



PAC-R-1373 Correspondence 3C.1
Meeting 125 08/05/2014

Ms. Niamh Maguire,
Clerk to the Committee of Public Accounts,
Leinster House,
Dublin 2

1st May, 2014

Re: Update briefing material for our meeting next Thursday, 8^h March

Dear Niamh,

In advance of the above mentioned meeting, I am pleased to enclose updates in relation to the following items on the agenda:

Vote 7 - Appropriation Accounts and general update on the Office of the Minister for Finance

Chapter 1 – Exchequer Financial Outturn 2012, including the Finance Accounts 2012, and update to current position

Chapter 2 – Government Debt

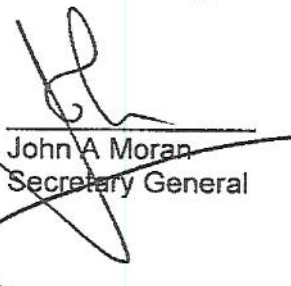
I thought certain other documents would be useful by way of reference for Thursday's discussion.

- (1) Statement of Strategy 2011-2014
- (2) Medium Term Economic Strategy
- (3) Stability Programme Update
- (4) The latest version of the periodic update we publish for stakeholders
- (5) A speech and related slides I gave yesterday morning on banking.

I should also mention that our Annual report 2013 is before Cabinet this coming week and, should it be approved, I shall send over copies at the earliest opportunity along with the updated April exchequer numbers.

My opening address will be forwarded on Tuesday next.

Yours sincerely,



John A. Moran
Secretary General

Vote 7 - Appropriation Accounts and general update on the Office of the Minister for Finance

The below table summarises the financial position for the Department since 2011.

Comparatives table 2011-2014 - €'000

Category	2011 Outturn	2012 Estimate	2012 Outturn	2013 Outturn	2014 Estimate
Gross Expenditure	24,394	33,336	26,195	27,341	32,700
A in A's	1,812	1,254	1,564	2,732	1,500
Net expenditure	22,582	32,082	24,631	24,609	31,200
Surplus to be surrendered	3,276		7,451	*8,578	

***provisional**

2012 Appropriation Accounts

The 2012 Appropriation Accounts show a surplus to be surrendered of €7.451m. This surplus arose across a number of subheads as follows:

- €4.6m savings on the paybill due to (a) slower than anticipated recruitment, (b) lower than budgeted starting salaries for certain grades, (c) the use of pro bono staff in a number of key positions while recruitment for these positions progressed; and
- €2.7m saving arising from lower than expected legal and other advisory fees.

Update since end 2012

A saving of €8.6m is provisionally reported for 2013. This saving arises primarily on the Financial Services Programme where costs were lower than anticipated because of:

- Cost-sharing with other bodies, and with the industry, in relation to the delivery of various projects within the National Payments Plan; and
- Lower than anticipated costs in relation to the restructuring of the banking sector. These costs cannot be predicted with certainty because both timing and nature of issues arising can vary.

Smaller savings occurred on the Economics programme because of the use of in-house expertise and that of other public sector colleagues, and consultative fora, which reduced the requirement for anticipated external advisor support.

Key Outputs of the Department since our last meeting

The Department of Finance Statement of Strategy 2011-2014 was revised in May 2012 to reflect the appointment of new management and the rapidly changing domestic and international environment that Ireland faced as we entered the second year of the EU/IMF Programme of support. Last year's Annual Review (previously submitted to you), provided a summary of the Department's achievements for the first year of the Strategy.

In 2013 the work of the Department was structured around three distinct areas:

- Performance against the five key ongoing goals in the Statement of Strategy
- The role of the Department in the EU Presidency
- Progress towards achieving a "higher performing Department".

(a) Performance against the five key ongoing goals

Our first strategic goal is the delivery of **sustainable economic growth**. Since our last meeting, much progress has been made. Economic growth has returned on a Gross National Product basis i.e. when distorting pharma patent cliff issues are discounted. The recovery which began as export-based is now broadening into the domestic economy. Investment has picked up, employment growth is gathering momentum and retail sales are increasing. Forward looking indicators such as consumer sentiment and Purchasing Manager Indices also point to further positive economic data to come. The nascent recovery has been assisted by targeted budgetary measures such as the reduction in air travel tax, maintenance of a business-friendly environment, supportive SME tax policy and most importantly a firm commitment to fixing the public finances and the financial sector.

Our path towards the second goal, **a sustainable macroeconomic environment and sound public finances**, is demonstrated by our successful delivery of each of the quarterly fiscal targets. As you know, strict budgetary targets have been put in place to correct imbalances and prevent future imbalances. Fiscal consolidation equating to 19% of GDP has been introduced since 2008, while still maintaining one of the most progressive tax systems in the OECD. 95% of the fiscal consolidation is now complete.

A significant focus of the work of the Department has been directed towards the introduction of policies to deliver our third goal, **an improvement in the living standards of our citizens**. Supporting job creation, through the Action Plan for Jobs and the Medium Term Economic Strategy, is beginning to reap rewards with 61,000 jobs created in 2013. The Department is also focused on addressing the problems associated with high levels of personal debt, particularly the issue of mortgage arrears, and on assisting appropriate resolution of excessive personal debt situations.

Ireland's return to international debt markets, so as to achieve an exit from the EU/IMF funding programme at the earliest possible date, has been demonstrated by our exit from the EU/IMF Programme without the need for a precautionary credit line, and our successful return to the markets in January of this year. €3.75 billion was raised by the NTMA in a syndicated bond sale of a 10 year bond at just over 3.5% and this has been followed by March's 10 year auction for €1bn at a yield of 2.967% and April's 10 year auction for €1bn at 2.917%. The Irish

Sovereign is now rated at investment grade by the three main rating agencies and is well funded to the end of 2015.

There has been considerable progress in **restoring the Irish banking system to financial health**. Mergers within the sector were completed, the banks were recapitalised, significant deleveraging has taken place and liquidity has improved. Continued progress has been made in the past 12 months. Stability has been restored with the focus now firmly on the implementation of new business models for the domestic banks. Amongst the numerous achievements in 2013, the State:

- Liquidated IBRC and refinanced the IBRC promissory notes
- Sold both the Bank of Ireland Contingent Capital notes and Preference Shares
- Sold Irish Life for €1.3bn
- Disengaged from Eligible Liabilities Guarantee (ELG) scheme and eliminated Emergency Liquidity Assistance (ELA) from the system
- Published the Mercer Review of Remuneration Practices and Frameworks at the covered Institutions.

(b) EU Presidency

International engagement has never been more important for our increasingly globalised economy. Ireland's ability to prove itself on the international stage has been critical in rebuilding our reputation as a country that can deliver results alongside our EU and international partners.

Ireland led a hugely successful Presidency of the EU in the first six months of 2013, with the Department of Finance playing a leading role.

The Department chaired six formal Ecofin meetings, together with one informal Ecofin, and achieved a wide range of policy outcomes. The Department chaired the relevant Working Groups of Council, such as the EU Budget Committee, to develop and run the Presidency programme, and successfully engaged with both the European Parliament and European Commission at official and political level. Agreement was secured on a large range of dossiers during the Irish Presidency and the Department developed, managed and advanced Irish interests in a European and international context. These include Banking Union, CRD Directive and Regulation, Tax Fraud and Evasion, Two Pack, EU Budget Discharge and 2014 Guidelines.

During the Irish Presidency, high-level political agreement was secured with the European Parliament on the €960 billion 2014-2020 Multiannual Financial Framework (MFF).

Further information on many of these issues is contained in our recently published Report Card, a copy of which is attached herewith.

(c) Higher performing Department

In 2013, the Department continued its progress towards the revised organisational structure set out in the revised Statement of Strategy. Instilling a greater culture of challenge within the Department has underpinned much of the organisational restructuring. The Department has advocated a greater sense of openness to internal and external challenge amongst its staff, to test thinking and to mitigate risks of 'group-think'. The goal is to ensure that all policy advice is rigorously assessed and questioned so that advice to the Minister and to Government incorporates all relevant considerations.

We now provide regular reporting against targets through our annual reports and our periodic report cards. Outreach to our national and international stakeholders has grown in order to better explain our work to others and help inform our policy development. The statistics bear this out - during 2013, the Department answered 5,866 Parliamentary Questions, processed 220 Freedom of Information requests, processed 302 Government memos, and delivered over 70 speeches and presentations.

As we move from a period of crisis management to recovery and renewal, the Department continues to adapt, realign and enhance resources. We have moved to a bi-annual allocation of resources so that resources can be aligned with shifting priorities.

Key organisational changes during 2013/14 included:

- The appointment of additional senior level officials to enhance the management team;
- Investing in and enhancing our learning & development strategy to ensure that staff are developed and appropriately skilled to meet the challenges;
- Strengthening the support functions that assist us in our day to day activities;
- Further reinvesting in areas which have been neglected during the "crisis" years;
- Improving the Department's structure and enhancing the capabilities of the risk, compliance and legal functions, a task cemented through the recruitment of a Compliance Officer;
- Embracing external independent oversight through the services of Internal Audit and the Audit committee;
- Beginning the upgrading of our IT infrastructure and systems to facilitate more modern, efficient work practices and enable the automation of certain processes; and
- Enhancing the Department's Strategic International policy positions

A number of high level appointments were made during the year to further enhance the Department's senior management team. John McCarthy was appointed as Chief Economist, Greg Dempsey was appointed as the Chief Financial and Operations Officer; Des Carville took over as head of the Shareholding Management Unit and Neil Ryan was appointed the Department's Chief Risk Officer. Further appointments have been made at all levels of the Department as we commit to augmenting our capabilities and rebuilding our teams.

While managing significant challenges in terms of policy, and undergoing organisational changes, the Department continues to work towards further improvements in terms of openness, transparency and accountability. We also leveraged new technology to achieve greater efficiencies. An example is illustrated by the Department's new ePQ system to process and

manage Parliamentary Questions, which was rolled out during 2013. The ePQ system allows for the electronic processing of parliamentary questions across the department with greater search and retrieval functions. The 2013 experience of 5,866 paper based files physically travelling around the Department for review and approval will no longer be a factor of our work in 2014.

Chapter 1 – Exchequer Financial Outturn for 2012, including Finance Accounts 2012, and update to current position

The key points to note in relation to the 2012 Financial Outturn are as follows:

2012 Receipts

Total receipts, at €41 billion, were up €2.4 billion (6.3%) year on year.

- Tax revenues, at €36.6 billion, were up €2.6 billion (7.7%) year on year on a head line basis.
- Income tax grew by 10% and Corporation tax by 19.8% on a head line basis, or 7.8% and 5.1% respectively on an underlying basis, when the impacts of once offs are excluded.
- Non-tax revenues amounted to €4.4 billion, which includes capital receipts of €1.6 billion.

2012 Issues

- Expenditure for 2012 is in line with target. While Headline net voted expenditure was €521 million (1.2%) above profile, adjusting for a €356 million shortfall in PRSI receipts, the underlying position shows a cumulative overspend of €165 million (0.4%).
- Non-voted expenditure (excluding the sinking fund*) of €11 billion, was €6.8 billion (38.3%) down year-on-year.

2012 Commentary

- Adjusting for CT receipts in Jan 2012 from 2011 and PRSI reclassification gives an underlying year on year increase in tax revenues of 5.3%.
- End December 2012 Exchequer Primary Balance TMU adjusted target was €13.1 billion – This was achieved by a margin of €0.8 billion.
- For 2012, the General Government deficit limit under the EDP was 8.6 per cent of GDP. An underlying General Government deficit of 8.2% of GDP was recorded for 2012.
- Main non-tax receipts include €1,025 million ELG Income, €958 million Central Bank and €1,075 million loans repaid (eg FEOGA).

Recent financial information

2013

- 2013 receipts, at €44.0 billion, were up €2.9 billion (7.2%) in year-on-year terms.
- 2013 issues, at €55.6 billion, were down € 0.4 billion (0.7%) year on year.
- Non-voted expenditure (excluding the sinking fund*) of €12.5 billion, was €1.5 million (13.2%) up year-on-year.
- An Exchequer deficit of €11,497 million was recorded in 2013. This compares to a deficit of €14,892 million in 2012. The €3.4 billion improvement in the deficit is primarily due to proceeds from the sale of the Bank of Ireland CoCos, higher tax revenues, reduced voted expenditure and the impact of the Irish Life transaction, both the investment going out in 2012 and the sale receipts coming in 2013. The largest factors offsetting these gains were guarantee payments arising from the liquidation of IBRC and higher debt servicing costs.

- For 2013, the general government deficit limit was 7.5 per cent of GDP, it has recently been estimated for 2013 by the CSO that a general government deficit of 7.2 per cent was attained and was achieved through continued growth in tax revenues and maintaining a strict control on expenditure levels.
- 2013 saw the introduction of the Local Property Tax (LPT). LPT amounted to €318 million which was €68 million above profile. However, a significant portion of this amount was in respect of prepayments for 2014.
- The increase in non-voted expenditure is due to pay outs of €1,035 million following the liquidation of IBRC and an increase of €333 million in the EU Budget contribution. Interest on the National Debt has also increased by €1,647 million year-on-year, reflecting the increase in national debt.

2014 year to date March

- Budget 2014, forecasted tax revenues of €40,040 million this year, and our target for the first quarter of 2014 was €8,975 million. Tax revenues of €9,232 million were collected at the end of the quarter 1, an increase of €415 million or 4.7% on the same period last year and €257 million or 2.9% above profile which is a solid performance.
- Budget 2014 forecasted net voted expenditure of €41.4 billion in 2014 and non-voted expenditure (excluding sinking fund) of €11.9 billion in 2014.
- For the first 3 months of 2014, net voted expenditure of €10.3 billion was €261 million (2.5%) below profile and down €631 million (5.8%) year-on-year.

Chapter 2 – Government Debt

The most recent estimates of general government balance and GGDebt are in the April 2014 SPU publication (2013-2018) and CSO's March 2014 EDP return (2010-2014)

GGB and GG Debt

	GGB €bn	GGB as % of GDP	EDP target	GGDebt €bn	GGDebt as % of GDP
2013	-11.8	-7.2%	-7.5%	202.9	123.7%
2014	-8.1	-4.8%	-5.1%	204.4	121.4%

- General government debt (GGDebt) has gone from €47.2 billion in 2007 to 123.7% GDP in 2013.
- SPU 2014 forecasts that the debt to GDP ratio peaked in 2013 at 123.7% and will begin to decline in the following years.

Composition of General Government Debt

- The main components of the 2013 GGDebt of €202.9 billion were €111 billion (54.7%) in Government bonds, €66.8 billion (32.9%) in IMF/EU assistance, €18.1 billion (8.9%) in state savings, €2.6 billion in short term debt and €4.4 billion in other debt.

National Debt

- Exchequer Debt/National Debt is the main component of general government debt.
- The ratio of gross national debt to general government debt is over 97 per cent in 2013.

Cost of Debt

- At end of December 2013 the cost of servicing the national debt as a percentage of GDP was 4.5%.
- Cash basis gives a debt service cost for 2013 of €7.3 billion (excludes sinking fund)

Debt Maturity

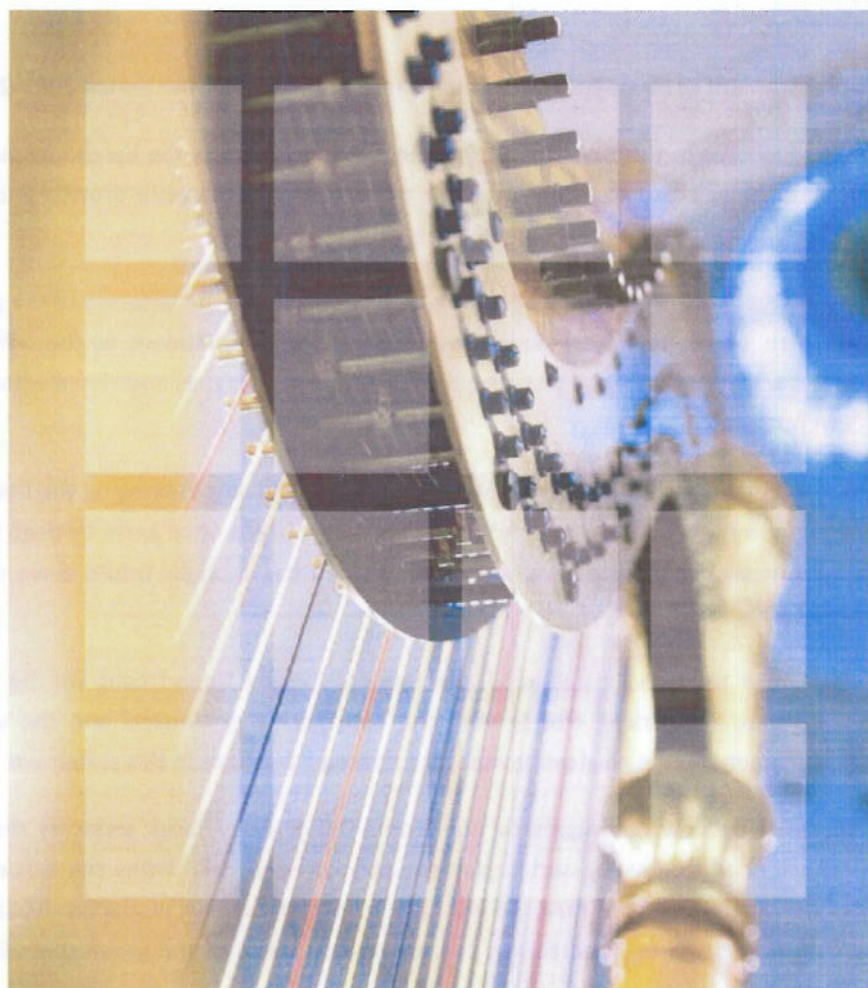
89% of GGD at end 2013 was medium to long term debt, up from 74% in 2007.

Other comments

- The first official reporting of the 2013 general government balance was compiled by the CSO as part of the latest March Maastricht (EDP) return. The deficit figure of 7.2% is within the EU/IMF target of 7.5%.
- The projected deficit total of 4.8% for 2014 remains unchanged from that previously forecast in last October's Budget 2014 document while there are some slight changes in the underlying composition. This is inside the EDP ceiling of 5.1% set for 2014.
- Ireland's GGDebt peaked in 2013 at 123.7% with an expectation that the debt will continue on a downward path beyond 2018 with a projection of 121.4% in 2014.
- Ireland's net debt is reported by the CSO at 98.3 per cent of GDP in 2013.



An Roinn Airgeadais
Department of Finance



Department of Finance
Statement of Strategy
2011-2014

2012 Revision

Message from the Minister



This is a revised Statement of Strategy for the Department of Finance for the period 2011-2014.

Delivering these objectives in this Statement of Strategy will help create the conditions necessary to ensure that Ireland is well and truly on the path to recovery, sustainable growth and increased employment.

I am pleased to say that we are already well on the road to correcting the excesses of the past. This is in no small way attributable to the tremendous dedication and commitment by the officials in the Department to the achievement of the tasks required which my colleagues and I have witnessed since coming into Government.

The Department of Finance will continue to play a central and vital role in bringing the Irish economy to a point where it can function in a manner that benefits its citizens once again through sustainable growth, employment and improving living standards. Ireland has a bright future if we continue to pursue the correct policies.

The development of a modern, professional and forward-looking Department will be the key to success. I look forward to working closely with the new Secretary General and the staff of the Department in implementing the changes to meet the strategic priorities in this statement.

I hope also to welcome new colleagues to our team. Our country faces some its most difficult challenges. We will need to develop and implement policies which will define the shape of Ireland and the lives of our citizens. For this task, we will need to call on the best resources available to us. I am confident that others will respond to this call to work on some of the greatest challenges ever faced by our country.

Michael Noonan, TD

Minister for Finance



Foreword by the Secretary General

I have the pleasure in presenting to the Government a revision of the Department of Finance's Strategic Plan 2011-2014.

For 2011, the Department had established goals, principally driven by the EU/IMF funding programme and the restoration of stability to the banking system. Very significant progress has been achieved in the furtherance of these goals as set out in the attached document. This task is not yet finished.

These goals were about crisis management and less about planning strategically for the future.

We believe that building on that progress, it is appropriate for 2012 to proactively revisit these goals and be more forward looking in the role we can play.

We believe that it is critical that we redirect our own primary focus more towards the identification and implementation of measures which will contribute to enhanced confidence and delivering sustainable growth in our economy. The establishment of the Department of Public Expenditure and Reform (PER) on 6th July 2011 has made this even more desirable since our colleagues in PER have taken over responsibility from our Department for the key task of control of public expenditure.

This realigned focus will allow our Department to take on a greater leadership and strategic planning role in the economic affairs of our country. We must strive to ensure success by playing our part to break down any barriers to and find innovative solutions for the implementation of this economic policy. Our people are key to the success of the Department and we have a team that are dedicated and determined to delivering our strategic goals and priorities.

But we cannot do it alone.

As part of a broader political and administrative system, we must at all time work closely with our colleagues in many other Departments and Agencies and with others in the private sector. We must also in turn play our part in achieving the implementation of the Government's broader social and reform agendas for which our colleagues are responsible.

I have no doubt our Department will rise to these new ambitious challenges.

John A. Moran

Secretary General

1. Our Mission

The Department's mission is to manage Government finances and play a central role in the achievement of the Government's economic and social goals having regard to the Programme for Government. In this way we will play a leadership role in the improvement of the standards of living of our citizens.

2. Our Goals

In pursuing this mission, the Department is working for the period 2011 to 2014 towards achieving the following principal goals:

1. A resilient Irish economy founded on sustainable and balanced growth and leading to significant increases in employment numbers.
2. A sustainable macroeconomic environment and sound public finances.
3. An improvement in the living standards of our citizens.
4. Return by Ireland to international debt markets so as to achieve an exit from the EU/IMF funding programme at the earliest possible date.
5. Completion of the restructuring of the banking system and a vibrant, secure and well regulated financial sector.

We will do this by providing **independent, impartial and well informed advice** to the Minister and Government on the most appropriate economic, taxation and budgetary policies to reduce national debt to more sustainable levels. We will also advise on and implement the policies that will ensure that Ireland's financial system will be able to operate on a stable, sustainable and commercial basis.

This advice will be provided in the **interests of society** as a whole with the objective of creating the framework conditions that are essential to allow the Irish economy to function in a manner that benefits its citizens once again through sustainable economic growth, increased employment and improved living standards.

In undertaking this the Department, on behalf of the Government, will **engage at all levels with European institutions and wider afield** to foster Ireland's economic and social interests and also to secure budgetary and economic stability in the Euro area and in the overall EU27 to support the achievement of the full economic growth potential of all EU Member States, including Ireland. These objectives will be underpinned by an effective contribution by the Department to ensure a successful EU Presidency by Ireland in 2013.

3. Our Principles

Underpinning our goals are certain overarching principles:-

- **Equity:** There is an urgent need to continue with the task of repairing the damage caused to the lives of ordinary people, the economy and the banking sector. This must be done in a way which encourages speedy but equitable resolution of the problems recognising that solving the problems of some sectors of the population may require the use of public funds contributed by others.
- **Partnership:** We cannot act alone. Rebuilding our economy and financial system requires the participation of many stakeholders. It requires therefore a heightened effort on our part to communicate and work constructively and collaboratively with all our stakeholders, including taxpayers, other governmental departments, agencies and regulators both in Ireland and internationally.
- **Leadership:** We cannot however abdicate our responsibilities to others. We must show leadership in the restoration of confidence in Ireland as an economy. We must show bravery and inventiveness in the development and implementation of policy choices for the Government. We must embrace with conviction and thoroughness our responsibility to ensure that other arms of the State are both fully equipped for and carry out fully their own roles in this process
- **Challenge:** We must be prepared to play a greater and more robust role in challenging the advice we receive and questioning fully the direction adopted by others. This requires a commitment on our part to review thoroughly suggestions made to us. It also requires our full participation in on-going programmes of training and education in order to ensure we draw from the best experience of others in applying ideas to the specifics of our own situation. We must also be prepared to challenge ourselves constantly to ensure that our prior decisions and choices remain best suited for any change in circumstances.
- **Integrity:** The immense responsibility entrusted to us by the public requires us at all times to act with integrity. We must devote ourselves fully and with energy to the tasks ahead. We must not just manage conflicts of interest but also must act

proactively to avoid situations which might create such conflicts. The taxpaying public must trust fully the way we manage the delivery of our services and the choices we make. We must also ensure that in making decisions involving the spending of public resources we act fairly and balance carefully the costs of expenditure against the benefits to be gained. We must also carefully manage the process so as to ensure efficient delivery of the desired results.

4. Moving Towards Our Goals

We have identified a range of short term strategies that we feel will help us move towards fully achieving our goals. Implementing these strategies will result in a number of positive outcomes for each goal. We have also identified a range of performance measures in order to monitor the success of our strategies. Our strategies, expected outcomes and performance measures are set out below. All performance measures will be considered both in absolute terms as well as against EU and international norms.

Goal 1:

A resilient Irish economy founded on sustainable and balanced growth and leading to significant increases in employment numbers

Outcomes	<p>Sustainable economic growth across domestic and international activities.</p> <p>Increase in competitiveness, employment and productivity growth.</p> <p>Appropriate credit available for viable households and businesses, etc.</p>
Short-term strategies to meet our goals	<p>Enhanced economic policy division to develop a coherent strategy for the Irish economy across all sectors, consistent with EU and other international developments.</p> <p>Particular focus on policy support for sectors likely to successfully drive growth in the economy.</p> <p>Enhanced two way communication with other policy makers, industry and academic commentators both domestically and internationally.</p> <p>Greater support of other governmental departments and agencies' efforts to drive strategies for economic growth and increased employment.</p> <p>Promote measures at an EU and international level to encourage growth and employment.</p>
Performance measures	<p>Performance measures will include among others:</p> <ul style="list-style-type: none">• Levels of GDP and GNP growth.• Level of employment.• Competitiveness, productivity levels and other relevant indicators benchmarked against EU and international norms.• Sustainable levels of personal debt.• Positive commentary, reports and assessments by external agencies, media and the global business community.

Goal 2:

A stable macroeconomic environment and sound public finances

Outcomes

Decline in General Government Deficit.

Decline of Government debt ratio in line with European requirements.

Return to sovereign debt markets by 2014.

Sustainable, robust and efficient tax system that meets budgetary requirements.

Short term strategies to meet our goal

Budgetary and economic policy designed to restore/maintain the sustainability of the public finances.

Efficient and effective operation of the NTMA and related entities to support Government policy.

Delivery of the agreed targets in the EU/IMF programme.

Enhanced budget formation.

Building an enhanced Department function to monitor and assess risks to financial stability.

Taxation policy which provides the resources required for Government programmes.

Implementation of the Fiscal Responsibility Framework.

Performance measures

Performance measures will include among others:

- Deficit ratios.
- Debt ratio levels.
- Spread of Government Bonds over German benchmark yield.
- Tax yields.

Goal 3:

An improvement in the living standards of our citizens

Outcomes	<p>Conditions to support growth in household income and wealth.</p> <p>Equitable, efficient and broadly-based tax system which meets Ireland's policy needs.</p> <p>Equitable access to governmental services that underpin long term sustainable growth.</p>
Short term strategies to meet our goal	<p>Economic policies to promote increased living standards.</p> <p>Greater engagement with other governmental departments and agencies' efforts to drive strategies for economic growth and increased employment.</p> <p>Broadening the tax base and distributing the tax burden in a manner that is supportive of growth, with taxation policy which supports the promotion of fairness, enterprise and competitiveness.</p> <p>Fair resolution of the problem of excess debt of citizens.</p> <p>Focus on financial inclusion to ensure access to financial services for all citizens.</p>
Performance measures	<p>Performance measures will include among others:</p> <ul style="list-style-type: none">• Per capita income.• International surveys of standards of living.• Distribution of income.• Levels of employment.

Goal 4:

Return by Ireland to international debt markets so as to achieve the exit from the EU/IMF funding programme at the earliest possible date.

Outcomes

A Programme of Support that meets Ireland's requirements.

Return to sovereign debt markets by 2014.

Short term strategies to meet our goals

Budgetary and economic policy designed to restore/maintain the sustainability of the public finances.

On-going review and negotiation of Programme of Support to meet changing circumstances.

Continued compliance with the policy and legislative requirements of the Programme of Support.

Full investor relations approach to return to market with appropriate transparency.

Performance measures

Performance measures will include among others:

- Deficit ratios.
- Debt ratio levels.
- Return to sovereign markets at sustainable prices.

Goal 5:


Completion of the restructuring of the banking system and a vibrant, secure and well regulated financial sector.

Outcomes	<p>A well-regulated, effectively supervised, competitive and more stable financial services sector.</p> <p>A banking sector servicing the economy and the wider population and built for the future.</p> <p>Continuing development of Ireland as a centre for international financial services and as a location of choice for investment for international foreign financial services firms.</p> <p>Appropriate credit available for viable households and businesses.</p>
Short term strategies to meet our goal	<p>Maintain effective and efficient structures and procedures for the financial regulation and supervision of individual service providers and the conduct of business by financial service firms.</p> <p>Enhance work with Central Bank, both nationally and internationally to maintain effective and efficient regulatory structures and procedures to monitor, assess and maintain the financial system to maintain financial stability.</p> <p>Solutions to the problem of distressed mortgages and difficulties with personal debt.</p> <p>Maximisation of the value of the State's investment in banks.</p> <p>Work with other agencies and in consultation with representatives of the sector to contribute to the development of financial services in the State.</p> <p>Reform and restructuring of the credit union sector consistent with the recommendations of the Commission on Credit Unions, to ensure a sustainable future for the sector.</p> <p>The adoption of domestic national financial regulatory and supervisory policies and legal frameworks which are consistent with EU financial services initiatives which in turn adequately encompass Irish national interests.</p>
Performance measures	<p>Performance measures will include among others:</p> <ul style="list-style-type: none">• Levels of credit available to households and business.• Investment into the Irish financial services sector.• Level of State support to the banking sector.• Return on investment in the banking sector.• Regulatory framework benchmarked against other EU and international jurisdictions.

- Recommendations of the report of the Commission on Credit Unions implemented, subject to Government approval.
- EU directives which reflect national interests and are transposed on time.
- Domestic legislation in line with requirements.
- Sustainable levels of personal and mortgage debt.

5. Our Achievements in 2011

This is a future-focused document identifying our goals to 2014. However, it is important to acknowledge what was achieved by the Department in 2011 while we identify how we can best work towards the attainment of our goals. Our high level achievements are set out below under the relevant policy areas.

Our Commitments under the Programme for Government are set out in appendix 1. Where our achievements correspond to a specific Programme for Government commitment which has already been achieved it is indicated below by the following symbol: 

We will of course continue to move toward the realisation of the remaining objectives.

5.1 Economic policy



In 2011 the Department developed economic policies and forecasts including the Medium Term Fiscal Statement, the Stability Programme Update and the Jobs Initiative, and represented Ireland in a range of fora to ensure that Irish economic policy and indicators are understood.

5.2 Budgetary policy



The Department developed budgetary policies and forecasts and delivered the Budget Strategy Memorandum for Government and Budget 2012. The Fiscal Advisory Council was also established. Ireland met all of its budgetary and fiscal targets for 2011.

5.3 EU/IMF Programme of Support



The Department is the primary manager of the State's relationship with the Troika under the EU/ IMF Programme and advised on the development and delivery of the Programme including changes to the interest rate payable on Programme funds as well as the quarterly reviews of the Programme. The Department also achieved all of its targets under the Programme on time over the course of 2011.

"Program implementation remains strong. The front-loaded fiscal consolidation is on track, with the 2011 deficit significantly below the program targets. The Irish authorities have continued to advance wide-ranging reforms to restore the health of the financial system so it can support Ireland's recovery. Reforms to enhance competitiveness and support growth and job creation are moving forward."

Statement by the European Commission, ECB and IMF on the review mission to Ireland, 19 January 2012

5.4 Taxation policy



The Department delivered a tax yield of €34bn for 2011. The Finance Bill, Finance (No 2) and Finance (No 3) Bills were all delivered. In addition the Department undertook a review of the Universal Social Charge, legacy property reliefs and published Tax Strategy Group papers. Corporate tax rates and income tax rates remained unchanged. In addition as part of the Jobs Initiative a temporary new rate of VAT of 9% was introduced in respect of certain goods and services mainly related to tourism.

5.5 Restructuring of banking sector



The Department developed and continued to implement a range of policies for the banking sector including a design for a new resized banking sector with two domestic universal pillar banks, policies to significantly reduce monetary financing, policies for HR and IR issues in banks designed to reduce significantly the costs of compensation and redundancy programmes in the banks. The banks also met their SME lending targets for 2011 - €3bn for each pillar bank.

5.6 State's shareholding in the bank



The banks were comprehensively recapitalised in 2011 with a significant (€7.5bn) private sector contribution. In terms of increasing private sector participation there were significant private investments in Bank of Ireland in 2011 with a consortium of third party investors purchasing €1.051bn of ordinary stock. In addition the deleveraging targets for 2011 (as part of the deleveraging strategies for the banks to 2013) were achieved – there was system-wide deleveraging of €44.7bn against a target of €34.6bn. Ministerial actions under the Credit Institutions (Stabilisation) Act 2010 and additional liability management exercises generated an additional €7bn of Tier 1 capital in 2011 from burden sharing on top of the €8bn already achieved in prior years. The Department also defended a number of legal challenges to Ministerial actions under the Credit Institutions (Stabilisation) Act, 2010.

5.7 Policy to deal with mortgage arrears



The Report of the Interdepartmental Group on mortgage arrears was published and the Department took the lead by chairing a Steering Group to assess and implement as desirable the recommendations of the report.

5.8 Financial sector stability



All eligible loans were transferred to NAMA. A Credit Union Commission was established in 2011 and delivered an interim report. The Department also prepared a report and a legal framework for the introduction of a statutory credit register in Ireland. The Banking Division also established a dedicated banking stability unit which reports publically on certain key stability metrics.

5.9 Structural reform of financial services



The Central Bank and Credit Institutions (Resolution) Bill and Insurance (Amendment) Act was passed and the Central Bank (Supervision and Enforcement) Bill was published. The Electronic Money Directive, Financial Conglomerates Directive, UCITS directive, Insurance Winding Up Directive and the Life Insurance Directive were all transposed over the course of 2011.

5.10 Ireland's interests in EU and international bodies



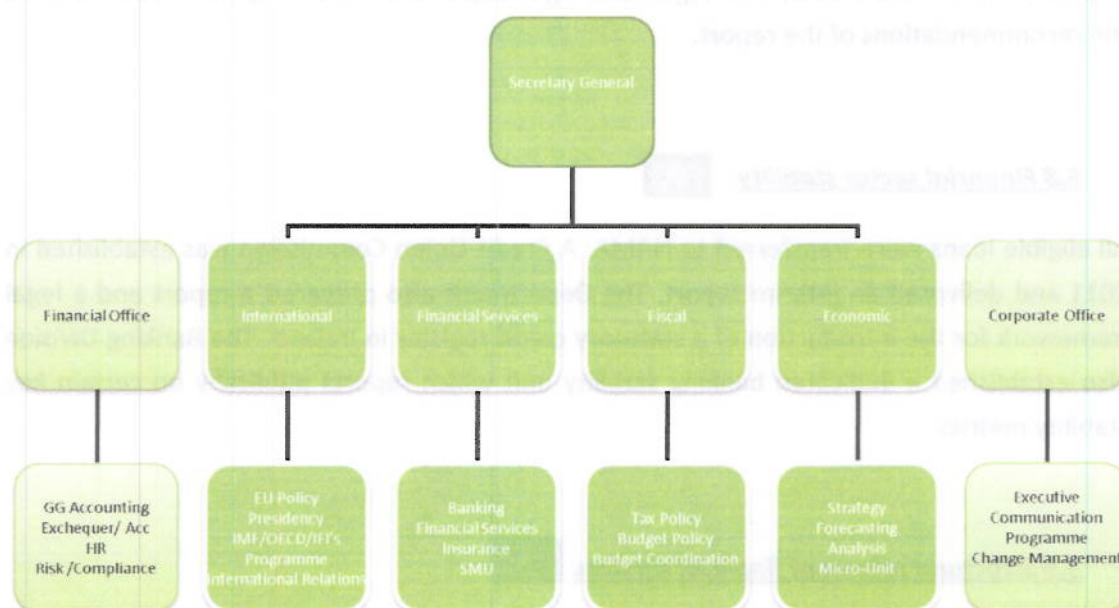
The Department provided advice in relation to, contributed to the work of and represented Ireland's interests in a range of EU and international bodies including OECD, IMF, other IFIs and various EU committees and working groups.

5.11 Investor Relations

The Department played an advanced role in investor discussions and conferences both in Ireland and abroad to better explain the work being done to restore the public finances. A potential indicator of this success can be seen in the downward movement in Ireland's 10yr sovereign yields from highs of 14% (July 2011) to 6.8% as at 30 March 2012.

6. Revised Structures in the Department

From 1 May 2012 we will operate the following revised structure:



7. Achieving a Higher Performing Department

7.1 Adapting our Resources

The delivery of the objectives of this plan requires a new approach by us to the workings of our department.

We must strengthen the **leadership role** we play in the rebuilding of our economy.

We must improve our performance by being more **flexible and adaptable** in the use of our resources.

In a period of budgetary difficulties, we must also work smarter and especially more efficiently leverage the **support available to us from across the government sector and the private sector**. We will focus on assisting other agencies and departments to align their efforts with our own objectives for the Irish economy. We will also play our part in leading the greater use of shared resources across the public sector.

7.2 Realigning our Resources

In recent years, the management of our economic and banking crisis has dominated the activities of the Department. This culminated in our negotiation of the IMF-EU Programme and in the careful and successful management of the Programme.

At this juncture, we must re-optimize our resources by **identifying our most significant initiatives** and realign our resources in line with our revised and more forward looking strategic plan. Everyone throughout the organisation will be working to common goals and to finding the solutions which forward the attainment of our objectives. Given the limited financial resources available to us; this may involve giving greater priority to certain tasks and lesser priority to others but with a particular focus on initiatives which contribute to economic growth and recovery.

Specifically; it will involve among others the following initiatives:-

- the development of **greater capabilities in our economic planning unit** to focus on greater strategic objectives and monitoring of the performance of the Irish economy and each sector thereof,
- the creation of an **enhanced project management unit** to deliver not just our commitments under the IMF-EU Programme but all that is required to be delivered to achieve the goals of this strategy document,
- the **enhancement of our risk capabilities** and a greater embedding of a risk management and control culture throughout all areas of activities in the department,
- the **enhancement of our international division** to play a greater and more leading role in the development of policies for economic recovery of the Euro area and to support the development of stronger economic relations outside of traditional markets, and
- delivering **efficient and effective services on a more centralised basis** including accounting, financial management, internal audit, payroll/pension, banking, facilities management, human resource management and statutory compliance and communication and where possible on a shared basis to Government Departments/Offices and Agencies.

7.3 Enhancing our Resources

Since 2008 pay and non-pay costs have fallen significantly reflecting a fall in staffing and associated supports. This **fall in investment in the Department** makes it impossible for us to achieve our overriding strategic goals set by ourselves and by the Government. This is particularly so with the key important roles to be undertaken by the Department during the Presidency of the European Union in 2013 and in spearheading the economic recovery of the country. To continue with such reduced resources is not sustainable or advisable given the greater challenges facing the economy and financial sector.

Greater use of **technology and business process improvements** will over time increase our ability to deliver more with less resources but this will take some time to implement and will also involve considerable investment given the depletion of these services in recent years.

The Government has agreed that it is necessary to invest given the importance of the ambitious goals we have set ourselves.

As a result, during 2012 and 2013, we will actively engage in a threefold action plan.

- This will firstly involve **training our existing teams** so that they can develop greater technical, management and leadership skills necessary to the challenge. Using the performance management evaluation system, we will review our staff and identify any skills which need enhancing so as to use the training resources most effectively.
- We will **challenge and acknowledge the efforts of our key performing staff** by further developing their skills and add to the value they contribute to the Department.
- In parallel, we will be adding to our teams to **supplement our skills base** where gaps are identified. This will also be necessary for succession planning for the work of future generations of our department.

8. Enhanced Communications and Transparency

We are very conscious of the importance of communication to our goals. We need an open dialogue to ensure that we are both providing sufficient information about our activities and providing channels for communication with the Department. We are committed to improve the effectiveness of our communications efforts.

In terms of **communication from the Department** we will provide up to date information on our objectives and our achievements. We will make better use of electronic communications, improving our internet presence and examining how we can use social media to communicate in more innovative ways.

As well as getting our information out we want to encourage **input into our decisions and actions**. To facilitate this we are publishing more consultation papers on proposed policy directions and specific proposals. We will be arranging workshops and briefings on key policy issues. This will ensure that we are communicating as effectively as possible with those whom Government policy directly affects. It will allow us to solicit a wider range of views before presenting policy options to the Government.

As well as these specific actions for direct communications we will be developing **broad channels for the communication of ideas and possibilities** to the Department. The Global Irish Economic Forum has highlighted the valuable resource available to Ireland – its people across the globe and closer to home. We will be looking at how best we can harness these resources and use them to help us in achieving our aim of developing a new model for a resilient Irish economy. Already, arising from the Global Irish Economic Forum, advisory groups are being established in Germany, China and the Middle East to directly communicate actions points and advice to our soon to be created international relations unit.

9. Challenges in our Operating Environment

Notwithstanding the strategies in place, achieving our stated goals will be influenced by the prevailing challenges in our operating environment and the limitations these may place on our actions. Clearly, given Ireland's position as a small open economy we must acknowledge the effects that **developments in the European and global economy and financial sector** could have on our own economy and our goals of a stable macroeconomic environment,

sound public finances and a vibrant, secure and well regulated financial sector. While we cannot eliminate this risk we can work to mitigate it through our involvement in policy making at a European and global level.

Within the Department we are conscious of the importance of **enhancing our risk assessment capacities** across all our activities and we are committed to monitoring risks, ensuring that there are procedures in place to seek to minimise the likelihood of risks materialising and increasing our preparedness to deal with any risks that do materialise including through contingency planning.

Appendix 1: Department of Finance Programme for Government Commitments

We will seek a reduced interest rate as part of a credible re-commitment to reducing Government deficits to ensure sustainability of our public finances.
We will re-commit to structural reforms required to accelerate growth, job creation and debt sustainability.
We will attach the utmost priority to avoiding further down-grades to our sovereign credit rating by setting further capital spend by the State on bank re-capitalisation at a level that is consistent with national debt sustainability.
In this regard, we will defer further recapitalisation of the banks until the solvency stress tests are complete and known to the new Government. Earlier recapitalisation in advance of publication of the stress tests will not contribute to market stability and confidence.
We remain committed to a smaller banking system that reduces its reliance on funding from the Irish and European Central Banks and volatile market sources. In order, however, to limit further calls on the State to cover bank losses from distressed asset sales, bank de-leveraging must be paced to match the return of more normal market conditions and demand for bank assets.
As an interim measure, we will seek to replace emergency lending to our banks with medium-term, affordable, official financing in a way that can restore confidence among other potential lenders in the liquidity position of our banks.
We will end further asset transfers to NAMA, which are unlikely to improve market confidence in either the banks or the State.
We will ensure that an adequate pool of credit is available to fund small and medium-sized businesses in the real economy during the re-structuring and down-sizing programme.
We will introduce a comprehensive special resolution regime for dealing with bank insolvencies.
The Government accepts that enabling provisions in legislation may be necessary to extend the scope of bank liability restructuring to include unsecured, unguaranteed senior bonds.
The new Government will seek to dispose of the public stakes in the banks as soon as possible at the best possible return to the taxpayer.
We will create an integrated decision making structure among all relevant State Departments and Agencies to replace the current fragmented approach of State bodies in dealing with the financial crisis.
The new Government will re-structure bank boards and replace directors who presided over failed lending practices. We will ensure that the regulator has sufficient powers of pre-approval of bank directors and senior executives. To expedite this change-over we will openly construct a pool of globally experienced financial services managers and directors to be inserted into key executive and non-executive positions in banks receiving taxpayer support.
We will insist on the highest standards of transparency in the operation of NAMA, on reduction in the costs associated with the operation of NAMA, and that decision-making in NAMA does not delay the restoration of the Irish property market.

Once the banking sector has been restored and is functioning effectively, we will introduce a bank levy based on the size of a bank's liabilities (other than shareholder capital).

We will establish a Strategic Investment Bank.

We recognise the important role of Credit Unions as a volunteer co-operative movement and the distinction between them and other types of financial institutions. In Government, we will establish a Commission to review the future of the credit union movement and make recommendations in relation to the most effective regulatory structure for Credit Unions, taking into account their not-for-profit mandate, their volunteer ethos and community focus, while paying due regard to the need to fully protect depositors savings and financial stability.

We support the future development of the IFSC as a source of future employment growth, subject to appropriate regulation. We will establish a taskforce on the future of the financial services sector to maximise employment opportunities in financial services for staff leaving employment as a result of downsizing.

We will ensure that the investigations into failures in the banking system are adequately resourced.

All remuneration schemes at banks subject to state support will undergo a fundamental review to ensure an alignment of interest between banks, their staff and the taxpayer.

Cut the 13.5% rate of VAT to 12% up to end 2013.

We will exempt from VAT service companies that export more than 90% of their output.

Subject to a cost benefit analysis, we will amend the RD tax credit regime to make it more attractive and accessible to smaller businesses, in the following ways: companies with RD expenditures of under €100,000 will be entitled to full tax credit on those entire expenditures as opposed to just the increment over the base year, with marginal relief for companies with expenditure just over €100,000, we will allow companies to offset the RD credit against employers. PRSI as an alternative to corporation tax, to cut down on red tape in the applications process, companies in receipt of a Research, Technology and Innovation (RTI) grant from one of the development agencies will be automatically deemed as entitled to the RD tax credit.

We will direct the Revenue Commissioners to examine the feasibility of introducing – on a revenue neutral basis – a Single Business Tax for micro enterprises (with a turnover of less than €75,000 per annum) to replace all the existing taxes on sole traders and small businesses to cut compliance costs and make starting a business much less daunting.

We will create a Strategic Investment Bank that will become a provider of finance to large capital projects, a conduit for venture capital and a lender to SMEs.

<p>The Government will put in place a parallel, commercially-financed investment programme in key networks of the economy to support demand and employment in the short-term, and to provide the basis for sustainable, export-led jobs and growth for the next generation. Streamlined and restructured semi-States will make significant additional investments, over and above current plans, over the next four years in “next generation” infrastructures in energy, broadband, forestry and water. These investments – and the accompanying semi-state restructuring process – will be financed and pro-actively managed by a New Economy and Recovery Authority (NewERA), which will absorb the National Pension Reserve Commission.</p>
<p>We believe it is appropriate, in order to enhance international credibility, to stick to the aggregate adjustment as set out in the National Recovery Plan for the combined period 2011-2012.</p>
<p>In preparation for Budget 2013, we will review progress on deficit reduction, and draw up a plan which will achieve the objective of reaching the 3% of GDP target for the General Government Deficit by the target date of 2015.</p>
<p>Should Ireland succeed in obtaining a lower interest rate on its loans, this should be offset against the aggregate adjustment required over the term of the programme.</p>
<p>We believe that achieving the 3% of GDP deficit target should be seen as an intermediate step in the process of restoring the public finances, and that further reductions in the general government deficit as a share of national income will be required thereafter.</p>
<p>As part of our fiscal strategy the new Government will: Keep the corporate tax rate at 12.5%.</p>
<p>Maintain the current rates of income tax together with bands and credits. We will not increase the top marginal rates of taxes on income.</p>
<p>We will reduce, cap or abolish property tax reliefs and other tax shelters which benefit very high income earners.</p>
<p>We will also ensure the implementation of a minimum effective tax rate of 30% for very high earners.</p>
<p>Consider, arising from the previous Government’s deal with the IMF, various options for a site valuation tax. Any site valuation tax must take into account the significant number of households in mortgage distress and provide local government with a reliable stream of revenue.</p>
<p>We will limit the top rate of VAT to 23%.</p>
<p>We will review the Universal Social Charge.</p>
<p>We will ensure that tax exiles make a fair contribution to the Exchequer.</p>
<p>We will establish an independent Fiscal Advisory Council (FAC), separated from fiscal decision-makers in government, that would undertake official fiscal macroeconomic projections and monitoring. Its functions would include identifying and advising on cyclical and counter-cyclical fiscal policies and structural deficits; the cyclical or temporary nature of particular revenues; and the need to maintain an appropriate and effective tax base. The Fiscal Advisory Council will be independent of Government and will report to the Dáil and the public.</p>

The modelling assumptions and inputs of the Fiscal Advisory Council will, as far as possible, be open to public scrutiny and its outputs would be freely available to external bodies, including in particular, the opposition parties.
We will open up the Budget process to the full glare of public scrutiny in a way that restores confidence and stability by exposing and cutting failing programmes and pork barrel politics.
We will reform the Department of Finance by bringing in new leadership and skills to restore its capacity and credibility in financial and macroeconomic management. Specifically, we will make an external appointment of an economist of international repute to head up the Department's Budget and Economic Policy division.
We will bring new talent and skills into the Department of Finance.
Tax incentives for private hospital developments will cease.
Increasing mortgage interest relief to 30% for First Time Buyers in 2004-08 (from the current sliding scale of 20% to 25% depending on the year the mortgage was taken out), financed in part by bringing forward the abolition of relief for new buyers from June 2011.
Directing any mortgage provider in receipt of State support to present Government with a plan of how intends to cut its costs, over and above existing plans, in a fair manner by a sufficient amount to forego a 25 basis point increase on their variable rate mortgage.
Introducing a two year moratorium on reposessions of modest family homes where a family makes an honest effort to pay their mortgage.
We will ensure that the Central Bank and the Financial Regulator supervise credit institutions' mortgage lending practices comprehensively and intensively
Where credit institutions fail to adequately control mortgage lending risks, the Central Bank will impose loan-to-value ceilings on mortgages, caps on loan-to income multiples, limits on the term of new mortgages, and more rigorous procedures for verifying borrowers' incomes
Increase the penalty for tobacco smuggling for commercial purposes and provide robust detection measures to counteract such smuggling.
Seek to combat drug supplies at source by providing x-ray scanners at major ports; greater patrols along coastline and increasing presence of Customs officers at smaller airports.
Tightly regulate moneylenders.
We will accelerate Capital Allowances on software purchases against income tax and corporation profits tax from 8 to 3 years subject to a cost benefit analysis.
We will exempt farm diesel from further increases in the carbon tax.

Total Commitments: 54

The Inaugural National Future Bank Summit

Thursday 1st May 2014

Address by John Moran, Secretary General, Department of Finance

The Irish Banking Landscape in 2020

Opening Remarks

I am very pleased to be here today and to address you on the topic of The Irish Banking Landscape in 2020. It is now over three years since I delivered conclusions of our Central Bank PCAR review to the Cabinet on the future direction for Irish banking in advance of the key decisions taken by the Government in March 2011 which have restabilised the Irish banking sector. The extent of progress which has been made towards stabilisation has been at the very high end of our expectations at that time.

I will structure my remarks under two main themes:

Firstly, to look back at the financial crisis, the impact on Irish banking and the progress along the path to normalisation we set out in 2011, and

Secondly, to share with you the main findings of the European High Level Expert Group (HLEG) on SME and infrastructure financing, of which I was co-chair and how the trends and recommendations we made there to European Policy makers are likely to impact on matters here in Ireland too.

1. Progress to Date

Let's start with a quick look back at what happened to the Irish banking landscape in recent years. Since the Financial Measures Programme was announced in March 2011, there has been considerable progress in restoring the Irish banking system to financial health:

1a. Mergers and acquisitions.

Significant restructuring of the Irish banking sector took place in 2011, namely the acquisition of EBS by AIB to create one pillar universal bank, Bank of Ireland being the second, the splitting up of Irish Life and Permanent, to release ptsb as a third competitive force and the decision to wind-down as a merged entity Anglo Irish Bank and Irish Nationwide (to form IBRC, which was subsequently liquidated). The mergers were completed ahead of the schedule set under the EU/IMF Programme of Financial Support for Ireland. The purpose of the restructuring was to ensure the sector was in a better place to service the needs of the Irish economy and to help return the banking system as a whole to long-term viability.

1b. Recapitalisation.

The Irish banking sector has been significantly recapitalised to cover the accumulated losses of the years of mismanagement. The total gross cost of the recapitalisation to the State amounted to €64 billion, an enormous sum representing circa 41% of 2011 GDP. This of course does not include the additional costs borne by shareholders and subordinated debt holders.

While the 2011 PCAR number of €24 billion has been reduced as a result of liability management exercises and disposals it still remains a net contribution of €16.5 billion pending further disposals.

Following the recent Balance Sheet Assessment (BSA) carried out by the Central Bank of Ireland, each of the banks confirmed that their capital ratios were above the regulatory minimum and consequently there was no current requirement for additional capital.

We now have sight of the intended stress test parameters and can begin to measure how we think the banks will stack up later this year.

1c. Deleveraging.

Across the eurozone, the crisis has resulted in banks deleveraging their balance sheets. Of course, the Irish deleveraging began before the 2011 PCAR with the removal of assets to NAMA and disposals of non-core operations like BZ WBK in Poland. Additional cumulative deleveraging at AIB, BOI & PTSB in the years since PCAR 2011 up to the end of September 2013 (mainly of non-Irish assets) has totaled over €71 billion. As recently reported, IBRC has now been wound down essentially without any further liability for the state and NAMA is well on the way to disposal of its assets into private sector buyers. Both AIB and BOI have achieved the original PCAR target Loan to Deposit Ratios (LDR) of 122.5%.

If they are successful in lending to viable borrowers, any further net deleveraging should only be the appropriate deleveraging we need to see unwind the unsustainable legacy build-up of credit in our economy. I regret to say that some of the less well informed commentary simplistically assuming that banks still deleveraging must be a bad thing chooses to ignore that we most certainly need to see some further deleveraging by households and businesses in Ireland of legacy debt and therefore this will be reflected in reductions of total credit extended by banks. Even back in 2011, we anticipated gross deleveraging of €30 billion might occur in the core Irish books of the PCAR banks.

1d. Liquidity.

Reliance on ECB funding has also reduced dramatically and deposit levels have stabilised. Concerns regarding solvency and subsequent deposit outflows resulted in the Irish banks significantly increasing their reliance on Eurosystem and the Central Bank of Ireland for funding in 2010 which peaked at over €150 billion in Q1 2011. This has now reduced to c. €20 billion. Deposit levels of the covered banks have increased €14 billion since the low in 2011. In turn, the infamous guarantee has been removed for new borrowing by the banks and a contingent exposure that once reached as much as €375 billion is now only c. €20 billion.

2. Legacy Issues Stabilising

Sentiment towards the Irish banking sector is clearly improving in the international markets as other legacy issues also stabilise. Recent results from the banks indicate that the return to profitability is edging closer across the

board and liquidity and income measures continue to recover. Some of the improving trends across a range of indicators of stability include:

2a. Profitability

Net interest margins (NIM) at the Irish banks are increasing driven by deposit repricing and higher lending margins. The improvements come despite significant mortgage tracker portfolios weighing on asset margins, low ECB rates and high levels of NPLs. The improving margins provide support for a return to profitability for the players in the Irish banking sector.

2b. High Non-Performing Loans (NPLs)

There are continuing signs that arrears levels at the Irish banks are stabilising. The Mortgage Arrears Resolution Strategy set out targets for the banks to restructure their non-performing loans for mortgages and these targets have been achieved to date. Restructuring of SME NPLs is also underway however absolute levels of NPLs remain high. I publicly called for more action on the restructuring of SME loans and of mortgages back in October 2012 at the IBF conference where I explained the dangers to our ability to get economic growth if these issues were not quickly resolved. We are now seeing more positive engagement and I would again call for continued and determined action from the banks to reduce the NPL burden both for themselves and the overly indebted businesses and households.

2c. Demand for credit.

While legacy issues remain for the banks, issues also remain for households and SMEs in Ireland who are over indebted and continue to deleverage. Therefore, as well as issues related to bank supply of credit there are also legacy issues impacting the demand for credit. As the economy improves, confidence continues to be restored and debt levels reduce, this should improve the demand for credit. Banks however must be able to respond to demand for credit from non-burdened borrowers and not be burdened by excessive fear in underwriting new credit – a topic I also touched during the IBF speech given in October 2012.

3. Changes to Funding Landscape

One issue that was not perhaps fully appreciated at the early stages of the crisis was how over dependent Ireland and indeed much of Europe was on bank funding in pre-crisis years.

During 2011, watching the ease at which we were able to deleverage the Anglo portfolio into a liquid US market, we at the Department observed first hand the value to a recovery of non-bank sources of funding. This observation reshaped our policy response to prioritise non-bank balance sheet funding mechanisms. A good example of this are the REIT funding mechanisms we introduced given the upcoming overhang of commercial real estate funding required on account of the deleveraging and wind down of banks.

Ireland (like indeed Europe) needs to continue to develop a more diversified and stable financial system with increased direct capital market financing and a greater involvement by institutional investors and alternative sources of finance. We took advantage of our presidency of the EU in early 2013 to help shape this debate, starting with an important inter-governmental and stakeholder workshop in Dublin Castle in 2012 on the topic.

Taking the SME sector as an example, government policy in Ireland to date has focused on developing and implementing a broad suite of measures and initiatives that are designed to build a more broad-based and responsive financial infrastructure that has the capacity to restructure SMEs and to finance SME capacity for growth.

The initial focus after the crisis hit was on bank lending including the establishment of the Credit Review Office and SME lending targets for AIB and BOI.

More recently, there has also been a strong emphasis on improving SME access to non-bank funding including sources of equity or mezzanine finance or greater involvement by capital markets in the direct financing of enterprises. Also, the availability of greater non-bank funding sources, better reserves scarce bank balance sheet capacity for households and SMEs loans for whom bank lending is key.

4. EFC Expert Group on Long Term Financing

To understand our views on the future of funding in Ireland, it is instructive to understand what is happening at European level. As a result of our efforts to open the debate during our Presidency, I have had the honour with Alberto Giovannini to co-chair the High Level Expert Group (HLEG) on non-bank financing of SMEs and infrastructure and recently presented our conclusions to all of the EU Finance Ministers and Governors of the European Union. The HLEG was set up in May 2013 with a mandate to make recommendations on increasing access to capital markets for SME and long term infrastructure financing in Europe.

4a. Importance of SMEs

Let us not forget, SMEs are a vital part of the European economy and account for approximately two thirds of the European workforce. Among SMEs, micro firms (i.e. firms up to 9 employees) make the largest contribution to EU27 employment.

Despite their economic importance in Europe, problems in relation to SMEs' access to finance are frequently highlighted, not just here in Ireland. SMEs, in particular in crisis periods, are prone to experiencing greater difficulties in obtaining funding compared to large firms.

The cost of bank lending for small-sized loans (a proxy for SME loans) relative to large loans has increased across the Euro Area through the financial crisis. The rising cost of SME credit also reflect the more marked deterioration of SMEs'

creditworthiness and firm-specific outlook compared with large euro area firms in less difficult macroeconomic environments.

4b. Impact of crisis greater in EU than US

The recovery from the financial crisis in Europe has also been slower than the US. For example, EU unemployment levels remain elevated compared to US unemployment levels which are in decline. Economic growth post crisis has been higher in the US compared to the EU. There are many factors at play here but I am left questioning whether this is not somewhat explained by European company's overreliance on banks for funding at a time of crisis in the banking sector too?

4c. Dependency on Banking

It is well known that in Europe, financial intermediation is largely bank-based. Around 80% of debt financing to the economy is provided by banks, in contrast to the US where bank-financing is as low as 20%. As a result, the aggregate balance sheet of European banks is about 4 times European GDP, whereas the corresponding number in the US is 0.8 times.

The financial crisis and the subsequent European sovereign crisis have highlighted the vulnerability of the European banking sector and of European economies. A series of complex but necessary reforms have been triggered, many of which have yet to be completed or fully implemented. These reforms are aimed at making banks stronger, managing better their ability to take on risk. Such reforms, for example, those around higher capital requirements for

supporting long term bank lending which are necessary to protect depositors will inevitably also impact on the volume or at least cost of financing available to SMEs and infrastructures, to the extent that they are reliant on bank funding.

4d. Now, imagine a Europe in which:-

The vision of the HLEG which formed the basis for the recommendations set out in the Report – “Finance for Growth” includes:

- Banking union which provides fairly priced bank funding in a genuine single EU market,
- Investors who see transparency and have access to data on a consistent pan EU basis about upcoming infrastructure projects and about the performance of SMEs and the various SME classes,
- A business environment (tax, bankruptcy rules etc.) that is uniformly conducive to growth and enterprise financing across the EU,
- Savers, pension funds and institutional investors that have alternative and direct links to provide funding for SMEs or infrastructure projects saving scarce public monies,
- Banks that can originate loans for their customers and access funding cheaply for this through use of securitisations or capital markets and
- A growth potential for Europe not constrained by lack of funding.

We are taking all of these principles and applying them in Ireland too.

4e. What lessons from “Finance for Growth”?

A number of lessons have been learnt as a result of the financial crisis including:

- Europe has been overly reliant on a bank financing model for its economy. This over-dependency on bank financing amplified the economy crisis when banks failed.
- With the advent of the banking crisis and the regulatory reactions to this, bank funding has become fragmented. For example spreads for SME lending between German rates and those in Portugal and Greece have increased by circa 300 basis points since 2008 and are yet to reverse.
- Europe requires a greater range of options for providing equity and mezzanine capital to European enterprises especially start-ups and those needing to rebuild balance sheets under stress. Too much has been written and said about banks not lending without recognising that banks should not lend to stressed and undercapitalised balance sheets and so equity for borrowers needs to be part of the solution, especially equity for growth phases of businesses.
- For infrastructure and larger SMEs, direct non-bank funding can provide finance while banks rebuild or conserve capital but it requires pan EU standardisation for efficient pricing to develop.
- Development of the securitisation of SME loans will assist in the disintermediation of SME credit across borders, reducing the risk to SME credit flows of banking sector failures.

4f. The following three slides give a summary of recommendations under the headings:

- **A new cross-cutting paradigm.** Across the EU, greater transparency and information is key in both SME and infrastructure sectors. EIB and NDBs will play a greater role in reducing supply fragmentation across borders.
- **A new paradigm for funding SMEs.** Bank lending remains important but alternative sources of funding should be developed, from crowd funding and P2P to private placements and mini-bonds.
- **A new paradigm for funding infrastructure.** A strong PPP market across Europe is important. In order to enable funding of scale, pools of capital can be channeled into EU infrastructure projects and multilateral banks involvement can be strengthened.

In the interests of time, I am not going to dwell on the individual recommendations which are set out in the almost 50 recommendations of our report. I would (well naturally) like though for those of you wishing to strategise in this area, refer you to read the report more fully.

5. Medium Term Economic Strategy (MTES)

But what therefore are we doing here in Ireland? It goes without saying that functioning economies need an adequate and efficient flow of credit and financing to grow. In Chapter 3 of the Medium-Term Economic Strategy published last December, the Government set out their ambition of developing a more diversified, competitive and responsive financial infrastructure that can finance this growth across the economy.

The MTES recognises that an essential ingredient of economic growth and jobs creation is the availability of financing and capital for infrastructure and for existing companies to grow and new innovative companies to be formed.

As the economy grows and demand increases, it is essential that well-priced financing is available to support businesses to trade, grow and create jobs.

Not unsurprisingly given everything I have just said, in the Medium-Term Economic Strategy we set out our ambition of developing a more diversified, competitive and responsive financial infrastructure that can finance this growth across the economy. To achieve this we will:

- Complete the necessary restructuring of the Irish banking sector in a manner that underpins a return to sustainable profitability and private ownership;
- Increase non-bank funding through direct capital market financing and alternative sources of finance; and
- Establish an Ireland Strategic Investment Fund as a source of funding of growth and in tandem with other European development banks, set up our own national development bank.

Work is well underway on all three fronts.

6. Future of Banking: Drivers of Change

I cannot conclude this speech without a final word on the other trends we are seeing which may change beyond recognition the functioning of banks and the banking sector itself. Most of what we have discussed above may mean that the quantum of funding in our economy from banks themselves will be smaller. But what of banks themselves, do we know what they will look like? I congratulate the organisers of this forum which will help debate some of the important issues. I shall merely therefore refer to these issues for completeness and look forward to the conclusions from the rest of today's discussions.

6a. Impact of Banking Union?

In recent weeks, the European parliament approved the final elements of a range of reforms to ensure shareholders and bondholders are the first to be impacted when banks fail and not the taxpayer. In addition, the creation of a new authority and fund for failing banks has been approved. This moves Banking Union another step closer to a reality.

While a core objective of Banking Union is to break the link between the sovereign and the local banking system, I believe there is a further major benefit for Ireland. As the European banking system becomes more integrated, under a common resolution system, the cost of bank finance to comparable SMEs and households should converge to the euro area average. This is particularly important for a country such as Ireland where our cost of funding has been consistently higher than the core euro area countries over the last number of years.

Equally, a single European regulator should mean an end to national regulatory reticence to allow cross border banking into less vibrant economies or countries. Banking Union should start to reverse the re-nationalisation of European banking which I warned about some three years ago. At the time, I feared as banking problems developed like ours in other countries we would see nationalisation occurring as a consequence of the failure of Europe to provide a European level mechanism for funding the resolution of failing banks and the application of state aid rules which often called for diversification of non-core non-home operations. Small countries like Ireland stand to benefit most from greater cross border banking especially in the Euro zone.

6b. Technology

Another significant driver of change is technology. As you will hear throughout today's conference, (1) technology is changing the way banks and customers interact and (2) technology is changing how banks work and operate.

The internet is now the most popular channel for Irish banking customers. Nearly one-third of Irish customers access their current accounts via mobile phone and approximately two-thirds of people do not go to their branch to request information¹.

¹ Source: Accenture

Advanced analytics is increasing banks' ability to offer customers the products and services they require. It also allows banks to continue to develop more advanced risk management analysis.

And then there are the developments in technology that are opening traditional bank services up to competition from non-bank entrants or even removing traditional forms of banking like the inescapable and indeed necessary moves to replace cash with new technology. Who could have imagined hailo email receipts and cashless payments when paying for a taxi even at the beginning of the outset of the crisis?

A number of speakers throughout the conference today will elaborate on these themes so I'll stop there on this point.

7. In Conclusion

It is worth repeating that:

7a. Considerable progress has been made:

- Significant restructuring of the banking sector has taken place
- The Irish banking sector has been significantly recapitalised
- Substantial deleveraging has been achieved
- Reliance on ECB funding has reduced and deposit levels have stabilised.

7b. The Irish banking system is emerging from the crisis:

- The Irish banks have reported improving trends across a range of indicators of stability and legacy issues are stabilising.

7c. The HLEG on SME and infrastructure financing concluded:

- Europe has been overly reliant on bank financing model for its economy.
- Increased levels of non-bank finance should be rolled out across Europe.

7d. Future of Banking: Drivers of Change

- Banking Union provides the platform for funding rates to converge across the Eurozone and
- Technology will continue to reinvent how banks and customers interact.

Thank you for your attention.

ENDS

