



System-wide funding and strategy

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Department of Finance



Contents

Executive Summary

Section 1

Domestic Context and Policy Issues

Section 2

Funding positions

Section 3

Risks and Next Steps...

Section 4



Executive Summary – domestic focus

Key domestic positives

- Covered Bank deposits increasing
- Reduced ELA exposure
- Reducing ELG to €93bn
 - Unguaranteed corporate deposits
 - BoI's UK subsidiary no longer offers on deposits

Critical domestic negatives

- Ability to access debt market remains constrained
- Increasing reliance on deposits and Central Bank Funding
- Deposit pricing distortions

Risks at a domestic level

- Rating agency actions
- Deposit pricing dynamics

Key 2011 balance sheet changes (€bn)

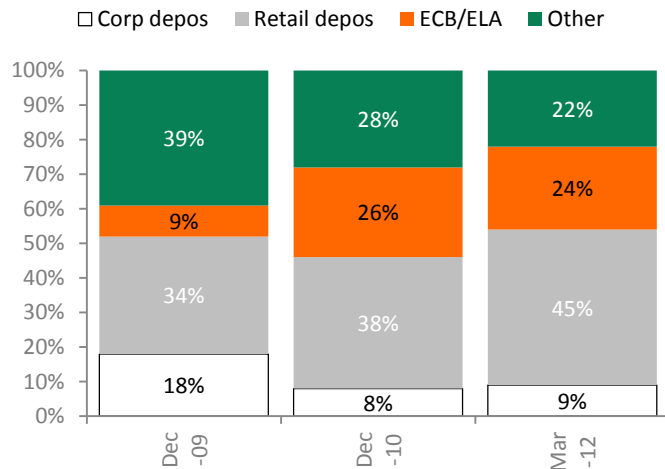


source : AIB, BoI and IL&P reported balance sheets; change in deposits shown benefits from acquisition of Anglo/INBS books but offset by sale of AIB Poland and outflows



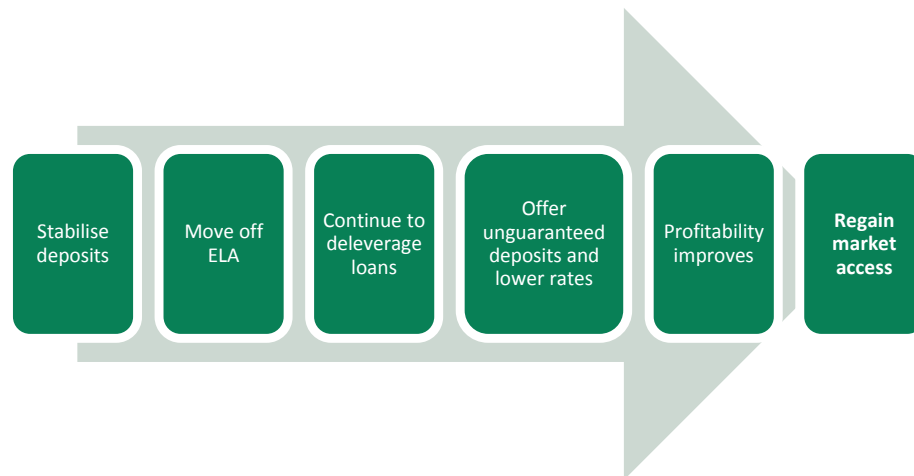
Executive Summary – broader focus

Funding Dominance



Figures for PCAR banks only

Assumed strategic staircase



- At a broader level across the Eurozone, there are similarities to the Irish experience emerging with increasing reliance on the two funding sources (i) Central Bank Funding (“CBF”) and (ii) deposits:
 - international capital markets continue to remain skeptical of Eurozone developments with concerns about Spain and Italy draining confidence
 - secured funding becoming ‘normal’ across the Eurozone and increased wholesale market pricing
 - post LTRO’s banking sector and that of Eurozone sovereigns more correlated
- A coherent, Eurozone wide funding solution would be valuable



Contents

Executive Summary Section 1

Domestic Context and Policy Issues Section 2

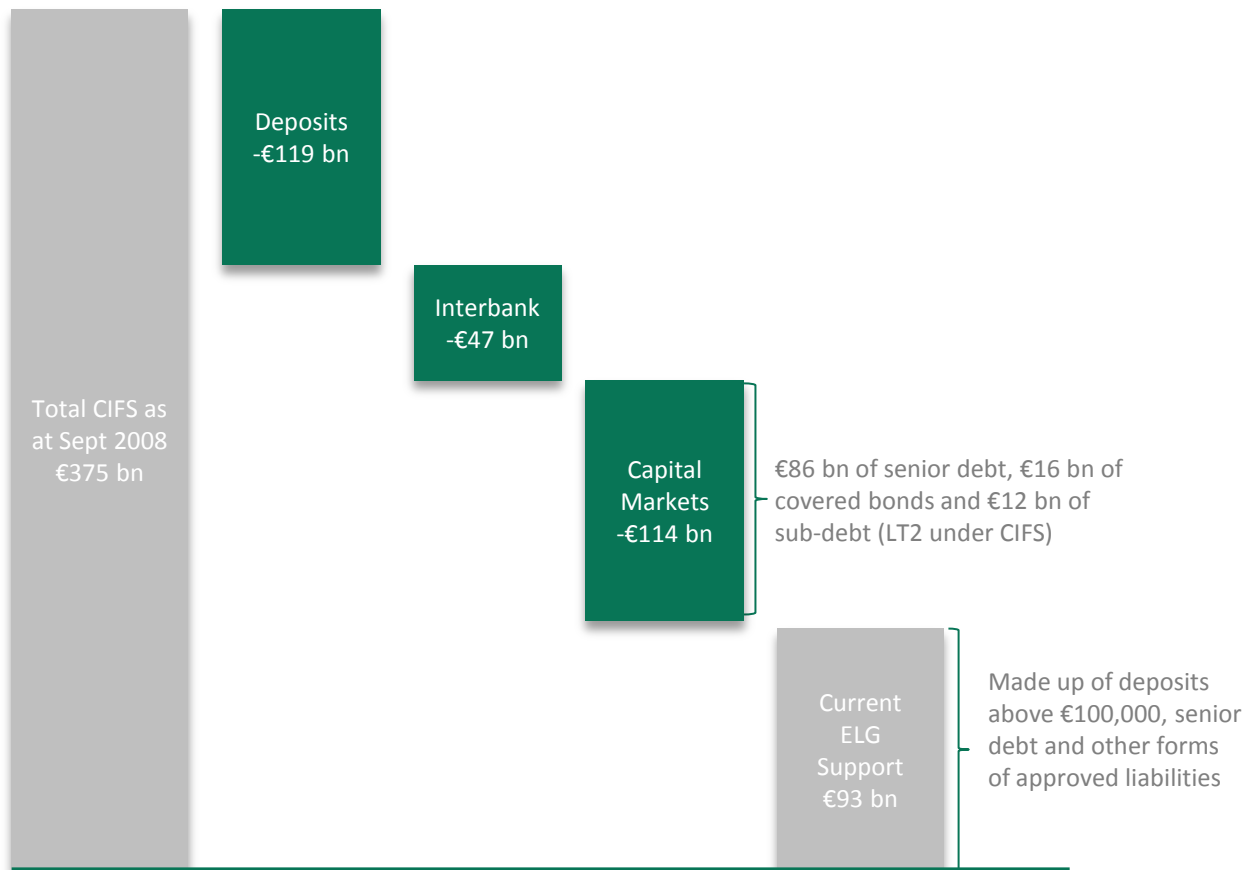
International issues Section 3

Risks and Next Steps... Section 4



State Support continues to fall

Changes in CIFS/ELG since inception





State Support for Funding Measures

The Department of Finance has been pursuing **two key policies** in relation to State support over the past 3 months:

- Reducing ELG exposures

A policy review paper was prepared in January 2012 for January – December 2011 and this led to increased scrutiny of three specific areas with the banks (i) UK deposits (ii) the costs of the guarantees following a review with DG Comp and (iii) potential for normalisation

- Reducing guarantees supporting ELA

The Department determined that the level of the contingent exposure was greater than required

- A more pro-active approach will see DoF vigorously engage with the banks to determine a speedy but prudent approach to wean them off ELG over a realistic timeframe as 2012 progresses
- Questions being asked?
 - How much value do customers put on the guarantee post heavy bank recapitalisation?
 - Is the guarantee needed for demand deposits or just term deposits or both?



Contents

Executive Summary	Section 1
Domestic Context and Policy Issues	Section 2
Funding positions	Section 3
Risks and Next Steps...	Section 4



Main sources of funding for Covered Banks¹

Central Bank Funding

€108 bn

- Reliance on Central Bank Funding is expected to reduce more slowly this year
- Eurozone risk and Irish economy concerns will continue to weigh on banks ability to find alternative sources of funding

Deposits

€149 bn

- Retail and corporate deposits at the Covered Banks have stabilised with Ireland showing genuine growth recently
- Deposit rates crowding out

Wholesale funding

€50 bn

- Covered Banks continue to look for opportunities (e.g. UK RMBS market)
- €13 bn of Covered Bank debt matures in 2012 if include IBRC

Bilateral Repo

€14 bn

- Deals from here generally need to be around Irish collateral. Some large international banks looking at Irish unsecured/secured books

Equity

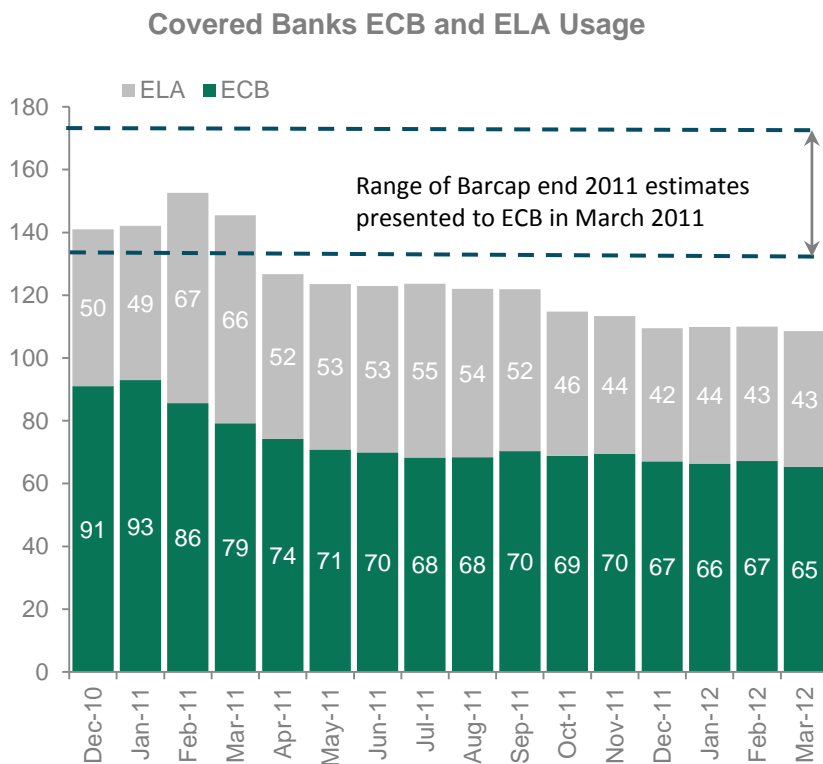
- Perception of Irish banks makes equity raising difficult.
- Competition from stronger European banks for scarce resources

1. as at 30th March 2012 (source: CBI)



Central Bank Funding remains on a downward trend

Funding trend since end 2010



Source: Central Bank of Ireland

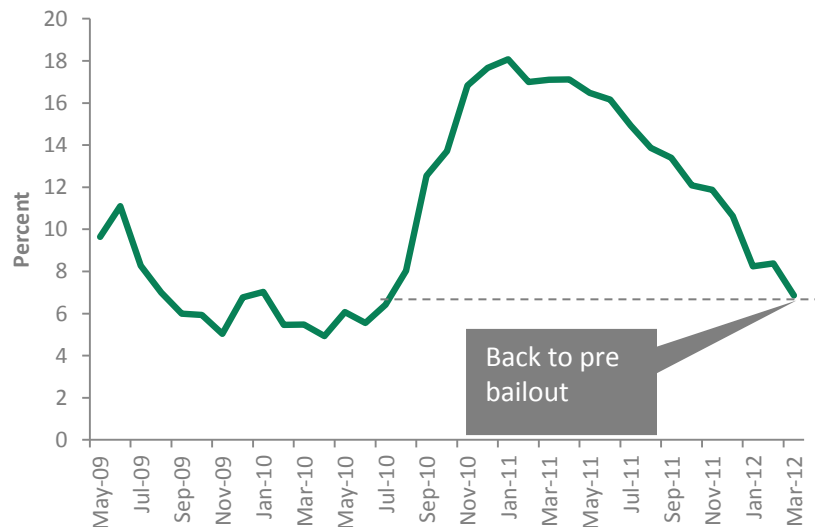
Key Observations

- CBF has declined modestly since last mission
- Little deleveraging activity in Q1 while maturities kicked in.
- Irish banks did not really play 'the carry trade' in the LTRO's



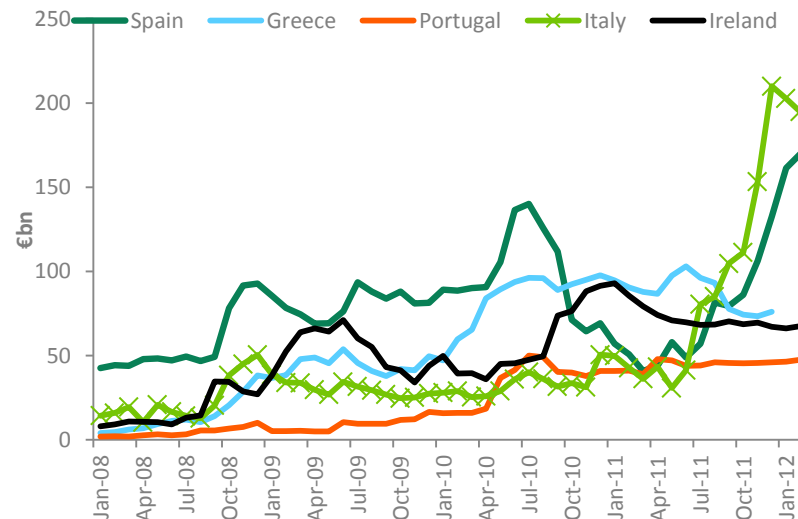
Covered Banks relative usage of ECB facilities fell significantly

Covered Bank Usage of ECB Facilities



Source: CBI, ECB Statistical Warehouse

ECB & ELA Usage by Country



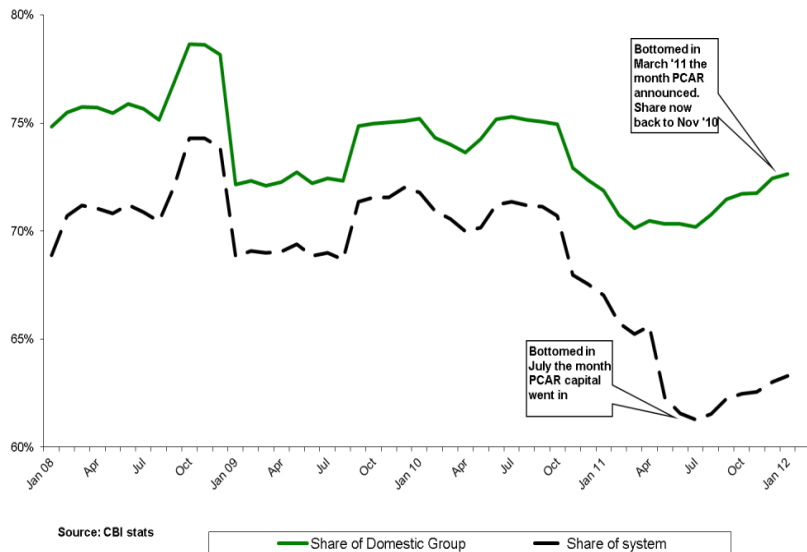
Source: CSFB

- Covered Banks' usage of ECB facilities has significantly fallen on a relative basis:
 - Covered Banks' usage of the total ECB facilities has reduced to 7% from 18%
 - Total usage had fallen to €65 bn at end March from peak of €93 bn
- Irish usage of ECB facilities has fallen at a time when other Eurozone members have drawn more heavily – contagion across the Eurozone system

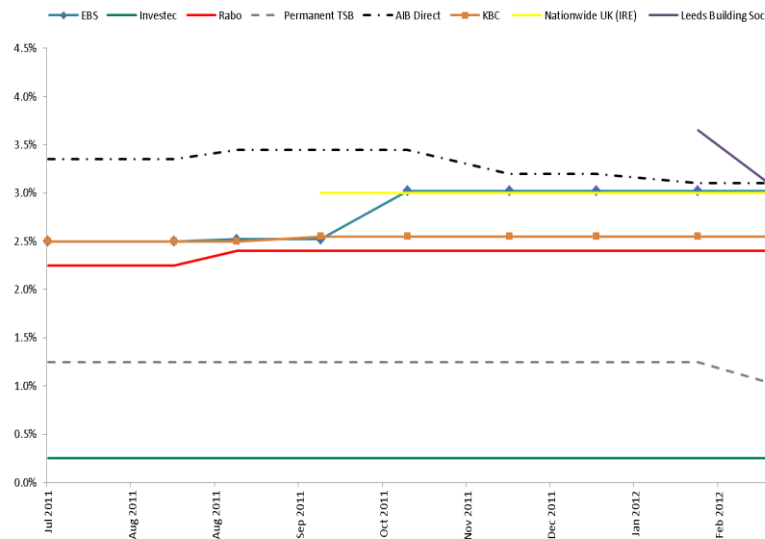


Covered Banks relative deposit position

Covered Bank share of deposit market



Pricing for demand deposits



- Some banks have moved rates decisively downwards
- Other Covered Banks are following
- Covered banks have regained some lost market share.



Contents

Executive Summary	Section 1
Domestic Context and Policy Issues	Section 2
Funding positions	Section 3
Risks and Next Steps...	Section 4



What risks should we be looking at?

Analysis of the Swedish banking crisis in the 1990s, identified ‘seven deadly sins’

- asset/liability mismatches
- supporting client’s balance sheet mismatches
- lending to over-indebted companies
- investing in non-core assets
- dealing with the non-banking financial system
- “Münchhausen markets” (no liquidity) such as real estate
- the continuity of the past to the future

“A blueprint for better banking – Svenska Handelsbanken and a proven model for more stable and profitable banking”. Niels Kroner (2009)

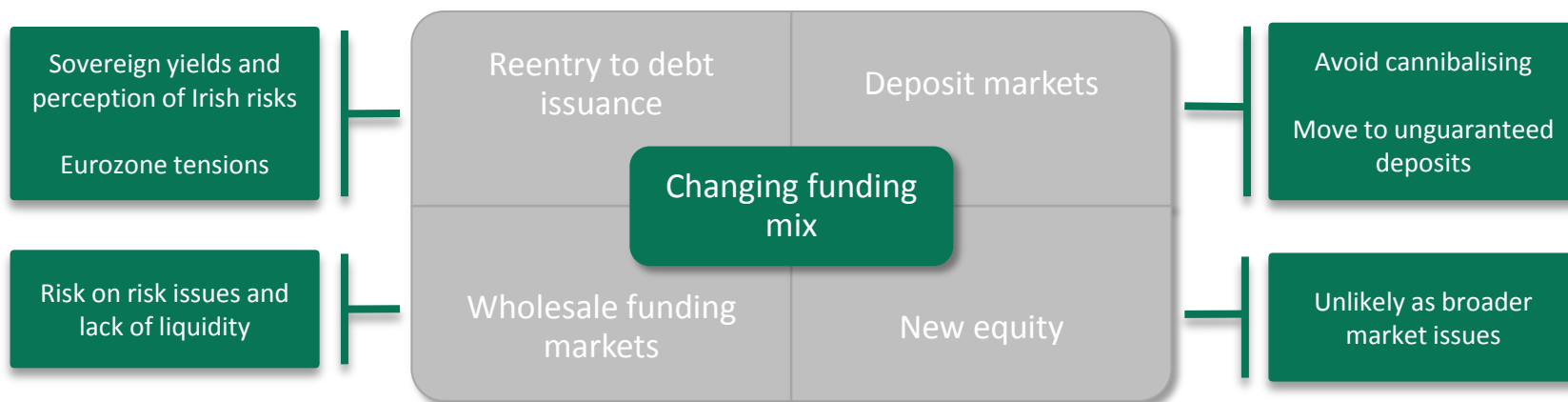
The one’s we should be worried about

asset/liability mismatch	The LDR or, indeed, deleveraging targets do not capture the fundamental asset/liability mismatches on bank’s balance sheets.
“Münchhausen markets”	The emphasis on short dated funding caused significant problems at international banks in the past and analysis of deposits is needed to clarify mismatches
the past as a predictor	The risk of Irish banks sustaining particular markets has been reinforced by the sale of (foreign) non-core assets while activity in residential and commercial property markets remains depressed While recent experience will always colour judgments, we need to generate a picture of banks in 3 – 5 years time with emphasis on slowly and thoughtfully rebuilding the fabric



Drivers of change in Covered Bank's positions

- The challenge for the Covered Banks will be to navigate a series of both domestic and international challenges in order to rebalance their funding profiles

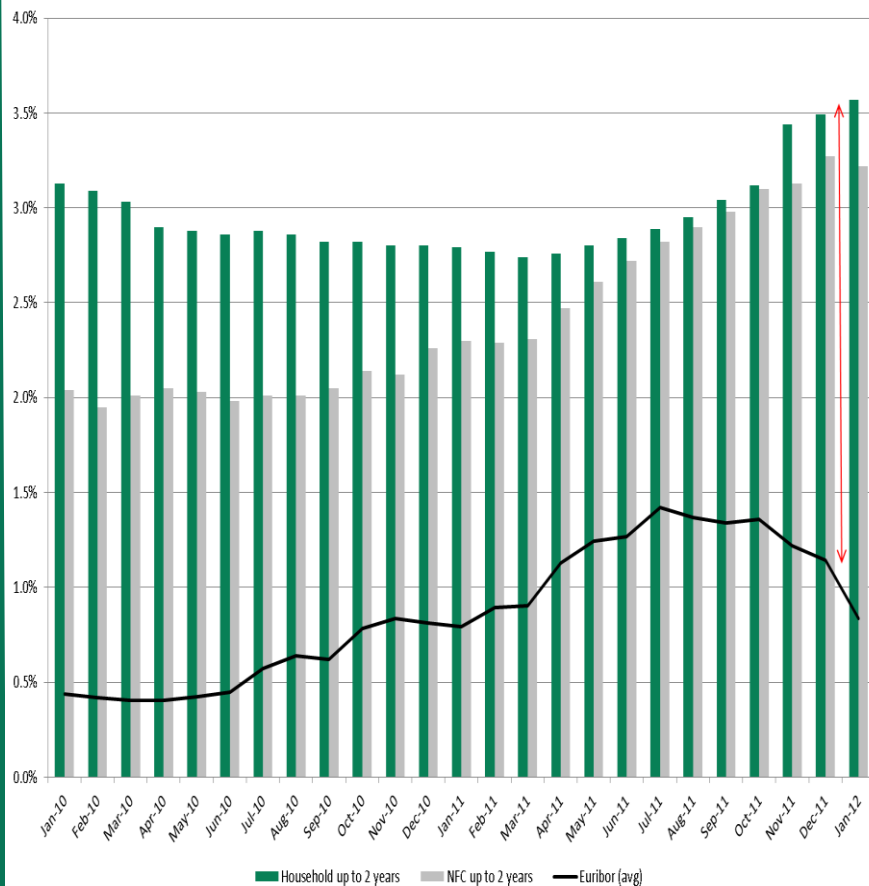


- There are undoubted challenges to be faced in the domestic market as issues such as mortgage and other consumer arrears persist
- Eurozone developments have not been positive
- Need to increase pricing transparency or liquidity in the wholesale markets



Deposit margins still an issue

Term deposit rates and euribor levels



Source: CBI

House price trends

Irish house prices, y/y %



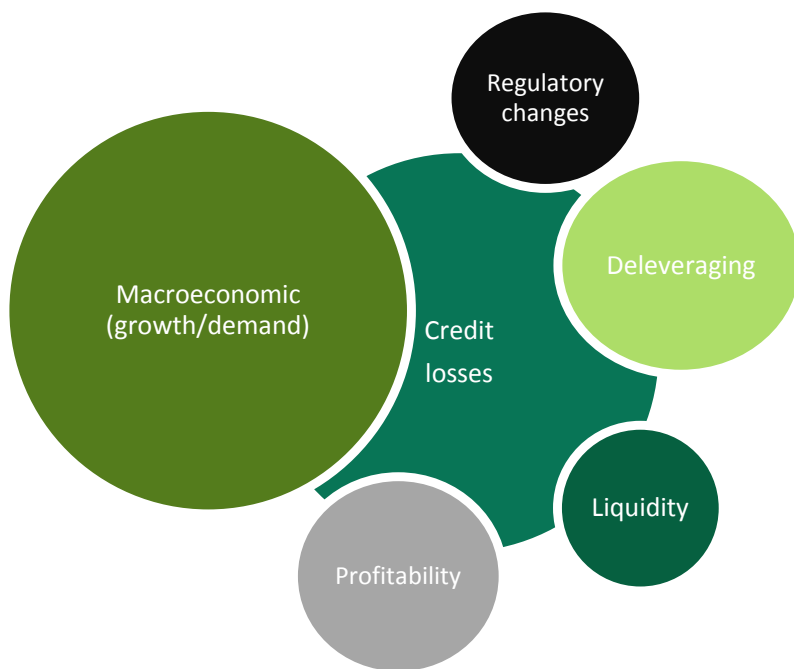
Source: Credit Suisse, April 2012

- Book value of mortgage loans falling while negative carry on sources of funding (deposits) remains



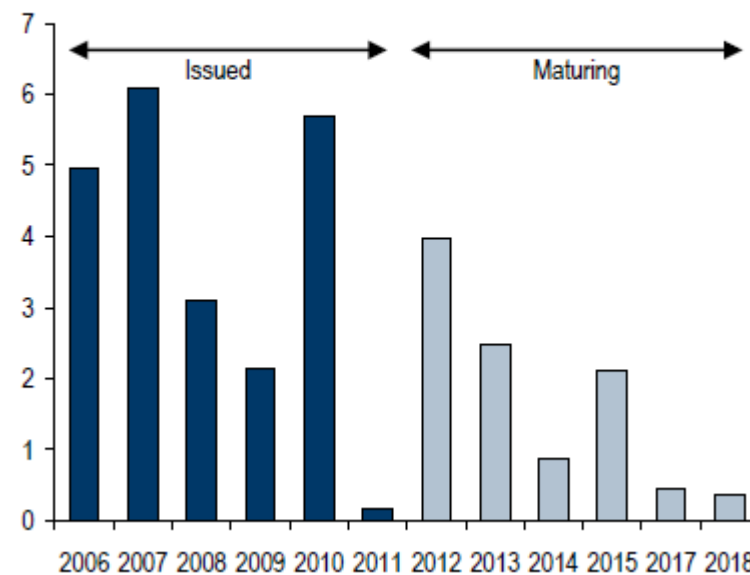
Questions international investors have in relation to Irish banks

Main drivers



Funding challenge

Domestic Irish bank debt maturing in coming year €bn



Source: Credit Suisse, April 2012



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