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21 November 2010

M. Jean-Claude Trichet
President
European Central Bank
Kaiserstrasse 29
60311 Frankfurt am Main
Germany

Dear Jean-Claude

I refer to your letter of 19 November 2010.

First, let me say that I fully understand your concerns and that of the Governing Council in regard to the implications of the current situation of the Irish banking system. As you know, Ireland has worked very aggressively, and to the limits of our fiscal capacity, to protect and repair the banking system in the light of the dangers to financial stability both in Ireland and Europe.

For example, in September 2008 the Government introduced an extensive Bank Guarantee to seek to bolster the funding difficulties of the banks by providing a Sovereign guarantee of bank liabilities. This was quickly followed by a bank recapitalisation programme announced in December 2008 and nationalisation of Anglo Irish Bank in January 2009. The establishment of NAMA was announced in April 2009 to remove the riskiest land and property development loans from the banks' balance sheets. At this stage, Ireland has provided or pledged some €32 billion of capital to the banking system.

These extensive set of measures have been taken in tandem with a most extensive programme of fiscal adjustment, amounting to some €15 billion of discretionary fiscal consolidation in 2009 and 2010 so far, with a further adjustment of another €15 billion planned by 2014. Measures for 2011 alone will amount to over €6 billion. Thus, Ireland has proved so far to be flexible and aggressive in dealing with its problems and will continue to be so.

These assertive measures, contributed to a substantial improvement in international sentiment towards Ireland and a partial recovery in the banks' funding position in the first quarter of 2010. The new Financial Regulator announced the results of his PCAR exercise and required the banks to meet it by the end of the year. The banks successfully commenced the process of accessing longer-term funding to manage the large redemptions cliff due in September. Reliance on bank funding from the Eurosystem was reduced. In addition, Bank of Ireland initiated and ultimately successfully completed its private capital raising exercise.

However it was not possible to sustain the improvement in the banking environment. As the year progressed there were a number of developments which led to a sharp reversal in financial conditions, of which the following are just some.

- Following the onset of the Greek debt crisis during April, international markets became increasingly concerned regarding Ireland's fiscal position, the strength of the Bank Guarantee and the fiscal capacity of the State to stand behind the banks.
- There was a slowdown in the pace of economic recovery nationally and increasing concern regarding the speed of recovery in the international economy particularly in the USA.
- Credit rating actions and negative market sentiment exacerbated the situation
- Uncertainty about the status of bondholders in the event of access to external support added to instability
- These events led to a crisis of confidence in both the Irish banking system and increasingly the Irish Sovereign. As a result, our banks, as you know so well, have had to turn to ECB/Central Bank funding to replace their market funding especially in September when a large number of bonds which matured under the two year Credit Institutions Financial Support (CIFS) Guarantee became due.

In order to seek to reverse these trends, I made a further comprehensive and detailed further Statement on Banking at the end of September and outlined the actions being taken to provide certainty to the international markets on the scale of bank losses. The Statement covered changes to NAMA to accelerate loan transfers and provide visibility on the final discounts expected to arise, the revised assessment of the capital positions of the banks on the basis of final expected NAMA discounts and the projected maximum capital requirements for Anglo Irish Bank.

While initially this information was initially well received, the credibility of projected bank loan losses was increasingly called into question by analysts and investors – there comes a point at which negative sentiment starts to feed on itself, even independently of underlying realities, and we are clearly at that point.

In relation to points (1) to (4) of your letter, I would like to inform you that the Irish Government has decided today to seek access to external support from the European and international support mechanisms. This grave and serious decision has been taken in the light of the developments I have outlined above and informed by your recent communications, and the advice you have conveyed to me personally and courteously in recent days.

The Government is clear, in the light of the very intensive and productive work done by Irish, European Commission, IMF and of course ECB officials, in recent days, that there is a potential programme which will be both workable and effective and which will incorporate real and significant restructuring measures in relation to the financial sector, structural reforms and fiscal consolidation, and the Government is committed to this. Indeed, your officials in Dublin have had the opportunity to see a draft of our proposed four year plan, so you may be aware that our fiscal and economic programme is in fact very extensive, and forms an appropriate basis for programme discussions.

It is also clear from the discussions over recent days that any programme will include provision for further capitalisation on a scale which should convince markets that capital is not a problem. I was very pleased to note that the intensive examination of the Irish authorities' work on capital requirements has not indicated any new and unanticipated 'hole' in the banks' capital position, and it would be helpful if this is made clear in internal and external communications. However, the fact is that the market has not accepted the current capital levels as adequate, so more must be done.

In relation to your fourth point, there are already such arrangements in place in respect of each bank in receipt of ELA which provide the assurances that you call for.

I hope that this will provide some reassurance to the Governing Council and that you will be able to reiterate in a public way the continuing practical support of the ECB for the liquidity position of the Irish banks, to help to reassure the market on this crucial point.

You know that we here will not be lacking in the will to do all that is necessary on our part to protect our economy and people and to play our role in the Eurosystem.

Yours sincerely

Brian Lenihan

Brian Lenihan, TD
Minister for Finance