An Roinn Airgeadais
Department of Finance

9 June 2015

Mr Gavin Sheridan
gavinsblog@gmail.com

Re: FOI request 142/2015

Dear Mr. Sheridan,

I refer to the request which you made under the Freedom of Information Act 2014 for records held by the Department of Finance in relation to:

> *"Agendas, briefing papers for attendees, minutes, notes and any other documents related to the following Ministerial meetings:*
> *Governor Honohan, March 2, 2012*
> *Governor Honohan, May 17, 2012"*

I, Finian Judge, have now made a final decision to part grant your request.

The purpose of this letter is to explain that decision. This explanation has the following parts:

1. a schedule of all of the records covered by your request;
2. an explanation of the relevant findings concerning the records to which access is denied, and
3. a statement of how you can appeal this decision should you wish to do so.

This letter addresses each of these three parts in turn.

1. Schedule of records

A schedule is enclosed with this letter showing the documents that this body considers relevant to your request. It describes each document and refers to the sections of the FOI Act which apply to prevent release. The schedule also refers you to sections of the detailed explanation given under heading 2 below, which are relevant to the document in question.

2. Findings, particulars and reasons for decisions to deny access

The sections of the Act which can apply to deny access to documents are known as its exemption provisions.

Record 2 has been redacted under section 33, 36, 40 and 41 of the Freedom of Information Act 2014.

Record 9 has been redacted under section 33, 40 and 41 of the Freedom of Information Act 2014.

Where appropriate, the Public Interest Test has been applied to these redactions.

3. Rights of appeal

In the event that you are unhappy with this decision, you may appeal it by writing to the Freedom of Information Unit, Department of Finance, Government Buildings, Upper Merrion Street, Dublin 2 or by e-mail to foi@finance.gov.ie. You should make your appeal within 4 weeks from the date of this notification, where a day is defined as a working day excluding the weekend and public holidays. However, the making of a late appeal may be permitted in appropriate circumstances. The appeal will involve a complete reconsideration of the matter by a more senior member of the staff of this body.

Should you have any questions or concerns regarding the above, please contact me by telephone on 01 604 5838.

Yours sincerely,

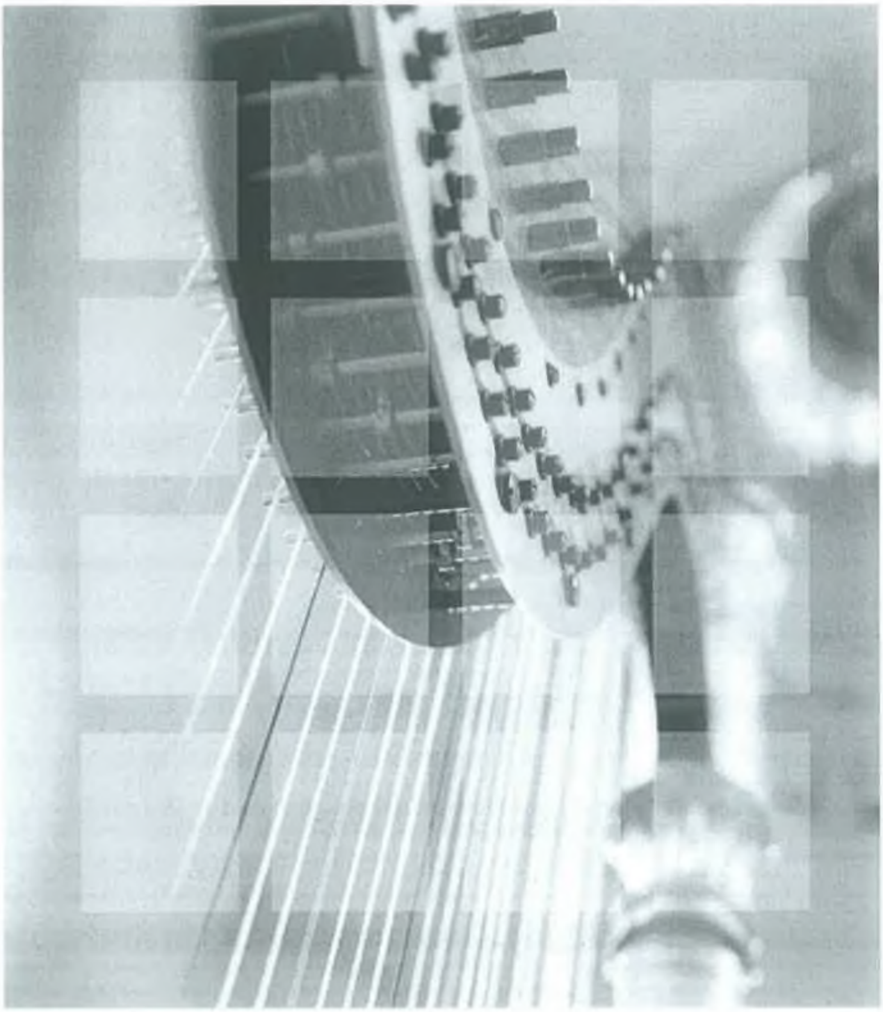
Finian Judge
Assistant Principal

FOI Request Reference: 086/2015
Schedule of Records: Summary of Decision Making:

Record No.	Brief Description & Date of Record	No. of Pages	Decision: Grant/Part Grant/Refuse	Basis of Refusal – Section of Act	Reason for Decision	Public Interest Consideration (if applicable)
1	Tap and swap considerations	2	Grant	N/A	N/A	N/A
2	Email with meeting request for 17 May 2012	2	Part Grant	Section 36, Section 33(1)(d), Section 33(3)(c)(ii), Section 40(1) , Section 41(1)(a)	Contains commercially sensitive information; contains information relating to the international relations of the State; Contains information communicated in confidence; contains information that may harm the financial and economic interests of the State; Contains information that is prohibited from	Yes

					disclosure by EU law	
3	Email of 3 May from Sean Kinsella – Meeting with Minister	2	Grant	N/A	N/A	N/A
4	Email of 3 May from Mary McKeogh – meeting with Minister	2	Grant	N/A	N/A	N/A
5	Email of 16 May from Ann Nolan re letter from Governor	1	Grant	N/A	N/A	N/A
6	Email of 16 May from John Cantwell re letter from Governor	22	Grant	N/A	N/A	N/A
7	Tap and swap considerations	7	Grant	N/A	N/A	N/A
8	Letter of 30 April 2012 from Minister Noonan to Governor Honohan	1	Grant	N/A	N/A	N/A
9	Letter of 17 April 2012 from Governor Honohan to Minister Noonan	2	Part Grant	Section 33(3)(c)(ii), Section 40(1), Section 41(1)(a)	Contains information communicated in confidence; contains information that may harm the financial and economic interests of the State; Contains information that is prohibited from disclosure by EU law	Yes

1



Tap and swap considerations

Commercially sensitive for FOI purposes

Letter dated 14th April

Summary issues

The following observations could be made:

1. ***Steps have been taken by the Authorities in relation to reducing State support for the banking sector – reduced ELG, clarity of the policy attitude towards State support, increasing deposit levels (although at moderate rates), the introduction of unguaranteed corporate deposit taking***
2. ***However, the banking debt overhang, and the accompanying contingent State exposure, is causing difficulty in a return to the capital market***

Our 'bottom line'

1. ***The inability of IBRC to access the ECB directly 'costs' the State (at the least, through cashflow and timing)***
2. ***IBRC is being capitalised to high levels which is an additional cost to the State and creates trapped cash***
3. ***The 'tap' increases our debt/GDP ratio and could affect our deficit as well – what is our incentive to do this***
4. ***If the issue is the promissory notes, is the 'swap' creating more problems on a systemic basis?***

Issues

1. ***If the portfolios are sold (in short order) what happens to the promissory notes?***
2. ***Do the promissory notes have to be retained within IBRC?***
3. ***Could that 'capital' be transferred to another bank/can other banks capital be sold as well?***
4. ***What 'subsidy' is available from the EU/ECB?***

Tactics

Work should be done at domestic level such that, if the opportunity arises through Eurozone developments, we can have a fully developed plan. It would be far more advisable to have a plan/series of plans to present rather than hope that a plan is presented to us.

2

Niamh Murtagh

Subject: Governor with Minister

Start: Thu 17/05/2012 10:15
End: Thu 17/05/2012 11:00

Recurrence: (none)

Organizer: Moran, John

PH, Ann, Minister.doc

Mary

Can we say 10.15 on the morning of the 17th?

Sean

From: McKeogh Mary [mailto:Mary.McKeogh@centralbank.ie]
Sent: 03 May 2012 11:22
To: Kinsella, Sean
Cc: Behan, Anne
Subject: RE: Meeting with Minister

Sean

Governor Honohan will be available on Monday 14 May (between 09:30 and 12:00) and Thursday 17 May (09:30-17:00). Please let me know if either of these dates would suit?

Kind regards

Mary

From: Kinsella, Sean [mailto:sean.kinsella@finance.gov.ie]
Sent: 02 May 2012 18:02
To: McKeogh Mary
Cc: Behan, Anne
Subject: Meeting with Minister

Hi Mary

In the context of the attached (which you should receive soon) you might let me have a general idea of the Governor's availability over the next week or 2.

Thanks

[redacted]

page redacted

PH., Am., Minister

3

Niamh Murtagh

From:	Kinsella, Sean
Sent:	03 May 2012 11:26
To:	Nolan, Ann
Cc:	Behan, Anne; Dorgan, Eoin
Subject:	FW: Meeting with Minister
Attachments:	ATT00002.txt

Ann

We will be in Brussels on the 14th so 17th is only runner – would that work from your side?

Sean

From: McKeogh Mary [mailto:Mary.McKeogh@centralbank.ie]
Sent: 03 May 2012 11:22
To: Kinsella, Sean
Cc: Behan, Anne
Subject: RE: Meeting with Minister

Sean

Governor Honohan will be available on Monday 14 May (between 09:30 and 12:00) and Thursday 17 May (09:30-17:00). Please let me know if either of these dates would suit?

Kind regards

Mary

From: Kinsella, Sean [mailto:sean.kinsella@finance.gov.ie]
Sent: 02 May 2012 18:02
To: McKeogh Mary
Cc: Behan, Anne
Subject: Meeting with Minister

Hi Mary

In the context of the attached (which you should receive soon) you might let me have a general idea of the Governor's availability over the next week or 2.

Thanks

Sean

a fháil, scrios é le do thoil agus cuir an seoltóir ar an eolas. Is leis an údar amháin aon dearcaí nó tuairimí a léirítear.
Scanadh an r-phost seo le Sophos agus deimhníodh go raibh sé saor ó víoras leis an bpatrúnchomhad atá in úsáid faoi láthair. Ní féidir a ráthú leis seo áfach nach bhfuil ábhar mailíseach ann.

Niamh Murtagh

From:	McKeogh Mary
Sent:	03 May 2012 14:01
To:	Kinsella, Sean
Cc:	Nolan, Ann; Behan, Anne; Fitzgerald, Margaret
Subject:	RE: Meeting with Minister
Attachments:	ATT00002.txt

Sean

Thursday 17 May at 10:15 is now in the Governor's diary.

Kind regards

Mary

From: Kinsella, Sean [mailto:sean.kinsella@finance.gov.ie]
Sent: 03 May 2012 13:26
To: McKeogh Mary
Cc: Nolan, Ann; Behan, Anne; Fitzgerald, Margaret
Subject: RE: Meeting with Minister

Mary

Can we say 10.15 on the morning of the 17th?

Sean

From: McKeogh Mary [mailto:Mary.McKeogh@centralbank.ie]
Sent: 03 May 2012 11:22
To: Kinsella, Sean
Cc: Behan, Anne
Subject: RE: Meeting with Minister

Sean

Governor Honohan will be available on Monday 14 May (between 09:30 and 12:00) and Thursday 17 May (09:30-17:00). Please let me know if either of these dates would suit?

Kind regards

Mary

From: Kinsella, Sean [mailto:sean.kinsella@finance.gov.ie]
Sent: 02 May 2012 18:02
To: McKeogh Mary
Cc: Behan, Anne
Subject: Meeting with Minister

Hi Mary

In the context of the attached (which you should receive soon) you might let me have a general idea of the Governor's availability over the next week or 2.

Thanks

Sean

Attention:
This e-mail is privileged and confidential. If you are not the intended recipient please delete the message and notify the sender. Any views or opinions presented are solely those of the author.
This email was scanned by Sophos and has been certified virus free with the pattern file currently in use. This however cannot guarantee that it does not contain malicious content.

Tabhair aire:
Tá an r-phost seo faoi phribhléid agus faoi rún. Mura tusa an duine a bhí beartaithe leis an teachtaireacht seo a fháil, scrios é le do thoil agus cuir an seoltóir ar an eolas. Is leis an údar amháin aon dearcaí nó tuairimí a léirítear.
Scanadh an r-phost seo le Sophos agus deimhníodh go raibh sé saor ó víoras leis an bpatrúnchomhad atá in úsáid faoi láthair. Ní féidir a ráthú leis seo áfach nach bhfuil ábhar mailíseach ann.

(5)

Niamh Murtagh

From: Nolan, Ann
Sent: 16 May 2012 11:39
To: Torpey, Michael; Ryan, Neil
Subject: RE: 17th April letter from Governor

Maybe the Minister's office acknowledged it. Can you guys put together a brief for tomorrow covering the tap and swap, the 40 for 40 and the more general position on funding?

Thanks.

Ann

From: Torpey, Michael
Sent: 16 May 2012 10:21
To: Nolan, Ann
Subject: 17th April letter from Governor

Was copied to us – we do not appear to have issued reply from this area.

Michael Torpey,
Banking Division,
Department of Finance,
Government Buildings,
Upper Merrion Street,
Dublin 2.

Tel: +353-1-6045326

(6)

Niamh Murtagh

From: Cantwell, John
Sent: 16 May 2012 17:49
To: Nolan, Ann
Cc: Torpey, Michael; Ryan, Neil; Buckley, Danny
Subject: FW: 17th April letter from Governor
Attachments: 090412 40 for 40.pptx; CONFIDENTIAL_Strengthening_Irish_Programme_Overview_v0 15.ppt

Ann

Please find attached briefing notes on the Tap and Swap and the 40 for 40 as requested. Neil will provide you with a brief on the more general position on funding.

Regards

John

From: Nolan, Ann
Sent: 16 May 2012 11:39
To: Torpey, Michael; Ryan, Neil
Subject: RE: 17th April letter from Governor

Maybe the Minister's office acknowledged it. Can you guys put together a brief for tomorrow covering the tap and swap, the 40 for 40 and the more general position on funding?

Thanks.

Ann

From: Torpey, Michael
Sent: 16 May 2012 10:21
To: Nolan, Ann
Subject: 17th April letter from Governor

Was copied to us – we do not appear to have issued reply from this area.

Michael Torpey,
Banking Division,
Department of Finance,
Government Buildings,
Upper Merrion Street,
Dublin 2.

Tel: +353-1-6045326

Strengthening the Irish Programme

Dublin, May 2012

An Roinn Airgeadais
Department of Finance

CONFIDENTIAL:
INFORMAL INFORMATION NOTE

HIGHLY CONFIDENTIAL
NOT FOR DISTRIBUTION
NOT APPROVED

Ireland's Programme: Key achievements through 2011

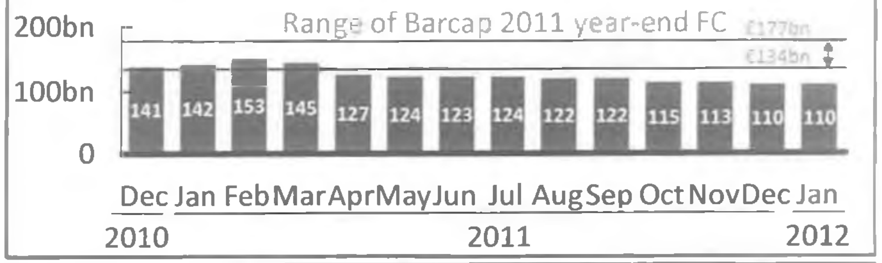
Ireland is ahead on strengthening the overall programme, the banking sector programme and the plan for IBRC

Ahead on strengthening overall programme
- Headline targets for all five quarters of EU/IMF Programme have been met.
- Budgetary outturn for 2011 is comfortably within target following tough austerity measures since 2008 equivalent to c. 15.5% of GDP (includes budget 2012).
- A substantial number of Programme actions – over 90 – have already been completed.
- €17.5 billion of the total programme funding of €85 billion coming from Ireland's own resources.

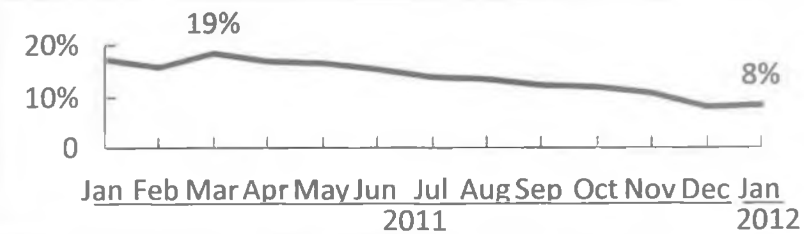
Ahead on banking sector programme
- Funding requirement for bank recapitalisation was €16.5 billion, below the €24 billion PCAR total capital.
- Reorganisation of banks completed ahead of deadlines.
- Deleveraging ahead of schedule: Banks achieved €40.5billion versus the PLAR target of €34.8 billion.
- ECB/ELA monetary funding down from February 2011 peak of €153 billion to €110 billion.

Ahead on plan for IBRC (formerly Anglo Irish Bank)
- IBRC launched the disposal of $9.2bn (gross of provisions) US loan assets in mid 2011.
- By year end 2011, $7.7bn (gross) of these loans had been sold at pricing which was broadly regulatory capital neutral. This allowed very significant early repayment of Central Bank funding.

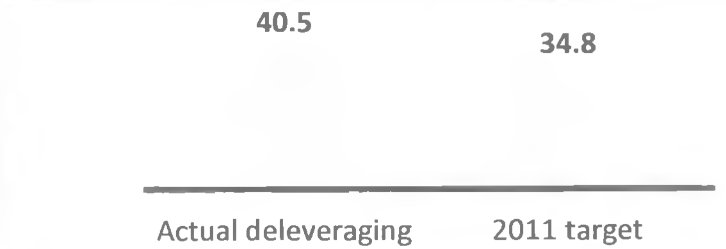
Eurosystem funding has fallen by €43bn since the peak in Feb.
Covered banks ECB and ELA usage, €bn



Irish usage of ECB facilities has fallen at a time when other Eurozone members have drawn more heavily
Covered bank usage of ECB Facilities, %



Deleveraging targets have been exceeded
2011 deleveraging[1] of BoI, AIB, IL&P, IBRC (to Nov 11), €bn



1 Year-to-date until November 2011
Source: Involved banks, Central Bank of Ireland

Context

Context for the 'Tap & Swap' restructuring proposal

- Ireland attaches the highest priority to the delivery of its Programme commitments.
- Minimising disruption to social cohesion in Ireland is also very important.
- We want to stand on our own two feet by exiting the Programme when it ends in 2013.
- The measures being considered do not involve any write-off of debt (PSI).
- From a wider euro area perspective it is essential to have a country successfully complete its Programme.
- A key objective is for the Sovereign and the banks to return to the markets as soon as possible in 2012/2013.
- To facilitate that process it would be very helpful if our existing Programme could be strengthened in a manner which has no direct cost implications for our partners.

HIGHLY CONFIDENTIAL
NOT FOR DISTRIBUTION
NOT APPROVED

The 'Tap & Swap' proposal would improve Ireland's position

Background

- Funding support for the capitalisation of IBRC is provided by the ECB through the Central Bank of Ireland acceptance of the Promissory Notes as collateral against ELA funding.
- Proposal being discussed at a technical level with the Troika involves two elements:
  - **'Tap':** Replacement of the existing Promissory Notes in IBRC with EFSF bonds followed by,
  - **'Swap':** An exchange of those EFSF bonds by IBRC for portfolios comprising principally residential mortgages held by Allied Irish Banks and PTSB, the banking arm of Irish Life and Permanent.

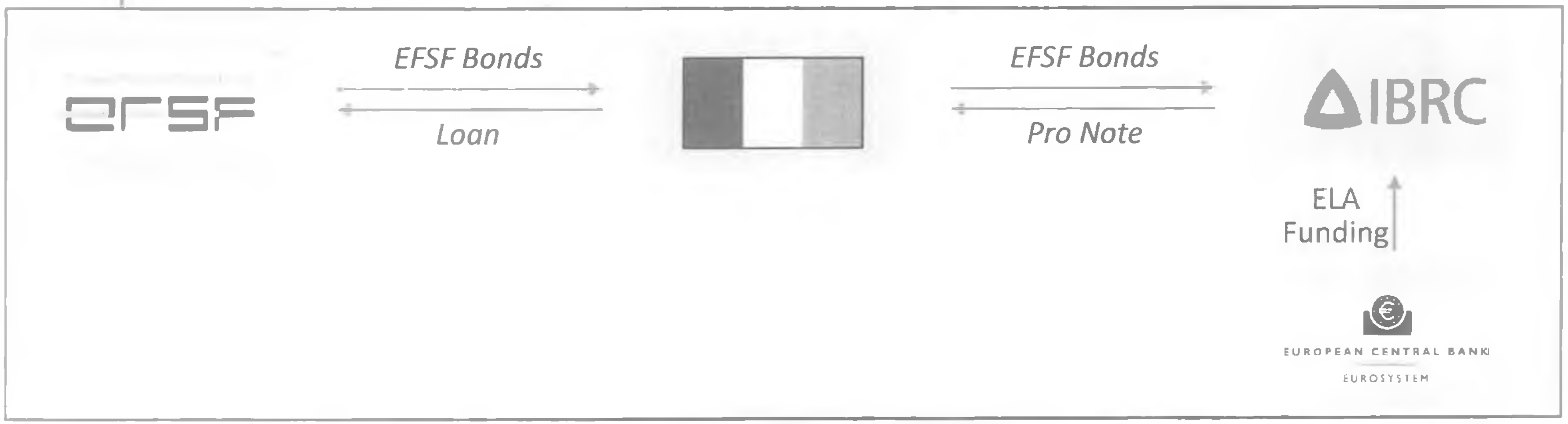
Expected benefits

- Stabilises and ensures the viability of AIB and PTSB,
- Enhances the availability of high quality collateral in the Irish system,
- Does not increase either current ECB funding support or Programme Support from Europe,
- Increases the ability of banks to raise 3rd party funding to repay Eurosystem,
- Reinforces market confidence in the stability of Eurosystem funding of the system (including IBRC),
- Reduces the post-programme funding demands on the Government and aids Ireland's faster return to the markets.

HIGHLY CONFIDENTIAL
NOT FOR DISTRIBUTION
NOT APPROVED

Mechanics of potential 'Tap & Swap' transaction: Step 1 – 'Tap'

Step 1 - Tap **Step 2 - Swap**



Step 1a – EFSF and State exchange identical bonds

- The EFSF issues par bonds (borrowing at circa 3.5% fixed coupon[1]) with a long dated maturity to the Irish State
- The State issues Government instruments (lending at the same notional, coupon and maturity) to the EFSF in return - as a result this entire transaction is cash flow neutral both initially and on an ongoing basis

Step 1b – State State replaces pro note with the EFSF bonds

- The State exchanges the IBRC promissory note with EFSF bonds
- IBRC receives EFSF bonds equal to the value of the pro note on the State's balance sheet (€28.1bn)
- Once this non cash exchange is complete, the pro note is cancelled
- No increase in the State's debt arises from these transactions

1 Modelling assumption only, yield will depend on EFSF yield curve at issuance, a variable could also be considered

If EFSF bonds were unavailable, Government bonds could be used – but with significant shortcomings

HIGHLY CONFIDENTIAL
NOT FOR DISTRIBUTION
NOT APPROVED

- Should no EFSF solution be feasible, Ireland could develop a variant of the 'Tap & Swap' using Government bonds
- This variant would be superior to the status quo but would have significant shortcomings compared to the EFSF solution
- However it also has selected advantages over an EFSF solution
- The Government bond variant has been discussed with the Troika albeit that the EFSF solution is seen as superior

Key shortcomings of using Government bonds

- Smaller reduction in direct deficit
- Higher total interest cost to State in case of a sale of either the bonds or the banks holding the bonds
- Build-up of reserves in banks which might be challenging to distribute
- Reduce risk of potential cannibalisation of primary issuance of Irish Government bonds

Key advantages of using Government bonds

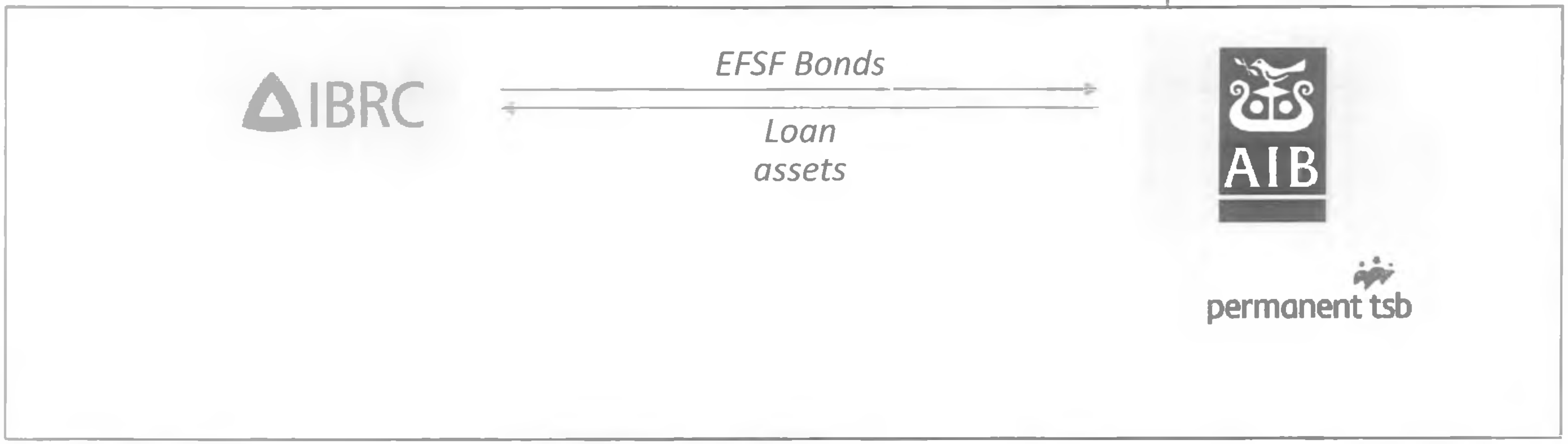
- Eliminates risk of perception as "second bailout"
- No expected capital requirements in "tap only" scenario
- Provision of significant positive carry to the banks

1 Depending on Audience

Mechanics of potential 'Tap & Swap' transaction: Step 2 – 'Swap'

Step 1 - Tap

Step 2 - Swap



- IBRC transfers all (or a portion of) the EFSF bonds to AIB, ILP and/or a new bank
- In exchange, IBRC receives low yielding loan assets of AIB (€20.0bn gross) and PTSB (€14.8bn gross) to be wound-down in IBRC
- Pure asset swap with funding remaining as before – although AIB and PTSB will now have 'high quality' collateral

Irish Authorities have a preference for longer dated EFSF bonds but the Troika propose a maturity aligned with the average duration of the existing assets

Assessment of 'Tap & Swap' with the 'EFSF' replacement option vis-à-vis status quo

HIGHLY CONFIDENTIAL
NOT FOR DISTRIBUTION
NOT APPROVED

Key advantages of the 'Tap & Swap'

- **Improved viability of AIB and PTSB** allowing for a **faster return of these banks to private ownership**
- **Lower interest costs improve State deficit**
- **Debt sustainability is improved** - Ireland would reach the 60% debt/GDP target two years quicker (in 2038 rather than 2040) and with a debt burden €27bn lower than status quo by that time
- **Cash flow benefit** as 'interest only' annual repayments means a reduction for the annual Exchequer funding requirement from €3.1bn to €1.0bn (until repayment in 2051)
- No 'refinancing noise' until maturity as **no annual principal repayments** directly to IBRC
- Reducing both the State's Pro Note refinancing requirements and the interest cost and helping remove the 2014 funding cliff would, therefore, **support the State's, and by extension the banks', prospects of returning to funding markets**

'Tap & Swap' significantly improves viability of AIB and PTSB

		Status Quo 2015		Post restructuring 2015
AIB	Capital	€10.8bn	+ €220 M	€11.0bn
	Profit before taxes	€0.85bn	+ €410 M	€1.26bn
PTSB	Capital	Maintaining the Status Quo, without initiating a restructuring, is not seen as a feasible option at this time.		€1.75bn
	Profit before taxes			€0.3bn

Information above is based on preliminary estimates

Assessment of 'Tap & Swap' with the 'EFSF' replacement option vis-à-vis status quo

Key shortcomings of the 'Tap & Swap'

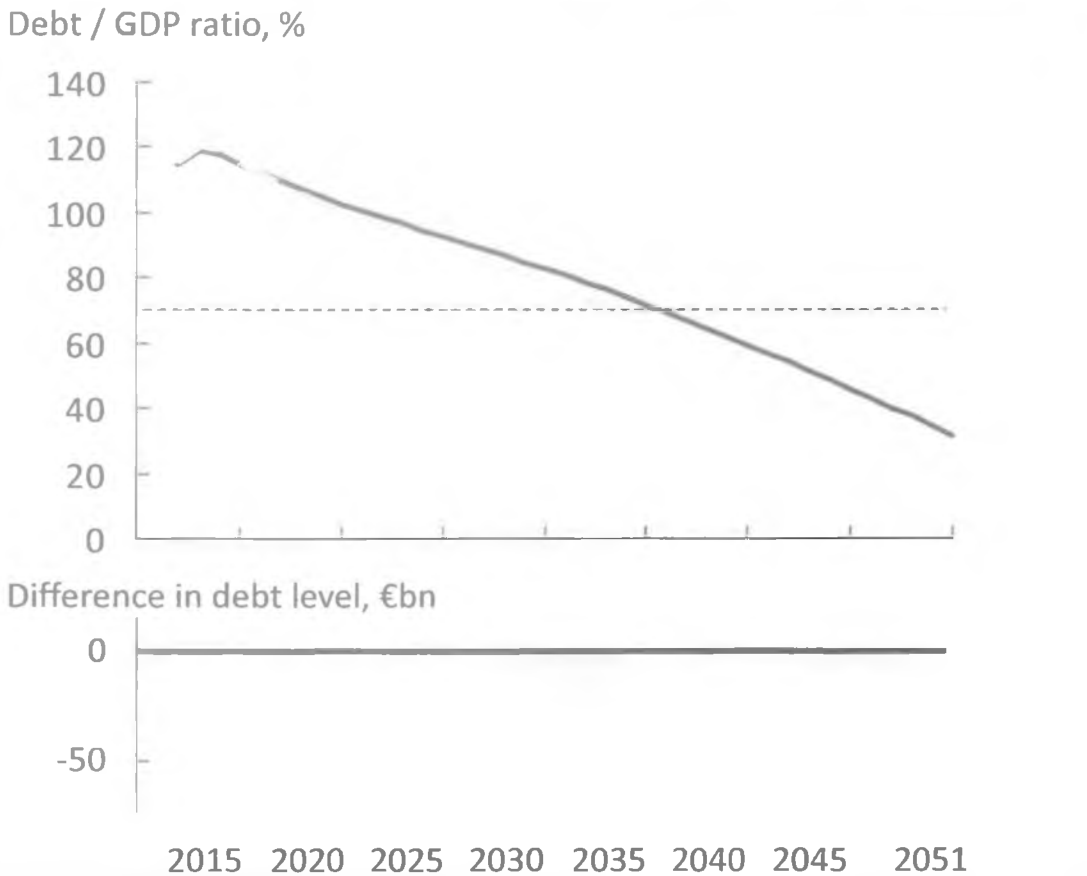
- A stable **long term funding solution for IBRC** is required for the solution to be effective and **is critical** to ensure a return of Ireland to the capital markets
- Could lead to negative market and public reaction as could be perceived as a **re-opening of discussions on bank recapitalisation** if upfront capital required – need for commensurate benefits and careful communications
- The **implementation poses** significant **operational challenges and operational risk** for the banks as transfers of individual portfolios are generally more complex, require more preparation and are higher risk than takeovers of entire banks
- The 'Tap & Swap' causes a **need for additional capital** in IBRC. This need would be considerably increased, if only the 'Tap' was implemented – in a 'Tap only' scenario, the requirement can be reduced if a funding cost lower than the cost of ELA is assumed in a 'Tap only' scenario

'Tap & Swap' considerably increases debt sustainability – leading to improved creditworthiness

HIGHLY CONFIDENTIAL
NOT FOR DISTRIBUTION
NOT APPROVED

Status quo
Debt / GDP ratio target
Replacement with EFSF bonds
Absolute difference in debt level vs. status quo

The decrease in Ireland's debt / GDP ratio ...



... improves its creditworthiness

- Ireland's **creditworthiness** is **improved**, positioning the country for **bond market re-entry in 2012**
- In 2015, the forecast **government deficit to GDP ratio would reduce from 2.9% to 2.3%**
- Ireland would **reach** the 60% **debt to GDP target** in 2037, **three years quicker** than in the status quo
- By that time the **debt burden** would be **€28bn lower**
- **Refinancing risk would be reduced dramatically** – only ~€1bn annual interest payment with a repayment of principal in 2051 instead of having to fund €3.1bn annual payment to IBRC

ASSUMPTIONS: ECB refinancing cost; NTMA interest cost assumptions for 2011-2015; refinancing and new issuance of all debt at 5.5% after 2015; GDP and debt figures are no DoF estimates; LR nominal GDP growth rate is 4%; from 2015 onwards, the 1/20th rule under new fiscal compact is applied; primary budget surplus (i.e. excluding interest payments) is 4% of GDP 2016-2020 incl., 3.5% 2021-2025, and 3% thereafter to 2051

HIGHLY CONFIDENTIAL
NOT FOR DISTRIBUTION
NOT APPROVED

Preliminary conclusions and next steps

Preliminary conclusions

- Reducing both the State's Promissory Note refinancing requirements and the interest cost would **support the Irish State's**, and by extension the **banks', prospects of returning to funding markets**.
- The proposal involves **no direct cost to European partners and no net funding from the EFSF**. The EFSF has Irish government risk (not IBRC risk).
- The proposal has no direct impact on EFSF market capacity.
- In order to **avoid jeopardising Ireland's Programme** work successfully completed to date, replacing the **Pro Note with EFSF bonds** (the 'Tap') to avoid a capital requirement needs to be coupled with a **long term funding solution** for IBRC **at a lower cost than ELA.**

Next steps

- Continue discussions with the Troika to further detail and **agree a solution feasible both for Ireland and the Troika on 'Tap and Swap'**
- Continue **planning and technical work** in relation to the 'Tap & Swap' proposal and considering detailed **operational issues to implement the transaction**

TECHNICAL ANNEX

Key assumptions related to modelling of replacement options

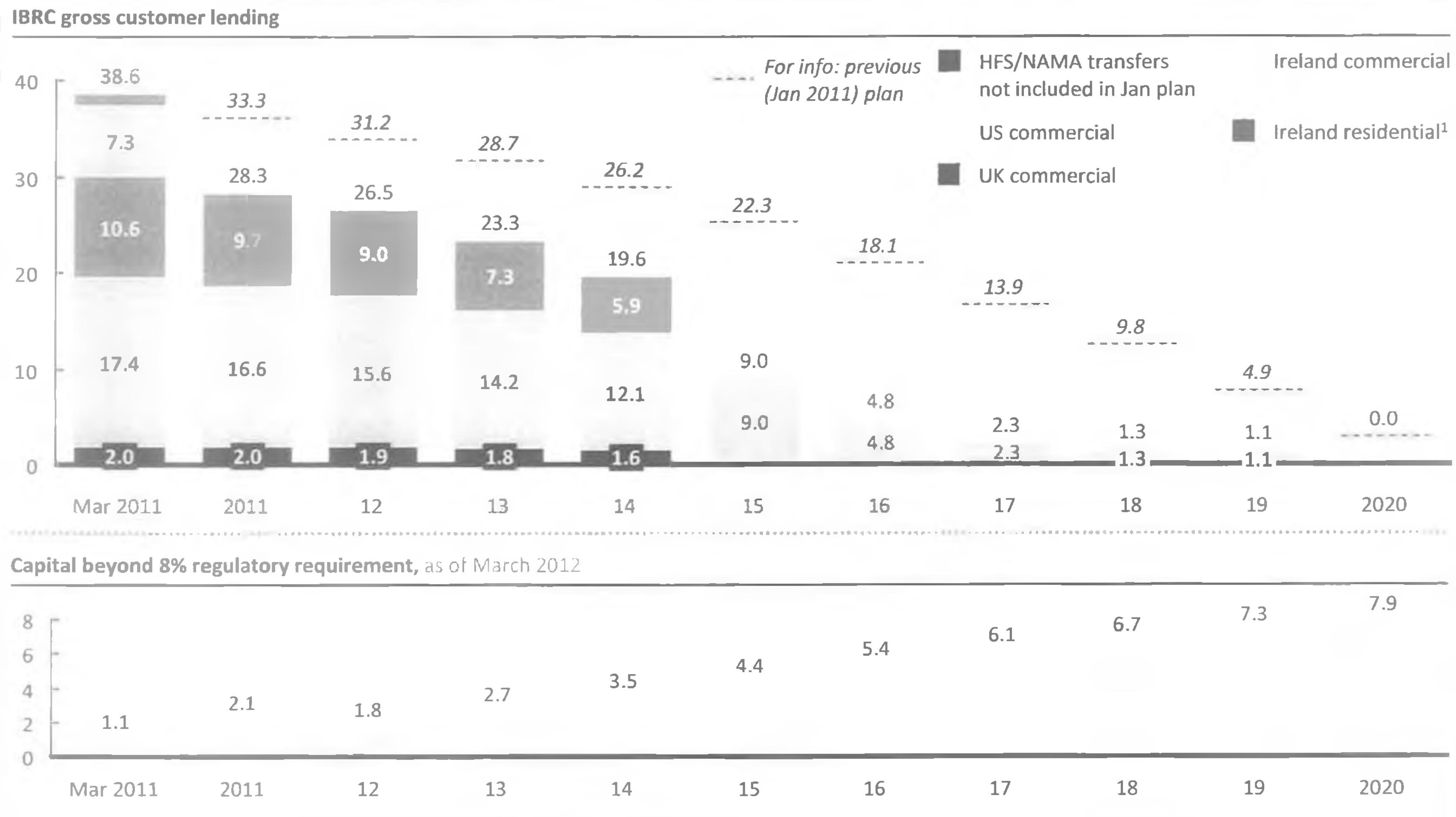
General	▪ All considerations assume that IBRC is kept off the State's balance sheet ▪ IBRC retains banking license ▪ Replacement of promissory note occurs on 1st January 2013 ▪ Capital injection is financed with 5.5% bullet long-term facility. There is no capital buffer assumed in the estimated capital requirement ▪ ELA funding assumes a profit at CBI of 175bps on 80% of outstanding ELA
Swap	▪ Assets transferred at book value and paid for with 'long term economic value'(LTEV) a value that assumes that at no point over the life of the portfolio additional capital is required based on an isolated view of that portfolio ▪ Asset data has been provided by the banks: Asset amortization profile, interest income, impairments, operating costs and standardized as well as IRB RWA ▪ IBRC's Minimum Regulatory capital requirement is assumed at 8% over the entire life of the portfolio ▪ Transfer of assets are assumed to be a "common control" transaction allowing for transfer at book values

- **Calculations are based on a partially outside-in model with limited capabilities (no full balance sheet, no full P&L statement, etc.)**
- **Calculations are based on inputs from IBRC**

IBRC's updated operating plan

€ billion

Updated deleveraging schedule forecast[1], July 2011



1 Forecast not updated in operating plan due to sale process
2 Estimated figure only, based on operating plan, forecasting process on a less granular level than for commercial portfolios

Updated estimates identify a capital need in IBRC following the 'Tap & Swap'

HIGHLY CONFIDENTIAL
NOT FOR DISTRIBUTION
NOT APPROVED

Capital impact calculation highly preliminary[2]

€ billion, assuming EFSF bonds

Two key changes since January 2012 ...

Increased provisions in IBRC

1.2

- IBRC have significantly revised their provisions booked in December 2011 since January 2012

Assumption of execution of Tap on year-end 2012 rather than mid-year 2012

0.8

- Replacing the promissory note 6 months later increases the valuation asymmetry as IBRC compounds interest during the State's interest holiday period
- This leads to a larger Day-1 capital hit for IBRC[1]

... lead to a necessary capital injection into IBRC in the 'Tap & Swap'

	Capital shortfall versus PCAR	Capital injection required
IBRC	0	1.3
PTSB	2.0	0
AIB	1.0	Dependent on out-come of other issues including treatment of deferred tax, and the outcome from de-leveraging

According to manage-ment plan there would be no requirement to inject capital

Losses could potentially be absorbed by capital allocated to remaining deleveraging

1 If the Pro Note is replaced at the State's book value, which is the current assumption
2 The capital impact calculated is highly preliminary and, given the tight timeline available, is still based on different sets of assumptions (AIB asset data from January assuming June Swap date; PTSB asset data from March assuming June Swap date; IBRC capital data from March, assuming end year 'Tap' date).

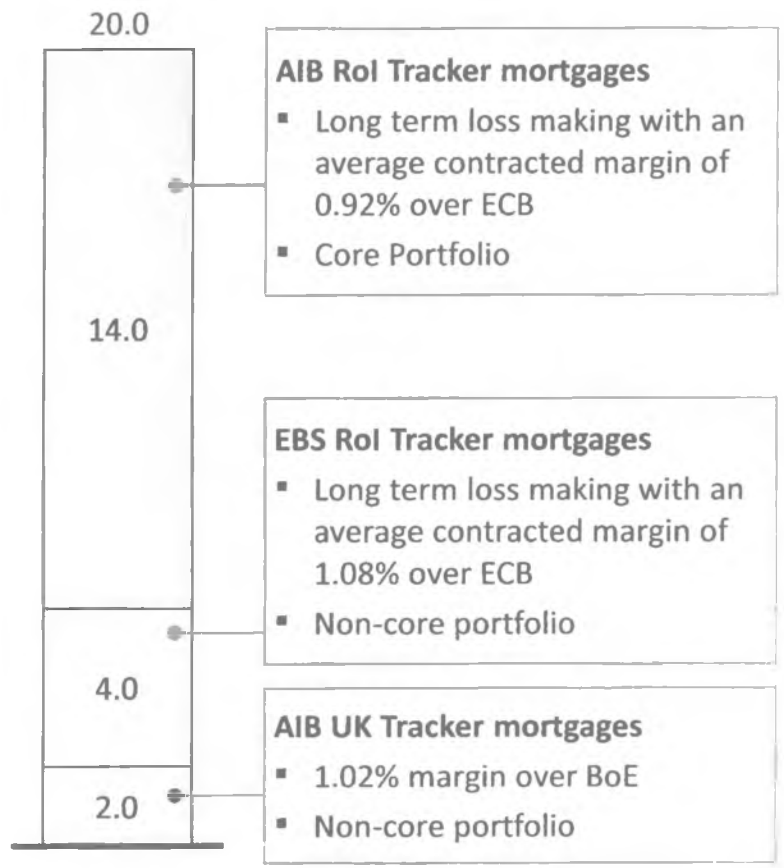
Preliminary proposal of assets to be swapped into IBRC

Overview of assets proposed to be swapped from PTSB

€ billion, gross, June 2012

Overview of assets proposed to be swapped from AIB

€ billion, gross, June 2012



HIGHLY CONFIDENTIAL
NOT FOR DISTRIBUTION
NOT APPROVED

"40 for 40" – Our interpretation

Preliminary draft paper

09 May 2012

An Roinn Airgeadais
Department of Finance

HIGHLY CONFIDENTIAL
NOT FOR DISTRIBUTION
NOT APPROVED

Context and objectives of this document

Context and objectives of this document

- This document is an initial interpretation of the Governor of the Central Bank's "40 for 40" proposals
- No details of the "40 for 40" proposals have been provided, this document sets out potential interpretations and options
- None of the proposals in this document have been modelled
- Figures included in this paper are not base don actual numbers and are purely for illustrative purposes

HIGHLY CONFIDENTIAL
NOT FOR DISTRIBUTION
NOT APPROVED

"40 for 40" what does it mean

Illustrative balance sheet - T&S

€bn	2012	2015	2020	2030	2040	2052
New loan assets (from Alpha)	17.9	15.3	8.9	3.4	1.3	-
New loan assets (from Ivory)	11.1	9.8	4.7	0.8	-0.0	-0.0
New collateral asset	2.4	2.4	2.4	2.4	2.4	-
Red lending	14.2	8.4	0.0	-	-	-
Red Pro note	-	-	-	-	-	-
Red Other assets	5.7	3.9	0.9	-	-	-
	51.4	39.8	16.9	6.6	3.8	-0.0
ELA	41.4	33.0	15.0	6.0	3.4	-0.0
Red Customer deposits	0.5	0.3	-	-	-	-
Other	4.2	2.8	-	-	-	-
Sub debt	0.5	0.5	0.3	-	-	-
Capital	4.8	3.1	1.6	0.7	0.3	0.0
	51.4	39.8	16.9	6.6	3.8	-0.0

Illustrative balance sheet - T&S including "40 for 40" *

€bn	2012	2015	2020	2030	2040	2052
New loan assets (from Alpha)	17.9	15.3	8.9	3.4	1.3	-
New loan assets (from Ivory)	11.1	9.8	4.7	0.8	-0.0	-0.0
New collateral asset	2.4	10.8	28.8	37.9	40.4	-
Red lending	14.2	8.4	0.0	-	-	-
Red Pro note	-	-	-	-	-	-
Red Other assets	5.7	3.9	0.9	-	-	-
	51.4	48.1	43.3	42.0	41.7	-0.0
ELA	41.4	41.4	41.4	41.4	41.4	-0.0
Red Customer deposits	0.5	0.3	-	-	-	-
Other	4.2	2.8	-	-	-	-
Sub debt	0.5	0.5	0.3	-	-	-
Capital	4.8	3.1	1.6	0.7	0.3	0.0
	51.4	48.1	43.3	42.0	41.7	-0.0

* It is assumed for "40 for 40" that the assets invested in have a return equal to ELA

- The table above opposite set out the run off balance sheet of IBRC assuming Tap & Swap. This proposal would work equally assuming there was no T&S
- As the assets are liquidated (through repayment or otherwise) it was assumed that ELA would reduce
- Reducing ELA in this manner reduces the availability of lower cost funding to the system
- The "40 for 40"assumes that, rather than repay ELA, the funds received from assets are retained and invested in new assets. The table below opposite shows this for illustrative purposes
- These new assets could be investments in Irish Government bonds, providing financing to other banks. Additionally, the liquidity could be used to pay dividends (if there were distributable reserves available)
- Providing financing to other banks could have a capital impact as they would carry a risk weighting
- Acquiring Government bonds could provide a needed carry trade to IBRC (currently reserves position declines to nil)

Executive summary - "40 for 40" pros and cons

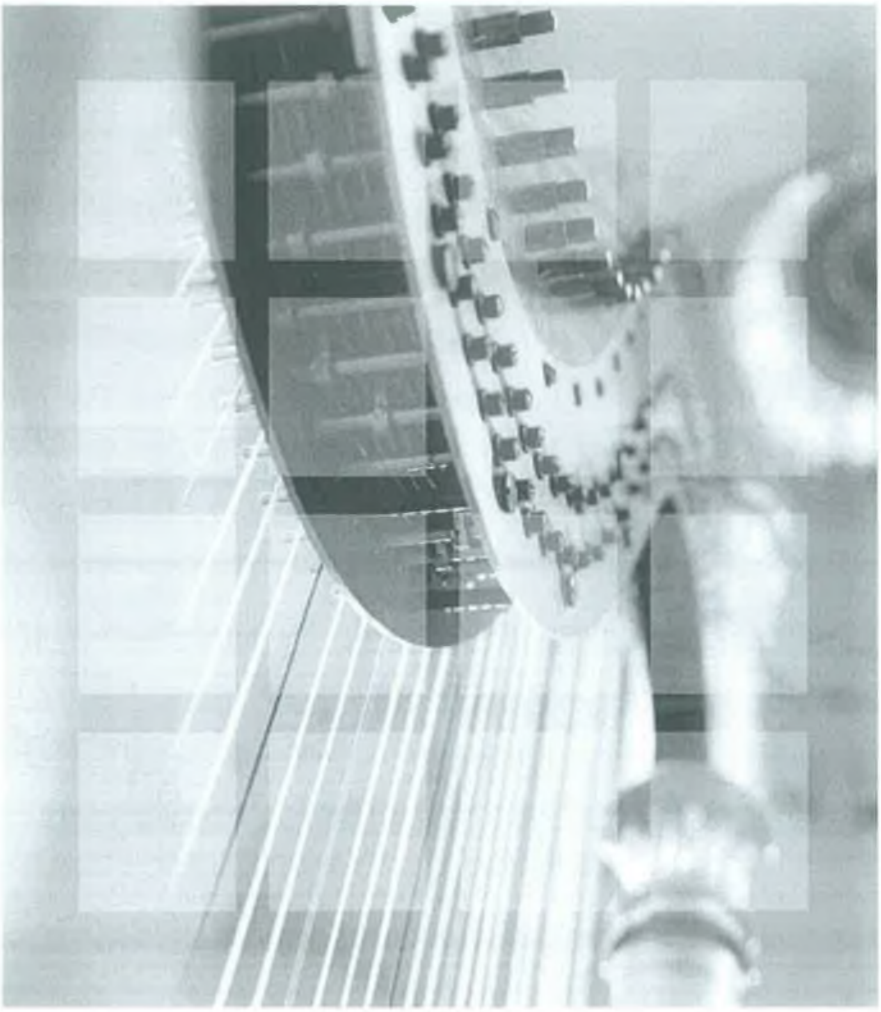
Pros

- The 40 for 40 would allow long term access to funding at a cost equal to ELA (currently ECB base rate (variable) plus 175bps)
- This funding could be used for the acquisition of Irish Government bonds or, with potentially less favourable capital implications, could be used to lend to the other Irish banks
- Proposal works for i) status quo, ii) "Tap" only or iii) "Tap & Swap"
- Assuming available distributable reserves, this would provide liquidity available to pay dividends
- Could immediately swap remaining promissory for long term Government paper to term out State's funding requirements
- Potential to free up capital if a banking license was not necessary

Cons

- ECB governing council "non objection" is required every two weeks
- If a unilateral local decision was taken consideration of ramifications would be needed given considerable other ECB support
- Consideration would need to be given to the impact of such a proposal on any private investors investment decision. While long term funding would be welcomed, the grossing up of the balance sheet may not be. Furthermore if a carry trade is being provided (through the acquisition of Government bonds for example) we would likely need to cap the upside for investors

7



Tap and swap considerations

Commercially sensitive for FOI purposes

Summary issues

<u>Letter dated 14th April</u>

The following observations could be made:

1. *Steps have been taken by the Authorities in relation to reducing State support for the banking sector – reduced ELG, clarity of the policy attitude towards State support, increasing deposit levels (although at moderate rates), the introduction of unguaranteed corporate deposit taking*
2. *However, the banking debt overhang, and the accompanying contingent State exposure, <u>is</u> causing difficulty in a return to the capital market*

Our 'bottom line'

1. *The inability of IBRC to access the ECB directly 'costs' the State (at the least, through cashflow and timing)*
2. *IBRC is being capitalised to high levels which is an additional cost to the State and creates trapped cash*
3. *The 'tap' increases our debt/GDP ratio and could affect our deficit as well – what is our incentive to do this*
4. *If the issue is the promissory notes, is the 'swap' creating more problems on a systemic basis?*

Issues

1. *If the portfolios are sold (in short order) what happens to the promissory notes?*
2. *Do the promissory notes have to be retained within IBRC?*
3. *Could that 'capital' be transferred to another bank/can other banks capital be sold as well?*
4. *What 'subsidy' is available from the EU/ECB?*

Tactics

Work should be done at domestic level such that, if the opportunity arises through Eurozone developments, we can have a fully developed plan. It would be far more advisable to have a plan/series of plans to present rather than hope that a plan is presented to us.

Summary issues

	[illegible]	[illegible]
Debt sustainability	[illegible] requirement from Exchequer.	[illegible] issue of debt over a number of decades, little impact on debt sustainability dynamics.
State aid	n/a	May be perceived as state aid for AIB. Ensuring that the regulations required around this issue are satisfied with DG Comp.
Competition	May help establish ILP as viable lender in mortgage market. Should allow [illegible] funding.	Ensure no subsidy given to the banks involved. May discourage foreign banks from investing / remaining in Ireland.
Market	Trackers isolated in [illegible] vehicle.	Does nothing to reduce gearing of financial system. Does not remove the negative carry from the system and [illegible]
Capital	[illegible]	[illegible]
Profitability		
Funding		

Summary issues

From State's perspective	• [illegible] as a pillar bank and [illegible] establish a viable ILP • Troika deleveraging targets met for AIB and ILP • Small cash flow benefit to the State as annual payments on Promissory Note replaced by lower payments on new bond issued ◦ Please note that the BOI/IRBC [illegible] only between cash payments [illegible] ◦ The real [illegible] State remains the cost of ELA [illegible] and not [illegible] rate on the [illegible] Note. [illegible]	[illegible] • Cashless transaction, therefore does nothing to reduce gearing of financial system ◦ ELA is repaid with the ECB MRO funding ◦ Increases ECB direct exposure • FRN or Irish Sovereign bonds in BOI/ILP will need to be financed • Tap & Swap therefore does not [illegible] long-term sources of funding State's debt sustainability • [illegible] does not materially improve State's debt sustainability dynamics • [illegible] [illegible] [illegible]

Summary issues

	[illegible]	[illegible]
From AIB's perspective	• [illegible] • Allows for clearer focus on core banking business • Should result in an improvement to Net Interest Margin • Reduces credit risk on the portfolio of assets transferred • Improves Return on Equity	• [illegible] forecast to be [illegible] negative for AIB (c. €[illegible] [illegible] RCAR requirement) • Establishing an appropriate price for the assets sold is critical to protecting AIB's capital base. • Crystallises negative carry at [illegible] point in cycle. • Significant operational risks. [illegible] arrangements likely to [illegible] significant costs. • [illegible] significant concentration to [illegible] sovereign • [illegible] are received as [illegible] it is unclear what [illegible] on these might be [illegible] could be viewed as • [illegible] still highly geared • [illegible] other [illegible] [illegible]

Summary issues

	Positives	Negatives
From ILP's perspective	• Smaller [illegible] bank • Improved asset quality as credit risk on 'bad assets' transferred to IBRC • Improves stability of ILP as reducing loan funding gap and improved capital ratio • Improves competitive environment if ILP were to become viable bank • Improves Return on Equity	• [illegible] quality of [illegible] bonds and whether those could be [illegible] • Does not improve profitability profile significantly • Operational issues re transfer of loans • Asset quality on retained book may be impacted depending on [illegible] of transferred loans
IBRC	Profitability • Improves net interest margin as ECB funding replaces ELA funding	Funding • Does not provide a secure source of funding as [illegible] • Not [illegible] IBRC funding [illegible] [illegible] • [illegible]

(8)

Ciarán Lonergan

An Roinn Airgeadais
Department of Finance

Oifig an Aire
Office of the Minister

Sráid Mhuirfean Uacht,
Baile Átha Cliath 2,
Éire.

Upper Merrion Street,
Dublin 2,
Ireland.

Teileafón / Telephone: 353-1 604 5626
Facsuimhir / Facsimile: 353-1 676 1951
Glao Áitiúil / LoCall: 1890 66 10 10
http://www.finance.gov.ie

12/1507/MF

Patrick Honohan
Governor
Central Bank of Ireland
PO Box 559
Dame Street
Dublin 2

30 April 2012

Dear Patrick

Many thanks for your letter of 17 April, which identified the need for a strategy for discussions on the future of the promissory notes with the external authorities. I agree with the need for planning ahead to avoid recurring short term solutions each year. A coherent approach is required to achieve our goals.

I would like to take up your offer of further discussions on this matter and suggest that we meet with a small team of officials to develop our next steps. My private secretary will be in touch to suggest a suitable time and date.

Yours sincerely

MICHAEL NOONAN

Michael Noonan T.D.
Minister for Finance

Copy to John Moran
Jim O'Brien
Michael Torpey
Neil Ryan

(9)
Redacted version

Banc Ceannais na hÉireann
Central Bank of Ireland

Patrick Honohan

Mr Michael Noonan T.D.
Minister for Finance
Department of Finance
Upper Merrion Street
Dublin 2

17 April 2012

Dear Michael

The experience of negotiating a deferral of the end-March Promissory Note payment to IBRC was instructive as well as fruitful.

As has been noted by market analysts, including (importantly) the rating agency Moody's, the transaction has made a modest improvement in Ireland's creditworthiness.

Arguably more important than the direct financial gain, though, have been

(i) the signal it has sent that the Irish authorities are serious about securing better terms on the banking debt and
(ii) the insight the negotiations have provided on the degree and dimensions of the opposition Ireland faces in achieving a more substantial and lasting deferral of this burden.

There are implications for forward planning. It would be unwise to simply seek an annual repetition of the exercise just completed to defer the 2012 instalment. Some more permanent arrangement must be secured well before the next instalment is due in 12 months' time. Presumably this can best be achieved in the context of the discussions around the proposed Tap & Swap scheme even though these discussions have not yet produced anything like what could be acceptable to the Irish authorities.

Above all, the need to place the €40 billion of central bank funding of IBRC on a secure multi-decade framework has not been conceded by the ECB. This issue is a complex one. In particular, many people wrongly assume that, because it involves a long-term bond, the tap and swap proposal would deliver sufficient long-term funding; it does not. Indeed, although ELA would be reduced considerably, after Tap & Swap, IBRC would be as heavily indebted to the Central Bank and ECB as it is today. Therefore it would remain vulnerable to constant pressure over the coming years to accelerate the disposal of its assets despite the difficulty of securing adequate prices.

(A further shortcoming of Tap & Swap is that it would expose the State to a larger jump in its measured General Government Debt if and when the threatened statistical reclassification of IBRC as part of the Government occurs.)

The Central Bank of Ireland is committed to providing all the supporting it can to the Irish effort to secure a deal that would ensure financial stability. But it now seems evident that the efforts of the Central Bank alone will not be sufficient.

[redacted]

I suspect that we may have a closing window of opportunity to reach a satisfactory conclusion on this crucial matter, in light of the increasing passage of time since the key original decisions were taken by the ECB in this area and due to the need to resolve matters in time for a smooth progression to market re-entry.

I would be happy to discuss further with you some ideas about how such an initiative could be steered and ways in which the Central Bank could help.

Yours sincerely