IRELAND AND ITS BANKS – AN UPDATE

APRIL 2017

An Roinn Airgeadais
Department of Finance

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This communication includes statements that are, or may be deemed to be, forward-looking statements. These forward-looking statements can be identified by the use of forward-looking terminology, including the terms "anticipates", "believes", "estimates", "expects", "intends", "may", "plans", "projects", "should" or "will", or, in each case, their negative or other variations or comparable terminology or by discussions of strategy, plans, objectives, goals, future events or intentions. Such forward-looking statements are not guarantees of future performance. Rather, they are based on current views and assumptions and involve known and unknown risks, uncertainties and other factors, many of which are outside the control of any relevant person and are difficult to predict, which may cause the actual results, performance, achievements or developments to differ materially from any future results, performance, achievement or developments expressed or implied from these forward-looking statements. A number of material factors could cause actual results to differ materially from those contemplated by the forward-looking statements. No relevant person undertakes any obligation to release publicly any revisions or updates to these forward-looking statements to reflect events, circumstances, unanticipated events, new information or otherwise occurring after the date of this communication. These forward-looking statements include all matters that are not historical facts. Due to various risks and uncertainties, actual events or results or actual performance may differ materially from those reflected or contemplated in such forward-looking statements. No representation or warranty is made as to the achievement or reasonableness of, and no reliance should be placed on, such forward-looking statements.

Economy - Key figures

GDP

growth of
7.2% in the fourth
quarter of 2016

1.026%

10 year bond yield
(at auction 9 Feb 2017)

Deficit

DEFICIT

General government deficit currently projected to continue on downward trajectory from 0.5% of GDP in 2016 to 0.4% in 2017

progress

Debt ratio

DEBT

Debt-to-GDP peaked in 2012 at almost 120%, now forecast to below 73% by end 2017

Employment

JOBS

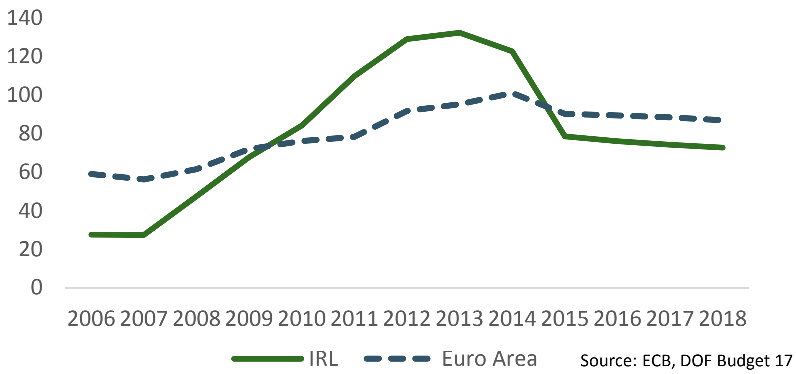
Continued strong annual employment growth of 3.3% (65,100) in the fourth quarter of 2016

63 months

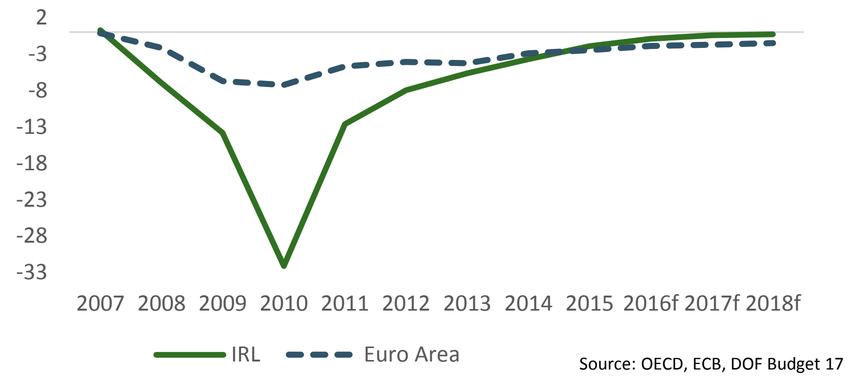
consecutive fall in
Live Register

A Strong Economic Recovery

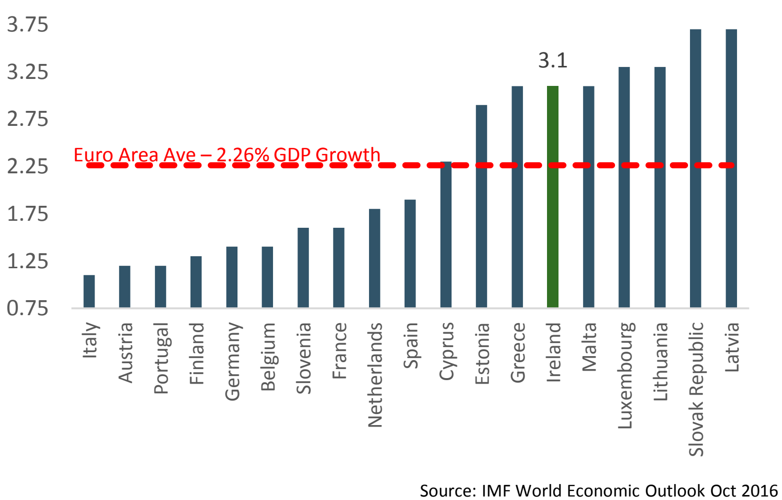
Government debt/GDP (%) [1]



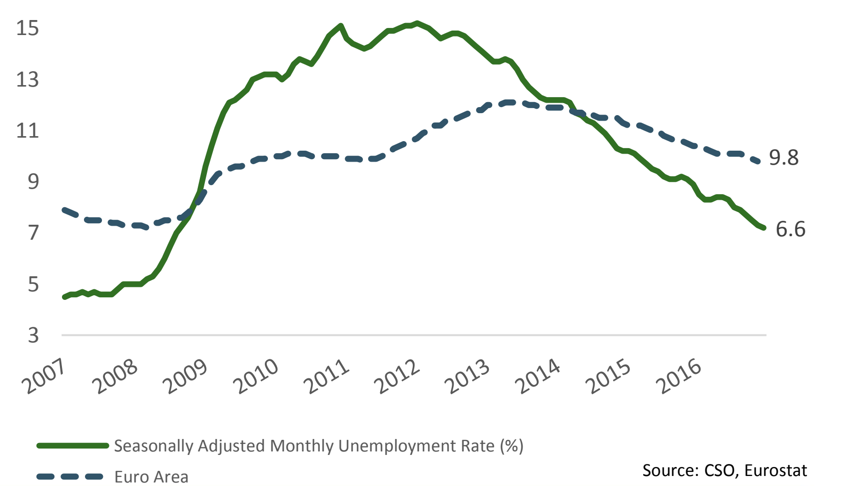
Government budget deficit (%) [2]



2018 Forecast Economic Growth



Unemployment has more than halved (%) [3]



[1] Government Debt to GDP significantly impacted by 2015 GDP revisions, however clear progress remains. Target to reduce to 45% by mid 2020s
[2] Deficit forecast to just 0.3% by 2018
[3] Seasonally adjusted unemployment rate (15.2% (2012) to 6.6%)

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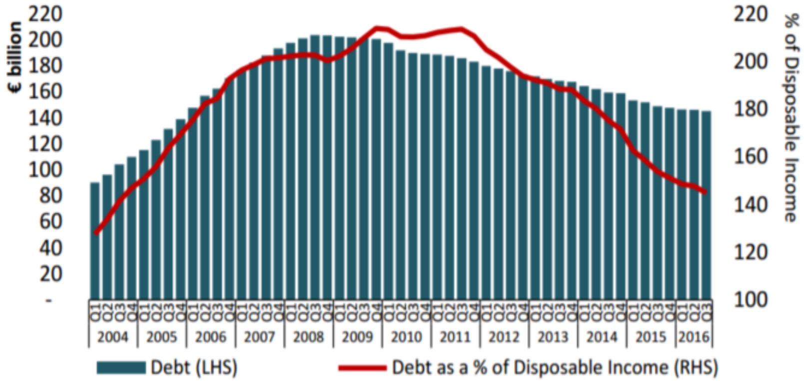
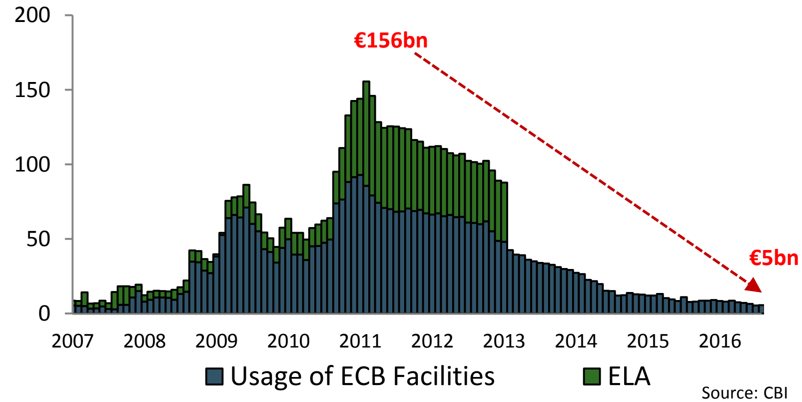
Systemic risks have reduced

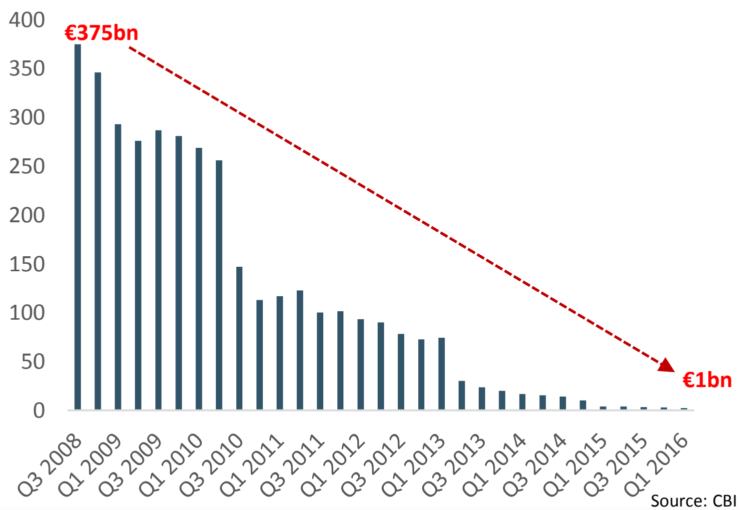
Household debt/disposable income



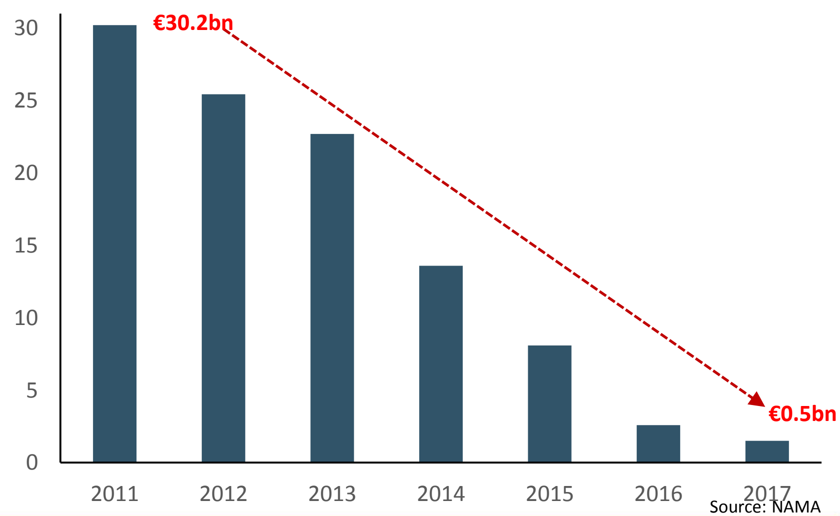
ECB/ELA funding in the Irish system (€bn)



Government guaranteed liabilities (€bn)



NAMA bonds (€bn)



Irish Economic Outlook – SPU April 2017

Macroeconomic forecasts for Ireland – April 2017					
Year-on-Year % change	2017	2018	2019	2020	2021
Real GDP	4.3	3.7	3.1	2.7	2.5
Nominal GDP	5.5	5.0	4.6	4.4	4.2
Real GNP	4.2	3.5	2.8	2.3	2.1
Personal Consumption	2.8	2.7	2.5	2.2	2.0
Govt. Consumption	2.6	2.1	2.0	1.9	1.8
Investment	-17.1	5.4	4.3	3.3	2.9
Exports	5.0	5.1	4.2	3.9	3.8
Imports	-2.0	5.3	4.5	4.2	4.0
HICP	0.6	1.2	1.8	1.9	1.9
GDP Deflator	1.2	1.3	1.5	1.7	1.7
Employment	2.7	2.4	1.9	1.5	1.4

- Growth forecast for 2017 upgraded to 4.3% and up to 3.7% for 2018
- The economic recovery is most clearly evident in the labour market with employment growth of 2.9 per cent recorded last year, representing an additional 56,000 jobs. There are now more than 2 million people at work for the first time since 2008. Unemployment is projected to average 6.4% for 2017 and 5.8% for 2018.

[1]Source: Dept of Finance April 17 SPU - http://www.finance.gov.ie/sites/default/files/20170410%20Draft%20SPU%20final.pdf

Irish Fiscal Projections - SPU April 2017

Fiscal forecasts for Ireland – April 2017							
(% of GDP)	2015	2016	2017	2018	2019	2020	2021
General government balance	-1.9	-0.5	-0.4	-0.1	0.1	0.6	1.0
General government primary balance	0.7	1.8	1.7	1.9	2.0	2.3	2.6
Structural Budget Balance	-2.2	-1.3	-1.2	-0.5	-0.2	0.4	1.0
Debt-to-GDP ratio (%)	78.6	75.4	72.9	71.3	69.5	65.2	62.8

- Our debt position continues to improve, with our general government debt-to-GDP ratio a little better than projected at Budget time at 75½ and 73 per cent for 2016 and 2017 respectively.

[1]Source: Dept of Finance April 17 SPU - http://www.finance.gov.ie/sites/default/files/20170410%20Draft%20SPU%20final.pdf

Irish Banking Policy – Introduction

- Irish economy has recovered strongly from a severe recession following painful corrective policy actions at a fiscal and banking policy level.
- Rescue of the banking system cost €64bn, the granting of numerous guarantees, creation of a bad bank (NAMA), etc.
- Government policy is that banks should be privately owned and, subject to market conditions, we will exit in a manner that generates value for the taxpayer.
- The Government's Programme agreement allows for the sale of up to 25% of the issued share capital of each of our three investments before the end of 2018.
- We are committed to recovering the €29bn invested in AIB, BOI and ptsb over time and have recovered c.€15bn of this to date through disposals, fees and interest income.
- Given a much improved financial position, the State is not under pressure to exit the remaining investments.

Irish Banking Policy – selected quotes

*"The position of the Government in regard to the State's shareholdings in the banking sector is very clear. These were investments the State had to make during the banking crisis, and it is the Government's intention that the State will **exit these investments in a measured and careful manner**."*

Minister for Finance Michael Noonan – 4th April 2017

"We do not believe a State bank is the best model for the Irish economy in the medium to long term."

Minister for Finance Michael Noonan – 2nd Oct 2014

*"The overarching objective of the banking strategy I set out in March 2011 was to have **a functioning, stable banking system operating in support of the Irish economy** and to reduce the cost of the banking bailout to the Irish taxpayer."*

Minister for Finance Michael Noonan – Irish Times 12th Jan 2015[1]

*"The State invested €20.8 billion in AIB through a range of instruments during the financial crisis, and has since recovered €6.6 billion through capital repayments, interest income and fees, and still owns about 99.9% of the ordinary share capital. **The primary objective of the Minister and of the Government is to recover all of this investment from AIB.** We believe that this is a **realistic objective over the medium to long term**."*

Taoiseach Enda Kenny – 21st March 2017

*"The Government is fortunately not under any particular pressure to sell, so the **market conditions will impact on when the Minister decides to make his recommendation to Government to sell**."*

Taoiseach Enda Kenny – 21st March 2017

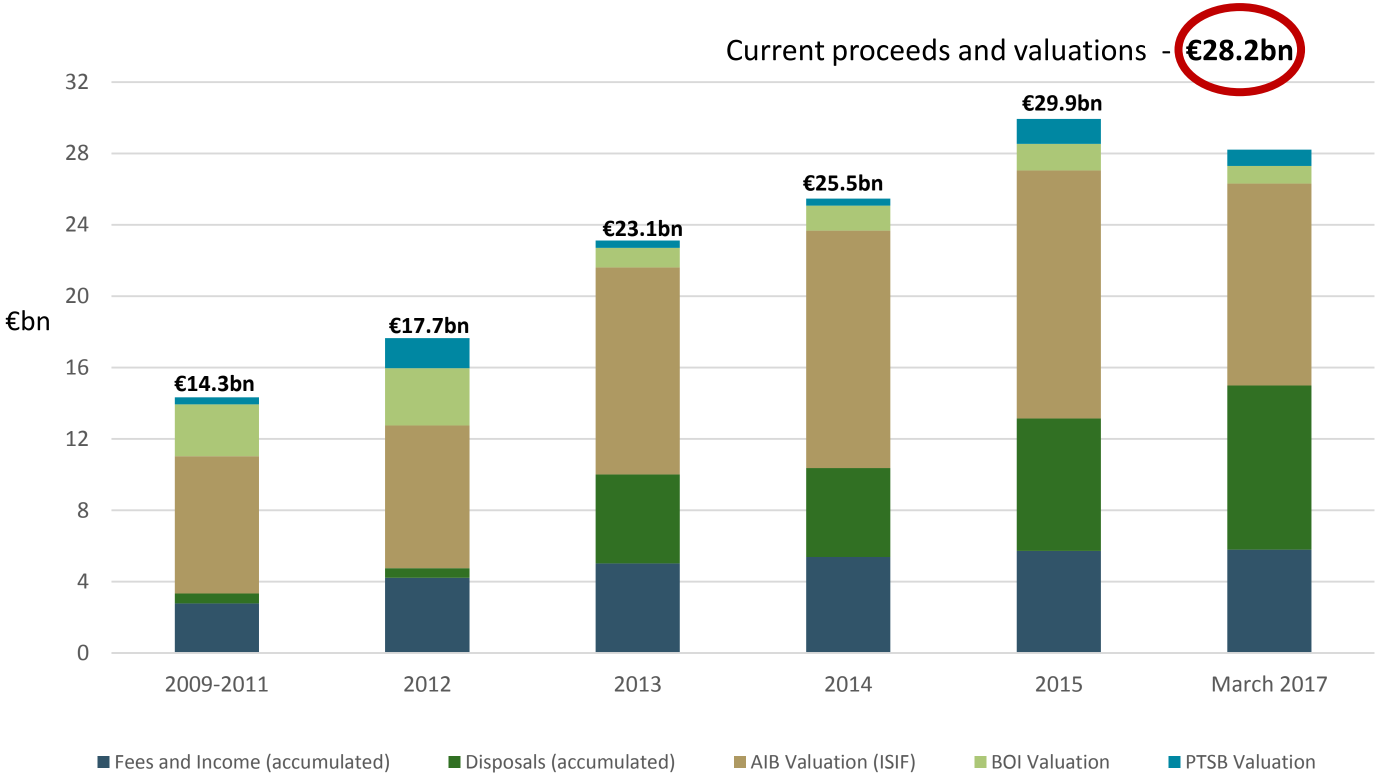
[1]Source: Irish Times – Jan 2015 - http://www.irishtimes.com/opinion/michael-noonan-strategy-for-dealing-with-banks-is-working-1.2062113

Dept. of Finance manages State's bank investments

- The Shareholding and Financial Advisory Division (SFAD) is a unit of the Department of Finance and reports to the Minister of Finance.
- SFAD is responsible for devising, recommending and executing strategies for returning the banks to private ownership.
- Our mission is to maximise the recovery of funds from our bank investments in a manner that is consistent with best institutional norms.
- A team of 17 professionals with a mix of capital markets, corporate finance, investment, banking, accounting and legal backgrounds. A blend of private sector expertise and experienced civil servants.
- SFAD is also responsible for the management of the Minister's shareholding in the National Asset Management Agency (NAMA) and representing the Minister's interests in relation to the liquidation of IBRC and has policy oversight for the Credit Union (savings & loan) sector.
- Published Relationship Framework Agreements (RFAs) govern our interaction and protect banks' independence. These are EC DGCOMP approved.

The road to recovering our €29bn bank investment

Investment in AIB, BoI and ptsb vs. State's recovery value



(1) The AIB equity valuation is the ISIF valuation for each respective period. This is an "outside in" valuation produced for accounting purposes and was not informed by management's views of the prospects and risks for the business.
(2) BOI and PTSB: equity valuations based on ISE closing prices, 6th March 2017.
(3) Disposals include sale/redemption of debt instruments, sale of Irish Life, and PTSB IPO.
(4) Fees and income include interest coupons, recap fees, and CIFS/ELG fees.

Slide previously published - http://www.finance.gov.ie/sites/default/files/20170310%20Ireland_Report_Card_Economy_and_Finances_Master%20%282%29.pdf

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Many milestones achieved

✓ Making progress recovering taxpayers investment:

AIB
- Capital Reorganisation - €1.6bn
- Contingent Capital redemption - €1.6bn
- Dividend - €250m
- Fees and Interest - €2.7bn

Bank of Ireland
- Sale of Pref Shares - €2bn
- Sale of Contingent Capital Notes - €1bn
- Fees and Interest – €2.3bn

permanent tsb
- Sale of Irish Life - €1.3bn
- Re-IPO and CoCo redemption - €550m
- Fees and Interest - €0.8bn

✓ Contingent liabilities for State effectively eliminated:

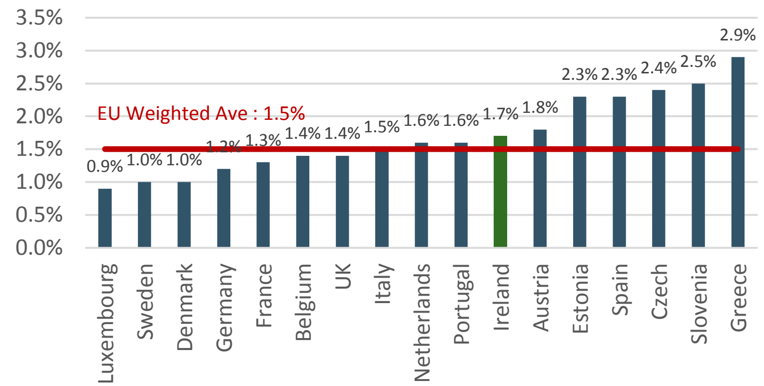
- Bank guaranteed liabilities (€375bn down to €1bn) & ECB funding back to normal levels.
- NAMA on track to repay last €500m of its €30bn senior debt by year end.
- IBRC Liquidation (c. €21bn loans brought to market) almost complete and €30.6bn of Promissory Notes eliminated.

✓ Banks deleveraged, returned to profitability & resolving legacy issues.

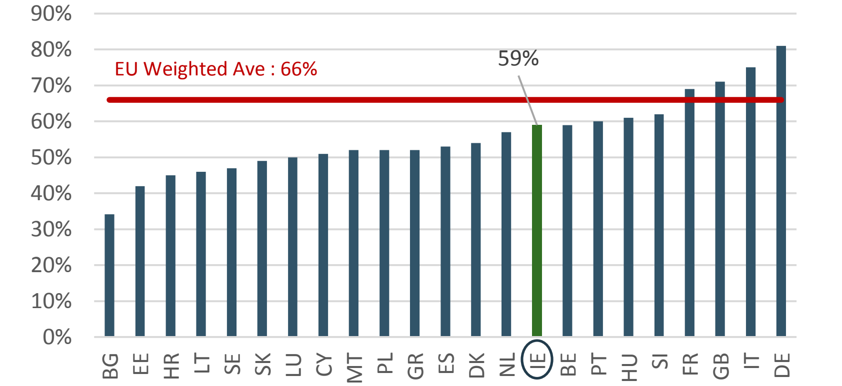
✓ EC/IMF/ECB programme commitments met and programme exited.

Bank sector snapshot

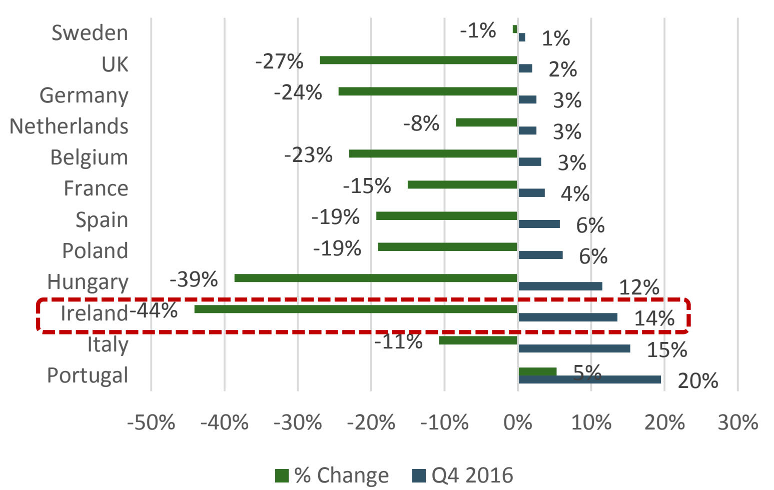
Net interest margins



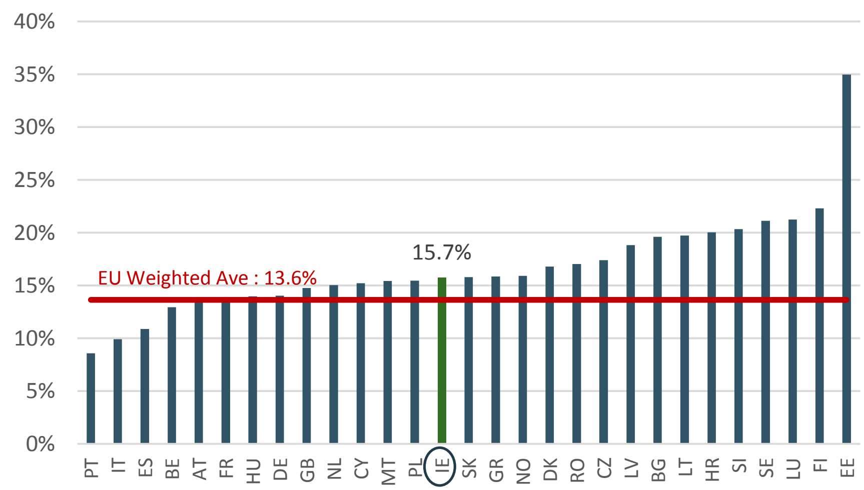
Cost/income ratios



NPL progression since Q3 2015



CET1 ratio (fully loaded)



Source (all charts): EBA Risk Dashboard Q4 2016

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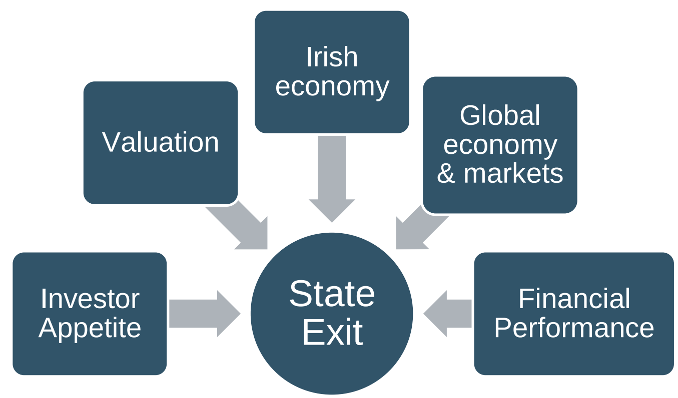
Government Objectives

Programme for a Partnership Government – May 2016[1]

"To complete the repair of the banking system and ensure that banks are supporting the wider public interest, we will:

- *Commit that the State will use its bank shareholding in the best interests of the Irish people*
- ***Not sell more than 25% of any bank before the end of 2018. (plus any small additional shareholding required by the under-writer to complete the sales process)***
- *Request the Central Bank to procure an independent assessment of the arrears and negative equity loan books of the banks*
- *Cease to appoint new Public Interest Directors to the banks, and reform the procedures for the appointment of bank directors by the State, with a view to increasing transparency in the process."*

What influences our exit strategy?



[1]Programme for Partnership Government: http://www.merrionstreet.ie/MerrionStreet/en/ImageLibrary/Programme_for_Partnership_Government.pdf

Separation of banks and State

- A fundamental principle – banks are independent
  - Relationship Frameworks govern the relationship between State and each bank e.g. manner of communication, Minister has consultation rights in a limited number of areas
  - With AIB and ptsb, State can offer a non binding view on bank strategy but has no influence over operational matters

- Documents which govern interaction:
  - Recapitalisation agreements ('08-'11) contain various consent requirements
  - Emergency legislative measures (e.g. CIFS/ELG, NAMA Act) linked to legacy systemic risks that are winding down
  - Remuneration – a pay cap of €500,000 (ex pension) and no bonuses are permitted

Relationship Frameworks in operation

The Frameworks **protect the separation of the banks from the shareholder** and provide:

1. each bank will continue to operate at arm's length from the State;
2. each bank will remains a separate economic unit with independent powers of decision;
3. each bank will continue to have its own independent board and management team;
4. there will be no cross-directorships between banks;
5. the board of each bank will determine the bank's strategy and commercial policy, including the adoption of its business plan and budget, and
6. the State will not intervene in the day-to-day operations of the banks or their management decisions including with respect to pricing and lending decisions;

"I have no statutory function in relation to banking decisions made by individual lending institutions at any particular time as ***these decisions are taken by the board and management of the relevant institution****. A Relationship Framework has been specified that defines the nature of the relationship between the Minister for Finance and each bank."*

Minister for Finance Michael Noonan – 27th Jan 2015

"Notwithstanding the fact that the State is a shareholder in a number of institutions, I must ensure that the banks are ***run on an independent basis to ensure the value of the banks as assets to the State****."*

Minister for Finance Michael Noonan – 16th Dec 2016

"There is a relationship framework, signed by my predecessors in office, with the banks and the essential component is that the political side will not interfere in commercial decisions. That is for a very good reason as ***we do not want to politicise the banks****. It would be a very sad day for the country if the first port of call for a person seeking a loan had to be the local Deputy rather than a bank manager."*

Minister for Finance Michael Noonan – 14th Jan 2016

Source – Oireachtas quotes - http://oireachtasdebates.oireachtas.ie/debates%20authoring/debateswebpack.nsf/yearlist?readform&chamber=dail

Relationship Frameworks - AIB (Link), BOI (Link), PTSB (Link)

Topical Issues

- Government (Fine Gael and Independents) does not have a majority in Parliament but has a “Confidence and Supply” agreement with largest opposition party (Fianna Fail). Possible that legislation (inc. banking related) can be passed that is not sponsored by the Irish Government
  - **Central Bank (Variable Rate Mortgages) Bill 2016**
    - **Opposition Bill to regulate mortgage interest rates**
      - Government has raised questions regarding potential impact on property rights of creditors and potential to harm competition rather than improve
      - ECB noted that as drafted it could impact competition and the supply of product in the market[1].
      - CCPC (Competition Authority) also recently raised significant concerns in relation to the draft legislation across a number of areas[2].
  - **Keeping People in their Homes Bill 2017**
    - **Independent Members Bill to introduce proportionality test to repossession proceedings**
      - Private members bill, not sponsored by the Irish Government
      - Subject to change through the legislative process and may or may not ultimately be adopted
- Other Issues
  - **CCPC (Independent Competition Authority) consultation on Irish Mortgage Market[3]**
      - On 20 February 2017, the CCPC published a public consultation to gather views about the future of the Irish mortgage market
      - Report intended to set out options available to the Irish Government on how to reduce the cost of secured mortgage lending and to improve competition and consumer protection.
      - Final report due to be published in May 2017

[1]Source: ECB opinion- https://www.ecb.europa.eu/ecb/legal/pdf/en_con_2016_54_f_signed.pdf

[2]Source: CCPC Consultation - http://ccpc.ie/central-bank-variable-rate-mortgages-bill-2016

[3]Source: CCPC Statement - http://www.ccpc.ie/sites/default/files/2017 02 20 Public Consultation on Mortgage Lending.pdf

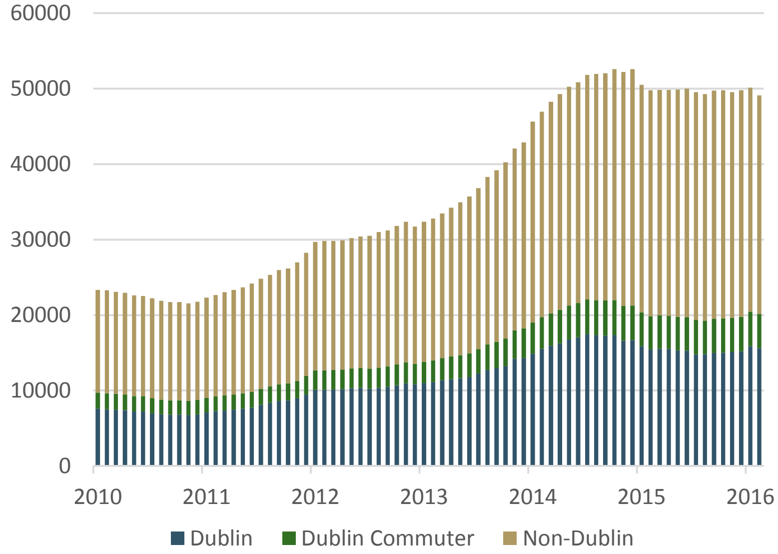
Policy Challenges (1) – boosting housing output

- A young growing population but housing output at 1970s levels
- Fixing this problem is a major priority for Government[1]
- Reasons for this market failure are complex and inter-related
    - Lack of development activity through the crisis created a supply shortage
    - Supply shortage created land price inflation compromising financial viability
    - Planning restrictions raised build costs compromising financial viability
    - Bank's not funding speculative development and requiring appropriate equity (i.e., lower LTC, LTV)
    - Few builders survived the crash with equity and taking time to adjust to sustainable funding model
- Plan to double residential output to 25,000 homes per year by 2020
    - Emergence of permanent capital vehicles (e.g. Cairn Homes, REITs) and build-to-rent development
    - Open up land supply & low-cost State lands
    - Local Infrastructure Housing Activation Fund - €200m
    - NTMA financing of large-scale "on-site" infrastructure

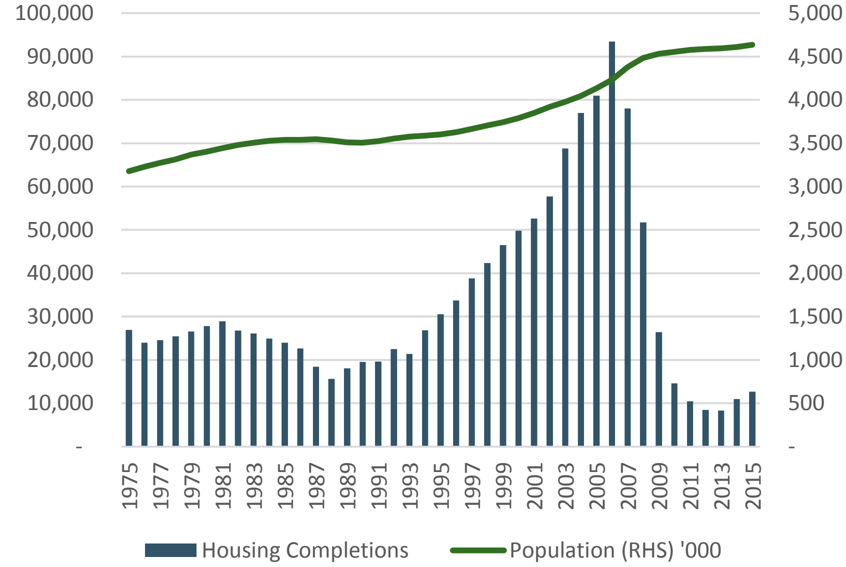
[1] http://rebuildingireland.ie/Rebuilding%20Ireland_Action%20Plan.pdf

Policy Challenges (1) – boosting housing output

Housing Transactions



Housing completions / Population Growth



- Planning Reforms
  - Larger housing proposals (+100 homes) to go directly to appeals board
  - Prioritising planning appeals (18 weeks)
  - More Strategic Development Zones (SDZ's) with fast track planning
- Deliver 47,000 units of social housing in the period to 2021

Source: CSO

Policy Challenges (2) - Brexit

- The UK's decision to exit the EU represents a risk to our economy.
    - Around 17% of Irish exports go to the UK but impact greater from an employment point of view given mix
    - Nearer 40% of Irish food exports to the UK
    - Ireland imports 25%-30% of its goods from UK so these are cheaper post STG move

- However there are also potential positives as we could benefit from displaced FDI

- Independent economic think tank the ESRI has estimated the cost in the level of output could be 2.3%-3.8% after 10 years depending on whether we have EEA or WTO arrangement.

- Department of Finance has produced a number of papers on the economic and financial sector implications of brexit on Ireland - http://www.finance.gov.ie/what-we-do/eu-international/brexit/brexit

- The measures set out in Budget 2017 are an important first step in mitigating the impacts on the Irish to: -
    - establish a contingency fund or "rainy day fund" and
    - a revised medium term Debt-to-GDP ratio of 45% of GDP

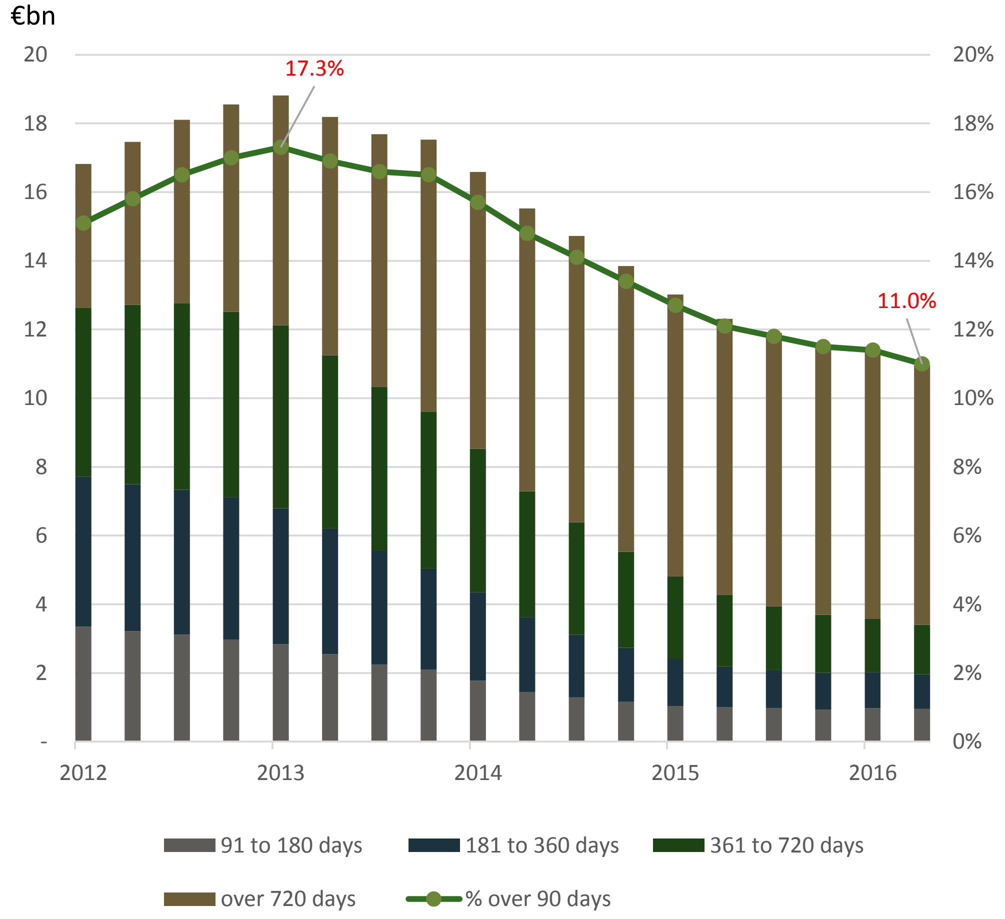
  to ensure the public finances are in a position to withstand Brexit related shocks.

- The Government will shortly publish a position paper re. Ireland's proposed approach to Article 50

Policy Challenges (3) – Legacy debt

- Significant progress made in reducing and restructuring personal and corporate debts and arrears since crisis
  - NPLs across three domestic banks down almost 60% from peak, with PDH mortgage arrears 90+ down to 11% from 17.3% at peak (by number)
  - Personal bankruptcy period reduced from 12 years to 1 year
  - New non judicial insolvency solutions
  - PDH arrears down from 17.3% at peak to 11%
- Government policy has focused on keeping people in their homes if at all possible
  - Banks and borrowers preferring to restructure loans
  - New solutions such as mortgage to rent
- Home repossessions and company liquidations have been comparatively low in Ireland given scale of downturn
  - Central Bank recently estimated the repossession rate in Ireland at 0.7% vs. 1.7% in UK, which has lowest arrears since 1994

Mortgage arrears (private dwelling homes) – by number



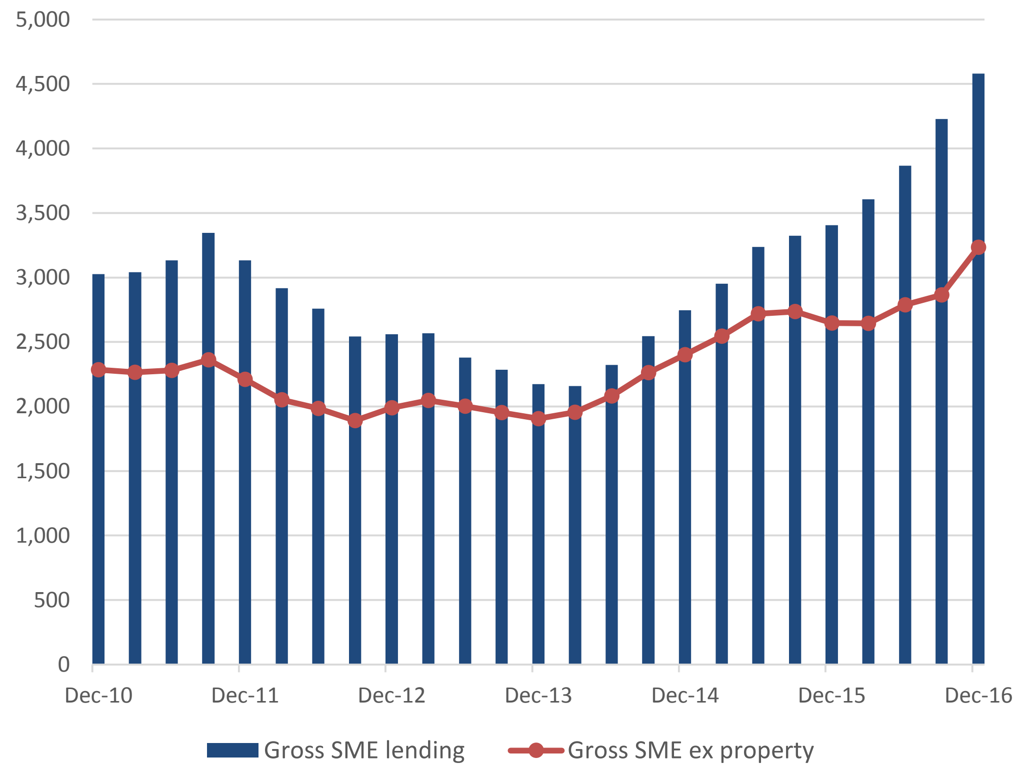
Policy Challenges (4) – credit appetite

- Primary (supply side) policy challenge was ensuring banks were downsized, recapitalised, and funding structures repaired – this has been achieved

- Economic rebound to date has been largely "credit-less"

- But signs of demand for credit picking up:
  - Mortgage approvals up 52% y/y in February and 68% y/y in value terms but loan stock still shrinking (see chart)
  - Stock of unsecured personal debt up 7.6% y/y in 2016
  - SME gross lending up (see chart) but stock shrinking
  - Credit to all enterprises now rising ex property but still shrinking if included (see chart)

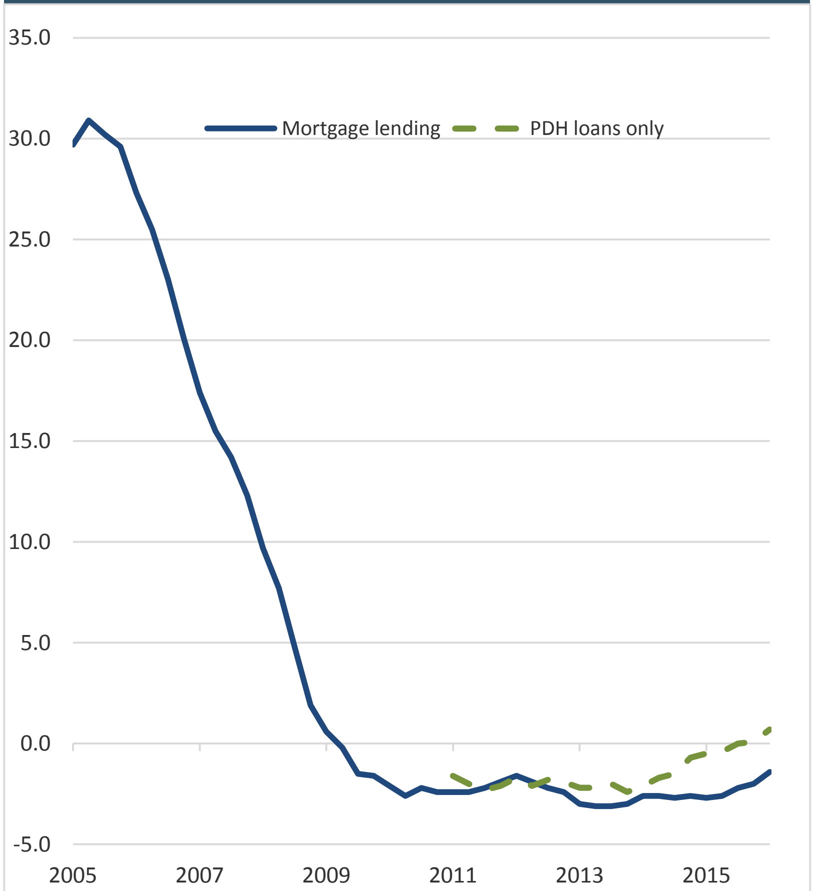
SME gross lending – rolling four quarter total



Source: Central Bank of Ireland. Figures are ex financial intermediation

Policy Challenges (4) – credit appetite

Mortgage lending % change y/y (stock)



Source: *Central Bank of Ireland*

Credit to Irish private Sector Enterprises % change y/y (stock)*

* ex financial intermediation

Policy Challenges (5) – Global tax environment

- A focus on FDI and a competitive tax rate has been a core plank of Irish economic policy for decades

- Ireland has been an early mover in implementing the OECD's Base Erosion and Profit Shifting (BEPS) project and has participated fully in important reforms at EU level. We are a strong supporter of tax transparency and administrative cooperation

- International tax reform is complex and requires all countries to work together. The evidence shows that real reform is happening and delivering results

- Ireland and Apple are appealing the recent EU tax ruling. Our position is that the correct tax was paid and no State aid was given.
    - The European Commission has stated that "This decision does not call into question Ireland's general tax system or its corporate tax rate".

- Corporate tax accounted for c. 15% of Ireland's tax revenues (€7.3bn of €47.9bn) in 2016

- There are no plans to change our 12.5% corporate tax rate

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