

Chapter 4

Banking Stabilisation Measures

Central Government

Banking Stabilisation Measures

4.1 Previous reports have outlined the measures taken to stabilise the banking system and its institutions in Ireland since the onset of the financial crisis of 2008. In 2010, and the first half of 2011 the State has continued this process through recapitalisation of banks, provision of guarantees of deposits and certain liabilities and through the provision by the Central Bank of Ireland (CBI) of liquidity to financial institutions domiciled in Ireland. As a result of the scale of capital injections, by mid 2011 the State had a controlling shareholding in Anglo Irish Bank Corporation (Anglo), Allied Irish Banks plc (AIB), Irish Nationwide Building Society (INBS) and EBS Building Society (EBS).

Chapter Focus

The purpose of this chapter is to

- outline the banking stabilisation measures taken
- set out the post-restructuring base value of the banks based on the assumptions in the Financial Measures Programme
- outline the State's liabilities under guarantee schemes
- set out the extent of liquidity support to the banking sector
- report the cost of consultancy related to stabilisation measures
- outline the credit availability measures taken to date
- review the arrangements for managing the State's investments in the banks.

Measures to Strengthen Banking Institutions

4.2 Measures taken to address the financial stability of credit institutions in Ireland have included

- purchase of impaired bank assets
- capitalisation of certain credit institutions
- guarantee of certain liabilities of credit institutions and
- liquidity support.

Purchase of Impaired Bank Assets

4.3 The National Asset Management Agency (NAMA) was established to acquire loans that had been advanced for the purchase and development of land and other related advances from five credit institutions that participated in the NAMA scheme³⁴.

4.4 By the end of 2010, NAMA had paid €30.2 billion to banks to purchase loans where the borrowers owed just over €71 billion. The loss incurred by the credit institutions on the loans was of the order of €41 billion, or almost 58%. NAMA issued debt to pay for the loans. 95% of the payment was in the form of Floating Rate Notes guaranteed by the Minister for Finance (the Minister). The NAMA Financial Statements in respect of 2010 reported a further impairment provision of €1.5 billion on the loans it acquired.

Capitalisation of Credit Institutions

4.5 By the end of 2010, the State had made capital injections of almost €47 billion into five Irish credit institutions. In March 2011, a Financial Measures Programme (FMP) Report published by the CBI identified a need for up to a further €20 billion of capital assistance for those five institutions and a requirement for up to €4 billion for a further institution.

4.6 By the end of 2010, the State's investment comprised

- €16 billion in new investment and
- €31 billion by way of Promissory Notes.

4.7 Figure 17 provides details of the capital injections made up to the end of 2010 and the extent of the projected future further capital requirements as determined under the FMP.

Figure 17 Capitalisation of Credit Institutions, December 2010

Credit institution	Cost of share acquisition^a	Cost of preference shares	Value of Promissory Notes issued	Total capital provided to 31 December 2010	Future capital needs	Total capital requirement
	€bn	€bn	€bn	€bn	€bn	€bn
Anglo	4.00	–	25.30	29.30	–	29.30
AIB	4.10	3.50	–	7.60	13.30	20.90
Bank of Ireland	1.91	1.84	–	3.75	5.20	8.95
INBS	0.10	–	5.30	5.40	–	5.40
EBS	0.63	–	0.25	0.88	1.50	2.38
Irish Life and Permanent	–	–	–	–	4.00	4.00
Total	10.74	5.34	30.85	46.93	24.00	70.93

Source: Department of Finance

Note: a Ordinary shares acquired are included at cost. The investment in ordinary shares includes dividends received in the form of ordinary shares from AIB (€280 million) and Bank of Ireland (€250 million) in 2010.

³⁴ The five credit institutions were Anglo, AIB, Bank of Ireland, INBS and EBS.

Assessments of Banks' Capital Requirements

4.8 In March 2010, following a Prudential Capital Assessment Review (PCAR)³⁵, the Financial Regulator determined a target capital ratio for banks of 8% for Core Tier 1 capital³⁶. In December 2010, the joint EU/IMF Programme outlined in Chapter 3 noted that a further PCAR would be carried out in 2011 based on criteria to be determined by the CBI in consultation with the European Commission, the European Central Bank (ECB) and the International Monetary Fund (IMF). The assessment would be carried out under two scenarios – a baseline scenario and a stress scenario³⁷.

4.9 Under the new PCAR (PCAR 2011), banks would be required to meet a minimum Core Tier 1 capital ratio of 10.5% under the baseline scenario and 6% under the stress scenario. Under the EU/IMF Programme €35 billion of funding was made available for the recapitalisation of the banks.

4.10 In March 2011, the CBI published the FMP Report, which comprised

- an independent loan loss assessment exercise carried out for the CBI by BlackRock Solutions (BlackRock)
- the results of PCAR 2011
- the results of a further Prudential Liquidity Assessment Review (PLAR) to establish funding targets for banks subject to PCAR 2011.

4.11 In summary, the reviews reported in the FMP Report concluded that a further €24 billion of capital was required³⁸

- The minimum amount of capital that the banks would be required to generate in order to meet the Core Tier 1 capital ratio targets was €8.7 billion on the basis of the combined results of three-year stress losses (up to end-2013) derived from the BlackRock and PCAR analyses.
- A further €5.3 billion by way of a capital buffer was added by the CBI to take account of the possible emergence of losses after 2013.
- In order to meet the funding targets under PLAR, the banks would be required to deleverage by disposing of non-core assets in order to achieve a target loan-to-deposit ratio of 122.5% by the end of 2013. The Report anticipated that the banks' losses from these disposals could amount to €13.2 billion before taking account of related loan impairment provisions already recognised by the banks. These projected losses were taken into account when calculating the capital requirements.

4.12 The €24 billion capital that the banks were required to raise could be provided either directly by the State or from private capital sources including, for example, new capital from shareholders, burden sharing with subordinated bondholders or the disposal of assets.

³⁵ PCAR is an annual stress test of the capital resources of domestic banks under a given stress scenario undertaken in order to calculate the extent of capitalisation necessary to meet CBI requirements.

³⁶ Core Tier 1 capital generally comprises share capital, capital contributions, retained earnings and certain preference shares.

³⁷ Baseline scenarios are built on assumptions about key economic variables – for example, Gross Domestic Product, unemployment rates, inflation and property prices over the period of the review. The stress case scenario assesses capital needs against a deterioration from the baseline forecast. The FMP Report noted that, to ensure clarity and consistency, the PCAR scenarios were to a large degree in line with the 2011 European Banking Authority stress tests on European banks.

³⁸ Four credit institutions were included in the reviews – AIB, Bank of Ireland, EBS and Irish Life and Permanent. Anglo and INBS were not included as their loan books are being wound down.

Restructuring of the Banking System

4.13 In March 2011, the Minister announced that the Irish banking system would have two full-service banks (Bank of Ireland and AIB/EBS) as its core pillars as well as a restructured Irish Life and Permanent (ILP).

4.14 On 24 February 2011, following a High Court order, €8.5 billion of deposits were transferred from Anglo to AIB and €3.6 billion of deposits were transferred from INBS to ILP. AIB and ILP also received assets supporting these liabilities comprising Senior NAMA bonds and Irish Government bonds together with Government guaranteed bonds issued by Irish financial institutions.

4.15 On 1 July 2011, AIB completed the acquisition of EBS to form one of the two pillar banks in Ireland. The Minister approved the acquisition under Section 7(11) of the Credit Institutions (Financial Support) Act 2008 on the basis that the result of the acquisition will not be to substantially lessen competition in the Irish banking market. On the same day, under Section 34 of the Credit Institutions (Stabilisation) Act 2010, the High Court ordered the transfer of all assets and liabilities of INBS to Anglo.

4.16 On 28 April 2011, the Minister for Finance and the Governor of the CBI wrote to the IMF, the European Commission and the ECB about progress in implementing the EU/IMF Programme. In the 'Memorandum of Understanding on Specific Economic Conditionality' accompanying the letter it was noted, *inter alia*, that

- the Irish authorities would ensure that the capital needs identified in PCAR 2011 would be fully met by 31 July 2011
- actual and forecast loan to deposit ratios would be reported to the CBI every six months
- the Department of Finance (the Department) would, by 31 July 2011, introduce legislation enhancing the powers of the CBI to intervene in the financial system when fulfilling its role as supervisor.

4.17 Following the enactment of this legislation, the CBI will have the power to enforce the implementation of a loan to deposit ratio of 122.5% as well as the power to direct the banks to sell assets.

4.18 By the end of July 2011, the capital requirements identified in PCAR 2011 had been substantially met

- The State invested €17.66 billion in capital in the newly merged AIB/EBS, Bank of Ireland (BoI) and ILP. €10.08 billion of the funds were sourced from the National Pensions Reserve Fund (NPRF) and €7.58 billion were sourced from the Exchequer.
- The three credit institutions had raised €4.9 billion by way of a number of measures including the repurchase of subordinated debt, the issue of new shares and rights issues.

4.19 Figure 18 provides details of the implementation of the bank recapitalisation programme under PCAR 2011.

Figure 18 Capitalisation of Credit Institutions, PCAR 2011

Credit institution	State investment			Capital raising measures to date ^a	Total capital requirement
	Cost of share acquisition	Cost of Contingent Capital Notes	Cost of capital contribution		
	€bn	€bn	€bn		
AIB/EBS	5.00	1.60	6.05	2.15	14.80
BoI	1.31	1.00	–	2.55	4.86
ILP	2.30	0.40	–	0.2	2.90
Total	8.61	3.00	6.05	4.9	22.56

Source: Department of Finance

Note: a These included the repurchase of subordinated debt, private investments and other internal capital raising exercises implemented by end July 2011. Anticipated further capital raising measures by BoI and ILP will bring bring the capital raised to just over €24 billion.

4.20 In addition to the investment of €8.61 billion in ordinary shares, the State provided a further €0.05 billion in capital

- € billion in contingent capital - this capital will convert to ordinary shares if the Core Tier 1 capital ratio in an institution falls to 8.25% and
- a capital contribution of €6.05 billion to AIB/EBS.

4.21 Following the July 2011 investments, the total State investment in the capitalisation of the banks stood at €64.88 billion³⁹.

4.22 Under a direction from the Minister, the NPRF will dispose of part of its shareholding in BoI to a group of institutional investors for €1.05 billion. Following this sale, the total amount of capital provided by the State to the credit institutions will be of the order of €63.83 billion.

³⁹ Including the reinvestment of dividends totalling €0.29 billion received in the form of ordinary shares from AIB in 2011.

Base Value of Bank Businesses

4.23 The key assumptions relative to the base value of the banks following their restructuring as set out in the FMP Report were

- a further €24 billion would be provided to banks by way of capital⁴⁰
- in the period to 2013, the banks will incur losses of between €3 billion and €41 billion of which around €10 billion had been provided for by the banks in the form of loan impairment provisions at the end of 2010
- €20 billion to €27.7 billion⁴¹ of the projected losses will be incurred in the normal course of their business and €3.2 billion from deleveraging through the disposal of certain assets in order to achieve the liquidity ratio targets set out in the PLAR.

4.24 Overall, the assumptions in the FMP Report are consistent with something of the order of €13.7 billion to €21.4 billion being available by 2013 as Core Tier 1 capital in those banks in which the State has invested. Under accounting norms, this capital would represent an equivalent amount of assets.

4.25 This asset value would accrue to the shareholders and the amount attributable to the State investment will be proportional to its shareholding. On foot of the recapitalisation transactions in July 2011, the State owns almost all of AIB and ILP. Following the sale of shares to a group of institutional investors and completion of BoI's liability management exercise, the State will own 15% of that institution.

4.26 The residual value of the capital injections that the State has made into Anglo and INBS will be dependent on the amounts realised from the disposal of the assets in the merged entity.

Liabilities under Guarantee Schemes

4.27 Certain liabilities of banks have been guaranteed by the State under three main schemes

- a Deposit Guarantee Scheme covering deposits up to a value of €100,000 per depositor per institution
- the Credit Institutions (Financial Support) Scheme which provided a two-year State guarantee in respect of a wide range of banking liabilities from September 2008 to September 2010
- the Eligible Liabilities Guarantee Scheme, which provides a State guarantee from 9 December 2009 for a narrower range of banking liabilities.

⁴⁰ The CBI made its decision on the required capitalisation based on loan-loss projections of BlackRock along with further calculations based on the prospective income, expenditure and deleveraging plans of the banks.

⁴¹ Projected losses are €20 billion under the baseline scenario and €27 billion under the stress scenario.

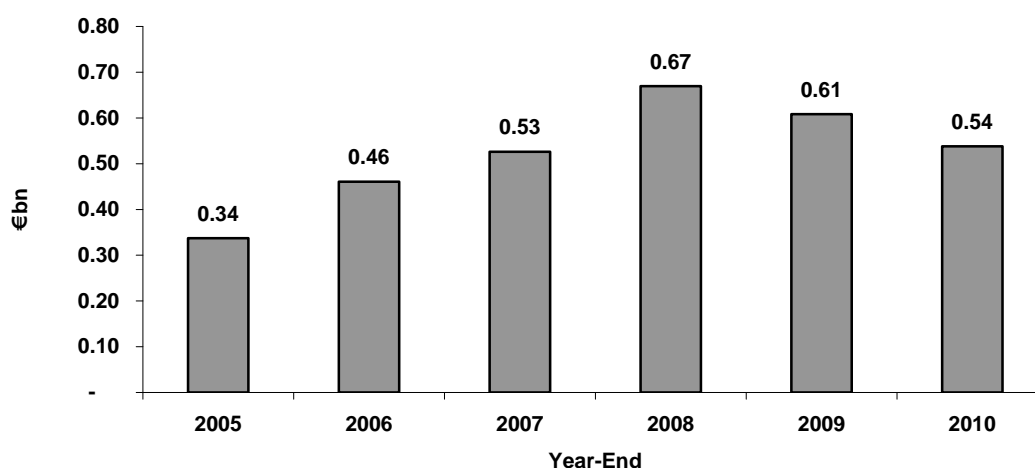
Deposit Guarantee Scheme

4.28 Under the Deposit Guarantee Scheme, deposits by individuals in credit institutions that are licensed to receive deposits in Ireland and are authorised by the CBI are guaranteed up to a limit of €100,000 per eligible depositor per institution⁴².

4.29 Credit institutions subject to the provisions of the scheme are required to deposit funds, to the value of 0.2% of all current customer deposits held by the institution, in a Deposit Protection Account administered by the CBI. Any claims of depositors under the scheme would be met in the first instance from the resources of the Deposit Protection Account and any residual shortfall would then be met from the Central Fund of the Exchequer, which would be recouped in due course from the banking sector. No claims have been made under the scheme since its inception.

4.30 At the end of 2010, 47 credit institutions were subject to the provisions of the scheme with the balance in the Deposit Protection Account being €0.54 billion. Comparative balances for the years 2005 to 2009 are also provided in Figure 19.

Figure 19 Deposit Protection Account Balance Movements from 2005 to 2010



Source: CBI Statement of Accounts for the years ended 2005 to 2010

4.31 The extension of the scheme included a provision that credit union deposits would subsequently be covered and the legislation provided for this. However, an order has not yet been made requiring credit unions to hold funds in the Deposit Protection Account.

⁴² The legal basis for the change from the previous limit of €20,000 was provided through the Financial Services (Deposit Guarantee Scheme) Act 2009.

CIFS Bank Guarantee Scheme

4.32 The Credit Institutions (Financial Support) Scheme (the CIFS Bank Guarantee Scheme), which commenced in September 2008⁴³, provided a guarantee for a broad range of bank liabilities for the seven institutions (covered institutions)⁴⁴ that opted to avail of the scheme.

4.33 The covered institutions were required to make quarterly payments to compensate the State for the scheme's impact on the cost of State borrowing. By mid-2011, just over €759 million had been received from the credit institutions under the scheme. A special account was set up at the CBI into which the covered institutions lodged their payments. The account earned interest of over €4 million which was also transmitted to the Exchequer.

4.34 The balance of this account was held as a reserve to cover any payments to be made under the scheme. Subsequent to the expiry of the scheme on 29 September 2010, the account's balance of almost €761 million was paid over to the Exchequer in October 2010. Subsequent payments amounting to just over €3 million had all been paid over to the Exchequer by April 2011.

4.35 Following the expiration of the CIFS Bank Guarantee Scheme, covered institutions can no longer make calls under the guarantee in respect of defaults of their obligations under covered liabilities.

Eligible Liabilities Guarantee Scheme

4.36 The Eligible Liabilities Guarantee Scheme (ELG scheme) came into effect on 9 December 2009. It was designed to provide a longer-term guarantee of certain banking liabilities and to bring the Irish bank guarantee structure more into line with guarantees in other EU member states.

4.37 The ELG scheme requires approval every six months from the European Commission under EU State aid rules. The scheme was initially approved in December 2009, and renewed approval has been given every six months, most recently in June 2011. This approval means that eligible debt securities and deposits issued or rolled over on or before 31 December 2011 will be guaranteed under the scheme up to a maximum maturity of five years.

4.38 The scheme is administered by the National Treasury Management Agency (the NTMA) on behalf of the Minister. The NTMA approved the participation of six of the credit institutions covered under the CIFS Bank Guarantee Scheme (including certain subsidiaries) in the new scheme⁴⁵.

4.39 The institutions participating in the ELG scheme pay a fee for the cover they receive, but at a higher level than provided for under the CIFS Bank Guarantee Scheme. The pricing is designed to encourage the institutions to reduce their reliance on State support over time.

4.40 The payment level for liabilities depends on factors such as the maturity profile and amount of the liabilities, and is based on ECB recommendations on pricing government guarantees of banking liabilities. For instance, an annualised fee of 0.5% applies to short-term debt (i.e. with a maturity of up to one year). For longer-maturity debts, an additional fee (based on the credit default swap rating of the institution prior to the banking crisis) is also applied. Since 1 July 2010, further additional fees of between 0.2% and 0.4% (depending on the credit rating of the institution) apply on all covered liabilities.

⁴³ The legal basis for the scheme was provided through the Credit Institutions (Financial Support) Act 2008, which was signed into law on 2 October 2008.

⁴⁴ AIB, Anglo, BoI, EBS, ILP, INBS and Postbank Ireland Limited.

⁴⁵ AIB, Anglo, BoI, EBS, ILP and INBS.

4.41 Fee payments by the institutions are made into a designated account at the CBI. These receipts accrue to the Exchequer and are not held in a reserve. Fees collected to the end of July 2011 amounted to €1.54 billion. Interest which is paid twice yearly in April and October amounted to just over €1 million to end July 2011. €1.17 billion had been paid over to the Exchequer by end of July 2011.

4.42 In response to my enquiries about delays in the payover of fees to the Exchequer, the Department stated that the ELG scheme was silent on the timing of the transfer of fees received from the participating institutions, unlike the CIFS Bank Guarantee Scheme which required that the scheme's account at the CBI should operate as a reserve account for the duration of the scheme. The Department advised that for the period when the two schemes were in operation it treated the fees received under the ELG scheme in the same manner – it allowed the fees to accumulate in the ELG account at the CBI. The Department also stated that the termination of the CIFS Bank Guarantee Scheme in September 2010 triggered the payment of fees collected under that scheme to the Exchequer and that the Department then decided to transfer the fees received under the ELG scheme with the transfer taking place in late October 2010. The Department pointed out that it has since regularised procedures for the transfer of ELG scheme fees to the Exchequer on a quarterly basis with the first quarterly transfer having taken place in April 2011.

Aggregate Value of Covered Liabilities

4.43 Figure 20 indicates the estimated total value of the liabilities covered by the guarantee schemes at the end of each quarter from December 2008 to June 2011.

Figure 20 Estimated Value of Guaranteed Liabilities of Covered Credit Institutions, December 2008 to June 2011

	Banking liabilities covered by			Total value of guaranteed liabilities
	Deposit guarantee ^a	CIFS Bank guarantee	Eligible Liabilities Guarantee	
	€bn	€bn	€bn	€bn
End Quarter 4 2008	82	346	–	428
End Quarter 1 2009	79	293	–	372
End Quarter 2 2009	79	276	–	355
End Quarter 3 2009	78	287	–	365
End Quarter 4 2009	77	281	–	358
End Quarter 1 2010	77	130	139	346
End Quarter 2 2010	78	103	153	334
End Quarter 3 2010	62	–	131	193
End Quarter 4 2010	72	–	113	185
End Quarter 1 2011	76	–	111	187
End Quarter 2 2011	74	–	123	197

Source: Department of Finance

Note: a This relates only to eligible deposits in the institutions that were covered by the CIFS Bank Guarantee Scheme.

Liquidity Support for Banks

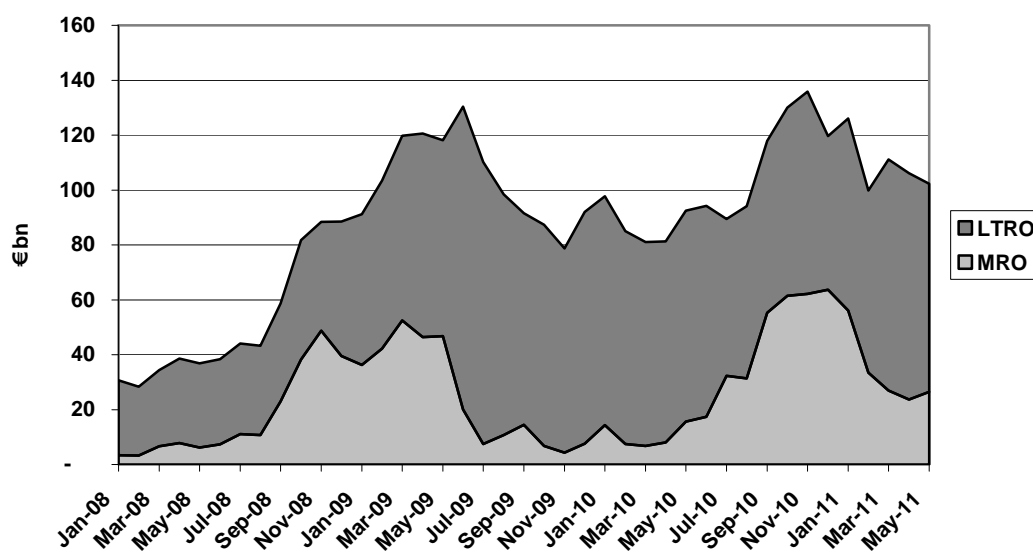
4.44 The CBI, through Eurosystem monetary policy operations, provides liquidity to the banking sector in the form of advances to credit institutions based in Ireland (including credit institutions based in the Irish Financial Services Centre). All the advances are secured by collateral approved by the Eurosystem. In practice, the Eurosystem has, since October 2008, provided as much liquidity as banks have sought⁴⁶. The credit institutions whose loans were acquired by NAMA can use the Floating Rate Notes they received as consideration for the loans to obtain collateralised liquidity from the Eurosystem under monetary policy operations as the Notes qualify as eligible collateral. Both retail and international banks can avail of Eurosystem liquidity through the CBI.

4.45 Advances under the Eurosystem fall into two broad categories

- The Main Refinancing Operations (MRO) comprise weekly offers of loans with a maturity of one week
- The Long Term Refinancing Operations (LTRO) comprise mainly monthly offers of loans with a maturity of three months. In 2008, loans with a maturity of six months were added and in 2009 loans with a maturity of 12 months were added. The last of these loans matured in 2010. In August 2011, an LTRO offering loans with a maturity of approximately six months (maturing on 1 March 2012) was announced.

4.46 As Figure 21 indicates, Eurosystem lending to credit institutions increased significantly from €31 billion at the end of January 2008 to a peak of €130 billion at the end of June 2009. Subsequently, the level of liquidity support fell, fluctuating in the range of €80 billion to €100 billion from August 2009 before rising again and peaking in November 2010 at a high of €136 billion. Since April 2011 the level of borrowing has levelled off at just over €100 billion and it stood at €103 billion at the end of June 2011. The drop in demand for liquidity coincided with the placement of around €9 billion of State funds on deposit with Irish commercial banks (€10 billion by the NPRF and €9 billion from Exchequer funds).

Figure 21 Eurosystem Lending to Credit Institutions, January 2008 to June 2011



Source: CBI Monthly Money and Banking Statistics

⁴⁶ The level of Eurosystem lending is limited, however, by the amount of available eligible collateral held by banks.

4.47 In addition to liquidity provision within the Eurosystem monetary policy operations, the CBI also provides Exceptional Liquidity Assistance (ELA) to domestic credit institutions where required. The CBI reports ELA lending as part of 'Other Assets' in its balance sheet. In its annual Statement of Accounts it reported that the amount of ELA advanced at the end of 2009 was €1.5 billion (90% of 'Other Assets') and €49.5 billion (98% of 'Other Assets') at the end of 2010. During 2011, the 'Other Assets' figure increased to €70 billion in February and had fallen back to €56 billion at the end of June.

4.48 As with the Eurosystem monetary policy operations the ELA lending must be collateralised. The collateral provided by the banks availing of ELA includes Promissory Notes issued by the Minister, loans including residential mortgages and investment or development loans and guarantees of the Minister⁴⁷. In addition, the CBI has received letters of comfort from the Minister. These confirm that any shortfall on the liquidation of collateral can be made good by the State.

Consultancy Costs

4.49 The State, through the Department of Finance, the CBI, the NTMA and the NPRF has used the services of advisors in the course of developing and implementing the measures aimed at stabilising the banking sector. By the end of June 2011, over €73 million had been paid on foot of consultancy costs. Figure 22 sets out the costs incurred, classified by the measure for which the related service was provided.

Figure 22 Consultancy Costs Classified by Nature of Service Provided

	2008	2009	2010	2011	Total
Phase of Stabilisation	€m	€m	€m	€m	€m
Recapitalisation, Restructuring and Guarantees	6.473	14.235	12.021	6.863	39.592
Financial Measures Programme	–	–	–	22.864	22.864
Crisis Management	0.036	2.012	0.338	0.016	2.402
Other ^a	0.026	2.357	1.771	1.392	5.546
NAMA ^b	–	2.042	0.462	0.090	2.594
Banking Crisis Inquiry	–	0.084	0.154	0.126	0.364
Total	6.535	20.730	14.746	31.351	73.362

Sources: CBI, NTMA, Department of Finance and the NPRF

Notes: a Other advice includes advice in respect of bank nationalisation, Credit Unions, liquidity assistance and advice of a general nature.

b NAMA related costs are those incurred by the CBI, the NTMA and the Department of Finance. Costs incurred directly by NAMA are not included.

4.50 The highest level of costs were incurred in respect of financial advice (€35.1 million) followed by legal services (€22.5 million) and accounting-related services (€15.6 million). Details of the costs incurred each year and the commissioning Department or agency are set out in Figure 23.

⁴⁷ Where appropriate discounts have been applied to the collateral by the CBI.

Figure 23 Agency Consultancy Costs Classified by Type

Consultancy Type	CBI €m	NTMA €m	Department of Finance €m	NPRF €m	Total €m
Financial services	19.555	15.360	0.076	0.146	35.137
Legal services	1.876	5.184	13.000	2.418	22.478
Accountancy services	13.734	0.223	0.100	1.580	15.637
Other services	–	–	0.110	–	0.110
	35.165	20.767	13.286	4.144	73.362

Sources: CBI, NTMA, Department of Finance and the NPRF

Credit Availability Measures

4.51 From the initial provision of support for the recapitalisation of AIB and BoI, a number of credit requirements directed at supporting small and medium sized enterprises (SMEs) and entrepreneurs have been set. This included a requirement for both banks to make available more than €3 billion each in new SME lending, to include working capital, in 2010 and 2011 (a total of €2 billion).

4.52 As part of the recapitalisation agreement, the Government established the Credit Supply Clearing Group, chaired by the Department of Enterprise, Trade and Innovation, in May 2009 with bank, business and State representation. Its role was to identify credit supply solutions where the flow of credit to viable businesses appeared to be blocked. The Group was responsible for the publication of ‘Your Business, Your Bank’ in December 2010 designed to help viable small businesses develop better relationships with banks and gain access to credit to grow and create jobs.

Credit Review Office

4.53 The Credit Review Office (CRO)⁴⁸ was established in March 2010, to help ensure that credit is not refused to viable businesses with valid business propositions. As an independent body, it has no regulatory or statutory powers to override banks’ lending decisions but gives an independent opinion on banks’ credit decisions. Banks are required to comply with the CRO recommendations or explain why it would not be appropriate to do so.

Review of Banks’ Lending Targets

4.54 The CRO publishes quarterly reports, which include a general summary on each bank’s lending outcomes outlining specific packages and supports provided. The quarterly report in May 2011, covering the period from April 2010 to March 2011, noted that each bank had exceeded the target of sanctioning €3 billion in lending and that, taken together, the cumulative amount of lending sanctioned was just over €8 billion. The amount actually loaned to customers is not tracked in those reports.

⁴⁸ The enabling legislation is in the guidelines issued under Section 210 (1) of the National Asset Management Agency Act 2009 relating to the review of decisions of participating institutions to refuse credit facilities.

4.55 In the CRO Report, the Credit Reviewer noted that while the loan sanction targets have been met, the two banks are experiencing a decline in their SME/Farm balance sheets due to two significant factors

- today's economic activity is smaller by 16% with the effect that repayment inflows from lending in earlier periods are outweighing the demand for new lending in the current climate
- a high proportion of new loans arise from restructuring of existing debt for some SMEs that are unable to service the original loan conditions on their legacy debt.

4.56 The CRO report notes that while it can be argued that restructuring of debt is providing little real economic benefit, without such restructuring activity many of these businesses would have gone out of existence.

4.57 In its quarterly report to June 2011 the CRO noted that

- The demand for credit from the SME and farm sectors remains unmeasured. However, interaction with the banks suggested a sluggish demand for credit and a slow drawdown of sanctioned facilities.
- There has always existed a 20% to 25% level of banks' declining credit.
- Businesses need to upskill in the areas of business case production to support applications for credit facilities.
- It will be a challenge for the two main banks to reach their €3 billion sanction targets for new and restructured facilities in 2011.

Appeal Applications to the CRO

4.58 In respect of the period from 1 April 2010 to 20 May 2011, 76⁴⁹ review applications had been received by the CRO⁵⁰. Of these

- in 22 instances, the bank's credit decision was upheld
- in 23 cases, the CRO disputed the banks credit decision and the bank subsequently provided credit
- 13 applications were awaiting an eligibility decision while 12 were proceeding through the review process
- six applications required further work by the borrower and bank or were withdrawn.

4.59 The CRO report in May 2011 noted that over 85% of credit applications in the SME sector were approved by the two banks. However, the Irish Small and Medium Enterprises Association (ISME) published the results of a survey in March 2011, which states that 48% of SMEs were refused credit by their banks in the previous three months and 79% reported that banks were making it more difficult to access finance. The CRO report notes that quarterly surveys by ISME cover all banks not just the two monitored by the CRO.

⁴⁹ 40 applications were in respect of AIB and 36 were in respect of Bol.

⁵⁰ This had risen to 98 in the report for the June quarter 2011. However, the outcome of reviews followed a broadly similar pattern.

Enterprise Ireland Bank Engagement

4.60 A Banking Relationship team was established within Enterprise Ireland (EI) in January 2010 to encourage banking support for exporting companies with difficulties in accessing credit for export development. As a result

- Both AIB and BoI have appointed senior executives in each bank to work with EI in relation to supporting companies and as appropriate to review lending decisions and to consider EI's experience of overseas markets and sectors. EI has also set up links with other banks that operate in Ireland.
- A range of sectoral seminars was arranged by EI along with ten workshops undertaken in 2010 on a variety of topics. Joint work was undertaken seeking to improve the delivery of existing and new financial products to support exporters including those in the technology sectors.
- During 2010, of 154 individual cases raised by EI with the banks regarding credit facilities for its clients, 36% resulted in the confirmation of existing facilities, 34% resulted in the provision of additional new facilities, 25% involved restructuring of facilities while in 5% of cases credit requests were declined. In addition, there were 38 cases where companies sought assistance in regard to matters other than credit requests including introductions to other banks, developing better working relationships with banks and planning for future requirements.

4.61 EI has stated that the banks need to develop intense knowledge of exporting businesses and sectors and to adopt a proactive cashflow lending approach to supporting Irish exporters rather than an assets based lending approach as had pertained over the previous ten years.

Managing the State Investments

4.62 By July 2011, the State had invested €65 billion in Irish financial institutions with an interest that ranges from minority shareholder up to nationalisation. As the State's attention moves from stabilisation to disposal it will be necessary to balance its obligations to

- maximise the value for the taxpayer
- maintain financial stability while doing so
- maintain competition within the sector in the interests of consumers and
- encourage the institutions to act commercially.

4.63 At the same time, it is necessary for it to maintain its normal policy and oversight roles. This range of objectives appears to suggest a need to address certain corporate governance issues including how the State's investment might best be consolidated and managed and what institutional adjustments, including separation of functions, might be appropriate. The current position is outlined below.

4.64 In March 2010, the Minister delegated certain banking functions to the NTMA⁵¹. The NTMA established a dedicated banking unit to carry out this function. The unit comprises nine permanent personnel including a number with previous experience in banking, corporate finance and research. As of 5 August 2011, the delegation order has been revoked and the banking functions have moved to the Department. The NTMA banking unit is now working on secondment in the Department.

⁵¹ Statutory Instrument 115 of 2010, National Treasury Management Agency Act 1990 (Delegation of Banking System Functions) Order 2010 and a Ministerial direction of 19 March 2010 in relation to the NTMA's functions under the statutory instrument.

4.65 The role of the banking unit includes

- advising the Minister about meeting the capital requirements of the credit institutions and the form any such capital injections might take
- implementing decisions by the Minister to make capital injections
- advising on the process towards ultimate disposal of the investments, including implementation of the disposals process and returning the banks to private ownership
- ensuring that the banks take appropriate steps to deleverage by disposing of assets within agreed price parameters.

4.66 The NPRF Commission operates under the aegis of the NTMA. Pursuant to directions issued by the Minister, the Commission had, at December 2010, invested €1.35 billion in AIB and BoI and, by July 2011, a further €0.37 billion⁵². The Commission cannot take any actions in regard to those investments other than in accordance with the Minister's directions.

⁵² These investments included the reinvestment of dividends received in the form of ordinary shares (2010: €530 million and 2011: €288 million).

Conclusion

€71 billion is required to capitalise Irish financial institutions according to the latest assessments carried out by the Central Bank of Ireland. To date €5 billion of this sum has been provided by the State. €1.05 billion of this investment will be recouped from the disposal by the National Pensions Reserve Fund of shares in the Bank of Ireland to a group of institutional investors.

As a result the State is managing a very large investment in the financial institutions. This management involves input from the Department of Finance, the National Treasury Management Agency and the National Pensions Reserve Fund. In view of the materiality of the investment and the number of State sector entities involved there may be merit in rationalising the structure for the management of the State's banking investment, so as to ensure a coherent approach by the State including an appropriate separation of its investment and policy roles.

Based on the assumptions implicit in the Financial Measures Programme Report, published by the Central Bank of Ireland, the associated asset value of the banks after making good the anticipated losses is projected to be between €4 billion and €21 billion by the end of 2013.

The State through the National Asset Management Agency is managing the 'work out' of distressed land and property loans with an original book value of €71 billion, which it acquired for €30.2 billion. In its first year of operation a further impairment provision of €1.5 billion has been recognised in its accounts. This was largely due to the continued reduction of property values.

The State had guaranteed liabilities and deposits of financial institutions to an aggregate amount of €197 billion at the end of June 2011.

Fee payments made by credit institutions whose liabilities are guaranteed are paid into a designated account in the Central Bank of Ireland where interest was earned at a rate of around 1% per annum. In 2010, there were delays in transferring the fees received into the Exchequer. The average rate of interest that the State pays on its borrowings under the EU-IMF Programme is just under 5.6%. In order to achieve optimum debt management all amounts due to the Exchequer should be transferred at the earliest opportunity.

The amount of liquidity advanced by the Central Bank of Ireland through Eurosystem monetary policy operations stood at just under €03 billion in mid 2011. These advances are fully collateralised by way of bank assets.

Further advances by way of Exceptional Liquidity Assistance have been made to credit institutions. These advances constitute the bulk of a category of assets totalling €56 billion reported by the Central Bank of Ireland in mid 2011. They are backed by collateral and sovereign guarantees.