TUARASCÁIL ón gComhchoiste Fiosrúcháin i dtaobh na Géarchéime Baincéireachta

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

REPORT of the Joint Committee of Inquiry into the Banking Crisis

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

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January 2016

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THEME: C5

Appropriateness and effectiveness of international, Ireland-specific policy responses

LINE OF INQUIRY: C5a

European Union (EU) / International Monetary Fund (IMF) / European Central Bank (ECB) programme of assistance

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21 November 2010

Mr Jean-Claude Juncker
Eurogroup President

Mr Didier Reynders
European Union Presidency

Dear Sirs,

On behalf of the Irish Authorities, I am writing to formally apply for financial assistance in the context of a joint EU-IMF programme. The external assistance sought is made under the terms of the European Financial Stabilisation Mechanism, the European Financial Stability Facility and the IMF assistance programme.

I welcome the statement by the Eurogroup and ECOFIN Ministers which concurred with the EU Commission and the ECB that providing assistance to Ireland is warranted to safeguard financial stability in the EU and in the euro area.

The Irish Authorities will cooperate fully in the preparation of the joint EU-IMF programme of assistance to the Irish State that will now be required to be developed.

Yours faithfully,

Brian Lenihan

Brian Lenihan TD
Minister for Finance

cc Mr Olli Rehn, Commissioner on Economic and Monetary Affairs, European Commission
Mr Dominique Strauss-Kahn, Managing Director, IMF
Mr Jean-Claude Trichet, President, European Central Bank

IMF Reaches Staff-level Agreement with Ireland on €22.5 Billion Extended Fund Facility Arrangement

Press Release No. 10/462
November 28, 2010

Mr. Dominique Strauss-Kahn, Managing Director of the International Monetary Fund (IMF), issued the following statement today on Ireland:
"The Irish authorities have today proposed a clear and realistic package of policies to restore Ireland's banking system to health and put its public finances on a sound footing. Immediate actions to tackle vulnerabilities in the banks and continued strong fiscal adjustment are set in a multi-year policy framework for sustained growth and job creation.

"In recent years, Ireland has resolutely carried out bold policies in a very challenging environment, and I have confidence in its ability to implement this new program. Supported by substantial financing, this program can underpin market confidence and bring Ireland's economy back on track.
"The strategy for the financial system rests on twin pillars: deleveraging and reorganization; and ample capitalization. A fundamental downsizing and reorganization to restore the viability of the system will commence immediately.

"At the end of this process, a smaller, more robust, and better capitalized banking system will emerge to effectively serve the needs of the Irish economy. The transition to this goal will be buttressed by substantial recapitalization based on higher capital standards and stringent stress tests and asset valuation to accurately determine the quality of banks' loan portfolios. In addition, structural measures—a special resolution scheme for deposit-taking institutions and a further strengthening of the supervisory system—will impart greater stability.

"On the fiscal side, the program incorporates a comprehensive National Recovery Plan that covers a period of four years. The plan will form the basis for the 2011 budget and also details fiscal consolidation measures through 2014. The process of budget formation will be reformed to safeguard these gains and bring greater sustainability to public finances.
"The fiscal plan strikes an appropriate balance between revenue and spending measures, and maintains Ireland's due regard to a social safety net.

"To restore strong sustainable growth the program includes a strategy to remove potential structural impediments to enhancing competitiveness and creating new employment opportunities. It also details appropriate sectoral policies to encourage exports and a recovery of domestic demand, thereby supporting growth and reducing long-term unemployment.

"A financing package of €85 billion (about US$113 billion) will support Ireland's effort to get its economy back on track. Of this, the European Union and bilateral European lenders have pledged a total of €45.0 billion (about US$60 billion). The Irish authorities have decided to contribute €17.5 billion to this effort from the nation's cash reserves and other liquid assets. The Fund's contribution would be through a three-year SDR 19.5 billion (about €22.5 billion; or US$30 billion) loan, representing about 2,320 percent of quota, under the Extended Fund Facility (EFF). The IMF has activated its fast-track procedures for consideration of Ireland's funding request, and I expect the EFF will go to the IMF Executive Board for approval in December."

The choice of an EFF offers Ireland a facility with a longer repayment period, with repayments to the Fund starting after four and a half years and ending after 10 years. The IMF charges member countries a uniform interest rate on nonconcessional loans, which is a floating rate based on the SDR interest rate, which is updated weekly. (The SDR interest rate is a weighted average of yields on three-month Treasury bills for the United States, Japan, and the United Kingdom, and the three-month Europe rate.) For amounts up to 300 percent of quota, the lending interest rate is currently 1.38 percent, while the lending rate on amounts over 300 percent of quota includes a surcharge that is initially 200 basis points and rises to 300 basis points after three years. At the current SDR interest rate, the average lending interest rate at the peak level of access under the arrangement (2,320 percent of quota) would be 3.12 percent during the first three years, and just under 4 percent after three years.

Ends

Government Statement

Announcement of joint EU - IMF Programme for Ireland

The Government today agreed in principle to the provision of €85 billion of financial support to Ireland by Member States of the European Union through the European Financial Stability Fund (EFSF) and the European Financial Stability Mechanism; bilateral loans from the UK, Sweden and Denmark; and the International Monetary Fund's (IMF) Extended Fund Facility (EFF) on the basis of specified conditions.

The State's contribution to the €85 billion facility will be €17½ billion, which will come from the National Pension Reserve Fund (NPRF) and other domestic cash resources. This means that the extent of the external assistance will be reduced to €67½ billion.

The purpose of the external financial support is to return our economy to sustainable growth and to ensure that we have a properly functioning healthy banking system.

The external support will be broken down as follows: €22½ billion from the European Financial Stability Mechanism (EFSM); €22½ billion from the International Monetary Fund (IMF); and €22½ billion from the European Financial Stability Fund (EFSF) and bilateral loans. The bilateral loans will be subject to the same conditionality as provided by the programme.

The facility will include up to €35 billion to support the banking system; €10 billion for the immediate recapitalisation and the remaining €25 billion will be provided on a contingency basis. Up to €50 billion to cover the financing of the State. The funds in the facility will be drawn down as necessary, although the amount will depend on the capital requirements of the financial system and NTMA bond issuances during the programme period.

If drawn down in total today, the combined annual average interest rate would be of the order of 5.8% per annum. The rate will vary according to the timing of the drawdown and market conditions.

The assistance of our EU partners and the IMF has been required because of the present high yields on Irish bonds, which have curtailed the State's ability to borrow. Without this external support, the State would not be able to raise the funds required to pay for key public services for our citizens and to provide a functioning banking system to support economic activity. This support is also needed to safeguard financial stability in the euro area and the EU as a whole.

Programme for Support

The Programme for Support has been agreed with the EU Commission and the International Monetary Fund, in liaison with the European Central Bank. The Programme builds on the bank rescue policies that have been implemented by the Irish Government over the past two and a half years and on the recently announced National Recovery Plan. Details of the measures are set out in the accompanying Notes for Editors.

The Programme lays out a detailed timetable for the implementation of the measures contained in the National Recovery Plan.

The conditions governing the Programme will be set out in the Memorandum of Understanding and the Government will work closely with the various bodies to ensure that these conditions are met. The funding will be provided in quarterly tranches on the achievement of agreed quarterly targets.

The Programme has two parts – the first part deals with bank restructuring and reorganisation and the second part deals with fiscal policy and structural reform. The requirement for quarterly progress reports covers both parts of the programme. When the documentation on the Programme is finalised, it will be laid before the Houses of the Oireachtas.

Bank Restructuring and Reorganisation

The Programme for the Recovery of the Banking System will be an intensification of the measures already adopted by the Government. The programme provides for a fundamental downsizing and reorganisation of the banking sector so it is proportionate to the size of the economy. It will be capitalised to the highest international standards, and in a position to return to normal market sources of funding.

Fiscal Policy and Structural Reform

The Ecofin has acknowledged the EU Commission's analysis that a further year may be required to achieve the 3% deficit target. This analysis is based on a more cautious growth outlook in 2011 and 2012 and the need to service the cost of additional bank recapitalisations envisaged under the programme. The Council has today extended the time frame by 1 year to 2015.

The Programme endorses the Irish Government's budgetary adjustment Plan of €15 billion over the next four years, and the commitment for a substantial €6 billion frontloading of this plan in 2011. The details of the Programme closely reflects the key objectives set out in the National Recovery Plan published last week. The adjustment will be made up of €10 billion in expenditure savings and €5 billion in taxes.

The Programme endorses the structural reforms contained in the Plan which will underpin a return to sustainable economic growth over the coming years.

The Government welcomes the support shown to Ireland by our Eurozone partners and in particular by the United Kingdom, Sweden and Denmark who have expressed their willingness to offer bilateral assistance. The Government also welcomes the assistance of the IMF.

As part of the Programme, Ireland will discontinue its financial assistance to the Loan Facility to Greece. This commitment would have amounted to approximately €1 billion up to the period to mid-2013.

28th November 2010

Statement by Minister for Finance, Brian Lenihan T.D. on the EU/IMF Programme for Ireland and the National Recovery Plan 2011 to 2014

A Cheann Comhairle, amid the sometimes hysterical and contradictory reaction to the external assistance programme on which the Government concluded agreement last weekend, one quintessential point has been overlooked. It is this: without this Programme, our ability to fund the payments to social welfare recipients, the salaries of our nurses, our doctors, our teachers, our Gardai, would have been extraordinarily limited and highly uncertain.

Fifty billion of the €67.5 billion we are receiving from our European partners and from the IMF will go to fund those vital public services over the next three years. In those circumstances, the only responsible course of action for any government was to accept the EU/IMF financial assistance fund.

Nonetheless, we enter this Programme not as a delinquent State that has lost fiscal control. We enter it as a country that is funded until the middle of next year; as a State whose citizens have shown remarkable resilience and flexibility over the last two years in facing head on, an economic and financial crisis the severity of which has few modern parallels internationally.

The team with whom we have negotiated has acknowledged our success in stabilising our public finances and they have endorsed our banking strategy. They have also accepted our four year Plan for National Recovery and have built their prescribed Programme around that Plan.

This needs to be emphasised because it shows that we do have the capacity to get out of our difficulties and that we have already made considerable progress in that respect. The fact is our economy is showing signs of recovery. As I have already reminded this house last week

- GDP will record a very small increase this year based on strong export growth.
- Exports are expected to grow by about 6% in real terms this year, driven by improvements in competitiveness and a strengthening of international markets.
- Conditions in the labour market are also beginning to stabilise.

The outlook for next year is much improved. As forecast in the Plan growth is expected to be around 1 ¾ per cent next year again driven by a remarkably robust export performance.

The Fine Gael leader referred to the European Commission's less optimistic forecasts in the Dail yesterday which he suggested had undermined our Four Year Plan. He ignored the substantial upward revision of the Commission's forecast on international trade which will benefit a small open economy like ours in which growth, by common consent, will be export led.

It is also the case that, under the Programme, we have been given an extra year to reach the deficit target of 3% of GDP precisely to take account of the Commission's lower growth forecast. I welcome this step but it does

not alter our budgetary plans as set out in the Plan. In other words the target of €15 billion of adjustments by 2014, remains but there is further room for manoeuvre in the event that growth is lower than expected.
In the later years, the Commission's growth forecasts are similar to my Department's. It is also the case that others - such as the ESRI for example - believe that the Department of Finance forecast is too pessimistic.

The Programme has adopted in its entirety the measures set out in the National Recovery Plan as a roadmap to return our economy to sustainable growth. The adjustment of €15 billion by 2014 has been accepted as has the breakdown of €10 billion in spending reductions and €5 billion in revenue raising measures. The details of the first €6 billion of this adjustment will be contained in the budget which I will present to the House next Tuesday.

The programme of structural and labour market reform aimed at improving our competitiveness has also been endorsed by the Programme. It set out a detailed quarterly schedule for the achievement of the agreed measures.

The negotiations on the Programme which took place over a ten day period were intense and at times difficult. They were conducted under my direction and that of the Governor of the Central Bank by the most senior officials from my Department, the Central Bank and the Financial Regulator, the National Treasury Management Agency and the Office of the Attorney General.

There has been the usual barrage of criticism of the outcome accompanied by the personal abuse of those involved that has become common place in our debased public discourse. But none of the critics explains how we could have secured the funds we require at less cost to the State.

Indeed the arguments put forward have been patently wrong. For example, it has been claimed that we are paying a higher interest rate than Greece even though Greece is now seeking our terms. The interest on Greek loans is 5.2% for 3 year loans. Ireland's interest rate will be 5.8% for loans that are on average for 7½ years. A basic fact of sovereign borrowing is that the longer a country borrows money, the higher the interest rate paid.
Germany can borrow at 2½% but the remainder of the EU member states are borrowing at either far closer to 5% or higher than 5% and they must cover their costs.

Of course, if at any time during the three years of the Programme, it emerges that we could borrow at a lower rate in the markets, there is nothing to stop us from doing so.

I want to clarify the position of the €85 billion funding package and its impact on our debt levels. Of the total, €50 billion is to provide the normal budget financing: in other words, it is money we would have had to borrow over the next three years in any event. The Programme provides these funds at a much lower rate than currently available to us in the market. This level of funding is already included in the plan. Of the remaining €35 billion - €10 billion is for immediate additional bank recapitalisation and the remaining €25 billion is to be used as a contingency fund, only to be drawn down if required

Furthermore, the State is in the happy position of being able to contribute €17.5 billion towards the €85 billion from its own resources, including the National Pension Reserve Fund. It can do this without prejudicing the commitments in the four year plan to use funds from the NPRF for projects such as the water metering programme and retrofitting.

This use of the NPRF has provoked the most bewildering criticism of all from parties who, having for years fundamentally disagreed with the very existence of the Fund, have now become its most ardent protectors. And on this point the arguments make absolutely no sense. Why would we borrow expensively to invest in our banks when we have money in a cash deposit earning a low rate of interest? And how on earth can we ask tax payers in other countries to contribute to a financial support package while we hold a sovereign wealth fund? We have a large problem with our banks which has forced us to seek this external assistance. In these circumstances, it is surely appropriate that our cash reserves should be deployed to help solve that problem.

The reason we had to seek external assistance is because the problems in our banking system simply became too big for this State to handle on its own. Our public finance problems are serious but we were well on the way to solving them. The combination of the two sets of difficulties in circumstances where the entire Eurozone was under pressure was beyond our capacity.

So the primary aim of the Programme agreed last weekend is to support the recovery and restructuring of our banking system.

It has been clear for some time that our banks were facing serious challenges in terms of their liquidity position. Lingering concerns in the market regarding their capital position led to negative market sentiment.

This was despite the substantial transfer of the banks' riskiest loans to NAMA and the detailed capital adequacy assessment made by the Financial Regulator in the summer as well as the significant recapitalisation measures that flowed from that.

But the Programme does not propose any departure from existing policy: its prescription is an intensification and acceleration of the restructuring process already being undertaken for the Irish banks. A key objective is to ensure that the size of the domestic banking system is proportionate to the size of the economy and is appropriately aligned with the funding capacity of the banks overall taking into account stable sources of deposit and wholesale funding.

The programme also seeks to demonstrate the capacity of the banks to accommodate very significant further deterioration in asset quality so as

to rebuild market confidence in the robustness and financial resilience of the banking system overall.
The Central Bank is requiring the banks to meet a Core Tier 1 capital ratio of 12% - a key measure of capital strength. If the banks cannot source it themselves, the State will inject the necessary capital. For that purpose, €10bn can be drawn down immediately from the overall Programme fund. A further remaining 25 billion euro will be available on a contingency basis.

The Central Bank will also carry out an updated capital assessment exercise or PCAR review of the capital position of the banks in early 2011 based on stringent stress testing and detailed reviews of asset quality and valuation. This exercise will ensure that over the coming years, the banks' capital ratio do not fall below 10.5% - this is a high standard in international terms and should give significant confidence to the market that our banks will be in a strong financial position. This in turn will provide the necessary reassurance to allow the banks to attract greater market funding in due course.

The Government will also undertake a process of significant restructuring and right-sizing of the banks to reduce their balance sheets. In this context, all land and development loans below €20m in Bank of Ireland and AIB will be transferred to NAMA.

Further work will be undertaken in the short-term with the banks to identify how the sector can be reorganised to ensure that we have a viable and financially strong banking system which meets the needs of the real economy and has the confidence of international markets. This strategy, developed in collaboration with the various international organisations and endorsed by them, builds on the measures adopted by the Government over the past two years to resolve our serious banking difficulties.

The Programme allows for an integrated approach to the restructuring of Anglo Irish bank and Irish Nationwide Building Society, building on the proposed Asset Recovery Bank structure to seek to maximise value from their loan books.
Revised restructuring plans for the two institutions will be submitted to the European Commission in early 2011 detailing the resolution of the institutions, in particular the arrangements for working out of assets over an extended period of time

I would like to reiterate that all deposits held with the domestic banking system are safe and covered by the Deposit Protection Scheme for sums up to €100,000. In addition, deposits are covered under the Eligible Liabilities Guarantee Scheme for sums over €100,000 for the full term of the deposit up to five years providing they are made prior to 30 June 2011.

There has been much commentary about the need for senior bondholders to accept their share of the burden of this crisis. I certainly raised this matter in the course of the negotiations and the unanimous view of the ECB and the Commission was and is that no Programme would be possible if it were intended by us to dishonour senior debt. The strongly held belief among our European partners is that any move to impose burden sharing on this group of investors would have an enormous ripple effect throughout the Euro system. That was confirmed by Professor

Honohan in an interview last Monday when he said there was no enthusiasm in Europe for this course of action.

There is simply no way that this country, whose banks are so dependent on international investors, can unilaterally renege on senior bondholders against the wishes of the ECB. Those who think we could do so are living in fantasy land. Worse still, those who know we cannot do so but who nonetheless persist with the line are damaging this country and its financial system: and all for the sake of a cheap headline. It is a case of politics as usual even at this most difficult time.

It is estimated that around 84% of Ireland's bonds are held by international investors. Whether guaranteed by the State or not, a decision to default on these bond obligations would seriously compromise the standing of the whole of the Irish financial system. That is the advice of the Governor of the Central Bank; that is the advice of the National Treasury Management Agency; that is the advice of the Attorney General.

The idea that is out there that somehow there are no costs associated with default is entirely incorrect. Ireland is hugely dependent on Foreign Direct Investment. These companies have large funds and investments in Ireland and directly and indirectly employ a quarter of million people in this economy. Any default on senior debt and the uncertainty that would cause would undoubtedly impact on the future investment decisions of these companies.

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Subordinate Bonds

Subordinated debt holders are in a different position. As I said in my statement on the 30th of September last, there will be significant burden sharing by junior debt holders in Irish Nationwide and Anglo Irish Bank. These two institutions had received very substantial amounts of State assistance and it was only right that this should be done.

My Department has been working with the Office of the Attorney General to draft appropriate legislation to achieve this and this is near finalisation. Parallel to this Anglo Irish Bank has run a buyback operation which will offer these bondholders an exchange of new debt for old but at a discount of 80%. This process is still underway and will be concluded shortly.

Obviously this approach will also have to be considered in other situations where an institution receives substantial and significant State assistance in terms of capital provided to maintain their solvency ratios. I hope to be in a position soon to announce this legislation.

We need a properly functioning banking system for this country. As I have indicated in the past we need to shift to a banking system commensurate with the economy but one that is strong and capable of meeting our needs. That has been the overriding objective of all our efforts since this crisis began two years ago. I believe the considerable funds provided by this Programme, will enable us to bring this crisis to an

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end and to secure the future of the Irish banking system so that it can play its full role in supporting the development of this country.

Conclusion:

We have been through a traumatic two years. Of course, we would have preferred to avoid resort to external assistance. But we can emerge from it a stronger and fitter economy. The attributes that brought us the boom: the quality of our workers, our entrepreneurship, our pro-business environment; all of these remain in tact. During the boom we built a top class transport infrastructure, sport and cultural facilities and educational sector. Over the last two years, we have won back much of the competitiveness we lost during the boom.

This 3 year EU/IMF Programme will provide the basis for funding us through our current difficulties. It provides the funding to restructure and recapitalise our banking system. And it will guide us through the implementation of the necessary budgetary and reform strategies set out in the National Recovery Plan. A Cheann Comhairle, we have every reason to be confident about the future of this economy.

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Dublin, 3 December, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. Strauss-Kahn:

1. Ireland faces an economic crisis without parallel in its recent history. The problems of low growth, doubts about fiscal sustainability, and a fragile banking sector are now feeding on each other, undermining confidence. To break this vicious circle, we are proposing a strong, wide-ranging, reform programme, backed by a substantial international financing package, to restore confidence and return the economy to a path of sustained growth and job creation.

2. At the root of the problem is a domestic banking system, which at its peak was five times the size of the economy, and now is under severe pressure. The Irish owned banks were much larger than the size of the economy. The fragility of the banking sector is undermining Ireland's hard-earned economic credibility and adding a severe burden to acute public finance challenges. Decisive actions to restore the strength of the financial sector and re-establish fiscal credibility are needed now.

3. The Irish authorities have already undertaken major steps to address these challenges. For the financial sector, these include measures to facilitate funding of banks, separate good assets from bad, asset disposals, and bank recapitalisation. On the fiscal side, we have pursued a large consolidation programme since 2008 and have announced a National Recovery Plan that accelerates the process of putting public finances on a sound footing.

4. But we recognise that more needs to be done. A fundamental downsizing and reorganisation of our banking system is essential. We are immediately undertaking several bold measures to achieve a robust, smaller, and better capitalised banking system that will effectively serve the needs of the economy. Restoring the banks to viability will also help insulate public finances from further pressures. We are mindful that the transition to a healthy banking sector will need to be actively managed to avoid fire sales of assets and

reduce market uncertainty. We are, therefore, expeditiously raising capital standards, stepping up efforts that will ensure that banks' losses are promptly recognised, and creating a mechanism to inject needed capital into the banks. We are also strengthening the banking resolution framework to promote financial stability.

5. In addition, we are also pressing ahead with our commitment to achieving a sustainable budget position. The National Recovery Plan lays out our strategy for staying the course of needed reform in a way that is socially fair and protects the most vulnerable. Recognising that Ireland already has put in place a business-friendly environment, our Plan also lays out a range of structural reforms that will be implemented to underpin economic stability, and enhance growth and job creation.

6. We are turning to our international partners for support as we implement these far-reaching objectives. Our estimate is that the financing need would be up to €85 billion until the end of 2013. We therefore request that the Fund support our policy programme through an arrangement under the Extended Fund Facility which can be drawn over a period of 36 months in the amount of SDR 19.4658 billion (€22.5 billion). This arrangement, along with support of €45 billion from the European Financial Stability Mechanism/European Financial Stability Facility including bilateral loans from the United Kingdom, Sweden and Denmark, and the judicious use of our own resources (€17.5 billion), will help ensure financial stability as we restore market confidence and return to durable growth.

7. The attached Memorandum of Economic and Financial Policies outline the economic and financial policies that the Irish authorities will implement during the remainder of 2010 and the period 2011–13. We are confident that the policies set forth in this memorandum are adequate to achieve the objectives under the programme. We stand ready to take any corrective actions that may become appropriate for this purpose as circumstances change. As is standard under Fund-supported programmes, we will consult with the Fund on the adoption of such actions in advance of necessary revision of policies contained in this letter.

8. This letter is being copied to Messrs. Juncker, Reynders, Rehn, and Trichet.

Sincerely,

Brian Lenihan

Brian Lenihan
Minister for Finance

Patrick Honohan
Governor of the Central Bank of Ireland

Irish Economy

Ireland’s Economy Back from the Brink, But Continued Progress Needed

IMF Survey

December 19, 2013

- Signs of growth emerging and unemployment has started falling
- Considerable achievements, but strong policy efforts still needed
- Lessons from the Irish experience for global policymakers

The successful completion of Ireland’s EU/IMF-supported program has left the country in a much stronger position than when its program began, say the IMF’s Ajai Chopra and Craig Beaumont.

Ireland has pulled back from an exceptionally deep banking crisis, significantly improved its fiscal position, and regained its access to the international financial markets.

In an interview, former Ireland country reviewer Chopra and current Ireland mission chief Beaumont—who were involved with the program from start to finish—share their views on the main achievements and the road ahead. Ireland needs to persevere with steady fiscal consolidation and reforms to help an emerging economic recovery become strong and lasting, say Chopra and Beaumont, noting that the program’s success owes much to the full commitment by the Irish authorities and its people—who persisted despite challenges and uncertainty during their program.

IMF Survey: Jai, you oversaw the Fund’s work on Ireland—what do you see as major successes under the program and what is left to do?

Chopra: Ireland has achieved a tremendous amount in the three years since the EU/IMF-supported program began in December 2010. Remember that this period included threats to the very existence of the euro area, making Ireland’s achievements all the more impressive.

The crisis in Ireland was first and foremost a banking crisis. Hence the immediate priority was to recapitalize and stabilize the banking system, which was achieved early in the program, stemming the outflow of deposits. Progress has also been made in reducing the size of the banking system, which had assets of almost 500 percent of GDP when the program started.

On the fiscal side, budget consolidation started even before the program. Over 2009–13, the structural primary deficit has been reduced by about 10 percentage points of GDP. This consolidation has been achieved in a pragmatic way with a good balance of spending and revenue measures and with due regard to fairness. As a result of this adjustment, Ireland should be able to achieve a primary balance in 2014 and government debt should soon be on a declining path.

We are also beginning to see signs of growth emerging and unemployment has been falling. Back in 2011, I had said that employment growth, which has been accelerating in recent quarters, would be the real test of whether the program is working.

Ireland has also implemented a range of institutional reforms to address weaknesses that led to the crisis. The medium-term fiscal framework has been strengthened and a credible and well-functioning fiscal council has been established. And on the financial side, regulation and supervision, which were deficient in the run-up to the crisis, have also been revamped.

But all that said, there is still much that needs to be done. This is not unusual—when problems are as severe as what Ireland faced, it is not possible to fix matters in three short years. This was recognized at the outset, and it does not detract from what has already been achieved.

Importantly, there's still a large overhang of debt that needs to be worked out. Households' debts amount to almost 200 percent of disposable income. Sovereign debt is also still high—we project it to peak at about 124 percent of GDP in 2013. So private balance sheet repair and fiscal consolidation both need to continue. Inevitably, these processes take time.

Despite the progress in recapitalizing and stabilizing the banking system, banks are not yet supporting the economy with adequate lending. Nonperforming loans are still high and progress in dealing with these impaired assets has been slow. And bank profitability remains weak. Work needs to continue to address these impediments to sustained recovery.

Looking forward, the critical objective is to generate higher growth based not only on exports, but also a revival of domestic consumption and investment. Such balanced growth is essential to create more jobs and make a bigger dent on unemployment.

The Irish authorities recognize that continued sound policies are needed to support Ireland's growth and they recently released a medium-term economic strategy to cover the period from 2014 to 2020. The determination to articulate and implement such a strategy is most encouraging.

IMF Survey: Thank you, Jai. And Craig, as mission chief, what do you think were the major steps that Ireland took to regain access to capital markets?

Beaumont: Ireland began to regain market access in the middle of 2012. It started by issuing Treasury bills, with the first issue happening to come immediately after the end-June Summit that called for banking union. Access continued to strengthen, especially after ECB President Draghi announced Outright Monetary Transactions.

Ireland was well placed to take advantage of improved market conditions in the euro area because its strong program implementation had addressed the acute uncertainties around public debt that prevailed at the end of 2010. The deficit target for 2011 was met and the budget for 2012 continued fiscal consolidation at a steady pace. As Jai mentioned, decisive actions on the banking sector during 2011 identified and met the banks' capital needs in a credible way, at an overall cost below expectations. Perhaps most importantly, markets gained confidence in Ireland's capacity to recover from the banking crisis as export-driven growth was quite strong in 2011 at 2.2 percent; investors we talked with considered that important.

So regaining market access reflected a combination of steadfast policy implementation, signals of Ireland's potential to recover economically from its deep banking crisis, and the significant steps forward in addressing the euro area crisis. Market access was confirmed through well subscribed bond issues in January and March this year, including a 10-year issue at a 4.15 percent yield, which is now trading at about 3.5 percent.

IMF Survey: How did the Fund and its European partners collaborate in support of Ireland during this period of turmoil and crisis?

Beaumont: Working with our EU Commission and European Central Bank counterparts was a very collaborative process, seeking a common position on all the key policies. This collaboration helped produce better policy proposals which were then very intensively discussed with the Irish authorities.

In advance of the missions in Dublin, we would coordinate on what the main policy issues were and alert the Irish authorities to those. During the missions we would learn a great deal from our discussions with the authorities, and also with private sector and academic economists, and need to adjust our views.

Typically during the weekend the troika teams would work together on drafts of the policy agreements (the Memorandum of Understanding and Memorandum of Economic and Financial Policies), which often required lengthy discussions among the experts on each issue—we would sometimes bet on when the meetings would finish!

The Irish authorities were the key party in developing and implementing the policies for the program supported by the EU and the IMF. This reflected Ireland's strong commitment to recover from the crisis, as seen in its significant contribution to program financing, with €17.5 billion of the total package of €85 billion coming from the Irish state.

IMF Survey: What was a broader social and political impact of the bailout?

Beaumont: The bailout was a dramatic shock for Irish society. The government that had negotiated the program soon resigned and elections were held in February 2011. The new coalition government formed in March had a strong mandate to implement its program for Ireland to recover from the crisis. It began by engaging with the troika on redesigning aspects of the program supported by the EU-IMF, including by revising the mix of budget measures to promote job creation.

The social impact of the bailout is hard to disentangle from the ongoing fallout from the banking crisis. Often the bailout is linked to difficult budget measures, though Ireland had been undertaking such measures for 2–3 years before the program, and in the absence of EU-IMF financing, even larger measures would have been required. There was also disappointment in Ireland that the program did not provide a more immediate turnaround in the economic situation. For example, unemployment kept on rising until it peaked in early 2012, though it has declined more recently. But the program did avert a sharper deterioration in the economy, which was likely given the deep loss of domestic and external confidence at the end of 2010, especially in the banking system.

Chopra: I would also add that the teams from the IMF, EC, and ECB made a concerted effort to have a dialogue with labor unions and with other organizations that had direct experience in dealing with vulnerable parts of society. This dialogue was very useful. No doubt, our counterparts will consider that not enough was done to address their concerns and I can understand that perspective. But we encouraged the government to design its fiscal consolidation measures with fairness and equity very much in mind.

IMF Survey: How do you see the prospects for Ireland's economy going forward?

Beaumont: After relatively strong growth in 2011, growth was sluggish in 2012 and into this year owing to weak trading partner activity and a "patent cliff" shock to Ireland's large pharmaceutical sector. But a range of indicators signal the economy is beginning to pick up in the second half of 2013.

We are projecting growth to rise to about 1¾ percent in 2014—a little below consensus estimates—and then to about 2½ percent in the medium term. Ireland's economy is highly open so the main contributor to higher growth is the recovery expected in trading partners, especially the United States, the United Kingdom, and the euro area.

By contrast, we anticipate modest gains in domestic demand next year, with the revival of domestic demand expected to be a protracted process as strained private balance sheets gradually become more healthy and also as the pace of fiscal consolidation eases. Improving financial sector health will also help sustain recovery though renewed lending, although near-term contributions are not expected to be significant.

Chopra: Here I think it's worthwhile to pick up on a point that Craig made, about the strength of trading partners. Ireland has grown faster than the eurozone average over the last three years. This is encouraging, but it should not obscure the fact that Ireland's prospects are inextricably intertwined with those of the eurozone. Therefore, Ireland's prospects will depend very much on the progress made to address demand and supply deficiencies in the eurozone, to achieve the ECB's inflation target rather than undershoot it, to reduce fragmentation, and to make more meaningful progress in improving the architecture of the monetary union.

IMF Survey: What lessons does the Irish experience hold for global policymakers?

Chopra: IMF rules require an independent staff team to prepare an ex-post evaluation of the Ireland program before the end of 2014. That evaluation will provide a more definitive view, but for now I'll offer five preliminary lessons.

The first is when the government is dealing with a systemic banking crisis it needs to come to grips with the situation quickly. It is essential to identify whether institutions are viable or not and then deal with them accordingly. Nonviable banks need to be resolved while viable ones need to be recapitalized, restructured and restored to healthy functionality.

Even though systemic banking problems in Ireland first blew up in 2008, confidence that these problems were being adequately tackled did not come till the publication of stress test results in March 2011, about three months into the program. These stress tests, together with the underlying asset quality diagnostics that were undertaken with the help of independent experts, have served as a model in other cases. The Irish also set a high bar for the transparency with which they communicated the results of the analysis underpinning banks' capital needs.

But it is not just a matter of recapitalizing banks. The banks also need to improve their profitability and get back into the business of lending. And to do that they need to be forceful in dealing with the bad debts on their books. Ireland was quick to set up an asset management company, NAMA, to deal with the large problem loans, especially in the property sector. But it is also essential to deal with smaller distressed borrowers, a problem that became more acute with the rise in residential mortgages that are in arrears. On this front, it took some time to develop a political consensus and the necessary legal framework and banks' operational capacity to deal with mortgage arrears. In retrospect, more rapid progress in dealing with mortgage arrears would have been worthwhile.

The second lesson is that it is unfair to impose the burden of supporting banks primarily on domestic taxpayers while senior unguaranteed bank bond holders get paid out. This not only adds to sovereign debt, but it also creates political problems, making it harder to sustain fiscal adjustment. Eurozone partners precluded the Irish from imposing haircuts on senior creditors of insolvent banks. But subsequent developments in the principles of orderly resolution of banks, after Ireland had paid off these creditors at great cost, have shown that imposing losses on senior bank bond holders is now becoming more accepted.

Third, on the fiscal front, steady but gradually phased fiscal consolidation that is designed within a well-specified medium-term plan, and that allows for the free play of automatic stabilizers, can be consistent with the return of confidence. There are some who wanted Ireland to move even faster with fiscal consolidation. This would have been a grave mistake. Investors also care about growth.

The fourth lesson from the Irish case is that it demonstrates how pernicious feedback loops can be. Weak balance sheets of banks, of the government, of households, and of companies all interact with each other. These interactions cause economic activity to stagnate and increase deflationary tendencies, further worsening all these sectors' balance sheets all over again. These feedback loops need to be arrested.

Some of this requires a domestic effort, which the Irish have accomplished as has already been outlined, although much remains to be done to reduce over indebtedness. But in a monetary union support is also needed from partners in the union. No doubt eurozone and EU partners have been generous and supportive of Ireland's efforts through various initiatives. Nevertheless, there remains an excellent case for even greater eurozone solidarity to break these adverse feedback loops, especially between banks and sovereigns. Such additional support would have a positive payoff, making it an investment that is worth undertaking.

Finally, and perhaps most importantly, the government's design and ownership of the program is critical. The Irish authorities' excellent record of policy implementation and compliance with conditionality under the program owes much to the fact that key components of the program were designed by the Irish themselves, and adopted only after they had been debated intensively both internally and with external partners. Social and political cohesion was maintained. Only then do you get full commitment to the measures as in Ireland. Moreover, the Irish persisted despite uncertainty and some dark moments. This makes me more confident that they will continue to persevere to get the economy growing again and to improve people's lives.

IMF Survey: Finally, Jai, you are leaving the program and the Fund and many people in Ireland are interested to hear about your plans.

Chopra: My involvement with Ireland over the past few years has been the capstone of a three-decade career at the IMF. This experience, together with other stimulating work I've done over the years at the IMF, motivates me to stay engaged in economic policy analysis and advocacy, but in a different setting here in Washington, D.C. I am also interested in doing volunteer work on financial literacy with low-income families and students. The manipulation of borrowers leading up to the crisis demonstrates the need for improving such literacy.

THEME: C5

Appropriateness and effectiveness of international, Ireland-specific policy responses

LINE OF INQUIRY: C5b

The Liquidation of Irish Bank Resolution Corporation (IBRC), the promissory notes refinancing and the relationships with the European Central Bank (ECB)

Copy #9

EMC paper

10th October 2012

STRICTLY SECRET: A disclosure of the contents of this proposal would prejudice the ability to implement it, if approved

Background

- Ireland continues to seek a significant improvement in its debt sustainability.
- A key pillar of any such solution relates to the restructuring of the Promissory Notes in IBRC.
- A number of potential restructuring options have been assessed in this respect (Tap & Swap; direct replacement with an alternative instrument), all of which present drawbacks from a State or Troika perspective.
- An alternative solution contemplating the liquidation of IBRC is now considered to achieve the objectives of both the State and the Troika.
- We believe that the ECB may tolerate this solution.

Transaction steps

1. CBI legally increase its security over all of IBRC's assets via a floating charge to reduce the Ministerial guarantee exposure
2. Approval sought and given by the ECB in relation to this proposal
3. New legislation to be introduced to allow the Minister to appoint a Special Liquidator which will allow the Minister to direct the Special Liquidator how to achieve an orderly wind-down of IBRC
4. The Minister appoints a Special Liquidator to IBRC and sets the mandate of the Special Liquidator
5. The CBI enforces the security which it holds over all of the assets of IBRC
6. The State and CBI settle the Promissory Notes by issuing a long-term (40-year) bullet repayment Government instrument
    a. [redacted]
    b. However, replacement of the Promissory Note with shorter-dated Government bonds would negate the benefit to the State and create a 'funding cliff' in the near-term, thereby severely hampering the State's ability to re-access debt markets, as the Irish market lacks capacity to absorb additional shorter-dated issues
    c. We believe that a 40 year Government bond should be acceptable to the ECB, as the ECB already accepts 40 year plus bonds from other countries as eligible collateral
    d. We would need a firm commitment from the ECB that this long term instrument to be held by the CBI would be recognised as a Special Holding and would be held to maturity. <u>*This is a critical consideration as the benefits to the Irish financial*</u>

system and to the well performing Irish Programme are dependent on the provision of this long-term funding support to the financial system.

7. The CBI will appoint a receiver to its secured assets, the receiver will dispose of the secured assets to NAMA or a subsidiary of NAMA
8. NAMA would have to pay fair value (e.g. long term economic value) for the assets it acquired. This would be required in order to ensure that Eurostat would not re-examine NAMA due to the State exerting control on NAMA and potentially include NAMA in the State debt figures
9. If the fair value that NAMA pays for the assets is at a significant discount to the net value of the assets in IBRC, this may create a capital shortfall for the CBI arising from the sale, for which the State would ultimately be liable as a result of the Ministerial guarantee.
10. In the event of a CBI shortfall, this could be rectified via a number of options:
    a. The CBI retains surplus income for a defined period instead of returning it to the State
    b. The State could provide a guarantee that it would meet any shortfall following the liquidation process (although this may result in an increase in Government debt).
    c. The State could make a cash payment to the CBI (which would result in adverse Government debt and deficit impacts).
11. The Special Liquidator would address issues such as transferring / netting of deposits, closing out derivative / hedging contracts, etc., and overseeing the liquidation of the remaining assets of IBRC

Benefits

The potential advantages of this solution, if feasible, would include:

- Significant net present value benefit to the State (based upon initial estimates, potentially up to a maximum c. €34 billion depending on agreement of the length of the replacement Government bond and its associated interest rate)
- Annual deficit improvement of c.€1.5 billion based upon initial estimates
- A substantial improvement in the State's debt position over time
- A substantial reduction in the current annual cash burden for the State
- A permanent solution for IBRC and the permanent removal of both IBRC itself as an entity, and the contentious Promissory Notes
- The removal of ELA from the Irish banking system
- Housing all the 'bad assets' in one entity (NAMA) resulting in just one wind-down vehicle, and the associated clean-up of the Irish banking system.

Risks

Copy #9

Pre-Existing Risks (on the basis that a floating charge will be put in place anyway)

A. The value ascribed to the collateral that the CBI can seize is a key determinant of any potential liability to the State. If there is insufficient collateral to cover the ELA lending, the Minister would be required to make good any shortfall.

B. The Minister may have a greater level of liability to make immediate cash payments under the guarantees than envisaged and may not be able to recover those payments from IBRC.

[redacted]

It is important to note that, under the status quo, any shortfall in assets available is ultimately a liability of the State. However, the transaction may serve to crystallise these liabilities immediately.

Transaction-Related Risks

A. A commitment would be required from the ECB that the long-term instrument to be held by the CBI would be recognised as a Special Holding to be held to maturity.

[redacted].

C. Any perception by the market of a sovereign default due to such a liquidation process will be mitigated, as the State will honour all its guarantees.

D. Risk that a cross-default is triggered with knock-on consequences for other transactions. It should be possible to manage this to ensure that it does not arise.

E. Maintaining confidentiality is critical.

F. No analysis of operational risks has been undertaken.

G. Potential for unforeseen consequences due to the complexities of the transaction, particularly in circumstances in which IBRC is not engaged in the planning process. Our analysis is based on limited financial and legal information in relation to IBRC. There is a risk that there are additional issues or financial downsides for the State.

Other Notes

- Net book value of customer loan book per IBRC 30 June 2012 accounts: €15.6 billion.
- Total ELA funding at end September 2012 (as advised by CBI): €40.6 billion. The Promissory Notes and NAMA Bonds are pledged against €24.4 billion of this €40.6 billion of funding. Additionally, €3.7 billion of funding has been provided against certain loans (nominal value: €5.4 billion). The balance of ELA funding (€12.5 billion) is made up by the Ministerial Guarantee.

KPMG

To: John Cronin

From: Kieran Wallace

Date: 15 October 2012

Calculation of the Red Liquidation outcomes

Introduction

- We have being asked by the Department of Finance to prepare a ***Base Case*** **("BC")** Estimated Outcome in respect of Project Dawn and provide commentary and assumptions in relation thereto.

- We have also been asked to prepare both a ***Positive Case*** **("PC")** and ***Conservative Case*** **(”CC”)** Estimated outcomes which are framed around the "BC" model.

- The information available to us was limited and our work has been based on;

  - Discussions with the Department of Finance including discussions on the transaction structure

  - Department of Finance calculations and assumptions

  - 30 June 2012 interim accounts for Red which we have assumed are not materially different to the current position.

  - The Interim accounts present the Consolidated position of RED. We have assumed that all material assets and liabilities are within RED and that any assets and liabilities in RED subsidiaries are not material.

  - Publicly available information.

  - March 2012 report carried out on the loan book of RED.

- Each Estimated outcome assumes deposit amounts are set off against customer loans and also assumes derivative counterparties exercise set off

- The Estimated outcomes exclude any tax charge which may arise on asset disposals, Liquidation

- costs and any other associated realisation costs.

- Any impact of the Barclays charge registered in RED has not been taken into account

- The assumptions used in the preparation of the various outcomes are attached

KPMG

Calculation of State Deficit

1 Asset adjustments

- The book value of the loans was originally €27.103bn and have now being written down to €15.565bn. The following further reductions in the book value of the loans has been assumed in the calculations;
  - *BC – a further reduction of 25%*
  - *PC – a further reduction of 20%*
  - *CC – a full provision of €1.185bn against loans to JV interests*

    – a further reduction of 50% against the balance of the €15.565bn

- Given recent loan portfolio sales in the Irish marketplace and a recent report we have seen on the quality of loans within Red and our discussion with the Department of Finance in our view the above assumptions which we have used in each of the scenarios are reasonable in the circumstances and appropriately reflect a suitable value range.
- In relation to the "CC" outcome we have further reduced realisations on Investment Property (€66m) and US loans (€85m), assumed excess collateral on Derivatives is not returned and written down the value of NAMA subordinated bonds to nil.
- In relation to the "PC" outcome we have also included an additional potential upside
  - Recognising €719m surplus between the nominal and carrying value of the NAMA subordinated bonds.

2 Preferential Creditors

- These claims comprise mainly of employee, pension and revenue claims. We have estimated the employee preferential claims at €€20m..
- It is likely that there may be a shortfall in the winding up of the pension schemes. The status of any shortfall should rank as a preferential creditor. We have estimated the pension shortfall at €10m.
- We have assumed that the Revenue Commissioners will set off the Revenue asset (€21m) against the Revenue liability of €46m.
- The current legislation provides that CBI floating charge ranks ahead of the preferential creditors

- Any increase the level of preferential creditors will have an impact of the deficit for the State.
- The preferential figure does not change in any of the models referred to above.

3 Costs of Liquidation

- No amounts are included for liquidation costs in the estimated outcome. These costs should not materially impact on the expected outcome under any of the Estimated Outcomes outlined above.
- All Liquidation costs incurred in this process will increase the CBI and State deficit.
- The costs should not be materially different under any of the various scenarios.

4 Unsecured/Contingent Claims

- It is likely that the unsecured claims will be increased due to the following creditor claims not currently included:
  - Legal Actions
  - Termination of contracts (employee and non employee)
  - Termination of property leases
  - Financial Instruments
  - Off Balance Sheet Items
- The increase in the unsecured creditor amounts should not impact on the overall deficit to the State. The amount of unsecured creditors could differ in each scenario but this is academic given that none of the estimated outcomes suggests any dividend to unsecured creditors.

State Deficit

- We have assumed that CBI steps into BOI's position and this affords them priority for the €2.845bn
- It is our understanding that the State is guaranteeing any deficit in the value of the loans taken over by NAMA.
- We are advised that any such liability arising under this guarantee will rank as a creditor ahead of other unsecured creditors. No provision has as yet been included for such a liability in the overall State liability as set out in each of the estimated outcomes.
- The analysis assumes that NAMA/any third party will pay the assumed percentage for the loans. Any amounts paid above this level will reduce the deficit to the State.

- In the same way, any amount paid below the assumed percentage threshold will increase the deficit to the State.
- The calculations (“BC”,”PC” and “CC”) shows the following Estimated Outcomes;

  - ***BC – CBI : Deficit of €1.701Bn State : Overall Deficit of €3.052Bn***
  - ***PC – CBI : Deficit of €0.192Bn State : Overall Deficit of €1.543Bn***
  - ***CC – CBI : Deficit of €7.429Bn State : Overall Deficit of €8.780Bn***

Conclusions

- The various outcomes show in a range in value for the CBI Deficit of €192m to €7.4Bn and for the State Deficit between €1.6Bn and €8.8Bn.
- Each scenario assumes no dividend for unsecured creditors
- Each model also assumes no additional funding by the State during the one hundred day loan book sale period.
- We have had limited information to review but based on the review carried out and discussions with the Department of Finance, we are of the opinion that assumptions used in the calculations are reasonable.

zxxzxxxxxxxxxxxxxxxzzzzzzzzzzzzProject Dawn

Key Messaging, February 2013

- Ireland is meeting its commitments to the Troika in the well-performing Programme of Financial Assistance. As part of this we have delivered extensive support to, and restructuring of, the domestic banking system.

- There still remains a structural liquidity issue in the Irish financial system. Much of this is captured in the Exceptional Liquidity Assistance (ELA) funding provided to IBRC, backed in large part by the Promissory Notes. We need to address this structural liquidity issue in a way which enhances the Programme and supports Ireland's sustained return to international debt markets.

- There is a shared recognition of the issues between Ireland and our international partners and we have been in discussion for the past year with the ECB towards agreeing a solution.

- We have put forward a proposed solution having reached agreement with the ECB in this regard.

- Some key elements of the proposal to be implemented are:

    - IBRC will be put into liquidation. A Special Liquidator, acting under the direction of the Minister for Finance, will be appointed to IBRC following the enactment of legislation for that purpose.

    - The Central Bank of Ireland will take ownership of collateral pledged as security against its lending to IBRC. This is mainly the Promissory Notes, which will be replaced with long term lower interest rate bullet maturity Government bonds. This will discharge some of the IBRC debt to the Central Bank.

    - NAMA will acquire the remaining Central Bank ELA debt together with the associated floating charge over IBRC assets and the Minister's guarantee in exchange for NAMA bonds to be issued to the Central Bank. In this way the debt to the Central Bank is fully discharged.

    - The Special Liquidator will value the IBRC assets and sell them to third parties or to NAMA, with the proceeds applied to super-preferential and preferential creditors, then to NAMA. Any residual will be distributed to other creditors in the normal way.

- The potential benefits of the proposal are considerable:
    - Removal of IBRC from the financial landscape;
    - Removal of Exceptional Liquidity Assistance and the inherent risk associated with short term borrowings which have to be rearranged on a fortnightly basis.
    - Efficiency gains from housing 'legacy assets' in a single vehicle, NAMA;
    - Establishing a permanent solution for a significant part of the structural shortfall of bank liquidity;
    - The provision of a longer term non-amortising (up to 40 years) portfolio of Government bonds to replace the amortising Promissory Notes which will have significant benefits from a market perspective as it ensures the liability to repay is beyond most credit investors' time horizon.

- Spreading the cost of the Promissory Notes from a weighted average life of c.8-9 years to circa 34-35 years at a low funding cost for the State, resulting in significant annual interest savings;
- Very substantial annual cash flow benefit to the State from non-amortising Promissory Notes (c.€2.3bn in the first year and c.€20bn over the next 10 years if costs of the transaction are excluded); and
- A reduction in the underlying deficit of c.€1bn per annum in the coming years (before transaction costs), reducing the forecast deficit by c.0.6% of GDP annually; and
- A significant improvement in the debt sustainability over time.

- It should be noted that certain costs are expected to be borne in connection with the proposal. These include ELG costs of c.€0.9-1.2 billion, potential costs in the event of a shortfall for NAMA, costs of the liquidation, and any potential costs associated with legal challenges.

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Mr Patrick Honohan
Governor
Central Bank of Ireland
Dame Street
Dublin 2

7th February 2013

Re: Irish Bank Resolution Corporation Limited (the "Company")

Dear Patrick

I refer to the European Communities (Reorganisation and Winding up of Credit Institutions) Regulations 2004 (SI No. 48 of 2011) (the "**CIWUD Regulations**") and to the European Communities (Settlement Finality) Regulations 2010 (SI No. 624 of 2010) as amended (the "**SFR Regulations**").

I hereby give you notice, for the purpose of Regulation 15(1) of the CIWUD Regulations and Regulation 8(3) of the SFR Regulations, that the Irish Bank Resolution Corporation Act 2013 (the "**Act**") was enacted on 7th February 2013 to provide a framework for the winding up of the Company.

The Minister for Finance has, pursuant to Section 4(1) of the Act, made a special liquidation order at 7:20 a.m. ~~p.m.~~ on 7th February 2013 (the "**Order**") and appointed Kieran Wallace and Eamonn Richardson of KPMG as joint special liquidators of the Company. The Order was immediately effective, and the winding-up of the Company (the "**Winding-Up Process**") commenced immediately upon the making of the Order.

I enclose a copy of the speech made by the Minister for Finance during the second stage of the Act's passage through the Dáil and a copy of the Q&A that is being issued by the Department of Finance in relation to the Winding-Up Process.

Yours sincerely

Michael Noonan

Michael Noonan TD
Minister for Finance

DE109/058/AC#6387898.7

Irish Bank Resolution Corporation Bill 2013

Second Stage Speech by Minister for Finance, Michael Noonan T.D.

6 February 2013

A Cheann Comhairle,

I move this Bill to be read a second time. I would like to thank you all for your attendance at such short notice.

As I have consistently informed this House, the Government has been in ongoing discussions with the European Central Bank to reach an agreed position on resolving the Promissory Note satisfactorily for all sides; the Irish State, the European Central Bank and the Eurozone. As many Deputies will have noted from this evening's media commentary, the ECB is considering a proposal from the Government as part of these ongoing discussions. In the discussions with the ECB it was envisaged that the first step would be the liquidation of IBRC and the sale of its remaining assets to NAMA or other market purchasers.

As soon as the information relating to the proposal to liquidate IBRC was made public, there was an immediate risk to the bank. Given this position, I as Minister for Finance, took immediate action to secure the stability of the Bank and the value of its assets, valued at €12 billion, on behalf of the State. To this end, I vested the powers of the Board temporarily in an employee of KPMG and a KPMG team is now in control of the Bank on my behalf.

The Government has met in the last hour and approved this proposed legislation for presentation to the Oireachtas.

What will happen to IBRC?

Once the legislation is passed joint Special Liquidators will be appointed to IBRC with immediate effect to wind up its business and operations.

It is intended that the net debt owed by IBRC to the Central Bank and its associated floating charge security will be purchased by NAMA, using NAMA bonds, in a way that ensures that there is no capital loss for the Central Bank. The Ministerial Guarantee underpinning the net debt owed to the Central Bank will also be transferred to NAMA. Eligible depositors, bondholders and counterparties will be repaid under the Deposit Guarantee Scheme and Eligible Liabilities Guarantee Scheme. There is also a Derivatives Guarantee in place. As is common in liquidations, all employment contracts in IBRC are immediately terminated, but the Special Liquidators have indicated that the majority of staff are likely to be re-hired to assist in the liquidation on such terms and for such duration as the Special Liquidators may designate.

As indicated, the IBRC debt to the Central Bank, which is intended to be purchased by NAMA, is secured by a floating charge over the assets of IBRC and a Ministerial Guarantee. Following an independent valuation process, the Special Liquidators will sell the assets of IBRC (which are subject to the floating charge) to third parties at or above their independent valuation and failing that, the Special Liquidators will sell the assets to NAMA at their valuation price. The proceeds of these sales will be used to repay creditors in accordance with normal Companies Acts priorities, so that preferred creditors, including employees would be paid first, and then the IBRC debt to NAMA would be paid under the floating charge. To the extent that there are proceeds available after repayment in full of the NAMA debt, these proceeds will be applied to remaining unsecured creditors who have not been paid under the guarantee schemes (which, for clarity, do not include the Deposit Guarantee Scheme). These remaining unsecured creditors will include the Minister to the extent that he has paid out under guarantee schemes. Similarly, if the proceeds are not sufficient to pay IBRC's debt to NAMA, the shortfall to NAMA will be met by the existing Ministerial guarantee.

The remaining subsidiaries will be wound up or sold by the Special Liquidators to optimise value, and once all of its obligations are resolved, IBRC will cease to exist.

Main Provisions of the Bill

I will now go through the sections of the proposed Bill.

Section 3 sets out the purposes of the Act.

Section 4 provides that the Minister will make a Special Liquidation Order in respect of IBRC.

Section 5 provides, among other things, for the publication of the Special Liquidation Order.

Section 6 provides, amongst other matters: (i) for an immediate stay on all proceedings against IBRC, (ii) that no further actions or proceedings can be issued against IBRC without the consent of the High Court, (iii) that no action or proceedings for the winding up of Red, or the appointment of a liquidator or an examiner can be taken, issued, continued or commenced, (iv) for the removal of any liquidator or examiner appointed prior to the Order, and (v) that the order constitutes notice of termination of employment for each employee with immediate effect.

Section 7 provides for the appointment of the Special Liquidators.

Section 8 limits the power to grant injunctive relief in certain proceedings.

Section 9 provides that the Minister will issue instructions and may issue directions to the Special Liquidators and requires the Special Liquidators to comply with such instructions and directions.

Sections 10&11 deal with the application of certain sections of the Companies Acts and Central Bank and Credit Institutions (Resolution) Act 2011 in the context of the winding up.

Section 12 provides for the sale or transfer of assets and liabilities in IBRC.

Section 13 provides that the Minister may give directions in writing to NAMA in relation to: (i) the acquisition by NAMA of the debt of IBRC to the Central Bank; and (ii) in relation to the purchase of assets of IBRC from the Special Liquidators.

Section 14 provides that the Minister shall direct the Special Liquidators in respect of the independent valuation of the assets of IBRC prior to sale;

Section 17 provides that the Minister may issue securities.

Customer Impact

The decision to liquidate IBRC is unique to IBRC and does not affect other banks. In the case of IBRC, the vast majority of IBRC's deposit accounts moved to AIB and Permanent TSB last year and they are unaffected by today's announcement. Deposit accounts that were retained in IBRC are generally associated with a wider ongoing relationship with the bank. It is important to state that all eligible deposits up to €100,000 for an individual and €200,000 for two individuals holding a joint account in IBRC are protected by the Deposit Guarantee Scheme in operation in the State and eligible deposits beyond this limit are guaranteed under the Eligible Liabilities Guarantee Scheme.

It is critically important that deposit account holders, mortgage account holders, and those indebted to IBRC understand that their situation following the liquidation should generally remain unchanged. If deposit account holders have any concerns they should make contact with the operators of the relevant schemes. Contact numbers are available on the Department of Finance website.

Staff Impacts

I wish to emphasise that the reason these steps are being taken is entirely distinct from the performance or direction of the Board or management of IBRC. It is simply compelling in the larger public interest to now take this action and the Government has made its decision on that basis alone.

I want to acknowledge, with much appreciation, the significant efforts the directors and staff of IBRC have made to the stabilisation of, and maintenance of value in, IBRC. I regret the abruptness of how this decision is communicated to the management and staff, but due to the scale, sensitivity and complexity of the economic issues involved, it was necessary in the public interest to keep the matter confidential until now.

Unfortunately, as is common in liquidations, all employee contracts will be terminated on the winding-up of IBRC. However, it has been indicated to me that the majority of staff will, if they wish, be re-hired for the purposes of the orderly liquidation on such terms and for such duration as may be determined by the Special Liquidators. Employees will rank, in the normal way, as preferential creditors ahead of NAMA and unsecured creditors in respect of certain amounts owing on a winding-up, including accrued wages, salaries, holiday pay, sick pay, statutory redundancy, pensions contributions and claims for damages arising from accidents.

I understand that this announcement will come as quite a shock to employees of IBRC and to some of those who do business with the bank and the Special Liquidators will be instructed to handle that as well as possible in the circumstances.

Conclusion

I would have preferred to be introducing this Bill in tandem with a finalised agreement with the European Central Bank. However, I understand that the European Central Bank will continue to consider the proposals made by the Irish Government tomorrow.

I commend this bill to the House

Q&A - IBRC liquidation 6 Feb 2013

Note: This Q& A document is provided solely for information purposes. It does not constitute (and shall not be construed as constituting) legal advice. It is also not a substitute for legal or other professional advice. No action should be taken or reliance placed solely on the information contained in this document.

1) What is happening?

The Bill passed today provides that joint Special Liquidators will be appointed to IBRC. When this is done the Central Bank will become the economic owner of the Promissory Notes. Apart from the wider economic considerations concerning IBRC, it makes very little sense at this point to retain two State organisations performing broadly similar functions. It is now appropriate that the remaining assets of IBRC which, following an independent valuation exercise and if not bought by third parties, will be sold to NAMA as part of the Special Liquidators' winding up of IBRC.

2) What will the liquidation of IBRC mean?

The liquidation of IBRC will involve winding up the institution and the funding structures put in place for it. Special Liquidators will be appointed to manage the winding-up of IBRC. As a key part of their appointment, the Special Liquidators will oversee a valuation and sales process for the assets of IBRC which may result in NAMA acquiring the bulk of the remaining IBRC assets. This will result in the housing and management of the remaining loans (that are not sold by the Special Liquidators to third parties) in one entity (NAMA) and a more efficient use of taxpayers' money. Furthermore, it will improve the health of the Irish banking sector by putting in place a longer-term solution for a significant part of the structural shortfall of bank financing that has emerged through the banking crisis.

There will be some upfront costs of the liquidation of IBRC. It is expected that claims will be made under the Deposit Guarantee Scheme ('DGS') and the Eligible Liabilities Guarantee ('ELG') scheme. Additionally, there could be costs arising under the Derivatives Guarantee. Claims under the guarantee schemes could cost the State between €0.9bn and €1.1bn based on current best estimates. There may be a further cost if the Minister for Finance is required to make up any potential difference between the consideration to be paid by NAMA for the IBRC debt it acquires from the Central Bank and the amount realised by the Special Liquidators on the sale of IBRC assets available to repay that debt. If, after an independent valuation exercise, the value of the assets sold by the Special Liquidators is not sufficient to compensate NAMA for the amount it paid for the net IBRC debt owed to the Central Bank, the Minister for Finance will be required to reimburse NAMA for the shortfall. If on the other hand, the value of the assets is sufficient to repay that debt in full, the Special Liquidators will retain surplus assets for the benefit of other unsecured creditors, including possibly refunding the State for payments made under guarantees.

3) What is the role of the Special Liquidators?

Like other liquidation processes, the Special Liquidators replace the Board and management in IBRC and will wind up its business and operations in the interests of its creditors. The Special Liquidators will, in general, have the same duties, powers and responsibilities as a normal liquidator except that they are appointed by the Minister for Finance rather than by the courts and they are obliged to comply with the instructions given to him by the Minister and act in the interests of the taxpayer under the provisions of the IBRC Act. As is common in liquidations, all employees of IBRC are made redundant but the Special Liquidators may rehire sufficient employees to assist in the liquidation on such terms and for such duration as he may determine. As a key part of their appointment, the Special Liquidators will oversee a valuation and sales process for the assets of IBRC which may result in NAMA acquiring the bulk of IBRC's assets.

Background

The IBRC debt to the Central Bank which will be purchased by NAMA is secured by a floating charge on the assets of IBRC. This floating charge, together with the benefit of a Ministerial Guarantee, will be transferred to NAMA. The IBRC assets will be valued by an independent professional advisor(s) appointed by the Special Liquidators. Any person that satisfies the criteria for bidders determined by the Special Liquidators may also bid for the assets in a sales process to be conducted by the Special Liquidators. The remaining assets will be transferred to NAMA in repayment of IBRC's debt to NAMA.

4) What will happen to the deposits in IBRC?

Eligible deposits are covered by the joint safeguards of the DGS and/or the ELG scheme. Eligible deposits of up to €100,000 for an individual and €200,000 for individuals with a joint account in IBRC are protected by the DGS. Eligible deposits above this limit are guaranteed under the ELG. Today's decisions will have no impact on the customers of any of the operating banks in the Irish banking system. Furthermore, the vast majority of IBRC's original deposit book moved to AIB and Permanent TSB in the first half of 2011 and these deposits are also unaffected by this announcement.

Background:

A significant majority of the remaining deposits in IBRC are held by depositors who have connected loans with IBRC. The status of these deposits will be considered by the Special Liquidators in terms of the contractual arrangements applying to them. To the extent that they are legally entitled to do so and having regard to the arrangement in place between IBRC and customers on their date of appointment, the Special Liquidators will set-off all existing deposits held as security for related lending against amounts due to the bank.

If a deposit is not eligible under either the DGS or ELG scheme the depositor will be treated in the same way as other unsecured creditors.

IBRC customers who have queries regarding their deposits can contact the helpdesk at 1800 3033632

5) What is the claims procedure for deposits?

Deposit Guarantee Scheme ('DGS')

There is no need to make a claim for compensation under the DGS. The Special Liquidators will provide details of eligible depositors and account balances to the Central Bank. Payments will be made by cheque within 20 working days of the appointment of the Special Liquidators and will be sent to depositors at the address held by IBRC.

In a limited number of circumstances, additional information may be required to confirm eligibility. In this instance, a formal claim is required. Depositors will be contacted but may also download relevant forms from the Central Bank website www.centralbank.ie

The Central Bank will keep customers of IBRC informed by providing regular updates on its website.

Eligible Liabilities Guarantee ('ELG') scheme

To the degree that customers are fully covered by the DGS no action is required as the Central Bank will be sending out cheques for amounts up to the first €100,000 of eligible deposits. To the extent that a deposit is not covered by the DGS and is covered by the ELG scheme, a claim must be submitted to the NTMA. Claim forms can be found on the NTMA website at www.ntma.ie

IBRC customers who have queries regarding their deposits can contact the helpdesk at 1800 3033632

6) How does this affect mortgage account holders / borrowers?

The contractual terms and conditions of customer mortgages and other borrowings will not change as a result of the appointment of the Special Liquidators and all debts owing to IBRC will remain due and enforceable. It is important that, to avoid breaches of their obligations, customers continue to make payments on their loans and otherwise honour the contractual obligations of their borrowings.

Background

All borrowers' loans including personal mortgages will initially be managed by the Special Liquidators. The terms and conditions of mortgage account holders will not change as a result of the liquidation and all debts owing to IBRC will remain due and enforceable. Portfolios of assets including the mortgage book will be identified by the Special Liquidators and these will be independently valued before being sold.

Third parties, including loan counterparties and other financial institutions, will be given the opportunity to bid for specific portfolios as part of an open and transparent sales process. If acceptable bids equal to or in excess of the independent valuation are not obtained, these portfolios will be sold to NAMA at the value determined by the independent valuation exercise until the IBRC debt to NAMA is repaid. This will ensure that the long-term value of the assets is received and a fire sale of assets will not occur. NAMA will not be required to acquire credit facilities advanced to current or former employees of IBRC (or any security or litigation relating to this category of loans). An assessment of this category of loans will be made by the Special Liquidators and a decision made in relation to how best to maximise the value of those loans.

Customers who have queries regarding their borrowings can contact the help desk at 1800 3033632

7) What will this mean for employees of IBRC?

Unfortunately today's announcement means that employees of IBRC will be made redundant with immediate effect.

However, the Special Liquidators will be entitled to re-hire employees, on such terms and for such duration as they may determine, for the purposes of the liquidation process. It is expected that the majority of staff will be retained for this purpose. Some staff may be offered positions by NAMA or other purchasers of assets but that will be a matter for the Special Liquidators, NAMA and the other asset purchasers. As is common in liquidations, the Transfer of Undertakings (Protection of Employment) regulations will not apply to the liquidation of IBRC.

Background/redundancy entitlements

Employees will rank as preferential creditors ahead of the floating charge holders and unsecured creditors in respect of certain amounts owing to them on a winding-up, including accrued wages and salaries, holiday pay, sick pay, statutory redundancy, pensions contributions and claims for damages arising from accidents. Listed below are the instances in which the employees rank as preferential creditors.

1) All wages and salaries in respect of services rendered to IBRC during the four month period prior to the winding-up – but subject to a maximum claim of EUR3,174.35 per employee;
2) All accrued holiday remuneration up to the date of the winding-up;
3) All sums due in respect of sick leave up to the date of the winding-up;
4) All contributions due from IBRC in respect of any superannuation benefits scheme (including a PRSA), and any contributions deducted from employees, as at the date of the winding-up;
5) Statutory redundancy lump sums, less the amount of any rebate due from the Department of Jobs, Enterprise and Innovation;
6) Any compensation awarded by the Employee Appeals Tribunal in respect of pay in lieu of notice and in respect of any claim for unfair dismissal; and
7) Any compensation due under the Workmen's Compensation Acts in respect of damages and costs in relation to an accident occurring in the course of employment prior to the relevant date (save to the extent insured).

In the normal course, liquidators do not make payments in respect of preferential claims owing to employees until all assets have been realised, which in the case of IBRC is envisaged take approximately six months. In those circumstances, the employees will be able to make a claim in respect of (a) their statutory redundancy entitlements from the Social Insurance Fund and (b) arrears of pay, sick pay, holiday pay or pay in lieu of statutory notice (limited to EUR600 per week up to a maximum of eight weeks) from the Insolvency Payments Scheme. The Minister for Social Protection will rank as a preferential creditor of IBRC in respect of any payments made to employees of IBRC from the Social Insurance Fund or the Insolvency Payments Scheme.

The Special Liquidators will assist any employee in respect of the processing of claims under the Insolvency Payments Scheme or the Social Insurance Fund. Further information in relation to the Social Insurance Fund and the Insolvency Payments Scheme is available on the Department for Social Protection's website.

8) What happens to unsecured creditors?

The normal Companies Acts' priorities will apply in this liquidation process. The proceeds from the disposal of IBRC's assets will be used to repay creditors in accordance with normal Companies Acts priorities, and consequently preferred creditors will be paid first and then the debt which NAMA will have purchased from the Central Bank will be paid. If there are proceeds available after repayment in full of the NAMA debt, these proceeds will be applied to remaining unsecured creditors. This will include the Minister for Finance to the extent that he has made payments under guarantee schemes.

Background

Amounts owing by IBRC to contractors, trade creditors and other service providers are unsecured debts which will rank for repayment after the IBRC debt bought by NAMA from the Central Bank has been repaid in full. It is unclear whether IBRC will have sufficient assets to repay unsecured creditors in whole or in part. The Special Liquidators will have the power to come to separate arrangements with any creditor that is considered crucial to maintaining value or vital in providing services for the day-to-day operations of IBRC. Where IBRC has issued bonds, guarantees or letters of credit to third parties at the request of customers under ancillary facilities arrangements, amounts owing under those bonds, guarantees or letters of credit may become due and owing to the relevant third parties upon the winding-up order in respect of IBRC. Unless covered by the ELG scheme, bonds, guarantees or letters of credit rank equally with debts to contractors and other service providers as unsecured debt.

9) Court cases

a) Cases taken by IBRC

IBRC's claims against third parties whether or not the subject of Court proceedings, will be unaffected by the winding up. The Special Liquidators will have the power to continue to manage any IBRC claims that currently exist and will have the ability to assert further claims where they arise. Alternatively, the Special Liquidators could sell IBRC's interest in any such claims to a third party, or to NAMA, in which case the acquirer will be entitled to continue those proceedings.

b) Cases taken against IBRC

The effect of the IBRC Act is to place an immediate stay on all proceedings against IBRC that are before the courts (including counter-claims which do not give rise to a set-off). Claimants who have issued proceedings against IBRC will now have to pursue and prove their debt to the Special Liquidators. Such claimants will rank as unsecured creditors in the liquidation. If a claimant is also a debtor of IBRC, and that debt is sold to NAMA or a third party buyer, such buyer will acquire the debt subject to that claimant's pre-existing valid and enforceable claims and counterclaims that give rise to an enforceable right of set-off against IBRC.

c) Future cases against IBRC

Any claims that have not been issued against IBRC by the date of the winding-up may only be made with the leave of the Court. As would be the case with any liquidation, claimants who issue proceedings against IBRC in respect of claims that arose prior to the winding-up will be unsecured creditors.

10) What will happen to ongoing regulatory investigations?

These investigations are unaffected by the liquidation of IBRC and the IBRC Act specifically provides that the issue of a special liquidation order under the Act does not affect any proceedings, investigations or disciplinary enforcement actions taken by the Director of Public Prosecutions, the Director of Corporate Enforcement etc.

11) What does this mean for IBRC?

The Bill passed today means that IBRC will be liquidated with immediate effect. The Special Liquidators will replace the Board and management of IBRC and will undertake the liquidation. Apart from the wider economic considerations concerning IBRC, it makes very little sense at this point to retain two State organisations, NAMA and IBRC, performing broadly similar functions. It is therefore appropriate that the remaining assets of IBRC (i.e., those which are not bought by third parties (following an independent valuation exercise) or those that are not retained by the Central Bank) are transferred to NAMA as part of the Special Liquidators' winding-up of IBRC.

Once all of the assets of IBRC have been realised and the proceeds have been distributed to the creditors in accordance with the priorities set out in the Companies Acts, the Special Liquidators will wind-down the business of IBRC and in due course IBRC will be dissolved and will cease to exist.

Background

The legislation passed means that Special Liquidators will be appointed to IBRC with immediate effect to take over from the Board and management of IBRC and to wind up its business and operations. After certain assets are retained by the Central Bank (e.g. Promissory Notes and NAMA bonds), the remaining net debt will be purchased by NAMA in a way that ensures that there is no capital loss for the Central Bank. Eligible depositors and bondholders will be repaid under the Deposit Guarantee Scheme and the Eligible Liabilities Guarantee scheme. As is common in liquidations, employees of IBRC will be made redundant with immediate effect but the Special Liquidators may rehire sufficient employees on such terms and for such duration as they may determine to assist in the liquidation. It is expected that the majority of staff shall be retained for this purpose.

The remaining IBRC debt to the Central Bank, after certain assets are retained by the Central Bank, which will be purchased by NAMA is secured by a floating charge on the assets of IBRC and a Ministerial guarantee.

Following a valuation process, the Special Liquidators will sell the assets of IBRC to third parties at or above their valuation and failing that, transfer them to NAMA at the independent valuation in repayment of IBRC's debt to NAMA. The proceeds of the loan sales will be used to repay preferred creditors under the Companies Acts first and following that, the IBRC debt to NAMA. To the extent that there are proceeds available after repayment of the IBRC debt to NAMA, these proceeds will be applied to remaining unsecured creditors. This will include the Minister for Finance to the extent that he has made payments under guarantee schemes. To the extent that there are insufficient assets of IBRC available to repay the debt to NAMA, the Minister will be required to make good this difference.

The remaining subsidiaries will be wound up or sold, whichever the Special Liquidators determine will realise greater value and once all of its obligations are settled, IBRC will cease to exist. Upon the appointment of Special Liquidators for the winding-up of IBRC, the board of directors will no longer have a role.

The directors of IBRC (including any former director of IBRC that ceased to hold that office within the 12-month period prior to the appointment of the Special Liquidators) will continue to owe obligations to IBRC (for example, with respect to the preparation of a statement of assets and liabilities for IBRC).

12) What will this mean for other banks?

It is important to note that this proposal is entirely separate from all other banks including AIB, Bank of Ireland and Permanent TSB and their customers, who are not impacted by these decisions.

13) Why is emergency legislation being used?

For financial stability reasons, it is critical to the orderly winding-up of IBRC that immediate certainty is provided to all stakeholders of IBRC in respect of its future. Financial stability is the reason why the potential for the winding-up of IBRC could not be signalled in advance.

14) Does this mean a debt write off for individuals?

No. All debts to IBRC remain due and payable in accordance with their terms. All loan payments should continue to be made. The Special Liquidators will be in direct contact with IBRC borrowers to notify them of any potential changes to payment details as a result of the liquidation. One of the objectives of the Special Liquidators will be to achieve the best valuation of these assets through the liquidation, which includes continuing to collect on all outstanding debts. They are also charged with achieving the best possible price for all other assets of IBRC as part of the liquidation.

An Roinn Airgeadais
Department of Finance

Private & Confidential

Attendees: DOF: Ann Nolan, John Moran, Gary Hynds
CBI: Patrick Honohan, Maurice McGuire, David Dolan
NTMA: Oliver Whelan, Frank O'Connor
Date: 02 Jan 2013
Re : PROJECT DAWN - MEETING BETWEEN CBI/NTMA/DOF BOND PROFILE

Governor Honohan opened the meeting with a brief update of recent discussions with the ECB around the profiling of the debt. The Governor outlined the three options currently under consideration

1. Fixed coupon instruments
2. Floating rate based on Euribor
3. Floating rate based on short term Irish paper

The ECB preference is for a fixed / tradable instrument however this causes issues for the CBI from an accounting perspective. The primary issues arise from the ECB requirement that prevents the CBI holding the bonds to maturity. The Governor is of the view that the ECB is not fully aware of the issues that this with cause the CBI in the long term due to the requirement to mark to market ('MTM') the value of the holdings. The MTM will introduce significant risks due to the volatility of the value of the bonds and the impact this will have on the capital position of the CBI. This may arise where there may be a capital deficit driven by the MTM impact of the valuations. The Governor was of the view that if a capital deficit arose then it would be unlikely that the CBI would be in a position to make distributions to the Exchequer until the deficit was addressed. The Governor was of the view that in any scenario it will be unlikely that the CBI will be able to hedge the instruments adequately. For these reasons the CBI would prefer a floating rate instrument.

A discussion was had around the possibility of introducing an option that allowed the holder to convert the bonds to fixed at the point of sale by the CBI. This proposal has the benefit of allowing the CBI to convert to a more conventional instrument (fixed at current market rates for equivalent notes) at the time of sale which would provide comfort to the ECB that the bonds are marketable. It was noted that floating rate instruments would continue to be marketable instruments prior to conversion but that valuation would be difficult given the lack of equivalent instruments in the market place.

In all scenarios the holding period remains a key concern. The Governor was of the view that the ECB would strongly resist any attempt to include any explicit requirement to hold the bonds for a specified period. This view seems to be led at a staff level in the ECB and driven by the legal theology in place. The NTMA stated that any disposal or discussion around possible disposals within 10 years may result in a significant reduction in the overall value of the deal.

Ann Nolan raised the possibility of specifying that the option to convert to fixed rate instruments could be only introduced after 15yrs and that only a certain percentage of the notes could be converted per annum out to maturity. While the holder would still retain the option to dispose of the floating notes this type of option could introduce an implicit agreement that the holder would hold the notes in line with this schedule.

Certain issues arise from this proposal;

- The holding period must be for a definable period of time and there must be public assurances to provide comfort around this.
- NTMA are concerned that the CBI may dispose to third parties during a period Irish credit spreads are high and we need some way to control this scenario.

The Governor confirmed that the CBI may be able to manage the second point through its obligations to maintain financial stability and where credit spreads were excessively wide, they would resist any attempt to sell the holding on stability grounds. The CBI highlighted that it is important that specific conditionality is not introduced that would detract from this discretion. In addition hard coded conditionality around disposals could have implications for the MTM valuation of the notes.

John Moran suggested that it may be possible for the NTMA to address the floating rate risk/volatility for the CBI by issuing a CDS to hedge the exposure. The NTMA committed to exploring this issue further but flagged that issues may arise if the NTMA were required to value the instruments and it could result in GGD volatility.

The NTMA were requested to draft a paper to develop the option proposal further. The proposal would look at an option to convert to fixed instruments not before 15yrs with conversion of a set percentage per annum thereafter to maturity. There will be significant caveats within the paper around the holding period and conversion risks that have been highlighted.

In relation to timing, the Governor confirmed that the matter is now high on the ECB agenda and he remained hopeful that the proposal would be discussed at the Governing Council meeting scheduled for the 10^{th} January.

THEME: C6

Appropriateness and effectiveness of other EU-wide policy responses

LINE OF INQUIRY: C6a

Basel III (CRD IV) and the impact on capital and liquidity of Irish banks

INTERNATIONAL MONETARY FUND

IMF Country Report No. 14/135

IRELAND

May 2014

DETAILED ASSESSMENT OF OBSERVANCE OF BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

This Detailed Assessment of Observance of Basel Core Principles for Effective Banking Supervision on Ireland was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in April 2014.

Copies of this report are available to the public from

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

IRELAND

April 2014

DETAILED ASSESSMENT OF OBSERVANCE

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

Prepared By
Monetary and Capital Markets Department

This Detailed Assessment Report was prepared in the context of an IMF stand-alone Reports on the Observance of Standards and Codes (ROSCs) mission in Ireland during September-October, 2013, led by Antonio Pancorbo, IMF, and overseen by the Monetary and Capital Markets Department, IMF. Further information on ROSCs can be found at http://www.imf.org/external/NP/rosc/rosc.aspx

CONTENTS

GLOSSARY

AML	Anti-Money Laundering
ASB	Accounting Standards Board
ASP	Administrative Sanctions Procedure
BCBS	Basel Committee for Banking Supervision
BCP	Business Continuity Plan
BCPs	Basel Principles for Effective Banking Supervision
CBCIR	Central Bank and Credit Institutions (Resolution) Act 2011
CDD	Customer Due Diligence
CBI	Central Bank of Ireland
CJA 2010	Criminal Justice Act 2010
COREP	Common Reporting
CP	Core Principle
CRD	Capital Requirement Directive
CRR	Capital Requirement Regulation
CT1	Core Tier 1 Capital
CTF	Counter Terrorist Finance
DGS	Deposit Guarantee Scheme
DOF	Department of Finance
DTA	Deferred Tax Asset
EBA	European Banking Authority
EC	Essential Criteria
ECB	European Central Bank
FATF	Financial Action Task Force
FMP	Financial Measures Program
FRA	Full Risk Assessment
FRR	Financial Risk Review
FSB	Financial Stability Board
ICAAP	Internal Capital Adequacy Assessment Process
KRI	Key Risk Indicator
PRISM	Probability Risk and Impact System
RABs	Recognized Accountancy Bodies
RMP	Risk Mitigation Program
RPL	Related Party Lending
S.I.	Statutory Instrument
SRC	Supervisory Risk Committee
SREP	Supervisory Review and Evaluation Process
SRU	Special Resolutions Unit

Introduction

1. **Ireland has significantly enhanced the legal framework to support banking supervision and implemented a risk-based supervisory approach, and compliance with the Basel Core Principles for Effective Banking Supervision (BCPs) is satisfactory.** This reflects the continued strengthening of the supervisory process undertaken by the authorities, which have been achieved in a challenging environment. The financial crisis and subsequent state intervention has transformed the Irish banking system and while acute crisis conditions have abated there is continued elevated stress within the system and vulnerabilities persist. Added to this is the continued pressure on industry to meet forthcoming higher regulatory standards, most notably the new Capital Requirements Directive and Regulations (CRD IV/CRR). In addition to substantial regulatory and legislative changes, the supervisory authorities have also had to adjust to the challenges of transition brought by re-design of the regulatory architecture.

2. **The Central Bank of Ireland (the Central Bank) has implemented the foundation for a risk-based supervisory approach.** In 2011 the Central Bank implemented a new framework for banking supervision called Probability Risk and Impact System (PRISM) to provide a structured framework for banking supervision. PRISM is the tool the Central Bank utilizes to employ resources based on the risk profile of the bank and its systemic significance. PRISM is based on: (i) a multi-step process to identify, measure and grade the banks' risk profile and risk management processes, (ii) a blend of onsite and offsite activities supported, and (iii) a follow-up system to track corrective action.

3. **The authorities have made significant progress in strengthening the legal framework and supervisory structure to support banking supervision**. The Central Bank Reform Act 2010 combined the functions of the Financial Services Authority of Ireland into the Central Bank. The Central Bank has responsibility for licensing, regulating and supervising banks in Ireland. The Central Bank (Supervision and Enforcement) Act 2013 was enacted in July 2013 (with a commencement date of August 1, 2013) and it enhances the Central Bank's enforcement authority by harmonizing the requirements across all the financial sectors supervised by the Central Bank. The Enforcement Act also provides the Central Bank regulation-making powers on conduct of business and corporate governance and also increases the amount of administrative sanction fines for an individual and a firm. The Central Bank Credit Institution Resolution Act (CBCIR) was enacted in 2011. The Act establishes a resolution regime and the Central Bank established a Special Resolution Unit to make the legislation operational. The Central Bank was designated as the competent authority under the Criminal Justice (Money Laundering and Terrorist Financing) Act (CJA) 2010 for supervising compliance with the act by banks. In 2010 the Central Bank issued the Code of Practice on Lending to Related Parties (RPL) and the Corporate Governance Code.

4. **A risk–based supervisory approach has been implemented based on consolidated supervision, and PRISM, a process to profile banks by risk.** Within PRISM, banks are assigned one of four Impact ratings: High, Medium High, Medium Low, and Low. PRISM allows the Central Bank a framework to adopt a consistent way of thinking about risk across supervised institutions and to allocate resources based on impact and probability.

5. The Central Bank has increased resourcing with a more intrusive approach to supervision. The PRISM framework allows for a structured approach to resource allocation and planning of supervisory activities. Built into PRISM is an ongoing monitoring capability that will pick up changes in risk profile through the use of financial ratios that, if triggered, will prompt supervisory attention/intervention. The risk rating in PRISM is updated after a supervisory activity is completed and in this way it is an ongoing measure of risk. Impact in PRISM measures the impact to the system of an individual bank failing. Banks that maintain a predominantly retail banking footprint are viewed as representing the greatest risk to the system and are assigned High Impact ratings. Resources, supervisory attention and intrusiveness are increased where the impact rating is higher and resources are prioritized for the High Impact banks. High Impact banks receive ongoing monitoring through offsite supervision, frequent onsite reviews, and ongoing engagement with bank senior management. As the Impact rating decreases, the level of supervision also decreases.

6. However, some issues require continued attention. The issues include: reviewing the provisioning requirements to determine whether they accurately reflect the current market conditions, continued implementation of the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (as amended) (CJA 2010), strengthening the monitoring of compliance with the related party lending code, and amending legislation to codify the operational independence of the Central Bank.

7. While there is no observed political interference, the Central Bank is encouraged to seek legislative changes to codify and foster the independence of the Central Bank. This could be achieved by stipulating in the Central Bank Act the exact conditions under which the Commission can be dismissed or removed by the Minister for Finance. Other legislative changes that would ensure independence include: (i) providing the Central Bank the authority to revoke a license or deny a licensing application without having to seek approval by the Minister, (ii) not including the Secretary General of the Department of Finance on the Central Bank commission, and (iii) eliminate the need for the Minister to approve the levy schedule.

8. There is a need to expand the coverage of related party transactions covered by the RPL Code and strengthen the Central Bank monitoring of compliance with the code. The RPL Code is comprehensive but only covers lending transactions and not, for example, asset purchases or deposits. Additionally, the Central Bank monitoring of compliance relies to a large extent on offsite review of reports filed by the banks. However, the reports do not provide information on the terms of the loans or dates of approval by the Board.

9. Supervision of AML/CFT compliance in banks should be strengthened. The CJA 2010 is comprehensive, and with the implementation of the Criminal Justice Act 2013 it was further strengthened. The Central Bank has enhanced its supervisory approach to AML/CFT compliance and has conducted in-depth onsite inspections and offsite analysis through the collection of risk assessment questionnaires. The CJA 2010 is comprehensive but the Central Bank's position would be strengthened if statutory guidelines, approved as envisaged by Section 107 of the CJA 2010, were issued. The extent of onsite reviews and the supervisory action following the reviews to enforce compliance should be reviewed to ensure that an appropriate base line, premised on sufficient onsite testing, is established and that strong corrective action requirements are implemented. Additionally, branches of member state banks should be subject to AML monitoring.

10. Currently the Central Bank Banking Supervision Divisions are operating below approved staffing level. The Central Bank operates under Civil Service pay scales and hiring rules which makes the salaries un-competitive with industry. Civil Service provides job security and other benefits that may offset the pay differential but increasingly bank supervision requires highly skilled staff as bank products and risk measurement techniques become more complex. The Central Bank is encouraged to review its turnover rates in skilled staff and determine reasons for turnover, consult other central banks to gauge how they attract skilled staff and determine how they achieved exemption from Civil Service pay limitations. It is also important to review advancement opportunities tailored to technical experts.

11. This assessment of the Basel Core Principles (BCP) was conducted[1] from September 25 to October 10, 2013 as part of the ROSC of the financial system of Ireland undertaken by the International Monetary Fund (IMF) [1]. It reflects the regulatory and supervisory framework in place as of the date of the assessment. It is not intended to represent an analysis of the state of the banking sector or crisis management framework.

Information and Methodology Used for Assessment

12. This assessment has been prepared according to the Revised Core Principles (BCP) Methodology issued by the BCBS (Basel Committee of Banking Supervision). The current assessment was thus performed according to a revised content and methodological basis as compared with the previous BCP assessment carried out in 2006. It is important to note that the two assessments will not be directly comparable, as the revised BCP have a heightened focus on risk management and its practice by supervised institutions and its assessment by the supervisory authority, and is therefore a more demanding measure of the effectiveness of a supervisory framework (see box for more information on the Revised BCP).

13. The Irish authorities chose to be assessed against the Essential and Additional Criteria but to be graded against only the Essential Criteria. To assess compliance, the BCP Methodology uses a set of essential and additional assessment criteria for each principle. The smaller number of additional criteria (AC) are recommended best practices against which the Irish authorities chose to be assessed but not graded, as provided for in the assessment methodology. The assessment of compliance with each principle is made on a qualitative basis. A five-part grading system is used: compliant; largely compliant; materially noncompliant; noncompliant; and non-applicable. This is explained below in the detailed assessment section. The assessment of compliance with each Core Principle (CP) is made on a qualitative basis to allow a judgment on whether the criteria are fulfilled

[1] The assessment was conducted by Christopher Wilson, IMF and José Tuya, Consultant.

in practice. Effective application of relevant laws and regulations is essential to provide indication that the criteria are met.

Box 1. The 2012 Revised Core Principles

The revised BCPs reflect market and regulatory developments since the last revision, taking account of the lessons learnt from the financial crisis in 2008-2009. These have also been informed by the experiences gained from FSAP assessments as well as recommendations issued by the G-20 and FSB, and take into account the importance now attached to: (i) greater supervisory intensity and allocation of adequate resources to deal effectively with systemically important banks; (ii) application of a system-wide, macro perspective to the micro-prudential supervision of banks to assist in identifying, analyzing and taking pre-emptive action to address systemic risk; (iii) the increasing focus on effective crisis preparation and management, recovery and resolution measures for reducing both the probability and impact of a bank failure; and (iv) fostering robust market discipline through sound supervisory practices in the areas of corporate governance, disclosure and transparency.

The revised BCPs strengthen the requirements for supervisors, the approaches to supervision, and supervisors' expectations of banks. The supervisors are now required to assess the risk profile of the banks not only in terms of the risks they run and the efficacy of their risk management, but also the risks they pose to the banking and the financial systems. In addition, supervisors need to consider how the macroeconomic environment, business trends, and the build-up and concentration of risk inside and outside the banking sector may affect the risk to which individual banks are exposed. While the BCP set out the powers that supervisors should have to address safety and soundness concerns, there is a heightened focus on the actual use of the powers, in a forward-looking approach through early intervention.

The number of principles has increased from 25 to 29. The number of essential criteria has expanded from 196 to 231. This includes the amalgamation of previous criteria (which means the contents are the same), and the introduction of 35 new essential criteria. In addition, for countries that may choose to be assessed against the additional criteria, there are 16 additional criteria.

While raising the bar for banking supervision, the Core Principles must be capable of application to a wide range of jurisdictions. The new methodology reinforces the concept of proportionality, both in terms of the expectations on supervisors and in terms of the standards that supervisors impose on banks. The proportionate approach allows assessments of banking supervision that are commensurate with the risk profile and systemic importance of a wide range of banks and banking systems

14. **The assessment was carried out on the basis of the legal framework governing the regulation and supervision of banks, principally the Central Banking Acts, the CJA 2010 and other relevant regulations and guidelines**. A review of prudential returns, licensing

documentation, and supervisory analysis records was also performed. The Team also examined on-site supervision reports and off-site analysis documentation. In addition, BCP assessors held extensive meetings with officials of the Central Bank, the Department of Finance, Financial Intelligence Unit, and additional meetings with auditing firms and sector participants from domestic and international banks. The authorities provided a self-assessment of the CPs rich in quality and comprehensiveness, as well as detailed responses to additional questionnaires, and facilitated access to supervisory documents and files, staff and systems.

15. The standards were evaluated in the context of the Irish financial system's structure and complexity. The CPs must be capable of application to a wide range of jurisdictions whose banking sectors will inevitably include a broad spectrum of banks. To accommodate this breadth of application, a proportionate approach is adopted within the CP, both in terms of the expectations on supervisors for the discharge of their own functions and in terms of the standards that supervisors impose on banks. An assessment of a country against the CPs must, therefore, recognize that its supervisory practices should be commensurate with the complexity, interconnectedness, size, and risk profile and cross-border operation of the banks being supervised. In other words, the assessment must consider the context in which the supervisory practices are applied. The concept of proportionality underpins all assessment criteria. For these reasons, an assessment of one jurisdiction will not be directly comparable to that of another.

16. The assessment does not include the Irish Credit Union Sector. The Central Bank considered that it was not appropriate at the time of the mission to conduct an assessment due to the significant amount of legislative and regulatory developments which have been recently implemented as part of Ireland's financial sector reform commitments under the EU-IMF financial support program for Ireland.

17. The BCPs are an independent benchmark and compliance determinations are not adjusted for local legislation. The EU has implemented a number of rules and supervisory practices that member states must follow, some of these practices may not meet the BCP requirements. The authorities highlighted some of these discrepancies, particularly as they relate to the supervision of EU banking branches that require less host involvement than required by the BCPs.

18. The mission appreciated the very high quality of cooperation received from the authorities. The mission extends its thanks to staff of the Central Bank who provided excellent cooperation, including extensive provision of documentation and access.

INSTITUTIONAL AND MARKET STRUCTURE - OVERVIEW

19. **The Central Bank Reform Act, 2010, created a new single unitary body – the Central Bank of Ireland - responsible for both central banking and financial regulation.** The new structure replaced the previous related entities, the Central Bank and the Financial Services Authority of Ireland and the Irish Financial Services Regulatory Authority. The Central Bank of Ireland has overall prudential responsibility for the authorization, regulation and supervision of Credit Institutions operating in Ireland. Credit Institutions regulated by the Central Bank of Ireland include Banks, Building Societies and Designated Credit Institutions. In addition, the Central Bank of Ireland is responsible for oversight of liquidity, Anti-Money Laundering and conduct of business for branches of non-Irish licensed banks operating in Ireland.

20. **The Central Bank of Ireland is an economic and sectoral regulatory authority charged with the regulation and supervision of financial services in the State; and, as such, a public body subject to administrative law.** In particular, the Central Bank exercises a number of key functions in relation to financial regulation: first, the function of making rules or setting standards; second, the function of licensing persons who wish to engage in regulated financial services activity; and thirdly, the disciplinary or enforcement function.

21. **The objectives in supervising Credit Institutions are twofold: (i) to foster a stable banking system; and (ii) to provide a degree of protection to depositors with individual credit institutions.** As set out in the Central Bank Act 1942 (as amended) the Bank shall perform its functions and exercise its powers in a way that is consistent with-

a. The orderly and proper functioning of financial markets,

b. The prudential supervision of providers of financial services, and

c. The public interest and the interest of consumers.

22. **In relation to the prudential supervision of providers of financial services the Central Bank of Ireland operates a risk based approach to supervision.** In 2011 the Central Bank of Ireland introduced a new framework for the supervision of regulated firms called Probability Risk and Impact System (PRISM) to provide a structured framework for credit institution supervision.

23. **The Constitution of Ireland vests the sole and exclusive power of making laws for the State in the Oireachtas (the National Parliament: consisting of the President, a House of Representatives called Dáil Éireann and a Senate called Seanad Éireann).** Primary legislation consists of Acts of the Oireachtas, also called statutes, which are enacted by the Oireachtas in a particular manner. Acts of the Oireachtas are passed by both Houses of the Oireachtas, and signed into law by the President. Primary legislation which concerns the financial services market in the State, and in particular the securities market or industry, is invariably initiated by the Minister for

Finance. The Central Bank cannot itself initiate primary legislation which is an aspect of the constitutional and parliamentary system.

PRECONDITIONS FOR EFFECTIVE BANKING SUPERVISION

A. Macroeconomic Overview

24. Ireland has pulled back from a severe banking crisis with the support of the EU-IMF program. The program that began in December 2010 followed an exceptionally deep banking crisis at a public cost of €64.1 billion (some 40 percent of GDP). Policy implementation has generally been strong, the fiscal framework has been strengthened, the financial sector has been stabilized, and spreads on Irish sovereign bonds have fallen to their lowest level since early 2010. However, risks to economic recovery remain large: Public debt is high and still growing; the banking system is not yet serving financing needs, including of the job-intensive SME sector; households must contend with heavy debts and depleted net wealth; high unemployment compounds the financial distress, undermines skills, and drives emigration; the euro area crisis creates uncertainty for exports, financial markets, and fixed investment.

25. Credit risk remains high as a result of weak profitability and revenue. Overall financing conditions for non-financial corporations (NFCs) have weakened. The volume of new lending by Irish banks to NFCs has remained below 12 percent of GDP since 2011, below the pre-bubble level of around 20 per cent in 2003-05. Nominal interest rates on NFC loans up to €1 million are higher suggesting higher real interest rates for small and medium enterprises (SMEs), which are particularly sensitive to bank lending conditions because they have few other sources of finance. Developments in the commercial property market are relevant to NFCs as real estate provides an important asset and source of collateral for them.

26. NFC debt levels are high, but debt owed to Irish banks is falling. This is due to net loan repayments, write-downs of bad debts and transfers of loans to the state-run National Asset Management Agency (NAMA). NAMA was created in 2009 to acquire nonperforming, property-related loans from the domestic banking sector. NFC sector's net debt remained stable because of corresponding acquisitions of debt instrument assets. Given that bonds and other debt securities are not a significant component of Irish corporate finance, a wider range of financing sources than Irish banks could potentially mitigate the effects of domestic financial sector risks on firms. High indebtedness raises the sensitivity of Irish firms to interest rate shocks. Interest rate changes are transmitted rapidly to NFCs because of the prevalence of floating-rate loans and short-term lending.

27. Mortgage arrears remain a key risk to financial stability. The overall level of mortgage arrears on both owner occupier and buy-to-let mortgages is a cause for concern and is high relative to other developed-country banking crises. Unemployment is a significant driver of mortgage arrears. Changes to employment conditions are likely to be modest and may relieve arrears only marginally.

Recommended Actions

A. Recommended Actions to Improve Compliance with the Basel Core Principles

Reference Principle	Recommended Action
Principle (2)	- Amend existing legislation to detail the framework for Central Bank independence. Also address reasons for removal of Commission members to be similar to Governor. - Take steps to fill vacancies in BSD.
Principle (5)	- Consider options for improving the CBI's ability to conduct fit and proper reviews during licensing of banks owned by unregulated parents. - Study enforceability of special conditions to the license that must be accepted by parent company at time of approval to enhance CBI enforcement authority.
Principle (9)	- Consider the distribution of resources and supervisory tasks across Medium Low and Low Impact ratings - Consider expanding KRIs in PRISM to include a broader suite of risk metrics i.e. operational risk and IRRBB
Principle (15)	- For banks accredited to use internal models, annual assessment that banks comply with supervisory standards (e.g. validation) - Implementation of framework to assess IT across regulated banks
Principle (17)	- Increase frequency and loan sample size for Medium Low banks
Principle (18)	- Greater frequency and depth of onsite reviews of loan loss provisioning practices (e.g. testing of assumptions against experience, recognition of default, prudent valuations)
Principle (20)	- Amend the RPL code to include asset sales, deposits and other areas addressed in CP. Also expand information in RPL regulatory reports so that a more complete offsite compliance assessment may be made.
Principle (27)	- Enact legislation giving the Central Bank the power to reject or rescind external auditors.
Principle (29)	- Expand supervisory scope to include branches of foreign banks, - Statutory guidelines, approved as envisaged by Section 107 of the CJA 2010, should be issued. Review the current balance between onsite and offsite reviews. Currently emphasis is heavily weighted on offsite.

Authorities' Response to the Assessment

1. Recognition of Financial Sector Reform and Strengthening of Supervision of Credit Institutions

The Irish authorities wish to express their appreciation to the IMF and its Mission team for their detailed assessment of Ireland's compliance with the Basel Core Principles for Effective Banking Supervision.

We welcome the IMF's acknowledgement of the continued strengthening of the supervisory process through substantial changes to both regulation and legislation, achieved in collaboration with our external partners under Ireland's financial support programme, in a challenging environment, which included the restructuring and stabilisation of the Irish banking sector.

A risk based supervisory approach to banking supervision was implemented by the Central Bank in 2011 by means of a new risk assessment framework. This framework was accompanied by a substantial increase in resources and encompasses a much more intrusive approach than existed previously. Our supervisory regime is determined further by our assessment of the impact risk of each credit institution and our resources are allocated to conduct supervisory engagement further to that assessment. In addition, significant changes to the legal framework have been achieved, which have resulted in enhanced powers for the Central Bank.

2. Specific Comments on IMF Findings and Ratings

While the Irish Authorities are generally in agreement with the report, the Irish Authorities would make the following comments in relation to those Core Principles which have been rated by the IMF as Materially Non-Compliant:

CP 2 Independence

The Irish authorities are pleased to note that there was no observed political interference with the Central Bank of Ireland. While we are disappointed with the IMF finding regarding CP2, we note that this relates to hypothetical concerns regarding a small number of legislative provisions from within the corpus of Irish financial services law, rather than any manifest experience of the Central Bank's statutory or regulatory independence being compromised.

The independence of the Irish Central Bank is a core pillar of the Irish financial system and is essential for both the system's effectiveness and its international credibility. For this reason, when introducing reforming legislation to restructure the Central Bank following the financial crisis, the Government took great care to reaffirm the Central Bank's independence. To underline this point, the Government has further introduced a range of measures to strengthen the powers of the Central Bank and to extend its remit into new areas of responsibility such as bank resolution.

While the Irish authorities do not fully agree with the IMF view under this category, we will consider the recommendation for a more detailed framework for Central Bank independence in the context of any future review of the statutory basis of the Central Bank.

CP 9 Supervisory Techniques and Tools

Ireland's approach to supervision is risk based and starts with the premise that all firms are not equally crucial in the banking system and the wider economy. Supervisory efforts and resources are focused on those firms whose failure would have a significant impact upon the banking system, the economy, the taxpayer and the consumer. This approach to supervision is in keeping with the IMF's and the Basel Committee's principle of proportionality.

The IMF has rated Core Principle 9 as being Materially Non-Compliant. However, the specific issues raised by the IMF mainly relate to potential calibration issues with the supervisory engagement model for the least risky and non-systemically important cohort of Irish licensed banks i.e. medium low impact banks. This cohort of 10 non-retail institutions comprises 3% of total Irish banking system assets, does not take retail deposits, comprises 2% of all Irish corporate deposits, is not involved in retail lending, and transacts with counterparties who are predominantly business to business and intra-group. Moreover, although the IMF views the Medium Low Impact engagement model as heavily reactive with light data validation/verification, this description is only accurate for low impact credit institutions, i.e. branches of EU Banks operating in Ireland, which are primarily under foreign prudential supervision. No Irish licensed bank has been categorised as low impact.

The Central Bank will follow the two recommendations made by the IMF relating to CP 9. We will review the distribution of resources and supervisory tasks across medium low and low impact credit institutions as the Single Supervisory Mechanism ("SSM") enters into force. As part of our implementation of the SSM requirements we will adhere to the requirements of the SSM Supervisory Manual which sets out the processes, procedures and methodology for the supervision of both Significant and Less Significant institutions, including supervisory tasks and KRIs.

CP 20 Related Party Transactions

Related party transactions in the Irish banking system are predominantly in respect of lending rather than service contracts or deposits, and accordingly the Central Bank has tailored its supervisory regime to capture higher risk transactions in this area. The supervisory approach includes a Code of Practice ("the Code") to which all licensed credit institutions must adhere and a detailed reporting framework is in place to ensure that the requirements set out in the Code are being met on an on-going basis. The framework also includes on-site testing, lending limits and the requirement for the prior approval of the Central Bank for transactions over €1m.

While the Irish Authorities therefore do not entirely agree with the IMF's rating of Materially Non-Compliant in relation to related party transactions, the Central Bank will undertake an evaluation of related party transactions and will evidence any potential risks outside the scope of the current Code. The Code will be amended accordingly.

CP 29 Abuse of Financial Services

The Irish Authorities will follow the IMF recommendations in relation to CP 29. In relation to Guidelines envisaged by Section 107 of the Criminal Justice Act 2010, the Central Bank will request that the appropriate authority, the Minister for Justice, issues such guidelines. Furthermore, the Central Bank will communicate its principal findings to the banking sector following the Anti-Money Laundering reviews undertaken in 2013. The Irish Authorities also note the comments regarding the balance between onsite and offsite reviews and will undertake a review to ensure the appropriate balance exists.

The Irish Authorities acknowledge that branches of foreign banks have not been inspected, and while this is considered to be consistent with our risk focused approach to AML supervision, branch inspections will be performed.

3. Concluding Authorities' Comments on IMF Findings and Ratings

The Irish Authorities acknowledge the importance of continually monitoring and seeking to improve the regulatory framework and supervisory practices and remain strongly committed to so doing.

To that end, the Irish Authorities will evaluate and consider the IMF's recommendations, in the context of the IMF's endorsement of Ireland's supervisory approach, as reflected in the compliant rating for CP 8. We are currently preparing to implement the SSM requirements from 4 November 2014. The Single Supervisory Mechanism will fundamentally alter the manner in which credit institutions are supervised within the euro area and will consequently change the way in which the Central Bank supervises credit institutions in Ireland.

THEME: C6

Appropriateness and effectiveness of other EU-wide policy responses

LINE OF INQUIRY: C6b

Banking Union (Single Supervisory Mechanism, Single Resolution Mechanism, Deposit Guarantee Scheme)

Executive Summary - Main Issues Addressed in 2013 and Plans for 2014

The Bank carried out a challenging and comprehensive programme of work in 2013 and its risk-based supervisory framework for regulated institutions and firms - PRISM - was further developed. The regulatory and supervisory framework is being continually deepened to help build a resilient financial sector and a strengthened consumer protection framework.

The Bank's risk-based supervisory framework was further developed and embedded during 2013. Under PRISM, the most significant institutions - those with the ability to have the greatest impact on financial stability and the consumer - receive a high level of supervision under structured engagement plans, leading to early interventions to mitigate potential risks. Those institutions or firms which have the lowest potential adverse impact are supervised reactively or through thematic assessments. The Bank takes targeted enforcement action against firms across all impact categories where that is merited due to failure to comply with regulatory requirements. It is important to continuously improve and enhance the risk-based supervisory framework in line with market and international developments. In 2013, a review of PRISM was undertaken and its findings and recommendations were considered by the Bank's Commission in early 2014.

During the year, the Bank's supervisory responsibilities for credit institutions included implementing obligations under the Financial Measures Programme (FMP). This included a point-in-time Balance Sheet Assessment and Asset Quality Review of the three Covered Banks (AIB, Bank of Ireland, and PTSB). Bank-led work continued to address mortgage and SME arrears.

In 2013, the Bank contributed technical assistance in formative processes that will establish the framework for the ECB's Single Supervisory Mechanism (SSM). The SSM will introduce a new system of financial supervision in Europe comprising the ECB and the national supervisory authorities of participating EU countries. The principal objectives of the SSM are (i) to ensure the safety and soundness of the European banking system and (ii) to increase financial stability in Europe. The ECB will fully assume its new role as supervisor of certain euro area banks in November 2014.

An important element of the supervision of (re)insurance companies in 2013 was the number of pricing, claims and reserving reviews that were carried out by the Bank. Following these reviews, where control weaknesses or a need to strengthen reserves was identified, the Bank engaged with the relevant companies to address the inadequacies. The Bank continued to engage with (re) insurance companies in relation to their implementation of the Solvency II Guidelines which are generally applicable from January 2014 (with certain provisions due later) and which will prepare companies for the full implementation of Solvency II from January 2016. The Bank widened its bi-and multilateral co-operation with other regulators during 2013, which is a key component in effective (re) insurance supervision. Engagement with EIOPA, through continued participation and contribution to various working groups and committees, was maintained during the year. The Bank's engagement with EIOPA will expand further in 2014 on issues to include implementation of Solvency II, Internal Models, Financial Stability and other supervisory matters.

Consistent with the Bank's Regulatory Strategy during 2013, a review of the effectiveness of the authorisation process for investment firms seeking to provide MiFID services was concluded. A new two-level process was developed which began operating in January 2014 and its effectiveness will be reviewed in 2015. Investment funds' reporting moved to the Bank's Online Reporting System (ONR) in April 2013. Since April, over 7,000 individual returns have been received through the ONR System, with this number set to substantially increase in 2014 when a full year's complement of reporting moves online.

The credit union sector faced continuing challenges in 2013. The sector faced ongoing aggregate decline as lending demand weakened further, and pressure on net margins grew. These factors have continued into 2014. The Bank's focus remains on credit unions building reserves and provisions and maintaining a prudent dividend policy stance. In a number of cases, regulatory action was taken including imposing lending restrictions until certain material risks were appropriately mitigated. Designed to ensure that credit unions do not expose members' savings to inappropriate levels of risk, such restrictions are kept under regular review.

During 2013, the Bank continued to take pre-emptive actions to resolve identified weak credit unions. This included the resolution of Newbridge Credit Union which culminated in its winding up and in the transfer of its assets (excluding premises) and liabilities to PTSB.

The Bank's consumer protection work in 2013 was concentrated on a number of key areas, particularly in relation to loan arrears, payment protection insurance (PPI), debt management, retail intermediaries and reviews of the moneylending sector. The revised Code of Conduct on Mortgage Arrears (CCMA) which was published in June 2013 provides a strong consumer protection framework and compliance with the CCMA will continue to be central to the Bank's work in 2014. The Bank's reviews of the sale of PPI continued during the year and have resulted in significant refunds to consumers where credit institutions did not comply with the Consumer Protection Code (the Code) when selling PPI or could not demonstrate compliance with the Code. A new regime for debt management firms was established and strengthening consumer protection work in this area will continue in 2014.Throughout the year, the Bank continued its themed inspections of the Retail Intermediary sector. It also undertook a cross sectoral review of sales incentives and completed wide ranging research into the moneylending sector commenced during the year.

During 2013, in terms of the Bank's Enforcement Policy, where regulated entities failed to comply with their regulatory requirements, enforcement was used as an important tool to effect deterrence, achieve compliance and promote the behaviours the Bank expects across the industry. The Bank continues to ensure that the results of enforcement actions are transparent and publicly available. The Bank also continued the programme for supervision of compliance with legislation pertaining to Anti-Money Laundering, Countering the Financing of Terrorism and EU Financial Sanctions activities through the completion of inspections and risk evaluations of firms in the banking, markets and credit union sectors.

The Bank continued to develop its Regulatory Transactions Strategy, the objectives of which are to improve effectiveness and efficiency of regulatory processes, improve the quality of regulatory information and improve the quality of service.

Work commenced, for delivery in 2014, on delivering a solution that will improve the efficiency and effectiveness of the Funds and Retail Intermediaries authorisation processes.

The 2013 Annual Regulatory Performance Review sets out an account of the Bank's regulatory and supervisory activities for the year. Appendix 1 provides a detail of the progress made during 2013 against the strategic objectives and actions of the Bank's Strategic Plan 2013 – 2015. Appendix 2 sets out the Bank's Regulatory Performance Plan for 2014. Details of the Bank's progress in meeting the commitments of the FMP for 2013 are set out in the Annex to this Regulatory Performance Statement.

Regulatory Performance Review 2013 - Introduction

Introduction

The Central Bank of Ireland (the Bank) has responsibility for central banking and financial regulation in Ireland. A statutory objective requires the Bank to carry out '…the proper and effective regulation of financial service providers and markets, while ensuring that the best interests of consumers of financial services are protected'.

The Bank regulates and supervises most financial service providers and funds in Ireland. Financial regulation in Ireland is underpinned by a risk–based approach to supervision coupled with the effective threat of enforcement. The Bank's objective in its supervision of financial institutions is to ensure that risks to financial stability and consumer protection are mitigated effectively. Under the Bank's Strategic Plan 2013 – 2015, the supervisory approach and capability is continually evolving through process improvements and efficiencies.

A range of indicators of regulatory performance are included in this Statement. Those indicators that are sector specific are integrated in the appropriate section of the report, while those that relate to the regulation of the financial services industry as a whole are included at the end of the 2013 Review. These include details on public consultations, guidance notes issued and appearances before Joint Oireachtas Committees on regulatory issues.

Proper and Effective Regulation of Financial Institutions and Markets

Regulation of institutions and markets is undertaken through assertive risk-based supervision which is underpinned by credible enforcement deterrents.

Risk-Based Supervision

Risk-based supervision starts with the premise that not all firms are equally important to the economy and that a regulator can deliver most value through focusing its energies on the firms which are most significant and on the risks that pose the greatest threat to financial stability and consumers. A risk-based system will also provide a systematic and structured means of assessing different types of risk, ensuring that idiosyncratic approaches to firm supervision are avoided and that potential risks are analysed for the higher impact firms using a common framework. This will allow judgements about potential risk in different firms to be made using a common risk typology on a common scale.

Box 1 – The PRISM Supervision Framework

The Probability Risk and Impact SysteM (PRISM) is the Bank's risk-based framework for the supervision of regulated firms. PRISM is designed to be implemented by a few hundred supervisors on several thousand regulated firms.

PRISM is designed to allow the Bank to:

- Adopt a consistent way of thinking about risk across all supervised firms
- Allocate resources based on impact and probability
- Undertake a sufficient level of engagement with all High Impact firms
- Assess firm risks in a systematic and structured fashion
- Ensure that action is taken to mitigate unacceptable risks in firms
- Provide firms with clarity around the Bank's view of the risks they pose
- Operate a risk-based supervisory framework similar to that operated by other significant financial regulators
- Use quality control mechanisms to encourage challenge and sharpen the supervisory approach
- Analyse better management information about the risk profiles of the firms and sectors supervised.

Risk-Based Model of Supervision

Under PRISM, the most significant financial institutions and companies - those with the ability to have the greatest impact on financial stability and the consumer - receive a high level of supervision under structured engagement plans, leading to early interventions to mitigate potential risks. Conversely, those institutions which have the lowest potential adverse impact are supervised reactively or through thematic assessments, with the Bank taking targeted enforcement action against firms across all impact categories whose poor behavioural risks jeopardise the Bank's statutory objectives including financial stability and consumer protection.

Supervisory Standards

Any system for evaluating risk has potential weaknesses. In order to lessen the risk that a firm could be exposed to inappropriate judgements by a single supervisor, PRISM incorporates a number of quality assurance processes. These ensure that high quality judgements are made and that appropriate outcome-focused Risk Mitigation Programme (RMP) actions are constructed based on those judgements. These include:

- Risk Governance Panels (RGPs) – bring together senior staff and risk advisors outside the supervisory chain of command to scrutinise a supervision team's strategy, judgements and RMP for a given firm. Panels give the supervisor an opportunity to debate their findings with a wider audience who are likely to have had extensive experience of supervising similar firms.
- Management oversight – any draft RMP action which is not scrutinised by a Risk Governance Panel is reviewed and approved by senior divisional management.

PRISM Licencing

During the course of 2013, the Bank licenced one supervisory authority to implement the PRISM framework within their jurisdiction, while a number of other jurisdictions are actively considering seeking similar licences.

Table 1 – Prudential Supervision Engagement Process 2013

PRISM ENGAGEMENTS	Banking	Insurance	Investment Firms & Fund Service Providers	Payment Institutions	Credit Unions
Full Risk Assessment (SREP)	7	13	26	1	21
Risk Governance Panels	13	25	29	1	25
Meeting with Chief Executive Officer (CEO)	72	164	94		
Meeting with Chief Financial Officer (CFO)	45	134	88		
Meeting with Chief Risk Officer (CRO)	82	129	57	1	
Meetings with Chairman	31	109	75	1	
Meetings with Senior Non-Executive Directors (NEDs)	21	166	80	1	
Meetings with Internal Auditor	37	42	19		
Meetings with External Auditor	25	103	82	1	
Board Meeting Attendance	7			1	
Attendance at Board Committees	9				
Meetings with other Senior Management	316	84	153		
Meetings with Actuary		115			
Other On-Site Meetings	31	24	33		
Meetings with Board Independent Non-Executive Directors (INEDs)	36	68	6	1	
Meetings with Group NEDs	10	30			
Meetings with Compliance Officer	54	74	58		
Financial Risk Review	24	44	2		
Other (not incl. FRR meetings)	13		11		
Reviews/Inspections	38		64		
Meetings with Supervisory Committee	1		1		
Thematic Review	12		5		
Authorisation Team Meetings		27			
Other Meetings (not as part of engagement model)	55	205		9	109
1-day engagements	1		6		90
Other Reviews – non-PRISM	87	134			9
Other – • ICAAP Review • Stress Test			 45 3		
TOTAL	**1,027**	**1,690**	**937**	**17**	**254**

Table 2 – Regulated Financial Service Providers

	2013[1]
Credit Institutions (including branches of overseas credit institutions)	65
Life Insurance Companies	53
Non-Life Insurance Companies	105

1 Figures do not sum due to multiple authorisations

Reinsurance Companies	77
MiFID • Investment Firms • Branches of overseas firms	 117 29
Non-Retail Investment Business Firms	10
Fund Service Providers	238
Retail Intermediaries, *including* • Investment Intermediaries (authorised advisors, multi-agency intermediaries, mortgage intermediaries) • Insurance/Reinsurance Intermediaries	2,964
Collective Investment Schemes (including sub funds)	5,599
Credit Unions	393
Money Transmitters and Bureaux de Change	14
Moneylenders[2]	40
Regulated Market/Market Operator	1
Moneybrokers	5
Retail Credit Firms & Home Reversion Firms	20
Payment Institutions	11

Table 3 – Authorisations/Revocations

	Authorisations	Revocations
	2013	**2013**
Credit Institutions (including branches of overseas credit institutions)	1	8
Life Insurance Companies	2	4
Non-Life Insurance Companies	0	7
Reinsurance Companies	1	11
MiFID • Investment Firms • Branches of overseas firms	 3 0	 10 0
Non-Retail Investment Business Firms	0	1
Fund Service Providers	14	30
Retail Intermediaries, *including* • Investment Intermediaries (authorised advisors, multi-agency intermediaries, mortgage intermediaries) • Insurance/Reinsurance Intermediaries	179[3]	491[4]
Collective Investment Schemes (including sub funds)	804	509
Credit Unions	0	6
Money Transmitters and Bureaux de Change	2	0
Moneylenders[5]	1	4
Regulated Market/Market Operator	0	0
Moneybrokers	0	0
Retail Credit Firms & Home Reversion Firms	2	0
Payment Institutions	2	1
TOTAL	**1,011**	**1,082**

2 Subject to annual renewal of licence.

3 During 2013, 179 retail intermediaries were authorised. This accounted for 244 individual authorisations as a number of firms seek authorisation under more than one retail intermediary authorisation type. (The figures do not include 74 tied insurance intermediaries which were authorised in 2013.)

4 During 2013, 491 retail intermediaries (including 101 tied insurance intermediaries) let their authorisations expire, had their authorisations voluntarily revoked or were otherwise involuntarily removed from the Bank's statutory registers. This accounted for 696 individual authorisations.

5 Subject to annual renewal of licence.

Banking Supervision

Banking supervision is responsible for the prudential supervision of domestic banks and foreign owned retail and wholesale banks. It also has supervisory responsibility in certain areas for branches of international banks which operate in Ireland.

As part of PRISM, the Bank engages in cyclical supervisory programmes for banks with the frequency of the engagement tasks based on the scale and overall impact categorisation of the institution.

Key trends affecting bank business models and strategy are communicated regularly, while tools to better identify and communicate industry trends and threats to the business models and/or strategy of supervised credit institutions are utilised and enhanced. Business model reviews for High Impact banks were completed during 2013 in line with the PRISM engagement model.

Stress Testing of Credit Institutions

The Financial Measures Programme for 2013 included a point-in-time Balance Sheet Assessment (BSA) and Asset Quality Review (AQR) of the three Covered Banks[6]. The AQR, conducted by Ernst & Young for AIB and PTSB, and KPMG for Bank of Ireland, comprised a quantitative assessment of the adequacy of provisions on an incurred loss basis and against the Bank's Impairment Provisioning and Disclosure Guidelines, a review of risk classifications with respect to impairment status and an evaluation of the calculation of risk weighted assets (RWAs) for credit risk. A Data Integrity Verification (DIV) exercise was also conducted to ensure the integrity of the data used in the AQR exercise. In addition, Boston Consulting Group (BCG) was appointed as the independent assessors of the overall exercise.

The *pro forma* results have been shared with the banks to help inform their financial planning and preparations for the Single Supervisory Mechanism (SSM). In addition, the results will also be used by the Bank to inform its Risk Mitigation Programmes as part of the Supervisory Review Process.

Restructuring and Deleveraging

A restructuring plan for AIB was submitted to the European Commission in September 2013. Under its 2012 plan, PTSB was reorganised into three distinct units: (i) the core retail bank; (ii) an asset management unit to house certain legacy assets; and (iii) the UK residential mortgage operation. Work is continuing to deliver on this plan. In 2013, Bank of Ireland agreed with the European Commission the substitution of the restructuring plan which envisaged the disposal of the New Ireland Assurance Company with other measures including the disposal of its ICS subsidiary. Work is ongoing to deliver against the revised targets.

Risk Modelling

The focus in 2013 was on completing the supervisory review framework for IRB models for the Covered Banks, as well as delivering key parts of the BSA work shared with external stakeholders at the end of November. As part of the BSA, RWA reviews were completed for portfolios that made up the AQR. Work was also completed in relation to the assessment of banks' mortgage provisioning models (including the design and application of a top-down model upon which provision estimates were determined). In relation to both areas of work, the framework was shared with the External Partners, Independent Assessors and banks through the course of the process, with findings and mitigating actions determined as relevant. Also, as part of the wider supervisory review process, detailed work was undertaken in relation to supporting RGP work completed during the year.

Mortgage Arrears

The issue and scale of mortgage arrears has been to the forefront of the Bank's domestic policy agenda throughout 2013. The Bank has taken a strategic approach to arrears/distressed credit recognising that excessive forbearance and a lack of long-term sustainable solutions to the arrears problem is a drag on the economy, new lending and the future profitability of the banks.

[6] AIB, Bank of Ireland, PTSB

In 2012, independent Distressed Credit Operations Reviews (DCORs) were undertaken across a number of the banks which produced significant findings and capacity shortfalls. The findings of the DCOR provided the basis for engagement with the CEOs of the banks. Despite considerable operational improvements, arrears levels continued to increase and the Bank determined that further action was necessary and, accordingly, introduced Mortgage Arrears Resolution Targets and Sustainability Guidelines. The first audits of these targets were completed in 2013 and will continue in 2014. While the level of mortgage arrears continues at an unsustainably high level, during 2013 there has been progress in addressing the significant mortgage arrears challenge and the total arrears fell in Q3 2013 for the first time since the financial crisis began.

In May 2013, the Bank published a ‘Framework for a Pilot Approach to the Co-ordinated Resolution of Multiple Debts owed by a Distressed Borrower’. The aim of the framework is to enhance co-operation between lenders of secured and unsecured debt, in order to fairly resolve distressed debt for the borrower. A pilot of the framework, where a sample of multi-debt cases was referred to an independent debt advice service, was facilitated by the Bank in Q4 2013.

Small and Medium Enterprises (SME) Arrears

In 2013, the Bank commenced operational on-site reviews and deep-dive loan file reviews to monitor progress in addressing distressed SME credit and introduce formal targets and a range of tracking performance indicators for the Covered Banks. Q3 target outcomes and other initiatives demonstrate that momentum is being achieved across relevant institutions in addressing distressed credit.

Risk Assessments/RMPs/Supervisory Colleges

All High Impact firms are subject to ongoing Financial Risk Reviews (FRRs) which cover areas such as market risk, credit risk, capital risk, etc. In 2013, 24 FRRs were conducted covering all relevant institutions. For banks rated below High Impact, seven FRAs were undertaken in the course of 2013 (10 in 2012). (Institutions that are not subject to an FRA were subject to oversight in line with PRISM.) The outcome of the FRRs and FRAs include the issuance of bank specific RMPs, which set out the work to be undertaken by institutions to remediate identified weaknesses. The Bank proactively monitors institutions’ full and timely implementation of RMPs.

As part of the consolidated supervision of banking groups which have operations in multiple jurisdictions, the Bank participates in Supervisory Colleges which are bilateral and multilateral fora for the exchange of supervisory information, co-ordination of supervisory oversight and to the extent possible, undertaking joint supervisory work. The Bank is a member of 15 Supervisory Colleges. Within the EU, Colleges are required to agree Joint Risk Assessments Decisions (JRADs) on the adequacy of capital for banking groups and in this regard the Bank contributed to JRADs where relevant.

The Bank hosted two Supervisory College meetings in respect of Irish banking groups. The colleges were held in line with the European Banking Authority Guidelines on Supervisory Colleges and involved input from the Prudential Regulatory Authority (UK), the Financial Conduct Authority (UK), the Federal Reserve Bank of New York (US) and the Connecticut Department of Banking (US).

Implementation of CRD IV

The objective of the Capital Requirements Directive is to strengthen the regulatory framework for financial institutions by ensuring that firms hold sufficient financial resources to cover the risk associated with their business. The latest version of the Capital Requirements Directive – CRD IV – came into effect on 1 January 2014.

In 2012, the Bank established an advanced monitoring framework covering all factors affecting banks’ Net Stable Funding Ratio (NSFR) which enabled it during 2013, to monitor Covered Banks’ progress towards meeting CRD IV requirements. Supervisors have maintained close engagement with the banks to monitor their overall plans, progress and impacts in terms of CRD IV implementation in 2014. Extensive training has been provided to supervisors to support this engagement.

Central Credit Register

The Credit Reporting Act 2013, enacted in December 2013, provides for the establishment of a national Central Credit Register (CCR). In the course of the year the Bank assisted the Department of Finance in developing the legislation and engaged with credit institutions, industry representatives and other stakeholders in preparing for the implementation of this important financial sector reform. It also initiated a procurement process to select a partner to assist in establishing and operating the CCR.

Regulatory Performance Review 2013 - Report on the Observance of Standards and Codes)

In February 2013, as per the EU-IMF Financial Support Programme, the Bank formally requested the IMF to conduct a detailed Report on the Observance of Standards and Codes which is an assessment of the extent of the Bank's compliance with the Basel Core Principles for Effective Banking Supervision (BCPs).

The 29 BCPs are the *de facto* minimum standard for sound prudential regulation and supervision of banks and banking systems, and are used as a worldwide benchmark for assessing the quality of supervisory systems. They are also used for identifying future work to achieve a standard for sound supervisory practice. The principles are updated regularly by the Basel Committee on Banking Supervision, with the most recent update occurring in September 2012.

In order to prepare for the IMF assessment, a comprehensive self-assessment exercise was undertaken by the Bank. The output of that assessment was provided to the IMF in advance of its on-site review.

During the on-site review, the IMF held a significant number of meetings with the Bank both to ensure that its understanding of Bank processes was correct and to challenge the information set out in the self-assessment document. The IMF team also met with, inter alia, the Department of Finance, banks, the Irish Banking Federation, and the Garda Síochána (Financial Intelligence Unit). There was extensive communication between the Bank and the IMF both before and after the review Mission.

It is expected that the IMF will publish its assessment in early 2014.

Insurance Supervision

The Bank supervises 235 insurance undertakings comprising life, non-life and reinsurance companies.

Non-Life Pricing and Claim Reserves

Under-reserving of claims and mispricing of insurance products are the two key reasons for failure of non-life (re)insurance companies. During 2013, a number of pricing, claims and reserving reviews were carried out by the Bank and where control weaknesses or a need to strengthen reserves was identified, the Bank engaged with the relevant companies to address the inadequacies.

Challenges Presented by a Low Interest Rate Environment

The asset quality of (re)insurance companies was an area of focus for the Bank due to the continuing low interest rate risk environment. A key objective was to ensure that potential shifts in companies' strategic asset allocations into higher yielding, less liquid investments was undertaken in an integrated way with the overall risk framework. A number of (re)insurance companies' asset quality and the related controls were reviewed during 2013 and, where weaknesses were identified, entities were required to take mitigating actions.

Variable Annuities (VA)

In co-ordination with life (re)insurance companies, the Bank developed a framework for the quantitative assessment of the scope and scale of the risks posed by a prolonged low interest rate environment. This framework focuses on closer scrutiny of interest rate risk and critical assessments of firms' product offerings in the marketplace. Relevant institutions' responses were received by 31 December 2013.

Use of Derivatives

The Bank completed an analysis of derivatives by High and Medium-High Impact (re)insurance companies during 2013 to establish if the use of derivatives was for efficient investment portfolio management. Where inefficiencies were identified, companies were required to take risk mitigating actions.

Reserving and Pricing for Non-Life Insurers and Reinsurers

In September 2013, with a view to developing the regulatory framework for reserving and pricing, the Bank issued a Consultation Paper (CP73) which proposed a number of new and additional requirements. The impact on the undertaking would be dependent on its PRISM impact rating. The proposals include:

- Prescribing the Signing Actuary Role as a Pre-Approved Control Function (PCF)
- Requirements for peer reviews of Statement of Actuarial Opinions (SAO) and the reports underlying the SAO, to be conducted by a Reviewing Actuary
- Requirements for Internal Audit to carry out an assessment of the company's reserving process
- Setting up of Reserving Committees to include at least one Independent Non-Executive Director.

In addition, CP73 also includes guidance on best estimate, risk margin and peer review reports. The Bank has engaged with industry representatives on this matter and will publish the final requirements after completing the consultation process.

Internal Models

Since 2010, the Bank has been working with insurance companies seeking approval of internal models to gain mutual understanding and to ensure that models meet the criteria specified for approval by the Solvency II Directive. In addition, the Bank has worked with other National Supervisory Authorities (NSAs) to develop the required technical standards. The European Insurance and Occupational Pensions Authority (EIOPA)[7] Peer Review Panel assessed the performance of all NSAs and its report was published in 2013.

Regulator-to-Regulator Engagement

Bilateral and multilateral co-operation with other regulators play a key role in the effective supervision of regulated (re)insurance companies, at both European and global levels. During 2013, the Bank signed three individual memoranda of understanding (MoUs) with the Florida Office of Insurance Regulation, the Indiana Department of Insurance and the Missouri Department of Insurance, Financial Institutions & Professional Registrations.

In February 2013, the Bank signed the International Association of Insurance Supervisors Multilateral Memorandum of Understanding (IAIS MMoU), which is a global framework for cooperation and information exchange between insurance supervisors. In addition, the Bank signed a bilateral agreement with the Board of Governors of the Federal Reserve System.

7 EIOPA is part of the European System of Financial Supervision consisting of three European Supervisory Authorities, the National Supervisory Authorities and the European Systemic Risk Board. It is an independent advisory body to the European Commission, the European Parliament and the Council of the European Union.

In December 2013, the Delaware Department of Insurance confirmed to the Bank their agreement to recognise Ireland as a qualified jurisdiction under Delaware State law.[8]
(Re)insurance companies based in Delaware reinsuring to companies based in Ireland can now apply for relief from collateral requirements.

Engagement with Industry

Effective communication with industry remains a key priority and is an important aspect of the Bank's supervisory agenda. The Bank had ongoing regular interactions with industry throughout the year on a range of different topics. Key industry fora include: DIMA (Dublin International Insurance & Management Association), Insurance Ireland, and the Taoiseach's IFSC Insurance Working Group. A seminar for (re)insurance companies' Independent Non-Executive Directors was organised by the Bank in October 2013.

Markets Supervision

In 2013, the Bank continued to pursue its strategy of (a) inbedding risk-based supervision via PRISM, (b) building its analytical supervisory capability through the collection of online regulatory returns and improvements in authorisation processes and (c) building its influence in European (and global) regulatory fora. Thirty FRAs and related RGPs for Medium High and Medium Low Impact investment firms as well as a series of thematic reviews on specific areas of risk were undertaken. The Low Impact firm supervisory strategy implemented during 2012 continued to deliver on the PRISM mandate through reactive supervisory alerts and triage events. Supervision of investment funds in particular was enhanced through the roll-out of the On-Line Reporting system. This work contributed to improved mitigation of risk in securities firms and a number of enforcement referrals.

The Bank's Markets and Consumer Protection Directorates also commenced a more active engagement in relation to Conduct Risk Assessment for investment firms. Recognising the frequent overlap between prudential and conduct risk, this initiative is bringing a fully holistic review of risk in investment firms.

Client Asset Regulations and Guidance

Following the review of the regulatory regime for safeguarding client assets published in March 2012, the Bank established a joint industry working group to develop detailed proposals to replace the existing Client Asset Requirements (issued November 2007). These proposals form the basis for the new client asset regime set out in Regulations, issued under the Central Bank (Supervision and Enforcement) Act 2013, and complemented by Guidance. The Regulations and Guidance were subject to a public consultation, which closed on 31 October 2013.

Proposed changes to the Client Asset regime include:

- The proposed regime provides for a framework based on seven Client Asset Core Principles, with a once-off Transitional Regulation in respect of a firm's initial Client Asset Management Plan.
- Firms will be required to provide clients with a simple 'plain language' standalone document known as the 'Client Asset Key Information Document' explaining the client asset regime.
- Firms will be required to appoint an individual to a Client Asset Oversight Role which will be a Pre-Approved Controlled Function, appointed under Part 3 of the Central Bank Reform Act 2010.
- Firms will be required to create, document and maintain a Client Asset Management Plan in order to safeguard client assets.
- Firms will be required to arrange for an external auditor to prepare a report in relation to the safeguarding of client assets by a firm, on an annual basis.

8 The US State of Delaware is a significant base for international (re)insurance activities. As a jurisdiction, it ranks 10th in the United States in national written premium and its Insurance Commissioner regulates companies with $506 billion in assets.

The 26 responses received to the public consultation were broadly in agreement with the Bank's proposals and will be considered when finalising the Regulations and Guidance. Before publication, the final Regulations must be approved by the Commission, the Minister for Finance and EU Commission. It is envisaged that the Regulations will be effective in the latter half of 2014.

Authorisation of Investment Firms under MiFID

Following a review of the process for firms seeking authorisation to provide services under the Markets in Financial Instruments Directive (MiFID), the Bank is introducing a more efficient risk-based approach to processing these applications. A two-level process has been devised whereby, depending on the size of the applicant firm and complexity of its business model, an applicant will be deemed to be either a Level One or Level Two applicant. It is expected that Level One applications will be processed within 3 months from receipt of the original complete application while Level Two applications may take up to 6 months. Within these timeframes there are various checkpoints and timing deadlines for the exchange of correspondence.

As part of the new process, the Bank has reduced the complexity of the Authorisation Application Form and improved the quality of the accompanying Guidance Note for applicants. It is now more prescriptive and provides instruction and assistance for every part of the application form.

Following a consultation process with industry during October and November 2013, which included workshops and presentations to industry stakeholders, the process became operational in January 2014. Following a period of 12 months in operation, the Bank will carry out a review of the effectiveness of the new process which will involve further engagement with industry stakeholders.

Effective Banking and Securities Regulation: Expectations, Challenges and Opportunities

On 11 October 2013, the Bank hosted a conference entitled 'Effective Banking and Securities Regulation: Expectations, Challenges and Opportunities'[9]. The conference brought together a distinguished group of international and domestic speakers and considered developments covering issues such as:

- Reform of prudential regulations for banks and investment firms
- Supervisory architecture
- Bank and non-bank resolution
- Regulatory approaches to the alternative investment and shadow banking sector
- The role of securitisation, repo and collateralised lending.

During 2013, the Bank also hosted or supported 31 separate Industry meetings and presentations ranging across issues such as the current review of the MiFID to the recently proposed Alternative Investment Fund (AIF) Handbook, highlighting the importance the Bank gives to engaging with and educating industry on the developments in regulation within Europe.

Collective Investment Schemes

Collective Investment Schemes (funds) are established for the purpose of investing the pooled subscriptions of investors (held as units or shares in the scheme) in investment assets in accordance with investment objectives published in the prospectus. The net asset value of Irish authorised funds amounted to €1.344 billion as at 31 December 2013 represented by 5,599 funds, including sub funds. The number of revocations (all voluntary) of existing funds, including sub funds, in 2013 was 509. In 2013, the total number of funds authorised under the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2003, Unit Trusts Act 1990, Part XIII of

9 The proceedings of the conference can be found at: http://www.centralbank.ie/regulation/marketsupdate/Documents/131011%20Central%20Bank%20of%20Ireland%20Conference%20-%20Effective%20Banking%20and%20Securities%20Regulation%20Conference.pdf

the Companies Act 1990, the Investment Funds, Companies and Miscellaneous Provisions Act 2005, and the Investment Limited Partnerships Act 1994 was 118 funds (804 including sub funds)[10].

IMF Assessment of IOSCO Principles

In early 2013, the Bank formally requested the IMF to conduct an assessment of Ireland's level of compliance with the 'IOSCO Objectives and Principles of Securities Regulation' (the Principles). These Principles set out the broad framework for the regulation of securities and represent one of the key standards and codes highlighted by the Financial Stability Board as critical to the existence of sound financial systems. In terms of practical application, the Principles are used by the World Bank and the IMF in their Financial Sector Assessment Program (FSAP).

The Bank submitted a detailed self-assessment document to the IMF in July 2013, prior to the arrival of the IMF assessors in September 2013. The assessment-mission lasted almost three weeks and included in-depth interviews with many divisions across the Bank, as well as numerous external meetings with other regulatory and State bodies (for example the Office of the Director of Corporate Enforcement and the Irish Auditing & Accounting Supervisory Authority), and a number of regulated entities. Both before and after the assessment-mission, there was extensive communication between the Bank and the IMF. It is expected that the IMF will publish its assessment in early 2014.

Market Related Supervisory Activity

The tables below provide detail on the volumes of market related supervisory activity under taken by the Bank during 2013.

Table 4 - Company Information Disclosures[11]

	2012	2013
Annual Financial Reports published	143	134
Half-yearly Financial Reports published	121	113
Interim Management Statements published	100	98
Major shareholding submitted	379	416
Number of Issuers whose securities were suspended from trading on the ISE by the Bank	8	14

Table 5 - Investigations under Securities Law

	2012	2013
Enquiries initiated regarding possible contraventions	76	52
Enquiries completed regarding possible contraventions	79	67
Suspicious Transaction Reports submitted to the Bank by persons professionally arranging transactions	19	27
Suspicious Transaction Reports submitted to the Bank by other EU Competent Authorities	5	8
Suspicious Transaction Reports transmitted by the Bank to EU Competent Authorities	16	21
Assistance rendered to other EU Competent Authorities	19	17
Stabilisation Notifications submitted to the Bank	0	1
Securities Law Settlement Agreements (concluded)	2	1
Securities Law Formal Private Cautions Issued	0	0

10 This data meets the Bank's reporting requirements under Section 3(6) of the Unit Trust Act 1990.

11 The Bank is the designated central competent authority for the purposes of the Regulations, except for the purposes of Article 24(4)(h) of the Transparency Directive in respect of which the Irish Auditing and Accounting Standards Authority (IAASA) has been appointed the relevant Competent Authority.

Table 6 - Market Monitoring Reports

	2012	2013
Transaction reports received from entities located in Ireland (millions)	58.5r	142.8
Transaction reports sent to other competent authorities via TREM* (millions)	50.1r	124.4
Transaction reports received from other competent authorities via TREM* (millions)	13.2r	17.0
Administrative Sanctions/Supervisory Warnings - Cases Opened	8	3
Administrative Sanctions/Supervisory Warnings - Cases Closed	4	8[12]
Audits conducted on firms' transaction reports	82	60

* Transaction Reporting Exchange Mechanism

r Revised to reflect corrections received post year-end

Table 7 - Prospectus Approval Process

	2012	2013
Number of Final Terms Filed	1223	1750
Number of Documents Approved	670	844
Number of Documents/Notifications published	2633	3124
Passport Certificates prepared	91	250
Inward Passporting Notifications processed	739	492
Number of Issuers whose securities were suspended from trading by the ISE at the request of the Bank	2	2

The difference between the number of documents that have been approved to date and the number of documents that have been published on the Bank's website relates to (i) Final Terms, Final Offer Price and Amount of Securities Announcements and Annual Information Reports (which do not require approval) that have been filed and published on the website and (ii) notifications in respect of prospectuses which have been approved by the Competent Authority of another Member State and which are then passported into Ireland and do not require the approval of the Bank.

Policy, Risk and Governance

Alternative Investment Fund Managers Directive (AIFMD)

The EU Directive (No. 2011/61/EU) on Alternative Investment Fund Managers (AIFMD) came into effect on 22 July 2013. It is supplemented by detailed Level II measures and also by guidelines issued by European Securities and Markets Authority (ESMA)[13] in the areas of remuneration and scope. In Ireland, the AIFMD was transposed into national law by means of S.I. 257/2013.

During 2013, the Bank finalised its revised framework for the regulation of AIFs and AIFMs which fall to be regulated under domestic legislation. The AIF Rulebook was published in July 2013 and the Bank then issued a consultation paper on types of AIFs, including Exempt Unit Trusts and Real Estate Investment Trusts (REITs). This work resulted in the Bank being the first jurisdiction in Europe to have in place its framework for AIFMD.

European Union Regulations to allow for the promotion of investment funds which invest in venture capital (EuVECA) and investment funds with socially responsible investment objectives (EuSEF) were agreed between the Council and Parliament in April 2013 and came into effect on 22 July 2013.

12 One case closed without resulting in any enforcement action

13 European Securities and Markets Authority (ESMA) is an independent EU Authority that contributes to safeguarding the stability of the European Union's financial system by ensuring the efficiency and orderly functioning of securities markets, as well as enhancing investor protection.

Revision of the Impairment Provisioning and Disclosure Requirements

In May 2013, the Bank issued a set of revised 'Impairment Provisioning and Disclosure Guidelines' (the Guidelines). The revisions were based on a review the Bank undertook regarding compliance with the disclosure requirements in the financial statements of the Covered Banks as at 31 December 2011 and 31 December 2012. The main changes to the revised Guidelines included the insertion of: (i) a definition of a 'Non-Performing Loan'; and (ii) a new section to clarify the concept of 'Cured Loans'.

Revision of the Code of Practice on Related Party Lending

During June 2013, the Bank revised the 'Code of Practice for Related Party Lending for Credit Institutions' (Code of Practice). The Code of Practice sets out requirements for banks in relation to the authorisation, amendment of, administration, monitoring and reporting to the Bank in respect of loans issued to related or connected parties, as defined in the Code of Practice, by banks. The changes introduced clarified certain aspects in relation to the practical operation of the Code of Practice.

Revision of the Corporate Governance Code for Credit Institutions and Insurance Undertakings

The Bank revised the 'Corporate Governance Code for Credit Institutions and Insurance Undertakings' (the Code) during December 2013. The Code sets out minimum statutory requirements on how credit institutions and insurance companies should organise the governance of their institutions and its key objective is to facilitate good corporate governance in those institutions which fall within its remit. The main changes to the Code include the requirement for institutions to appoint a Chief Risk Officer (CRO), a new section has been introduced which outlines the role and responsibilities of the CRO and other amendments aimed at enhancing the principle of proportionality throughout the Code. The revised Code comes into effect on 1 January 2015.

Revision of the Auditor Protocol between the Central Bank and the Auditors of Regulated Financial Service Providers

The 'Auditor Protocol between the Central Bank and the Auditors of Regulated Financial Service Providers' (the Auditor Protocol) provides a framework between the Bank and auditors for exchanging information on a timely basis with the aim of enhancing both the regulatory and statutory audit processes. The revisions have the effect of extending the scope of the Auditor Protocol from applying only to firms rated as High Impact under PRISM to applying to all meetings between auditors and the Bank. The Auditor Protocol was also updated to reflect recent changes in legislation in the form of the provision in Section 58 of the Central Bank (Supervision and Enforcement) Act 2013, relating to the limitation of liability in the reporting of certain matters by auditors.

Engagement with the Irish Accounting and Auditing Supervisory Authority

The Bank engages with Irish the Accounting and Auditing Supervisory Authority (IAASA) on matters relating to the affairs of mutual interest entities and holds a seat on the IAASA Board.

Engagement with European Supervisory Authorities

Box 2 - Single Supervisory Mechanism

The Single Supervisory Mechanism (SSM) represents a new system of financial supervision in Europe comprising the European Central Bank (ECB) and the national competent authorities of participating EU countries. The principal objectives of the SSM are (i) to ensure the safety and soundness of the European banking system and (ii) to increase financial stability in Europe. Under the SSM, the ECB will supervise 'significant' credit institutions. Approximately 130 banks will be directly supervised which account for almost 85 per cent of the total banking assets in the euro area. The ECB will fully assume its new role as supervisor of euro area banks in November 2014.

On 23 October 2013, the ECB announced that it would perform a Comprehensive Assessment (Assessment) comprising:

- A supervisory risk assessment to review, quantitatively and qualitatively, key risks, including liquidity, leverage and funding
- An asset quality review (AQR) to enhance the transparency of bank exposures by reviewing the quality of banks' assets, including the adequacy of asset and collateral valuation and related provisions
- A stress test to examine the resilience of banks' balance sheets to stress scenarios.

These three elements are closely interlinked. The assessment will be based on a capital benchmark of 8% Common Equity Tier 1, drawing on the definition of the Capital Requirements Directive IV/Capital Requirements Regulation, including transitional arrangements, for both the AQR and the baseline stress test scenario. The details concerning the stress test will be announced at a later stage, in co-ordination with the European Banking Authority.

The assessment process commenced in November 2013 and is expected to be completed by October 2014, at which time the final outcome will be communicated publicly. The Irish banks included in the Assessment are:

- AIB
- Bank of Ireland
- PTSB
- Ulster Bank
- Merrill Lynch

The Supervisory Board of the SSM was established in January 2014 and its first meeting took place on 30 January. Cyril Roux (Deputy Governor, Financial Regulation) is a member of the Supervisory Board of the SSM.

Further information and updates on the Single Supervisory Mechanism are available on the Bank's and ECB's websites.

European Supervisory Agencies

During 2013, the Bank continued to contribute to the work of the three European Supervisory Agencies (ESAs)[14] covering banking, insurance/occupational pensions and securities/markets. It actively participates on a wide selection of the standing committees and sub groups within the ESAs, many of which are responsible for the initial drafting of delegated acts and technical standards in relation to forthcoming European legislation.

EBA

The Bank is a member of the European Banking Authority (EBA)[15] Board of Supervisors. In 2013, the Bank continued to engage with and influence the direction of supervision at a European level through involvement with the EBA. The Bank was also represented on the Standing Committee on Operations and Practices, sub groups of this Committee and various other working groups.

The Bank also supported the development of the Single Supervisory Mechanism (SSM) and has commenced planning for the delivery of the required work, e.g. Comprehensive Assessment and organisational changes required to implement SSM within the Bank, both of which are strategic priorities for 2014.

EIOPA

As part of the European Insurance and Occupational Pensions Authority (EIOPA)[16] programme for Groups Supervision, EIOPA recommends that Supervisory Colleges attended by other global regulators be held on an annual basis to discuss key aspects of the group's performance and to ensure a holistic view is obtained of the supervisory risks for such a group. A key output of this College is a work plan to ensure all key risk areas are addressed. It is the responsibility of the group supervisor to ensure this plan is executed effectively before the next college meeting.

The Bank was heavily involved in Regulatory Colleges during 2013. A total of 56 regulated entities were subject to Regulatory College examination involving 38 separate college meetings. The Bank also held three supervisory colleges with other supervisory authorities, as part of the programme for groups' supervision.

The Bank chairs EIOPA's Internal Governance Supervisory Review and Reporting (IGSRR) Sub Group.

ESMA

The Bank is a member of the European Supervisory Markets Authority (ESMA) Board of Supervisors and it has representatives on each of the Standing Committees which deal with such subjects as market structure, investor protection, investment management, market integrity, financial innovation, corporate reporting and corporate finance. ESMA also has a number of sub groups and Task Forces that work on particular issues under each of the Standing Committees. The Bank actively participates in a wide selection of these sub groups, many of which are responsible for the initial drafting of delegated acts and technical standards in relation to forthcoming securities legislation.

The Director of Consumer Protection was appointed Chairman of FinCoNet, a new international organisation for financial consumer protection supervisory authorities whose aim is to promote sound market conduct and strong consumer protection.

14 European Banking Authority (EBA), European Insurance and Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA)

15 The European Banking Authority (EBA) is an independent EU Authority which works to ensure effective and consistent prudential regulation and supervision across the European banking sector.

16 EIOPA is part of the European System of Financial Supervision consisting of three European Supervisory Authorities, the National Supervisory Authorities and the European Systemic Risk Board. It is an independent advisory body to the European Commission, the European Parliament and the Council of the European Union.