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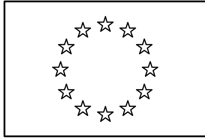

EUROPEAN COMMISSION

Brussels, 3.12.2010
COM(2010) 730 final

2010/0351 (NLE)

Proposal for a

COUNCIL DECISION

on granting Union financial assistance to Ireland

SEC(2010) 1516 final

EXPLANATORY MEMORANDUM

Ireland has recently come under increasing pressure in financial markets, reflecting rising concerns about the sustainability of the Irish public finances. The current crisis has had a dramatic impact also on Ireland's public finances. Support measures for the banking sector including significant capital injections have added greatly to the deterioration in the public finance position caused by the recession. Current market concerns primarily reflect the fact that the solvency of the Irish sovereign and the banking system have become inextricably linked in the crisis; they have led to a steep increase in Irish sovereign bond yields, while the domestic banking system is effectively cut off from international market funding and has been increasingly relying on the Eurosystem for funding.

In view of this severe economic and financial disturbance, Ireland officially requested financial assistance from the European Union, the euro-area Member States and the International Monetary Fund (IMF) on 21 November 2010 with a view to supporting a policy programme to restore confidence and enable the return of the economy to sustainable growth, and safeguarding financial stability in Ireland, the euro area and the EU. The draft economic and financial adjustment programme submitted to the Commission and the Council aims at restoring financial market confidence in the Irish banking sector and the sovereign. It contains three main elements. First, a financial sector strategy which comprises fundamental downsizing, deleveraging and reorganization of the banking sector, complemented by appropriate recapitalisation. Second, an ambitious fiscal consolidation strategy setting out detailed fiscal consolidation measures aiming at putting gross public debt on a firm downward path in the medium term. Third, an ambitious structural reform agenda, notably for the labour market, with a view to facilitating adjustment and strengthening the economy's growth potential.

The programme covers the period 2010-2013. The financial package of the programme will cover financing needs of up to EUR 85 billion, including up to EUR 35 billion to support the banking system and up to EUR 50 billion covering possible fiscal financing needs. Half of the banking support measures (EUR 17½ billion) will be financed by an Irish contribution through the Treasury cash buffer and investments of the National Pensions Reserve Fund. Union assistance to Ireland of up to EUR 22.5 bn under the European financial stabilisation mechanism (EFSM) established by Council Regulation (EC) No 407/2010 of 11 May 2010 has been requested. This would be part of total support provided by Ireland's European partners amounting to EUR 45 bn together with a loan from the IMF of SDR 19.5 bn (around EUR 22.5 bn) under an Extended Fund Facility. Against this background, the provision of Union assistance to Ireland of up to EUR 22.5 billion under the European financial stabilisation mechanism (EFSM) established by Council Regulation (EC) No 407/2010 of 11 May 2010 would allow supporting the return of the economy to sustainable growth, ensure a properly functioning banking system and safeguard financial stability in the Union and in the euro area. The union assistance would be disbursed in up to 13 instalments and be linked to economic policy conditions. It needs to be supplied on terms and conditions similar to those of the IMF.

2010/0351 (NLE)

Proposal for a

COUNCIL DECISION

on granting Union financial assistance to Ireland

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 122(2) thereof,

Having regard to Council Regulation (EC) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism[1],

Whereas:

(1) Ireland has recently come under increasing pressure in financial markets, reflecting rising concerns about the sustainability of the Irish public finances in view of comprehensive public support measures to the weakened financial sector. Due to its excessive exposure to real estate and construction projects, the domestic banking system has experienced large losses in the aftermath of the collapse of these sectors. The current economic and banking sector crisis has had a dramatic impact also on Ireland's public finances, compounding the impact of the recession. Falling tax revenue as well as an increase in cyclical expenditure, notably due to rising unemployment, have contributed to a high general government deficit and steep increase in debt, compared to their favourable pre-crisis positions and despite the implementation of five important fiscal consolidation packages since mid-2008. Support measures for the banking sector including significant capital injections have added greatly to the deterioration in the public finance position. Current market concerns primarily reflect the fact that the solvency of the Irish sovereign and the banking system have become inextricably linked in the crisis; they have led to a steep increase in Irish sovereign bond yields, while the domestic banking system is effectively cut off from international market funding and has been increasingly relying on the Eurosystem for funding.

(2) In view of this severe economic and financial disturbance caused by exceptional occurrences beyond the control of the government, the Irish authorities officially requested financial assistance from the European Union, the euro-area Member States and the International Monetary Fund (IMF) on 21 November 2010 with a view to supporting the return of the economy to sustainable growth, ensuring a properly functioning banking system and safeguarding financial stability in the Union and in the euro area. Agreement at technical level was reached on 28 November 2010 on a comprehensive policy package for the period 2010-2013.

[1] OJ L 118, 12.5.2010, p. 1.

(3) The draft economic and financial adjustment programme (hereafter 'the programme') submitted to the Commission and the Council aims at restoring financial market confidence in the Irish banking sector and the sovereign, enabling the economy to return to sustainable growth. To achieve these goals, the programme contains three main elements. First, a financial sector strategy which comprises fundamental downsizing, deleveraging and reorganization of the banking sector, complemented by appropriate recapitalisation to the extent needed. Second, an ambitious fiscal consolidation strategy, building on the National Recovery Plan 2011-2014 published by the authorities on 24 November 2010. The plan sets out detailed fiscal consolidation measures aiming at putting gross public debt on a firm downward path in the medium term. The authorities are committed to reducing the deficit to below 3% of GDP by 2015, the revised deadline set by the Council on [7] December 2010. Third, also building on the National Recovery Plan, the programme sets out an ambitious structural reform agenda, notably in the labour market, with a view to facilitating adjustment and strengthening the economy's growth potential. The authorities are requesting financial assistance from the Union, the euro area Member States, bilateral loans from the United Kingdom, Sweden and Denmark and the IMF in support of this ambitious policy package.

(4) Under the Commission's current projections for nominal GDP growth (1.4% in 2011, 2.7% in 2012 and 3.8% in 2013), the fiscal adjustment path specified in the [7] December 2010 Council Recommendation to Ireland under Article 126(7) of the Treaty is consistent with a path for the debt-to-GDP ratio of 98.9 % in 2010, 113.5 % in 2011, 120.0 % in 2012 and 121.8 % in 2013. The debt to GDP ratio would therefore be stabilised in 2013 and be placed on a declining path thereafter, assuming further progress in the reduction of the deficit. Debt dynamics are affected by several below-the-line operations, which are projected to increase the debt-to-GDP ratio by 5.3 pps. of GDP in 2011 and 0.8 pps. of GDP in 2012 and reduce it by 1.3 pps. of GDP in 2013. These include projected capital injection into banks in 2011, reductions in cash reserves and differences between accrued and cash interest payments.

(5) The assessment by the Commission, in liaison with the ECB, is that Ireland needs financing of a total amount of EUR 85 bn over the period from December 2010 to end 2013. Notwithstanding the significant fiscal adjustment, the financing gap for the sovereign may sum up to EUR 50 bn over the programme period. This assumes roll-over rates for maturing long-term debt of 0% until end-2011, 20% in 2012, and 80% in 2013. Conservative roll-over assumptions are also made regarding short-term debt. The financial sector strategy contained in the programme to restore confidence in the Irish banking system on a sustainable basis contains a banking support scheme of up to EUR 35 bn. This comprises an immediate capital injection of up to EUR 10 bn into selected banks to bring their core tier 1 capital ratio to 12%, while also funding early measures to support deleveraging and taking account of haircuts on the additional loans to be transferred to the National Asset Management Agency (NAMA). Further contingent capital provisions of EUR 25 bn should provide assurance that banks are able to meet current and future capital requirements. Actual funding needs may, however, be substantially lower, in particular if market conditions improve significantly and no severe unexpected banking losses materialize during the programme period.

(6) The programme would be financed through contributions from external sources and the use of Irish financial buffers. Union assistance to Ireland would reach up to EUR

22.5 bn under the European financial stabilisation mechanism (EFSM) established by Council Regulation (EC) No 407/2010 of 11 May 2010. This would be part of total support provided by Ireland's European partners amounting to EUR 45 bn. Further to the support from the EFSM, loans from Ireland's EU partner countries would include contributions from the European Financial Stability Facility (EUR 17.7 bn), and bilateral lending support from the United Kingdom, Sweden, and Denmark (EUR 4.8 bn in total). In addition, Ireland has requested a loan from the IMF of SDR 19.5 bn (around EUR 22.5 bn) under an Extended Fund Facility. The Irish contribution would be EUR 17.5 bn, and would come from the use of the existing Treasury cash reserve and contributions from the National Pensions Reserve Fund (NPRF). The support from the EFSM needs to be supplied on terms and conditions similar to those of the IMF.

(7) The Council should review on a regular basis the economic policies implemented by Ireland, in particular in the context of the annual reviews of Ireland's update of the stability programme and implementation of the National Reform Programme, as well as under the excessive deficit procedure.

(8) The Union financial assistance should be managed by the Commission. The specific economic policy conditions agreed with Ireland should be laid down in a Memorandum of Understanding. The detailed financial terms should be laid down in a Loan Facility Agreement.

(9) The Commission should verify at regular intervals that the economic policy conditions attached to the assistance are fulfilled through missions and regular reporting by the Irish authorities, on a quarterly basis.

(10) Throughout the implementation of the programme, the Commission should provide additional policy advice and technical assistance in specific areas.

(11) The operations which the Union financial assistance helps to finance must be compatible with Union policies and comply with Union legislation. Interventions in support of financial institutions must be carried out in accordance with Union rules on competition.

(12) The assistance should be provided with a view to supporting the successful implementation of the programme.

HAS ADOPTED THIS DECISION:

Article 1

1. The Union shall make available to Ireland a loan amounting to a maximum of EUR 22.5 billion, with a maximum average maturity of 7.5 years.

2. The financial assistance shall be made available during three years starting from the first day after the entry into force of this Decision.

3. The Union financial assistance shall be made available by the Commission to Ireland in maximum 13 instalments. An instalment may be disbursed in one or several tranches. The maturities of the tranches under the first instalment may be longer than the maximum average maturity referred to in paragraph 1. In such cases, the

maturities of further tranches shall be set so that the maximum average maturity referred to in paragraph 1 be achieved once all instalments have been disbursed.

4. The first instalment shall be released subject to the entry into force of the Loan Agreement and Memorandum of Understanding.

5. Ireland shall pay the actual cost of funding of the Union for each tranche plus a margin of 292.5 basis points, which results in conditions similar to those of the IMF support.

6. In addition, costs referred to in Article 7 of Regulation No 407/2010 shall be charged to Ireland.

7. If required in order to finance the loan, the prudent use of interest rate swaps with counterparties of the highest credit quality shall be permitted.

8. The Commission shall decide on the size and release of further instalments. The Commission shall decide on the size of the tranches.

Article 2

1. The assistance shall be managed by the Commission in a manner consistent with Ireland's undertakings and recommendations by the Council, in particular the Recommendations addressed to Ireland in the context of the implementation of its National Reform Programme as well as of the implementation of the Stability and Growth Pact.

2. The Commission shall agree with the authorities of Ireland the specific economic policy conditions attached to the financial assistance as laid down in Article 3. Those conditions shall be laid down in a Memorandum of Understanding consistent with the undertakings and recommendations referred to in paragraph 1. The detailed financial terms shall be laid down in a Loan Facility Agreement to be concluded with the Commission.

3. The Commission shall verify at regular intervals that the economic policy conditions attached to the assistance are fulfilled. To this end, the Irish authorities shall place all the necessary information at the disposal of the Commission and cooperate in full with the latter. The EFC shall be kept informed by the Commission of possible refinancing of the borrowings or restructuring of the financial conditions.

4. Ireland shall adopt and implement additional consolidation measures to ensure macro-financial stability, in case such measures will be necessary during the assistance programme. The Irish authorities shall consult the Commission in advance of the adoption of any such additional measures.

Article 3

1. The adjustment programme prepared by the Irish authorities is hereby approved.

2. The disbursement of each further instalment shall be made on the basis of a satisfactory implementation of the adjustment programme of the Irish Government to be included in the Stability Programme of Ireland, in the National Reform Programme and, more particularly, the specific economic policy conditions laid down in the Memorandum of Understanding. These shall include, inter alia, the measures provided for under paragraphs 4 to 11 of this Article.

3. The general government deficit shall not exceed 10.6 % of projected GDP in 2011, 8.6 % of GDP in 2012 and 7.5 % of GDP in 2013, in order to place Ireland on track to reduce the deficit to below 3% of GDP by 2015. The projected annual deficit path does not incorporate the possible direct effect of potential bank support measures in the context of the government's financial sector strategy as set out in the Memorandum of Economic and Financial Polices (MEFP) and specified in the Memorandum of Understanding to be signed by the Commission and the Irish authorities. Further, this path is consistent with the preliminary view of Eurostat on the ESA95 accounting treatment of time of recording of interest payments on promissory notes payable to Anglo Irish Bank[2], such that a revision of that view would result in a revision of the deficit path.

4. The measures specified in paragraphs 7 to 9 below shall be adopted by Ireland before the end of the indicated year, with exact deadlines for the years 2011-2013 being specified in the Memorandum of Understanding to be signed by the Commission and the Irish authorities. Ireland shall stand ready to take additional consolidation measures to reduce the deficit to below 3% of GDP by 2015 in case downside risks to the deficit targets specified in paragraph 3 materialise.

5. With a view to restoring confidence in the financial sector, Ireland shall adequately recapitalise, rapidly deleverage and thoroughly restructure the banking system as set out in the Memorandum of Understanding. In particular, Ireland shall:

(a) take action to ensure that Allied Irish Banks, Bank of Ireland, Educational Building Society and Irish Life and Permanent are recapitalised in the form of equity, if needed, so as to ensure that the minimum capital requirement of 10.5% core tier 1 capital will be maintained, depending on the results of the Prudential Capital Adequacy Review for 2011.

(b) implement the divestiture of participations in banks acquired during the crisis within the shortest timeframe possible, in a manner compatible with financial stability and public finance considerations.

(c) implement a specific plan for the resolution of Anglo Irish Bank and Irish Nationwide Building Society, which will seek to minimise capital losses arising from the working out of these non-viable credit institutions.

6. Ireland shall adopt the following measures before the end of 2010:

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[2] See http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/methodology/advice_member_states.

Adoption of a budget for 2011 including fiscal consolidation measures in a total amount of EUR 6 bn aiming at a reduction of the general government deficit within the timeframe referred to in Article 3(3). The budget shall include revenue measures to raise at least EUR1,400m in 2011, including a lowering of personal income tax bands and credits or equivalent measures to yield EUR945m in 2011; a reduction in pension tax relief and pension related deductions to yield EUR 155m in 2011; a reduction in general tax expenditures to yield EUR 220m in 2011; increases in excises and miscellaneous tax measures to raise EUR 80m in 2011. In addition, the budget shall specify that the government will outline methods to raise at least EUR 700m in one-off and other measures in 2011. The budget shall also include a reduction of current expenditure in 2011 of at least EUR 2,090m, including: social protection expenditure reductions; a reduction of public service employment; a reduction of existing public service pensions on a progressive basis averaging over 4%; other expenditure savings including cuts in goods and services spending and in other transfer payments; a reduction of at least EUR 1,800m in public capital expenditure against existing plans for 2011. In exceptional circumstances, other measures yielding comparable savings than those mentioned above shall be considered, in close consultation with the Commission.

7. Ireland shall adopt the following measures by the end of 2011:

(a) A 10% pay reduction for public service new entrants. Government shall also consider an appropriate adjustment, including in relation to the public service wage bill, to compensate for potential shortfalls from projected savings from administrative efficiencies and public service numbers reductions.

(b) Adoption of a budget for 2012 including fiscal consolidation measures amounting to at least EUR 3.6bn and aiming at a reduction of the general government deficit within the timeframe referred to in Article 1(3). The draft budget shall notably include revenue measures to yield EUR 1.5bn in a full year including, inter alia, a lowering of personal income tax bands and credits; a reduction in private pension tax reliefs; a reduction in general tax expenditures; a new property tax; a reform of capital gains tax and capital acquisitions tax; an increase in the carbon tax. The budget shall provide for a reduction of expenditure in 2012 of EUR 2.1bn including social expenditure reductions; cuts in public sector employment; adjustments in public sector pensions and in other programme expenditure; and reductions in capital expenditure.

(c) Finalisation of an independent assessment of transfer of responsibility for water services provision from local authorities to a water utility, and preparation of proposals for implementation with a view to starting charging in 2012/2013.

(d) Adoption of legislation to increase the state pension age to 66 years in 2014, 67 in 2021 and 68 in 2028, with a view to enhancing the long-term sustainability of the public finances. Further, pension entitlements for new entrants to the public service shall be reformed with effect from 2011. This shall include a review of accelerated retirement for certain categories of public servants and an indexation of pensions to consumer prices. Pensions shall be based on career average earnings. New entrants' retirement age shall be linked to the state pension retirement age.

(e) Adoption of measures reinforcing a credible budgetary strategy and to strengthen the budgetary framework. Ireland shall adopt and implement the fiscal rule that any additional unplanned revenues in 2011-2015 will be allocated to deficit and debt reduction. In accordance with the proposal set out in the National Recovery Plan 2011-2014, Ireland shall establish a budgetary advisory council to provide an independent assessment of the Government's budgetary position and forecasts. Ireland shall adopt a Fiscal Responsibility Law introducing a medium-term expenditure framework with binding multi-annual ceilings on expenditure in each area. This shall be made taking into account any revised economic governance reforms at EU level and build on reforms already in place.

(f) Ireland shall adopt legislative changes to remove restrictions to trade and competition in sheltered sectors including the legal profession, medical services and the pharmacy profession.

(g) Recapitalisation of Irish domestic banks to an initial level of 12% core tier 1 capital, taking account of haircuts on the additional loans to be transferred to NAMA, and funding of early deleveraging by making available EUR 10 billion in the system. The recapitalisation shall take the form of equity shares (or equivalent instruments for Educational Building Society).

(h) Introduction of legislation to reform the minimum wage in such a way to foster job creation and act to prevent distortions caused by sectoral minimum wages, and undertaking, in agreement with the Commission, an independent review of the framework Registered Employment Agreements and Employment Regulation Orders.

(i) A reform of the unemployment benefit system to enhance incentives for an early exit from unemployment. Activation measures shall be strengthened by identifying job seekers' needs better, enhancing engagement, and developing sanctions to ensure job search or training by beneficiaries; this shall be underpinned by more effective monitoring. The sanctions mechanism shall be set to cause an effective loss of income without being excessively penal.

(j) Publication of an in-depth review of the personal debt regime, and start of work on a reform of legislation which will balance the interests of both creditors and debtors.

(k) Preparation of a report providing an independent assessment of the electricity and gas sectors to assist with the public financing need as well as to increase competition. The authorities shall consult with the Commission on the results of this assessment with a view to setting appropriate targets.

(l) To enhance competition in open markets, legislation shall be reformed to generate more credible deterrence by providing for the possible imposition of fines and other sanctions in competition cases. In addition, the competition authorities will be required to identify sectors which are effectively outside the scope of competition law and identify processes to address those exclusions.

(m) To encourage growth in the retail sector, the government will conduct a study to examine the economic impact of eliminating the current cap on the size of retail

premises with a view to enhancing competition and lowering prices for consumers. Implementation of the policy of the study will be discussed with the Commission.

8. Ireland shall adopt the following measures by the end of 2012:

(a) Adoption of a budget for 2013 including fiscal consolidation measures amounting to at least EUR 3.1bn aiming at a reduction of the general government deficit within the timeframe referred to in Article 1(3). In particular, the budget shall include revenue measures to raise at least EUR 1.1bn (inclusive of carryover from 2012), including: a lowering of personal income tax bands and credits; a reduction in private pension tax relief; a reduction in general tax expenditures and an introduction of property tax. The budget shall also provide for a reduction in expenditure in 2013 of at least EUR 2bn including: social expenditure reductions; a reduction of public service employment; public service pension adjustments; cuts in other programme expenditure; and reductions in capital expenditure.

(b) Submission of legislation to Parliament to reform the personal debt regime with a view to ensuring better balance of the interests of both creditors and debtors.

9. In order to ensure the smooth implementation of the programme conditionality and to help restoring imbalances in a sustainable way, the Commission shall provide continued advice and guidance on fiscal, financial market and structural reforms and within the framework of the assistance program, together with the IMF and in liaison with the ECB, shall periodically review the effectiveness and economic and social impact of the agreed measures and recommend necessary corrections with a view to enhancing growth and job creation, securing necessary fiscal consolidation and minimising harmful social impact, particularly regarding the most vulnerable members of the Irish society.

Article 4

Ireland shall open a special account with the Central Bank of Ireland for the management of the Union financial assistance.

Article 5

This Decision is addressed to Ireland.

Article 6

This Decision shall be published in the *Official Journal of the European Union.*

Done at Brussels,

For the Council
The President

BUDGETARY IMPACT STATEMENT

(cf. Article 16 of the Internal Rules)

POLICY AREA: TITLE 01 – ECONOMIC AND FINANCIAL AFFAIRS
ACTIVITY: FINANCIAL OPERATIONS AND INSTRUMENTS
TITLE OF ACTION: EUROPEAN FINANCIAL STABILITY MECHAMISM - FINANCIAL ASSISTANCE TO IRELAND

1. NAME OF THE PROPOSAL: BUDGET HEADING CONCERNED AND TITLE

01 04 01 03 European Union guarantee for Union loans raised for financial assistance under the European financial stabilisation mechanism

2. LEGAL BASIS:

Art. 122(2) of the Treaty; Council Regulation N° 407/210.

3. OVERALL FIGURES FOR THE FINANCIAL YEAR (IN EUROS)

This item constitutes the structure for the guarantee provided by the European Union. It will enable the Commission to service the debt (principal, interest and other costs) should the debtor (Ireland) default.

The budget entry ("p.m.") reflecting the budget guarantee will be activated only in the case of an effective call on the guarantee. It is expected that normally the budget guarantee will not be called.

3a – Current year

Not applicable

		CA
Initial appropriation for the financial year (budget)		
Transfers		
Additional appropriation		
Total appropriation		
Appropriations already set aside by another work programme		
Balance available		
Amount for the action proposed		

3b – Carry overs

Not applicable

		CA
Carry-overs		
Appropriations already set aside by another work programme		
Balance available		
Amount for the action proposed		

3c – Next financial year

Not applicable

		CA
Initial appropriation for the financial year (budget)		p.m.
Transfers		
Additional appropriation		
Total appropriation		
Appropriations already set aside by another work programme		
Balance available		
Amount for the action proposed		p.m.

4. DESCRIPTION OF THE ACTION

The proposed medium-term financial assistance to Ireland consists of a Union loan (to be financed by Union borrowings in the international capital markets) in the amount of EUR 22.5 billion. It will be provided in the context of an international financing package. In particular, loans from Ireland's EU partner countries would include contributions from the European Financial Stability Facility (EUR 17.7 bn), and bilateral lending support from the United Kingdom, Sweden, and Denmark (EUR 4.8 bn). In addition, Ireland has requested a loan from the International Monetary Fund of SDR 19.5 billion (around EUR 22.5 billion) under an Extended Fund Facility. The Irish contribution would be EUR 17.5 bn, and would come from the use of the existing Treasury cash reserve and contributions from the National Pensions

Reserve Fund (NPRF). The Union financial support to Ireland is intended to support the return of the economy to sustainable growth and ensuring a properly functioning banking system. At the same time, this assistance makes a contribution to safeguarding financial stability in the EU and in the Euro Area, by restoring confidence.

The Union borrowings raised on the capital markets or from financial institutions for the purpose of extending the loan to Ireland are covered by the Union budget. The amount in principal of loans which will be granted to Ireland amounts to EUR 22.5 billion.

The structure for the guarantee provided by the European Union budget will enable the Commission to service the debt should Ireland default.

In order to honour its obligations, the Commission may draw on its cash resources to service the debt provisionally. In this case, Article 12 of Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000 implementing Decision 2007/436/EC, Euratom on the system of the European Communities' own resources (OJ L 130, 31.5.2000, p. 1) will apply.

5. METHOD OF CALCULATION ADOPTED

Not applicable.

6. PAYMENT SCHEDULE (IN EURO)

Not applicable.

Heading	Appropriations		Payments				
			Year n	Year n+1	Year n+2	Year n+3	Subsequent financial years
	Year n						
	Year n+1						
	Year n						
	Year n+1						
	Total						