Economic Research

Irish State support for the Banking Sector –a Timeline 14 May 2015

On the morning of the 30th September 2008 the Irish Government announced a blanket guarantee covering most of the liabilities of Irish banks , a date later described by the current Finance Minister as the *'blackest day in Ireland since the Civil war Broke out'.* The scheme was to run for two years and covered the deposits of the Irish institutions (excluding those deposits, up to €100,000 per person per institution, already included under an existing scheme), senior debt and dated subordinated debt. The liabilities total was initially estimated at around €440bn (240% of GDP) although the Department of Finance now puts it at under €400bn. Over the next few years the State injected capital to the value of €64bn into the banking system, making it one of the most expensive bailouts in relative terms in modern history, and in this paper we examine how such an enormous sum emerged, given that the original guarantee was seen as a short-term solution to a perceived liquidity problem and not the answer to a systemic solvency issue for the banking sector.

The table below breaks down the total support by institution, revealing that just two banks accounted for almost €50bn or over three quarters of the total. In what follows we develop a timeline of events, outlining the sums involved at specific periods. The year 2010 emerges as crucial, involving as it did the scale of Nama haircuts , crystallising huge bank losses on commercial and real estate loans, and the first of the Central bank's prudential capital assessments. The emergence of the sovereign debt issue in Europe also played a role, as did the Franco-German policy change on support for banks, moving from a bailout strategy to a bail-in approach. We conclude with an estimate of the net cost to the State.

Institution	**Capital Injection (€bn.)**	**Share of Total (%)**
EBS	0.875	1.4
ILP	4.0	6.2
BOI	4.7	7.3
INBS	5.4	8.4
AIB	19.9	31.0
Anglo	29.3	45.7
Total	**64.1**	**100**

2009 : Capital Injection €11bn

In December 2008 the Minister for Finance has flagged that the State would inject capital into Anglo Irish, AIB and Bank of Ireland, by way of preference shares. The sums involved were to be €2bn for each of the larger banks and €1.5bn for Anglo although the latter plan was dropped when that bank was taken into public ownership in January 2009. Instead, the State injected €4bn in equity into Anglo via three separate tranches (€3bn, €0.8bn and €0.2bn), with the final one completed in September.

The approach to AIB and BOI was different, in that the capital injection took the form of an investment by the National Pension Reserve fund (NPRF). The Initial Preference share proposal was retained but the sum involved rose to €7bn. Each institution received €3.5bn, with the shares paying an 8% coupon and redeemable at par within 5 years, with the price then stepping up to 125. The shares also included warrants, giving the NPRF the option to purchase equity in the banks at various strike prices. In the event of a bank not being able to pay the coupon in cash it would be met via the issuance of shares to the NPRF.

2010 : Capital Injection €35.275bn

In March 2010 the Minister for Finance made a statement on the banking system following a Central bank Prudential Capital Assessment Review (PCAR), which had subjected the banks to a stress test, covering the period 2010-2012. The Central Bank deemed that an 8% core tier 1 capital ratio was required, including 7% in equity, and on that basis concluded that the Irish banks required additional capital of varying orders of magnitude. The results included the initial round of transfers to the National Asset Management Agency (Nama), with an average haircut of 47% on what were largely commercial and real estate loans.

The Minister announced that *'we now know the extent of losses in our banking system* ' and the Promissory note first emerged as a method of injecting State funds into the Irish financial system, designed to spread out the cash payments. INBS was taken into public ownership by way of a €100mn equity injection, with a further €2.6bn coming via the said note. EBS was dealt with in a similar fashion, albeit on a smaller scale (€100mn equity and a €775mn Prom note) but this was dwarfed by the sums announced for Anglo Irish Bank. The Minister noted that *'the bank has estimated that ..it could become profitable over the medium term and a target exit for the State could take place in 5-7 years'*, but would require €8.3bn in the short term to help absorb losses to date, with additional capital needed further out, possibly amounting to another €10bn. Anglo duly received €8.3bn in a Promissory note at the end of March, which was topped up by an additional €2bn in May.

AIB was deemed to require €7.4bn in equity but was given some time to raise that sum, Including the sale of foreign assets. The capital figure for Bank of Ireland was €2.7bn and it raised €3.4bn via a rights issue in April, using some of the proceeds to purchase the warrants attached to the original Preference share deal. The NPRF converted some of the Preference shares into Bank of Ireland equity and participated in the rights.

By September, the situation had changed, in part due to the emergence of much larger haircuts on Nama transfers, with the average for the second tranche rising to 55.6% (from 47%). The INBS figure was 72% (from 58%) and the State announced a further €2.7bn via the Prom note route. Anglo's haircut had also risen sharply, to 62% from 50%, and by year end had received an additional €15bn, bringing the grand total for that institution to €29.3bn, with the Prom note accounting for €25.3bn. AIB was also deemed to require additional capital, on top of the March estimate, and in December the NPRF injected €3bn into the bank via equity.

The liquidity situation of the Irish banks had also deteriorated, in part due to the perception of a 'funding cliff' on termination of the original liability guarantee and in part a reflection of the sovereign deb crisis that had blown up earlier in the year. In October, a Franco-German decision was announced, reversing the previous stance on bank bailouts, and allowing for a private sector 'bail in', which exacerbated the funding position of many banks, including those in Ireland. ECB liquidity support for Irish headquartered banks rose sharply, peaking at over €90bn in early 2011, with ELA an additional €70bn.

2011: Capital Injection €16.55bn

The market proved unwilling to fund Ireland's fiscal deficit in the latter months of 2010 and in late November the Government negotiated a €67.5bn loan from the EU and the IMF. In March 2011 the Central Bank announced the results of another PCAR, this time encompassing four banks (AIB, BOI, EBS and ILP) with a minimum capital requirement of 10.5% core Tier 1 in the base case and 6% in the stress. The stress resulted in total projected losses of €27.7bn over the three years 2011-2013, equivalent to 10% of existing loans, ranging from 8% (BOI) to 13.4% (AIB). In terms of sectors, residential mortgages accounted for €9.5bn (6.8% of total mortgage loans) with Commercial and Real Estate at €8.9bn (22% of CRE loans). The Central Bank then adjusted for expected pre-impairment profits (€3.9bn) and losses on the required asset disposals (€13.2bn), arriving at a capital requirement figure of €18.7bn which was then supplemented by additional buffers amounting to €5.3bn, giving a grand total of €24bn. The buffers included Contingent Capital notes , a debt instrument which converts into equity if a bank's equity ratio falls below a trigger level. The Central Bank also required the participating banks to reduce the size of their balance sheets and set loan/ deposit targets, with the overall aim of placing the *'Irish banking system in a position where it can fund itself and generate capital without undue further reliance on the Irish or European public sectors'.*

The required capital injections (excluding the Contingent Capital) would initially raise core Tier 1 ratios to very high levels, according to the Central bank estimates, ranging from 16.1% (BOI) to 21.9% (AIB) and 32.4%(ILP). EBS was deemed to require €1.5bn in additional capital but was merged with AIB, a deal completed in July. In that month the State also injected €2.3bn in equity into ILP, plus an additional €0.4bn via Contingent Capital.

Bank of Ireland was required to raise €5.4bn in additional capital and in June announced a debt for equity swap and a Rights issue. The NPRF participated in the latter to the tune of €1.2bn but sold shares shortly afterward for €1bn, leaving a €0.2 equity injection. The Bank of Ireland also raised €1bn in Contingent capital by issuing a note to the Minister for Finance.

The capital sum required by AIB was €13.3bn and it too issued a Contingent capital note to the State, this time for €1.6bn. In addition the NPRF was instructed to inject €5bn in equity plus €3.8bn as a 'capital contribution'. The Minister also added an additional €2.3bn 'capital contribution'.

Anglo Irish Bank and INBS were formally merged in July to form the Irish Bank Resolution Corporation (IBRC)

2012 : Capital Injection €1.3bn

The State purchased Irish Life for €1.3bn in March, so completing the cycle of Government support for the banking system begun three years earlier. Alongside Preference shares and Contingent Capital notes, the State (through the NPRF) was left owning 14.1% of Bank of Ireland, 99.8% of AIB and 99.2% of the Permanent Group.

2013 to date

In January 2013 the Government sold the €1bn Bank of Ireland Contingent capital note to private investors. Irish life was sold for €1.3bn in February 2013 (the State did receive a dividend). In the same month IBRC was put into liquidation , triggering the liability guarantee. In December of that year the NPRF sold the remaining Preference shares in Bank of Ireland, leaving ordinary equity as the only State involvement. In October 2014 Permanent tsb was deemed to need €0.85bn in additional capital following a European Banking Authority stress test. In April 2015 that institution raised €525mn from private investors, including €400mn in equity, and bought back the €0.4bn Contingent Capital note from the Minister. The NPRF also sold some shares, for €98mn, so reducing the State's equity stake to 75%.

The Net Cost

In a sense it is impossible to quantify the full financial impact of the financial crisis and subsequent State bailout, as the absence of a fully functioning banking system exacerbated the economic downturn in Ireland (GDP fell by some 12% from peak to trough) and contributed to the collapse in property values. Some €20bn of State support was via the NPRF and hence not added to the national debt or annual fiscal deficits but the rest was, so contributing to the scale of the fiscal adjustments imposed by successive governments, including cuts in current exchequer spending and a substantial rise in the tax burden on the average household. The crisis and subsequent cost also resulted in significant non-financial scars, leaving the general public angry and disillusioned with banks, governments and regulators.

With those caveats in mind, the table below, largely based on NTMA data, gives an indication of the current net cost of the support. The net interest figure is sourced from the CSO and includes their estimate of the impact of the banking support on Ireland's cost of borrowing. The final figure, including the value of investments in the three banks, is currently €34.4bn, which, perhaps appropriately, happens to be almost exactly the sum injected into Anglo and INBS. The table also makes no allowance for any gain on the liquidation of IBRC or any profit from Nama.

Total Costs and Revenue from Bank Support	**€bn.**
Gross Cost of Support for banks	**64.1**
Revenue	13.3
Sale of securities	7.0
Contingent Capital notes	1.4
Guarantee fees	4.4
Central bank Income	5.1
Interest received– payable	-4.6
Net Cost	50.8
Value of Assets	16.4
AIB –equity	11.7 (as at end-2014)
AIB-Contingent capital note	1.6 (valued at par)
BOI-equity	1.6 (based on market price)
Permanent tsb-equity	1.5 (based on market price)
Cost net of assets held	**34.4**