="list-style-type: none"> <li>■ Significant read across to other banks</li> <li>■ Mark assets down at other banks to liquidation levels</li> <li>■ Capital and liquidity impact</li> <li>■ Investor perception of Ireland Inc. and financial stability more generally</li> <li>■ Perception that authorities not in control of developments</li> </ul>
Considerations	<ul style="list-style-type: none"> <li>■ Commercial vs. penal rate funding</li> <li>■ Over-collateralisation possible</li> <li>■ Appropriate tenure</li> <li>■ Shareholder control maintained as well as management structure</li> <li>■ ELA or AIB / BoI ECB access could also be used</li> </ul>	<ul style="list-style-type: none"> <li>■ Should it be available to all Irish banks?</li> <li>■ Can be structured to place government capital injection ahead of existing Equity</li> <li>■ If this is the chosen path, most likely to be a second stage solution</li> <li>■ Will require guarantee for senior / subordinated debt holders</li> </ul>	<ul style="list-style-type: none"> <li>■ Irish Nationwide / Anglo Irish to be taken into state control</li> <li>■ Will require guarantee for senior / subordinated debt holders</li> <li>■ Put business into run-off</li> </ul>	<ul style="list-style-type: none"> <li>■ Irish Nationwide / Anglo Irish to be taken into state control</li> <li>■ All cards played immediately</li> <li>■ Equity market perception?</li> </ul>	<ul style="list-style-type: none"> <li>■ Option discounted due to impact on state / other financial institutions</li> </ul>



## Draft Preliminary Analysis

## Strategic Options

	Secured Lending Scheme / ELA	Good Bank, Bad Bank	Protective Custody of INWE / ANG	Guarantee for 6 Primary Regulated Irish Banks	Liquidation
Quantification	<ul style="list-style-type: none"> <li>■ [REDACTED]</li> <li>■ [REDACTED]</li> <li>■ [REDACTED]</li> <li>■ [REDACTED]</li> <li>■ [REDACTED]</li> </ul>			<ul style="list-style-type: none"> <li>■ [REDACTED]</li> <li>■ [REDACTED]</li> <li>■ [REDACTED]</li> <li>■ [REDACTED]</li> <li>■ [REDACTED]</li> </ul>	
Legal	<ul style="list-style-type: none"> <li>■ Relatively straightforward (subject to checking existing powers)</li> <li>■ NTMA to be granted relevant powers in current bill</li> <li>■ Property structured, should not encounter a state aid issue (commercial terms and as non-selective as possible)</li> </ul>	<ul style="list-style-type: none"> <li>■ Very difficult to identify and address all legal issues in immediate timeframe</li> <li>■ New legislation required</li> </ul>	<ul style="list-style-type: none"> <li>■ Legislation in hand</li> <li>■ Preferred share approach could be accommodated in timeframe</li> <li>■ Guarantee based on either               <ul style="list-style-type: none"> <li>(a) rescue aid basis, applying for approval for restructuring aid within 6 months; and/or</li> <li>(b) Art 87 (3)(b) to remedy serious disturbance to the economy</li> </ul> </li> <li>■ Legislative power to be drafted into current bill to provide further guarantees if necessary</li> <li>■ Clear statement by Minister of intent to provide further aid as necessary should not attract additional state aid problems</li> </ul>	<ul style="list-style-type: none"> <li>■ Legislation in hand</li> <li>■ Preferred share approach could be accommodated in timeframe</li> <li>■ Rescue aid rules applicable to the intervention with Anglo / INBS</li> <li>■ General guarantee to banking system would be based on Art 87(3)(b) – serious disturbance to the economy (systemic risk)</li> <li>■ Should investigate whether on basis of Art 87(3)(b), guarantee limited to the 6 banks would be allowable</li> <li>■ Danger that the Commission would not accept this basis for the general guarantee</li> </ul>	<ul style="list-style-type: none"> <li>■ N/A</li> </ul>





## 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					
Impact on Non-Primary Regulated Banks	<ul style="list-style-type: none"> <li>■ Restrict collateral to commercial real estate and to primary regulated banks to deter foreign-owned institutions</li> </ul>	<ul style="list-style-type: none"> <li>■ N/A</li> </ul>	<ul style="list-style-type: none"> <li>■ Other institutions scope for possible complaints but no legal grounds</li> <li>■ Long-term reputational issues for Ireland</li> </ul>	<ul style="list-style-type: none"> <li>■ Other institutions scope for possible complaints but no legal grounds</li> <li>■ Long-term reputational issues for Ireland</li> </ul>	<ul style="list-style-type: none"> <li>■ N/A</li> </ul>
Systemic European Impact	<ul style="list-style-type: none"> <li>■ No effect</li> </ul>	<ul style="list-style-type: none"> <li>■ No effect</li> </ul>	<ul style="list-style-type: none"> <li>■ No effect</li> </ul>	<ul style="list-style-type: none"> <li>■ Most contentious</li> </ul>	<ul style="list-style-type: none"> <li>■ No effect</li> </ul>
Timing	<ul style="list-style-type: none"> <li>■ Immediate liquidity issues need to be addressed</li> <li>■ Maximum 2 week window, more likely 7 – 9 days</li> <li>■ No reason to expect significant liquidity improvement in the market</li> <li>■ TARP issues in US still to work through</li> <li>■ 30 September quarter end money market redemptions will prevent any meaningful change in market conditions</li> </ul>				



## Draft Preliminary Analysis

### Market Backdrop For Financial Institutions

Severe Stresses In The Financial Markets Remain Amidst Volatility

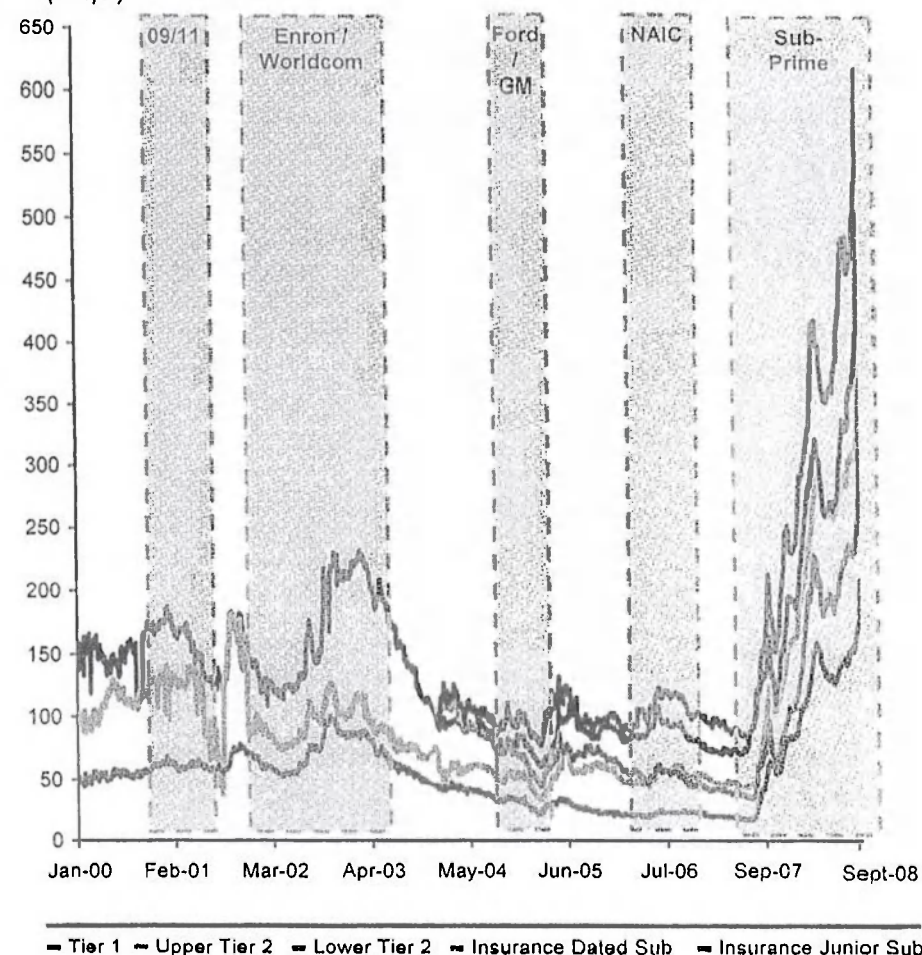
#### Aggregate Spread Performance By Asset Class

- 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 26<sup>th</sup> 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

Asset Swap Spread  
(in bps)



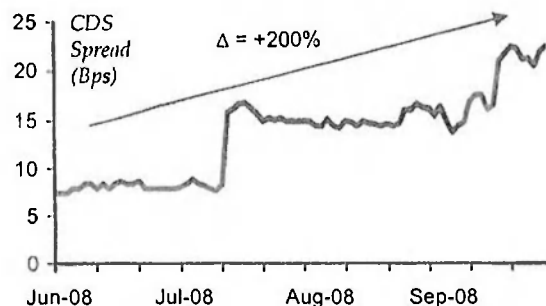


## Draft Preliminary Analysis

# Market Backdrop For Financial Institutions

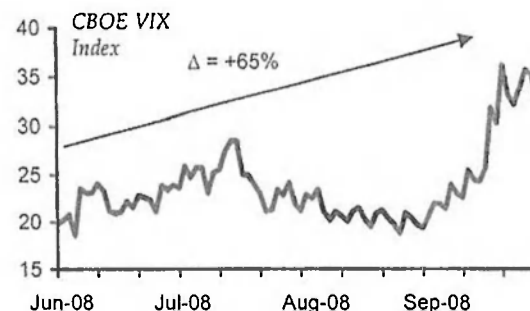
## Severe Stresses In The Financial Markets Remain Amidst Volatility

### 10-Year US Treasury CDS



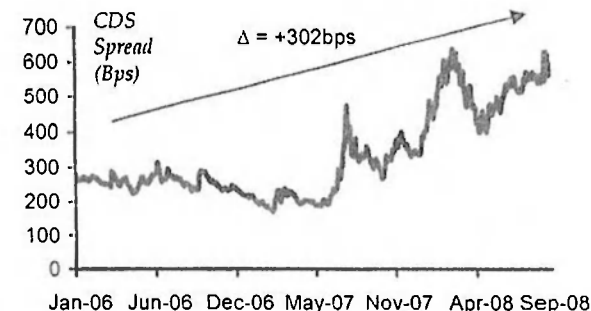
The cost to insure the debt of 10-year US treasuries has risen to an all time high as over the US fiscal position

### VIX Volatility Index



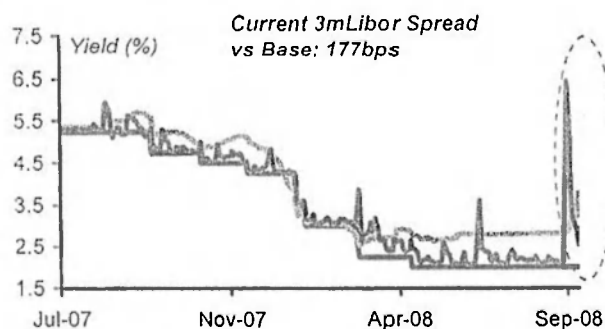
The VIX volatility index, one of the best guides to risk in the market rose close to six year highs as risk aversion jumped

### iTRAXX Cross-Over



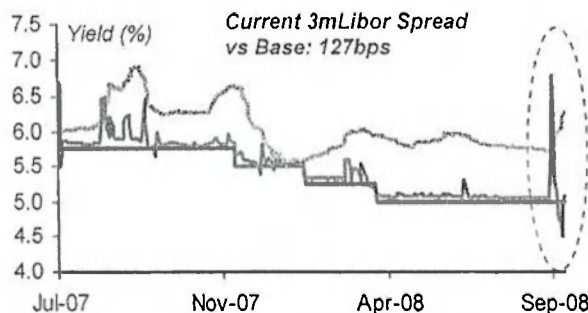
The iTRAXX Crossover index has again breached the 600 mark with substantial pressure being seen on secondary spreads

### US Interbank Rates



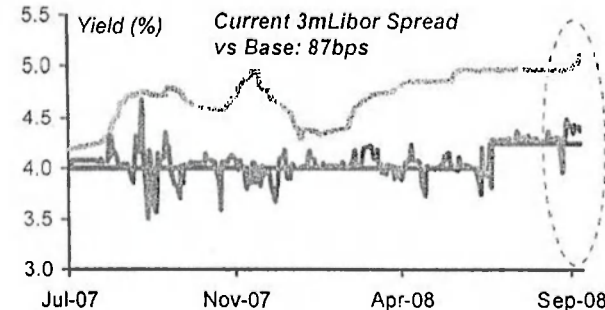
— FED Base Rate — US 3m\$ Libor — US Overnight Rate

### UK Interbank Rates



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

### EUR Interbank Rates



— ECB Base Rate — 3m Euribor — ECB Overnight Rate

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.



## Draft Preliminary Analysis

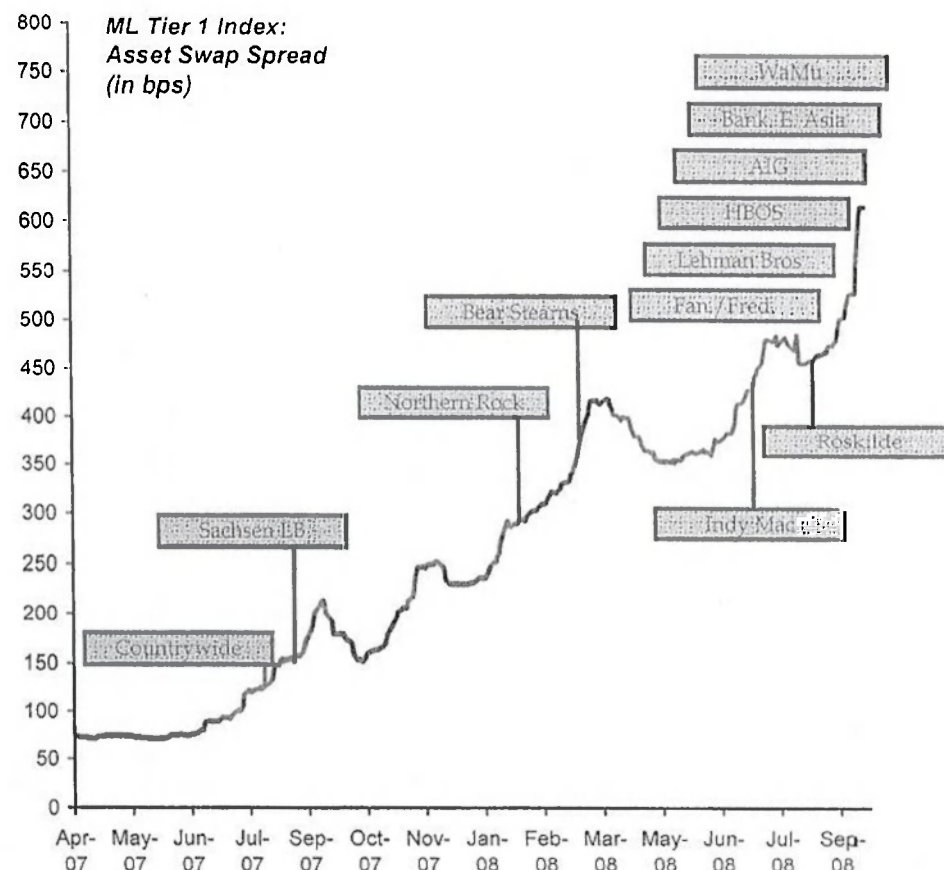
# Market Backdrop For Financial Institutions

## Acceleration of Bank Failures & Impact on Capital Markets

### List of Key Bank Failures

- Washington Mutual (Put into receivership on 26<sup>th</sup> September, 2008)
  - \$19bn of expected losses on portfolio - ratings downgrade to non-investment grade - deposit withdrawals and liquidity crisis
- Bank of East Asia (Hong Kong Central Bank support on 25<sup>th</sup> September 2008)
  - Run on the bank following rumours of insolvency
- AIG (Federal Reserve intervention on 17<sup>th</sup> September 2008)
  - Concerns over subprime / CDS exposures & liquidity pressure - \$85bn liquidity shortfall
- HBOS (acquired by Lloyds TSB on 16<sup>th</sup> September 2008)
  - Concerns regarding ability to fund - funding gap estimated at c £200bn
- Lehman Brothers (Filed for Chapter 11 on 15<sup>th</sup> September 2008)
  - Concerns regarding insolvency led to liquidity crisis -
- Fannie Mae & Freddie Mac (Federal Reserve Intervention on 8<sup>th</sup> September 2008)
  - Mounting defaults on portfolio lead to concerns regarding insolvency - US stepped in explicit manner to ensure both entities continue to fund
- Roskilde (Danish Bank resumed control on 25<sup>th</sup> August 2008)
  - No longer met solvency requirements. Bought by Danish Central Bank after no external buyers found
- Indy Mac (Filed for chapter 11 on 11<sup>th</sup> July, 2008)
  - Depositors withdrew at elevated levels post profits warning. Subsequently seized by US regulators after viewed to fail
- Bear Stearns (acquired by JPM Morgan on 16<sup>th</sup> March, 2008)
  - Concerns regarding exposure to subprime and level of capitalisation triggered a rapid and non-reversible liquidity crisis
- Northern Rock (Nationalised by UK Government on 15<sup>th</sup> February 2008)
  - Capital markets dislocation lead to impossibility to meet funding gap
- Sachsen LB (acquired by LBBW on 25<sup>th</sup> August, 2007)
  - Received emergency funding following the inability of Sachsen LB's ABCP to fund in the CP markets
- Countrywide Financial (Acquisition by Bank of America 16<sup>th</sup> August, 2007)
  - Drew on \$11.5B from 40 global banks and liquidity providers following inability to fund in wholesale markets. Subsequently acquired by Bank of America

### Bank Failures Substantially Impact Credit Markets



## Draft Preliminary Analysis

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Lonergan, Ciara

From: Baldock, Henrietta (IBK EMEA) [henrietta\_baldock@ml.com]  
Sent: 29 September 2008 18:43  
To: Cardiff, Kevin  
Subject: RE: in meet with taoiseach - need note on pros and cons of guarantee a sap

Attachments: ML Memo 28 9 08 v8.doc



ML Memo 28 9 08  
v8.doc

This is the entire note.

Regards

Henrietta

-----Original Message-----

From: Cardiff, Kevin [mailto:Kevin.Cardiff@finance.gov.ie]  
Sent: 29 September 2008 18:37  
To: Baldock, Henrietta (IBK EMEA)  
Subject: in meet with taoiseach - need note on pros and cons of guarantee a sap

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Sunday 28<sup>th</sup> 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 28<sup>th</sup> 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 not seen 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 billion. The asset quality of the commercial loan book is regarded as being generally good. However there are concerns over the influence of the Chief Executive. 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. In the extreme stress case analysis the total writeoffs including loss of interest income would just deplete most of INBS reserves of €1.8 billion.

### Anglo Irish Bank

Anglo is 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 deplete ordinary shareholders and other lower category subordinated debt by €7.5 billion. 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 30<sup>th</sup> September growing to €4.9bn by 24<sup>th</sup> October. On Friday 26 September Anglo have formally requested a short term liquidity advance of €1.7bn from the Central Bank 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.

#### 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 a penal interest rate 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 makes 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

#### Advantages

- 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 all private sector banks' liquidity issues.

#### 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 encouraged 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. 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. There is a risk banks could 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 stabilise 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. In these markets a bank in ELA is vulnerable because the market will no longer provide funding.

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 stabilise 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.

**(c) 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 liquidity advance is important to stabilise Anglo (and possibly 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

#### Irish Nationwide Building Society

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*

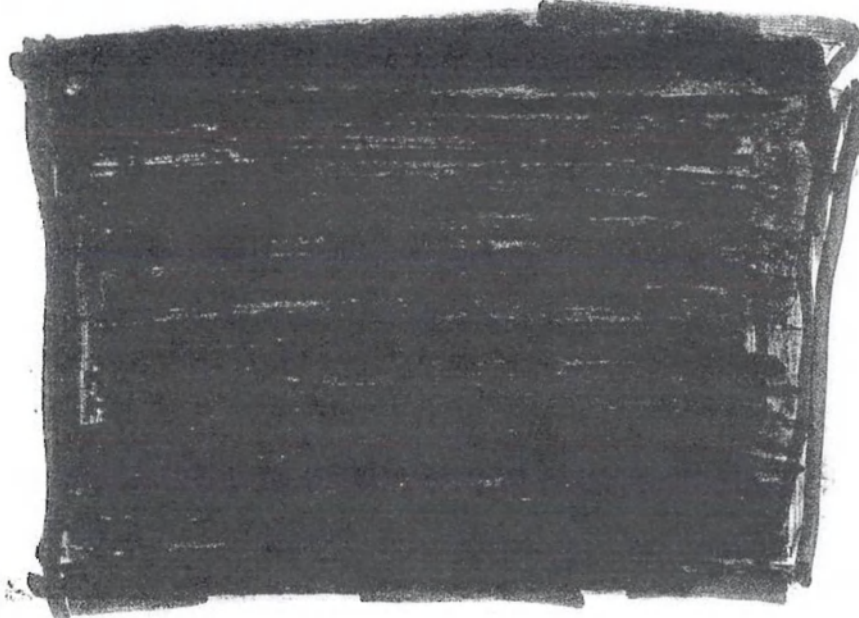
*Subordinated* €0m

Tier 2 Capital: €476m

*Which includes:*

*Dated subordinated* €314m





#### Anglo Irish Bank

Description: Monoline lender, commercial property assets

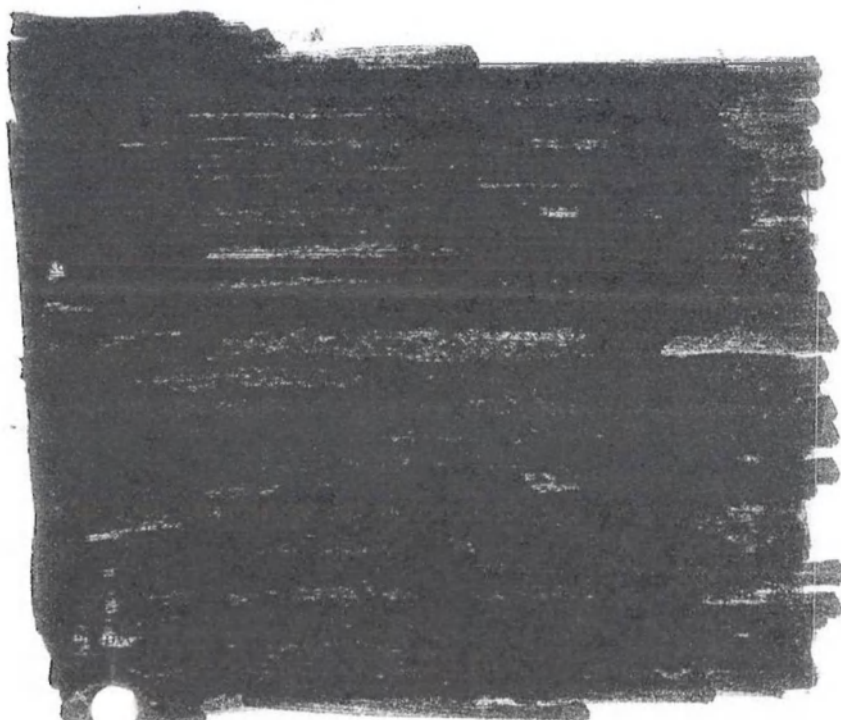
#### Overview of Loanbook:


- 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
<i>Which includes:</i>	
Preference shares	€370m
Undated junior	
Subordinated-;	€2,151m
Tier 2 Capital:	€2,642m
<i>Which includes:</i>	
Undated subordinated	€424
Dated subordinated	€2,136m





### 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
<b>Net Loans and receivables to Customers</b>	<b>41,005</b>	<b>39,120</b>

- 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 (€2,096, net of deductions)

Which includes:


Undated junior subordinated €0m

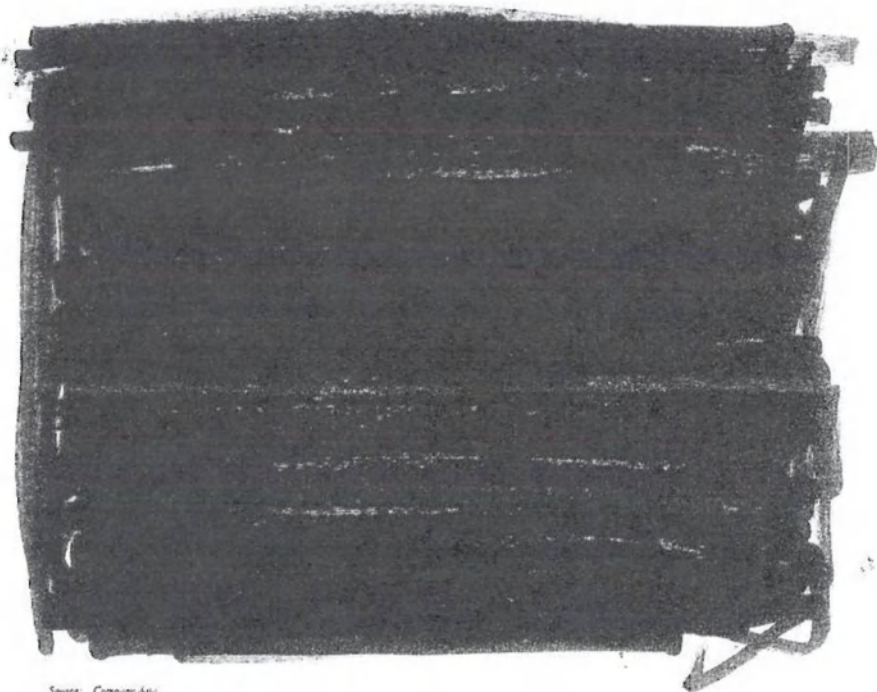
Tier 2 Capital: €1,487m

Which includes:

Undated subordinated €455m

Dated subordinated €1,144m





Source: Company data

## Appendix B

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

On 21<sup>st</sup> 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 rate, 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
<ul style="list-style-type: none"> <li>■ enhanced ability of the GSEs to meet their obligations</li> <li>■ Additional security and clarity to GSE debt holders – senior and subordinated</li> <li>■ 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</li> <li>■ Covenants prevent debt from being increased to more than 110% of its debt as of June 30, 2008</li> </ul>	<ul style="list-style-type: none"> <li>■ Preferred stock will continue to trade</li> <li>■ No voting rights</li> <li>■ Preferred dividends are suspended</li> <li>■ Existing preferred shareholders will bear any losses ahead of the government and not already absorbed by common shareholders</li> <li>■ Covenants prevent purchase or redemption of capital stock</li> <li>■ Covenants prevent new capital issues</li> </ul>	<ul style="list-style-type: none"> <li>■ Common stock will continue to trade</li> <li>■ No voting rights</li> <li>■ No common dividends to existing shareholders</li> <li>■ Existing common stock shareholders will bear any losses ahead of the government and preferred shareholders</li> <li>■ Dilution due to issue of warrants</li> <li>■ Negative impact on EPS available to common due to dividends on senior preferred</li> <li>■ Covenants prevent purchase of redemption of capital stock</li> <li>■ Covenants prevent new capital issues</li> </ul>

### AIG

On September 23<sup>rd</sup>, 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
<ul style="list-style-type: none"> <li>■ Enhanced ability of AIG to meet on-going obligations</li> <li>■ Additional security and clarity to AIG debt holders – senior and subordinated</li> <li>■ Incentive to reduce balance sheet through asset disposal</li> </ul>	<ul style="list-style-type: none"> <li>■ The fate of hybrid capital holders remains uncertain. Current secondary trading levels seem to indicate that AIG will suspend coupon payments on these securities</li> </ul>	<ul style="list-style-type: none"> <li>■ Common stock will continue to trade</li> <li>■ Diluted voting rights</li> <li>■ AIG suspended dividends on Common Stock on 23<sup>rd</sup> September</li> <li>■ Existing common stock shareholders will bear any losses ahead of the government and preferred shareholders</li> <li>■ Negative impact on EPS available to common due to dividends on senior preferred</li> </ul>

#### Roskilde

On 24<sup>th</sup> 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 22<sup>nd</sup> August, 2008)

#### Implications by category of investors

Debt / MBS	Preferred Equity	Common Equity
<ul style="list-style-type: none"> <li>■ Enhanced ability of the New Bank to meet on-going obligations</li> <li>■ Additional security and clarity to New Bank debt holders – senior</li> <li>■ Suspension of coupon payments on subordinated debt which is by nature deferrable and loss absorbing in Denmark</li> </ul>	<ul style="list-style-type: none"> <li>■ N/A</li> </ul>	<ul style="list-style-type: none"> <li>■ Common stock of the Bank will continue to trade</li> <li>■ No voting rights</li> <li>■ 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</li> </ul>

### 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 led 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
<ul style="list-style-type: none"><li>■ enhanced ability of the Bank to meet on-going obligations</li><li>■ Additional security and clarity to the Bank's debt holders – senior, subordinated, Upper Tier 2 and non voting hybrid Tier 1</li></ul>	<ul style="list-style-type: none"><li>■ Only preference shares with voting rights were cancelled</li><li>■ Compensation for holders to be determined by an independent body</li></ul>	<ul style="list-style-type: none"><li>■ Common equity de-listed</li><li>■ Compensation for holders to be determined by an independent body</li></ul>

# *Fortis:*

- Following market fears over Fortis and the sudden plunge by c.20% of Fortis share price on Friday 26 September, Governments of Belgium, Luxembourg and the Netherlands have announced on Monday 29 September that they would invest €11.2bn in the respective Fortis bank institutions in each country:
  - the Government of Belgium has agreed to invest €4.7bn in Fortis Bank (Belgium) in exchange for a 49% share in the common equity of this entity
  - the Government of the Netherlands has agreed to invest €4.0bn in Fortis Bank Nederland (Holding) N.V. in exchange for a 49% ownership in this entity.
  - the Government of Luxembourg will invest €2.5bn in Fortis Banque Luxembourg SA. in the form of a mandatory convertible loan. Next to other rights, Luxembourg will be entitled, upon conversion, to 49% of Fortis Banque Luxembourg.
- Due to the change in strategy, the deteriorated business environment and the decision to further de-risk the balance sheet, total value adjustments are expected of around €5bn after tax in the third quarter.
- Above measures lead to an estimated Fortis core equity of around €30bn. This results in a €9.5bn excess core equity for Fortis and a Bank core equity ratio of above 9% (Basel I) at end of the third quarter 2008. This translates into a total regulatory capital ratio for Fortis Bank of 13%.
- Equity injection is in ordinary shares, therefore the solvency of the opcos and of the group are greatly increased, to the benefit of non-dilutive Tier 1 holders (which rank senior to ordinary shares). Fortis reiterated its intention to continue paying distributions on its Tier 1 deals (there is no write-down or conversion into preferred) and reminded investors that their TI have ACSM mechanisms anyway (the Alternative Coupon Settlement Mechanism provides that suspended coupon payments will be cumulative and repaid at the option of the issuer through the issuance of common stock). Those ACSM mechanisms will not be used, and distributions will be paid in cash. That applies to all their non-dilutive Tier 1 issues - whether out of Fortis Bank Belgium (2001 and 2004 TI) or FHF (2006 and 2008 deals).
- Fortis will sell its stake in RFS Holdings, i.e. the acquired activities of ABN AMRO, excluding Asset Management (already transferred in the 2nd quarter of 2008). This sale, at a price below the acquisition price of €24bn will lead to an impairment. This impairment will not impact total regulatory capital. However, a sales price below €12bn would, for that difference, negatively impact core equity.
- Maurice Lippens decided to step down from the Fortis Board of Directors. The new Chairman will be recruited from outside the company in consultation with the Belgian government. In addition, the governments of Belgium, the Netherlands and Luxembourg will receive significant board representation in the respective Fortis banks.
- The recapitalisation does not create a credit event on the CDS.

Debt / MBS	Preferred Equity / Hybrid Capital	Common Equity
<ul style="list-style-type: none"> <li>■ Enhances ability of the Bank to meet on-going obligations</li> <li>■ Additional security and clarity to the Bank's debt holders – senior, subordinated, Undated subordinated (UT2) and non voting undated junior subordinated (hybrid Tier 1) are all protected</li> </ul>	<ul style="list-style-type: none"> <li>■ NA</li> </ul>	<ul style="list-style-type: none"> <li>■ Common equity is diluted</li> </ul>



#### IRE:

- Hypo Real Estate, the Dax-listed company, is one of Europe's biggest financiers of commercial property but is thought to have faced refinancing problems within Depfa, the public sector lender that it bought in 2006
- Hypo Real Estate Holding AG, together with its subsidiaries DEPFA Bank Plc, Hypo Real Estate Bank AG, Hypo Real Estate Bank International AG and DEPFA Deutsche Pfandbriefbank AG has secured a €35bn Euro short-term and mid-term credit facility to cover the Group's funding needs well into the future
- HRE is understood to have secured credit line in the form of bank loans and credit guarantees from a consortium of listed and public-sector banks in Germany as well as the Government
- The guarantees are designed to encourage banks to start lending money to Hypo Real Estate, which relies on unsecured money market debt to finance a significant proportion of its funding needs, at a time when the money markets have ground to a halt
  - Hypo Real Estate's public finance operation, which is conducted through its Depfa Bank subsidiary and comprises just over half the entire company's activities, raised 22% of its financing needs, or €54 billion, in the unsecured money market at the end of June
  - The company's real estate division, which lends to commercial property projects, raised 4% of its financing this way, or €4.3 billion
- The risk coverage is understood to be divided in two tranches - a first loss tranche of €14bn and a second loss tranche of €21bn. Private banks will cover for 60% of the first tranche, while the government will cover for 40% of the first and the entire second tranche. The German government has received no equity stake and does not plan any nationalisation of Hypo Real Estate
  - "We are planning no nationalization of Hypo Real Estate," the government said. The bail out package has been backed by German Chancellor Angela Merkel and Finance Minister Peer Steinbrueck.
- HRE is a one of the largest issuers in the local Pfandbrief market. HRE is about a 20% participant in the €900bn Pfandbrief market. There are indications that intervention was executed in order to stabilise the Pfandbrief market
- As a consequence of the arrangement, Hypo Real Estate Holding AG will have to impair the goodwill of its holding in DEPFA Bank Plc. This impairment will have a significant material effect on the Group's P&L statement. A dividend distribution for the financial year 2008 is not expected in order to mitigate the capital impact. Equity analysts have voiced concern about current management and have lost all confidence in their abilities

Debt / MBS	Preferred Equity / Hybrid Capital	Common Equity
<ul style="list-style-type: none"> <li>■ Enhances ability of the Bank to meet on-going obligations and funding</li> <li>■ Additional security and clarity to the Bank's debt holders – senior subordinated, undated subordinated (Upper Tier 2) and non-voting undated junior subordinated (hybrid Tier 3); are all protected</li> </ul>	<ul style="list-style-type: none"> <li>■ No effect</li> </ul>	<ul style="list-style-type: none"> <li>■ No effect</li> </ul>

#### *Glitnir Bank:*

- The government of Iceland has announced that it will acquire a 75% stake in Glitnir Bank at the price of €600m (\$859m), through the intermediation of the Central Bank of Iceland which stated that it does not intend to keep its stake for an extended period
- The new equity will be issued on the 29 September. The capital adequacy ratio will be 14.5 percent after the government's action
- This action is taken in light of temporary liquidity difficulties faced by Glitnir and because of the unusually difficult situation currently reigning in the global financial market.
- The government has asked Larus Welding to remain in his role as CEO which he has agreed to
- Glitnir said that the bank's board voted to accept the proposal at a meeting Monday morning. The bank now plans to call a shareholder meeting to approve the deal

Debt / MBS	Preferred Equity / Hybrid Capital	Common Equity
<ul style="list-style-type: none"> <li>▪ Enhances ability of the Bank to meet on-going obligations and funding</li> <li>▪ Additional security and clarity to the Bank's debt holders – senior, subordinated, undated subordinated (Upper Tier 2) and non voting undated junior subordinated (hybrid Tier 1) are all protected</li> </ul>	<ul style="list-style-type: none"> <li>▪ No effect</li> </ul>	<ul style="list-style-type: none"> <li>▪ No effect</li> </ul>

#### *Bradford & Bingley:*

- The UK Government announced today that it takes control of troubled mortgage lender Bradford & Bingley Plc ("B&B")
- Following recent turbulence in global financial markets, B&B has found itself under increasing pressure as investors and lenders lost confidence in its ability to carry on as an independent institution. The FSA determined on Saturday, September 26, that the firm no longer met its threshold conditions for operating as a deposit taker under the Financial Services and Markets Act 2000 and FSA rules
- For savers and borrowers of B&B it will be business as usual. Customers should continue to use their normal branches to access their accounts.
- Chancellor of the Exchequer has transferred B&B's UK and Isle of Man retail deposit business and branch network to Abbey National Plc, a unit of Spain's Banco Santander S.A.
- The remainder of B&B's business such as customer loans and treasury assets, including the 41 billion-pound mortgage assets and its wholesale liabilities, will be taken into public ownership
- The Treasury has put in place a 6 month guarantee to safeguard certain wholesale borrowings, and derivatives transactions of and wholesale deposits with B&B existing as at midnight on 28<sup>th</sup> September 2008. The Government intends to seek state aid approval from the EC to extend these guarantee arrangements
- In the initial period of public ownership the senior management team of B&B will remain in place to manage the transition

#### Debt / MBS

- The Treasury ensures that unsecured and senior wholesale deposits and borrowings and any accumulated interest on them will be repaid when falling due
- Dated and undated Subordinated do not benefit from the guarantee
- The securities issued pursuant to B&B's securitisation and covered bond programme will not benefit from the guarantee

#### Preferred Equity / Hybrid Capital

- No guarantee provided.
- The Government has varied the terms of B&B's subordinated debt in order to allow for the wind-down.

#### Common Equity

- Bradford & Bingley's stock market listing was cancelled shortly before markets opened Monday. Shareholders may get little if any compensation from the government.

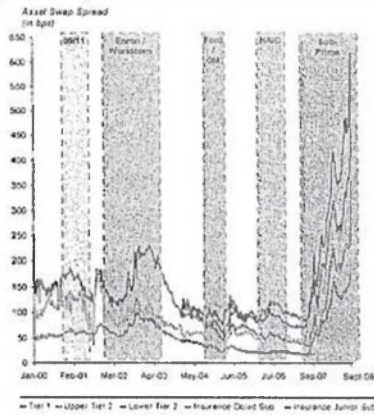
## Market Backdrop For Financial Institutions Severe Stresses In The Financial Markets Remain Amidst Volatility

### Aggregate Spread Performance By Asset Class

- Over the last few weeks we have seen a dramatic widening of market conditions. Uncertainty regarding the health of financial institutions have led 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 T-bill currently yielding 2% nearing the lows reached at the time of the Bear Stearns collapse
- Banks deposited \$100 in new yielding facility with the Fed on Thursday 28<sup>th</sup> September (vs historical maximum of \$100) rather than lend to each other

Asset Class	Product Type	Jan 1 Jan 01	Apr 1 Oct 01	Mar 1 Dec 01	Current
Equity	US CP Outstanding	\$2.2 trillion	\$1.8 trillion	\$1.8 trillion	\$1.77 trillion
Equity	US CP	2.2 + 15 bps	20 + 30 bps	20 + 40 bps	40 + 50 bps
USCP	US ABCP Outstanding	\$1.3 trillion	\$100 bn	\$100 bn	\$100 bn
USCP	1-3M ABCP	8 + 12 bps	30 + 40 bps	40 bps	100 + 150 bps
USCP	3-6M ABCP	15 + 20 bps	80 + 100 bps	10 + 80 bps	150 + 200 bps
USCP	6-12M ABCP	15 bps	17 bps	20 + 30 bps	60 bps
USCP	1-3M Public Sector	1 bps	1 bps	1 bps	30 + 30 bps
USCP	3-6M Public Sector	1 bps	1 bps	1 bps	30 + 30 bps
USCP	6-12M Public Sector	1 bps	1 bps	1 bps	30 + 30 bps
USCP	AAA	10 + 12 bps	15 bps	15 bps	130 + 150 bps
USCP	BBB	40 bps	250 bps	200 bps	400 bps
USCP	BBB-1	70 bps	140 + 150 bps	140 + 200 bps	500 + 550 bps
USCP	BBB-2	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-3	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-4	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-5	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-6	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-7	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-8	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-9	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-10	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-11	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-12	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-13	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-14	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-15	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-16	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-17	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-18	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-19	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-20	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-21	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-22	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-23	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-24	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-25	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-26	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-27	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-28	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-29	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-30	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
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USCP	BBB-71	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-72	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-73	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-74	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-75	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-76	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-77	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-78	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-79	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
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USCP	BBB-85	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-86	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-87	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
USCP	BBB-88	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
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USCP	BBB-90	80 bps	150 + 160 bps	150 + 200 bps	500 + 550 bps
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### Current Cycle Much More Severe Than Previous



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#### 4) Market Backdrop

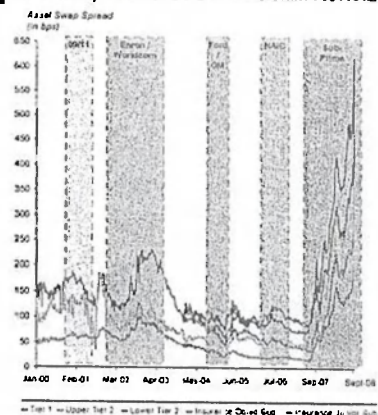
### Market Backdrop For Financial Institutions Severe Stresses In The Financial Markets Remain Amidst Volatility

#### Aggregate Spread Performance By Asset Class

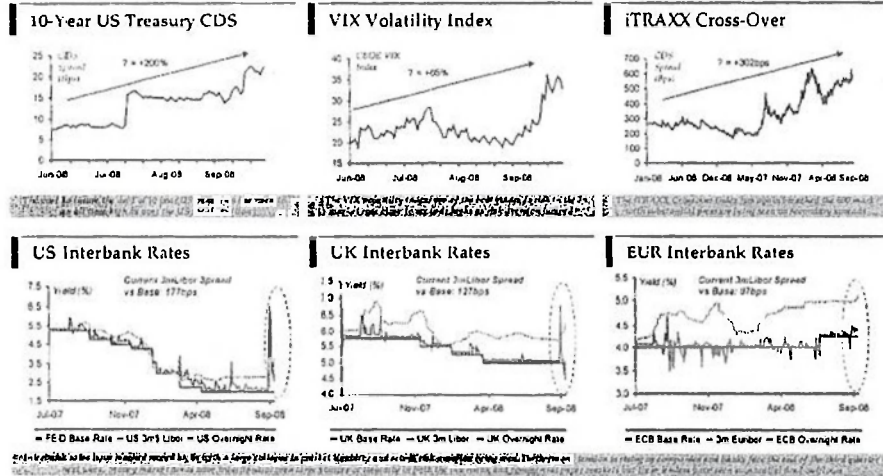
- Over the last few weeks we have seen a dramatic increase in market conditions. Uncertainty regarding the health of financial institutions have led to a total paralysis of the capital markets with very overnight funding currently available
- USCP volumes circa 60% of weekly placed overnight
- Massive flight to quality with the 2 yr Tbill recently yielding 2% nearing the lows reached at the start of the 90s sterling volume
- Banks deposited £6bn in new 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	Sep / Oct 07	Nov / Dec 07	Current
CP	A1/P1	1.5bp	1.1-1.2bp	1.1-1.2bp	1.1-1.2bp
	US CP Outstanding	12.2 trillion	\$1.8 trillion	\$1.8 trillion	\$1.75 trillion
MBS	A1/P1	1.5bp	1.1-1.2bp	1.1-1.2bp	1.1-1.2bp
	US MBS Outstanding	12.2 trillion	\$1.8 trillion	\$1.8 trillion	\$1.75 trillion
Secured Bonds	3y AA CDS	1.5bp	1.1-1.2bp	1.1-1.2bp	1.1-1.2bp
	3y A CDS	1.5bp	1.1-1.2bp	1.1-1.2bp	1.1-1.2bp
Covered Bonds	10y Mortgage Backed	1.5bp	1.1-1.2bp	1.1-1.2bp	1.1-1.2bp
	10y Public Sector	1.5bp	1.1-1.2bp	1.1-1.2bp	1.1-1.2bp
Securitisation	AAA	1.5bp	1.1-1.2bp	1.1-1.2bp	1.1-1.2bp
	BBB	1.5bp	1.1-1.2bp	1.1-1.2bp	1.1-1.2bp
Bank Capital	Banking Tier 1 (AA)	1.5bp	1.1-1.2bp	1.1-1.2bp	1.1-1.2bp
	Bank Tier 1 (AA)	1.5bp	1.1-1.2bp	1.1-1.2bp	1.1-1.2bp
Insurance Capital	Banking Tier 1 (AA)	1.5bp	1.1-1.2bp	1.1-1.2bp	1.1-1.2bp
	Banking Tier 1 (AA)	1.5bp	1.1-1.2bp	1.1-1.2bp	1.1-1.2bp
CRAAA	CRAAA Index	1.5bp	1.1-1.2bp	1.1-1.2bp	1.1-1.2bp
	CRAAA Index	1.5bp	1.1-1.2bp	1.1-1.2bp	1.1-1.2bp
VIX	VIX Index	1.5bp	1.1-1.2bp	1.1-1.2bp	1.1-1.2bp
	VIX Index	1.5bp	1.1-1.2bp	1.1-1.2bp	1.1-1.2bp
Government Bonds	2 year - Treasury Yield	4.61%	4.15%	3.78%	3.47%
	2 year - Treasury Yield	4.61%	4.15%	3.78%	3.47%

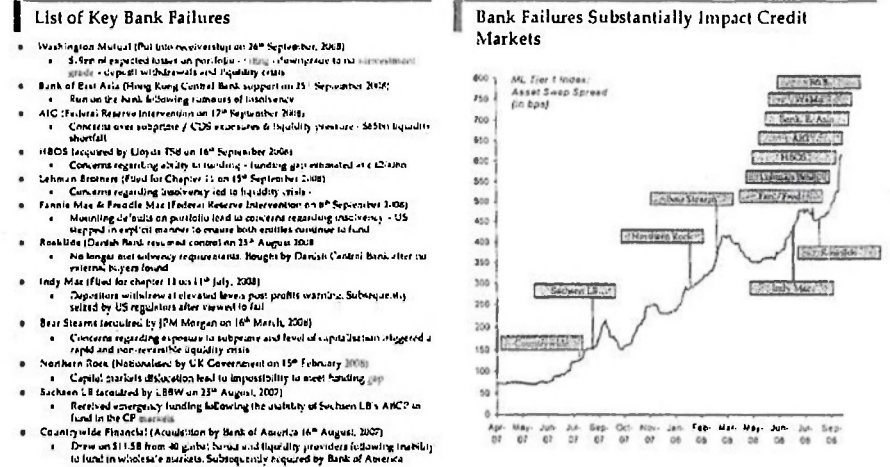
#### Current Cycle Much More Severe Than Previous



## Market Backdrop For Financial Institutions Severe Stresses In The Financial Markets Remain Amidst Volatility



## Market Backdrop For Financial Institutions Acceleration of Bank Failures & Impact on Capital Markets





## Government Decision to safeguard the Irish Banking System

Speaking points for the Taoiseach, 30 September, 2008

### What are the Guarantee arrangements announced by the Government?

- The Statement issued by the Government today states that following the advice of the Central Bank and Financial Regulator, the Government has decided to guarantee the retail, wholesale, dated term debt, secured borrowings and interbank deposits of the six domestic credit institutions (AIB, BoI, Anglo-Irish, Irish Life and Permanent, Irish Nationwide, EBS).
- In taking this action the Government is acting first and foremost in the interest of the stability of the Irish economy and the long term interest of the taxpayer.
- A secure and stable financial sector is essential for the Irish economy and it is in the best interests of the Irish people.
- Normal practice is that the guarantee would extend to wholly owned subsidiaries within the Irish bank's group, but this is subject to confirmation of status of the relevant entity to the Government by the bank and FR
- It is important to note that this guarantee is intended to secure the funding of these institutions. Equity investors and those holding junior debt will take first charge on the risk of any losses in these institutions over time under the guarantee provided by the State is not intended to insulate them from the risks that they have taken on.
- Since the onset of the current period of turmoil in 2007, the Government has stressed its commitment to the stability of the Irish financial system.
- The Minister has highlighted in recent weeks that money placed with an Irish credit institution would not be placed at risk.

- The measure is being taken as a response to the severe dislocation in the international credit markets, which has impacted both in the US and the EU.

### **What is the extent of financial exposure of taxpayers?**

- It is important to stress that the risk of any potential financial exposure is significantly mitigated by a very substantial buffer made up of the equity and near-equity (high yielding subordinated debt). There is, therefore, a significant buffer before there is any question of credit impairments impacting on the Exchequer on foot of the guarantee.
- The guarantee provided by the State relates to the liability side of the institutions' balance sheets - some €400bn or so in deposits - retail, corporate and wholesale - and their senior and dated subordinated debt. These liabilities are supported by €500bn in assets.
- Owing to the importance from the point of view of market sensitivity of putting definitive figures into the public domain, the Minister for Finance has asked the CBFSAI to confirm detailed figures.
- The asset quality in our financial institutions is good with a strong concentration in residential mortgages with a relatively low loan-to-value ratio (LTV) on average. While Ireland along with all developed economies has experienced a sharp decline in its property market there is very significant capacity within the institutions to absorb any losses.

### **What are the protections put in place to protect Irish Taxpayers?**

- Firstly, I would stress that this guarantee was not given lightly. It was informed by the strong advice of the Central Bank and Financial Regulator that on account of unprecedented disruption in

international financial markets the system-wide State guarantee was required to

- ensure that Irish financial institutions has access to the normal liquidity and funding to effectively operate their day-to-day business
  - provide confidence to depositors and wholesale lenders that they should continue to transact their business as usual with the institutions concerned.
- The interests of taxpayers will be very firmly safeguarded from any risk of loss from the very substantial warranty that the State is now providing.
  - Legislation which is to be brought forward to underpin this guarantee will
    - provide for specific terms and conditions, including fees, in relation to a guarantee provided
    - provide a very useful mechanism, alongside existing regulatory powers, to ensure that the Irish financial institutions are managed and operated in a manner which is fully consistent with their long-term sustainability
  - The intensified scrutiny and oversight of financial institutions which has been put in place since the onset of the current turmoil will be maintained and strengthened further to ensure that high regulatory standards are achieved in Ireland and that the quality of corporate governance in these institutions is a bulwark against any risk of loss for the State.
  - As far as the question of 'moral hazard' is concerned, it will be a priority for the Government to ensure that the highest regulatory standards and standards of corporate governance apply in all of the institutions concerned including in relation to lending practices to safeguard the interests of taxpayers against any risk of financial loss

#### **Will there be a return to Taxpayers from this intervention?**

- This guarantee will not be a free ride. Legislation which is to be brought forward to underpin this guarantee will provide for specific terms and conditions, including fees, in relation to a guarantee provided

- In taking this action the Government is acting first and foremost in the interest of the stability of the Irish economy and the long term interest of the taxpayer.
- A secure and stable financial sector is essential for the Irish economy and it is in the best interests of the Irish people.
- The protection of taxpayers' interests is the primary focus of this measure.

**Has consideration been given to taking an equity option in banks assisted?**

- This intervention is about enabling Irish banks to meet their liquidity needs in the current very difficult international financial circumstances to allow them to work through these difficulties and realise the value in their loan books.
- This guarantee will be paid for and the taxpayer who ultimately underwrites this support will be paid for the support provided.
- The commercial terms will ensure that the taxpayer gets value for money.
- We are not subsidising the banks as they are receiving the guarantee on commercial terms.
- The purpose of this measure is to provide security to all depositors and ensure confidence in the Irish Banking System. This confidence is essential in order that our citizens can access the liquidity that is crucial for the effective operation of our economy

**What will the Government get for the guarantee?**

- The first and most important point to be made is that the measure helps secure the stability of the Irish banking system. As is clear from the impact of the international credit crunch on the Irish economy, the financial system overall plays a central role in the economy and in the day-to-day lives of ordinary people.
- So the Government's objective for the guarantee is to stabilise the Irish financial system as much as possible against the backdrop of



the very uncertain and volatile international environment at present so that individuals and businesses can transact their normal financial business in a normal way.

- The Government's announcement makes clear that the guarantee will be provided at a charge to the institutions concerned and will be subject to specific terms and conditions so that the taxpayers' interest can be safeguarded.
- The Minister of Finance will be drawing on the advice of the Central Bank and NTMA to put a fee mechanism in place to remunerate the guarantee taking into account such factors as the possibility of increased funding costs for the Exchequer, the economic value for the institutions and need to support the investor confidence in the Irish financial system overall.
- In current highly abnormal market conditions I don't think it is useful to speculate on what might be described as commercial rate for the guarantee . It is important to be clear that it is only the State that could provide such a warranty; no market mechanism would of course provide it.
- The State in its approach to costing the guarantee will wish to take all relevant factors into account including to ensure that in the medium-term the Irish economy supports a strong and viable banking system, the benefit and value it creates for the financial sector and above all else that the Exchequer suffers no financial loss from having provided it.

## Supplementary Speaking Points

### **Are Credit Unions covered?**

Credit Union deposits of up to €100,000 are already guaranteed.

### **What are the difficulties that have occurred?**

- Global problems in relation to how credit institutions are funded have lead to a lack of liquidity across the global financial environment.
- Because of the global credit crunch, Irish institutions have had difficulty raising the funds they need to lend to customers.
- In a normal environment, as its own borrowings on the wholesale money markets (where banks lend to each other) fall due for repayment they would either be continued (rolled over) or new loans taken to replace them. But with the credit crunch new funds are no longer available.

### **Where is the money coming from? Commercial terms – what is the rate?**

- The Exchequer will be remunerated by the financial sector for giving the guarantee to ensure that no financial liability is permanently borne by the taxpayer.
- The commercial terms will be market rates.

### **How will it be transacted?**

The Central Bank will secure funding/liquidity to those banks that seek it and fulfil the commercial terms required.

### **Why now, why not last week or next week?**

- The continued uncertainty in the financial markets has come to a head over the weekend as evidenced by difficulties for a number of banks throughout the global economy, including in Germany, Belgium, Holland, the UK and the US.
- This measure has been heavily influenced by the further uncertainty created by the failure of the US Congress to agree a package.
- This is a measure which is within our remit. It is important that we do whatever we can to secure our financial interests.



**Will this be enough to secure the Irish banks? How do you know?**

- This is a pre-emptive measure to secure confidence in the Irish banking system. It will give certainty to customers and the market about the ability of Irish Financial Institutions to honour their financial commitments.

**What happens if this isn't enough?**


- The Government, in conjunction with the Central Bank and the Financial Regulator has made this decision as it is viewed as the most appropriate measure at this time.
- The Government, in conjunction with the Central Bank and the Financial Regulator, has taken steps to plan for alternative scenarios and will act as necessary to ensure the stability of the Irish financial environment.

**Will they help people and businesses to get loans?**

- Access to liquidity will only improve when the difficulties in the Financial sector are resolved. This decision should remove any uncertainty on the part of counterparties and customers of Irish institutions.
- Greater confidence in our financial system will increase the liquidity of the Irish financial system, thus improving the prospects for people and businesses in accessing loans.

**Are there any consequences for those banks that have given bad loans? Aren't you just bailing out bad banks and bad management?**

- The difficulties faced by all global financial institutions is related to lack of liquidity throughout the entire global financial markets.
- tion the Government is acting first and foremost in the interests of the Irish economy and taxpayer.
- A secure and stable financial sector is essential for the Irish economy and it is in the best interests of the Irish people.



## Government Decision to Safeguard Irish Banking System

The Government has decided to put in place with immediate effect a guarantee arrangement to safeguard all deposits (retail, commercial, institutional and interbank), covered bonds, senior debt and dated subordinated debt (lower tier II), with the following banks: Allied Irish Bank, Bank of Ireland, Anglo Irish Bank, Irish Life and Permanent, Irish Nationwide Building Society and the Educational Building Society and such specific subsidiaries as may be approved by Government following consultation with the Central Bank and the Financial Regulator. It has done so following advice from the Governor of the Central Bank and the Financial Regulator about the impact of the recent international market turmoil on the Irish Banking system. The guarantee is being provided at a charge to the institutions concerned and will be subject to specific terms and conditions so that the taxpayers' interest can be protected. The guarantee will cover all existing aforementioned facilities with these institutions and any new such facilities issued from midnight on 29 September 2008, and will expire at midnight on 28 September 2010.

The decision has been taken by Government to remove any uncertainty on the part of counterparties and customers of the six credit institutions. The Government's objective in taking this decisive action is to maintain financial stability for the benefit of depositors and businesses and is in the best interests of the Irish economy.

The Financial Regulator has advised that all the financial institutions in Ireland will continue to be subject to normal ongoing regulatory requirements.

This very important initiative by the Government is designed to safeguard the Irish financial system and to remedy a serious disturbance in the economy caused by the recent turmoil in the international financial markets.

**Ends**