OPTIONS FOR IRELAND'S LEGACY BANK DEBT

BRIEFING PAPER COMMISSIONED BY THE LABOUR PARTY

PROFESSOR KARL WHELAN
UNIVERSITY COLLEGE DUBLIN
MAY 2014

Labour

Contents

Executive Summary

- The total outlay of funds by the Irish government on the banking sector was €64 billion, which is about 40 percent of current GDP.

- About half of these outlays were financed by promissory notes which have now been converted into long-term bonds. The other half was financed with direct expenditures of public money and there are no specified public debt issues that can be directly associated with these expenditures.

- The June 2012 euro area summit statement pledged to "*examine the situation of the Irish financial sector with the view of further improving the sustainability of the well-performing adjustment programme*."

- As of yet, the Eurogroup has made no explicit statement about undertaking an examination of Ireland's situation so, in this sense, the June 2012 commitment has not been met.

- One way to deliver on the June 2012 statement would be for ESM to provide money to the Irish government to acquire AIB and Permanent TSB. The official guidelines on how ESM investments in banks will operate include the possible retrospective use of funds for recapitalisation.

- Another way Europe could assist with reducing the burden of Ireland's bank debt would be to help with funding a special "tracker mortgage only" vehicle, thus allowing AIB and PTSB to be sold to the private sector without these problem assets.

- The long-term bonds associated with the IBRC debt are now held by the Central Bank. At present, the interest payments on these bonds end up coming back to the Exchequer so the arrangement is effectively costless. The ECB has insisted, however, that these bonds be sold to the private sector due to concerns about monetary financing. Agreement to allow a slow pace of sales is crucial to maintaining the potential gains from last year's liquidation of IBRC.

- MEPs can play an important role in making the case for a bank debt deal for Ireland through public debate, through involvement in the parliament's Economic and Monetary Affairs committee and through highlighting Ireland's case when debating future banking-related legislation.

1. Introduction

Ireland's banking crisis has inflicted a huge economic cost on the people of Ireland with this cost substantially increased by the policy of the last government to bail out creditors of domestic banks. The fiscal implications of the banking crisis played a key role in triggering the EU-IMF programme and continue to represent a significant risk to economic stability: While Irish government bond yields are currently at low levels, they are still quite a bit higher than in countries like Germany because the ratio of public debt to GDP is still very high by international standards.

This briefing paper documents the role the banking crisis played in building up Ireland's public debt and discusses the implications for Ireland of the commitments given at the June 2012 summit of euro area heads of state. The summit statement promised that "*The Eurogroup will examine the situation of the Irish financial sector with the view of further improving the sustainability of the well-performing adjustment programme*." German Chancellor Angela Merkel subsequently acknowledged that Ireland represents a "special case" among euro area countries.

As of yet, the Eurogroup has made no explicit statement about undertaking a specific examination of Ireland's situation so, in this sense, the June 2012 commitment has not been met. This paper discusses the potential routes by which the European Union could assist in reducing this burden in light of the June 2012 euro area summit statement which promised.

The paper is structured as follows.

Section 2 provides figures for the outlays on the banking system by the Irish state and how these outlays were allocated. It also addresses the current situation in relation to the debts issued to support the IBRC and the assets acquired with other state investments.

Section 3 discusses the euro area summit statement of June 2012 and subsequent developments related to the guidelines for the use of the European Stabilisation for recapitalising banks.

Section 4 discusses three different areas where European institutions can take actions that can help to reduce the burden of Ireland's banking-related debt.

Finally, Section 5 briefly addresses what MEPs can do to help make progress for Ireland on these issues.

2. Size and Sources of Legacy Bank Debt

The term "Ireland's bank debt" has been used commonly in public debate in recent years. This may suggest that there is a specific itemised set of debt obligations that we can single out as being "the bank debt" with a further possible suggestion being that we can approach the people to whom we owe this debt and negotiate with them to have it restructured. The reality is more complex. The question of how to handle the legacy of the banking crisis partly relates to handling of specific debts and partly relates to what can be obtained from banking assets that were acquired by the state.

This section outlines the different ways in which the banking crisis added to Ireland's debt burden and discusses some key issues with respect to debts that have been issued and banking assets that have been acquired.

Outlays on Bank Recapitalisation

The Irish state's outlays to recapitalise the banking system came in three forms: Expenditure of general exchequer funds, use of funds from the National Pension Reserve Fund (NPRF) and the issuance of promissory notes. Only the latter item has resulted in specific and identifiable forms of government debt that were clearly earmarked as being related to the banking crisis: While the promissory notes have now been retired, they have been replaced by new long-term bonds.

In the cases where Exchequer funds and the NPRF were used, the link between banking-related expenditures and debt is an indirect one. If these funds had not been directed towards banks, they could have instead financed other types of government spending and the level of Irish public debt would have been lower. However, there is no direct link from these expenditures to any specific set of Irish government bonds.

The box on the next page, taken from a report by the Irish Fiscal Advisory Council, details the sources of the money used to recapitalise the Irish banks as well as the how these funds were allocated.[1] The total outlay of funds on the banking sector was €64 billion. This figure represents about 40 percent of current Irish GDP. Ireland's public debt to GDP ratio last year was 124 percent while the average public debt ratio in the euro area was 95 percent.[2] Thus, without these banking-related expenditures, Ireland would have a debt ratio that was below the euro area average.

---

[1] The table comes from "The Government's Balance Sheet after the Crisis: A Comprehensive Perspective" by Sebastian Barnes and Diarmaid Smyth. This report is available at http://www.fiscalcouncil.ie/wp-content/uploads/2013/09/Balance-Sheet1.pdf

[2] These figures are available in the Statistical Annex of the European Economy published by the European Commission. This is available at http://ec.europa.eu/economy_finance/publications/european_economy/2013/pdf/2013_11_05_stat_annex_en.pdf

Irish Fiscal Advisory Council Calculations

Box D: Domestic Bank Recapitalisation to end-2012

Since 2009, the Government has injected approximately €64 billion into the banking sector. This has involved a number of institutions, instruments and vehicles (Table D1).

Table D1: Domestic Bank Recapitalisation: Gross Cost

€ Billions	AIB	BOI	IL&P	IBRC	Total
Pre-PCAR 2011					
Preference shares	3.5	3.5			7.0
Ordinary shares				4.0	4.0
Promissory notes	0.3			30.6	30.9
Special Investment Shares	0.6			0.1	0.7
Ordinary Share Capital - NPRF	3.7				3.7
Total pre-PCAR 2011	***8.1***	***3.5***		***34.7***	***46.3***
PCAR 2011					
Exchequer	3.9		2.7		6.6
NPRF	8.8	1.2			10.0
Total PCAR 2011	***12.7***	***1.2***	***2.7***		***16.5***
Irish Life[16]			**1.3**		**1.3**
Total	***20.8***	***4.7***	***4.0***	***34.7***	***64.1***
Source of Funds					
Promissory Notes	**0.3**			**30.6**	**30.9**
Exchequer	**4.5**		**4.0**	**4.1**	**12.6**
NPRF	**16.0**	**4.7**			**20.7**

Source: NTMA and Department of Finance.

The €64 billion outlays was divided between promissory notes of €30.6 billion and direct outlays of €33.3 billion, which itself was made up of €12.6 billion in expenditure of normal Exchequer funds and €20.7 billion in funds from the NPRF.

There were significant differences in the approaches used to deal with different banks.

- The IBRC institutions were capitalised by promissory notes of €30.6 billion and €4 billion of Exchequer funds.
- Irish Life and Permanent was capitalised with €4 billion of Exchequer funds.
- Bank of Ireland was capitalised with €4.7 billion from the NPRF.
- AIB was capitalised with €16 billion from the NPRF and €4.5 billion from the Exchequer.

The two different options used to capitalise the banking system – promissory notes and direct expenditures – mean there are two different sets of issues relating to the burden on the Irish public finances associated with these expenditures.

Promissory Notes

The first set of issues relates to the funds used to pay off the IBRC's creditors.

The Bond Swap

The IBRC borrowed enormous sums from a Central Bank of Ireland Emergency Liquidity Assistance (ELA) programme to pay off its obligations to depositors and bond-holders. Most of these borrowings were secured by promissory notes issued in 2009 and 2010. These notes were set to pay €3.1 billion per year from the state to the IBRC until the early 2020s. This money would in turn be used to retire the liquidity created by the Central Bank of Ireland when it granted the ELA.[3]

In February 2013, the IBRC was liquidated. Rather than pass the promissory notes on to the Central Bank of Ireland to repay the ELA, the IBRC liquidation bill saw the Central Bank provided with €25 billion in new bonds with low interest yields and maturity dates ranging from 2038 to 2053.

At present, the new arrangement has effectively no annual interest costs for the Irish public sector. The bonds belong to the Central Bank of Ireland. However, the Central Bank hands back its surplus income to the Irish Exchequer, so these interest payments can be considered a circular

[3] My paper "ELA, Promissory Notes and All That: The Fiscal Costs of Anglo Irish Bank" discusses the properties of the promissory notes in greater detail. This paper is available at http://www.esr.ie/article/view/40/32

transaction in which interest is handed over to the Central Bank to eventually be handed back to the Irish government.

IBRC Bond Sales

The current cost-free arrangement for the IBRC bonds is not set to last. The Central Bank of Ireland has agreed to dispose of the bonds over time by selling them to the private sector. Ultimately, all of the IBRC bonds will be owned by the private sector and the interest payments and large principal payments at maturity will go from the Irish state to private bondholders.

The costs associated with a fast pace of sales for the IBRC bonds may not be limited to making earlier interest payments to the private sector. The longest maturity Irish private bond that currently trades on financial markets matures in 2025, thirteen years before the shortest-maturity IBRC bond. It may turn out that the only way the Central Bank can sell these low-yielding long-dated bonds to the private sector is to do so by incurring a capital loss. Reducing the Central Bank's stock of assets will ultimately reduce the annual flow of income coming from the Central Bank to the Exchequer, so these potential losses could exacerbate the costs already associated with passing the bonds on to the private sector at their current par value.

At present, the Central Bank has agreed to sell a minimum amount of bonds of €500 million per year through to 2018, €1 billion per year from 2019 to 2023 and €2 billion per year thereafter. A faster pace of sales is possible but the Bank has undertaken that it will only do so when it is not "disruptive to financial stability".[4] One way in which these bond sales could disrupt financial stability would be if they made it more difficult for the NTMA to sell new Irish government bonds at the same time as the Central Bank is also seeking private sector buyers for bonds from the same issuer.

This condition that the Central Bank sells these bonds to the private sector stems from the European Treaty's prohibition of monetary financing of governments by central banks. IBRC was a state-owned institution. If the Central Bank created money to pay off IBRC's debts and then this money was not repaid, it is likely that the European Court of Justice would consider the whole transaction to be in violation of the European Treaty.

The question of the pace of sales of the IBRC bonds remains an unresolved issue. Mario Draghi's comment last year about "taking note" of the IBRC transactions was interpreted by many as a tacit approval of the operation. In fact, the official procedure in this area is that, each year, the ECB undertakes a formal assessment of all participating central banks to check for their compliance with monetary financing laws as part of its annual report process.

In its annual report released on April 7, the ECB stated:[5]

[4] Details on the new bonds and the minimum sale schedule are available at http://www.finance.gov.ie/sites/default/files/newjmpres.pdf

[5] The comments about Ireland are on page 110 of the report which is available at https://www.ecb.europa.eu/pub/pdf/annrep/ar2013en.pdf

> *The liquidation of the Irish Bank Resolution Corporation (IBRC) raises serious monetary financing concerns. These concerns could be somewhat mitigated by the disposal strategy of the Central Bank of Ireland.*

This statement should be a source of concern because a faster pace of bond sales than currently planned will undermine the potential benefits from last year's bond swap operation.

State Banking Assets

The €34.7 billion spent by the Irish state on the IBRC was a one-way arrangement that saw the state paying out a fortune to see private creditors protected while receiving nothing in return. In contrast, the remaining €29.4 billion expenditure on the banking sector has resulted in the state acquiring assets that have either returned some amount of money already or could realise money through future sales. Specifically, the state acquired total ownership of two financial institutions (Irish Life and Permanent and AIB) and partial ownership of Bank of Ireland.

Irish Life and Permanent

The state spent €4 billion recapitalising Irish Life and Permanent and thus acquired almost complete ownership of the institution. It has since sold Irish Life for €1.3 billion but retains ownership of Permanent TSB (PTSB).

At the end of 2013, PTSB's accounts showed a book value of shareholder equity of €2.4 billion. However, the bank has a number of problems that probably mean the true market value of the equity stake is lower than this figure. In addition to problems with loan arrears, the bank has a large amount of tracker mortgages which earn a very low rate of interest: At the end of last year, trackers accounted for just over half of the bank's €38 billion in assets.[6]

PTSB is also dealing with funding problems. Customer deposits only fund about half of the bank's assets and it owed the ECB about €7 billion at the end of 2013. The bank is working to reduce this reliance on ECB funding, partly by increasing deposits and partly by using loan repayments to reduce liabilities and shrink the size of the bank. Total assets declined by 8 percent in 2013, mainly due to a reduction in loans to customers.

Beyond the possibility of retrospective compensation for the Irish public for the money it invested in PTSB, an alternative possible course of action would be for the European authorities to co-operate with the Irish government to restructure the bank in a way that does not cost the Irish state any further money. I discuss options for restructuring in Section 4.

---

[6] This report is available at
http://www.permanenttsbgroup.ie/~/media/Files/I/Irish-Life-And-Permanent/Attachments/pdf/2014/ptsb-annual-report-2013.pdf?

Allied Irish Banks

While Anglo is the Irish bank that has received most of the negative attention from the public, the failure of AIB has also been extremely costly for the Irish state. The state has invested €20.8 billion in AIB and, thus far, has received no return in the form of dividends or share sales. The NPRF valued its share holdings in AIB at €10 billion at the end of 2013. This is roughly in line with the €10.5 billion listed as the book value of shareholder equity in the bank's annual accounts. [7]

Like PTSB, AIB has been focused on reducing its funding from the ECB by shrinking its balance sheet and increasing deposits. Total assets at the end of 2013 were €118 billion, down from €123 billion at the end of 2012 as the bank continued cutting back on its supply of credit. Deposits rose by €2 billion to €66 billion. Together, these developments allowed the bank to reduce its borrowings from the ECB from €22 billion at the end of 2012 to €13 billion at the end of 2013. Tracker mortgages are not as big a problem for AIB as PTSB but, at €16 billion at the end of 2013, its tracker portfolio is large and still represents a drain on profitability.

NPRF Valuation of Its Bank Assets

NPRF Banking Investments Since Inception				
	Original investment €bn	Cash received to date €bn	End 2013 value €bn	Total value and income €bn
Preference shares	1.8	3.2	--	3.2
Ordinary shares	2.9	1.0	1.1	2.2
Bank of Ireland	**4.7**	**4.2**	**1.1**	**5.4**
Preference shares	3.5	0.0	3.5	3.5
Ordinary shares	8.7	--	6.5	6.5
Capital contribution	3.8	--	-	-
AIB	**16.0**	**0.0**	**10.0**	**10.1**
Total Bank Investments	**20.7**	**4.2**	**11.2**	**15.4**

Bank of Ireland

The state's involvement with Bank of Ireland has been a more positive one. A total of €4.7 billion was spent at various times acquiring preference shares, ordinary shares and contingent capital bonds. The state has sold its €1 billion in contingent capital bonds for about €1.1 billion, redeemed €1.8 billion in preference shares for €2.05 billion and sold just over €1 billion in ordinary shares to private investors. In addition, the state also received about €700 million from

[7] The bank's annual report is available at http://www.aib.ie/servlet/ContentServer?pagename=AIB_Investor_Relations/AIB_Report/aib_d_reports&cid=1201859759654&channel=IRFP

Bank of Ireland in transactions fees and dividends.[8] Together, this constitutes €5.4 billion in funds received so far from the investment in Bank of Ireland.

The state retains a 14 percent ordinary equity stake in Bank of Ireland. At the bank's current market capitalisation of about €9 billion, this stake would be worth about €1.3 billion. All told, the state is set to make a healthy profit from its investment in Bank of Ireland and the cost of this investment is unlikely to feature in any discussions with the European authorities in relation to reducing the burden of Ireland's bank debt.

[8] Seamus Coffey discusses the state's investment in Bank of Ireland in detail here http://economic-incentives.blogspot.ie/2013/12/a-profit-from-boi-bailout.html

3. The June 2012 Summit Commitment

This section discusses the statement made by the euro area heads of government on June 29, 2012 and subsequent developments related to the prospect of Ireland achieving a new deal on banking debt.

The Summit Statement

The euro area summit of June 2012 took place at a time when concerns about the future of the euro were nearing their peak. Greece had defaulted and both Ireland and Portugal had entered EU-IMF programmes. Italy was coming under pressure and Spain had just agreed to borrow from ESM for a programme to recapitalise its banks. Importantly, Mario Draghi had yet to make his "whatever it takes" speech or introduce the Outright Monetary Transactions programme.

Combined with Ireland's crisis, events in Spain had illustrated how the safety of the sovereign debt of many European countries was being threatened by the weakness of the banking sector. At the same time, the ECB had recently provided very large amounts of credit to European banks in its Long-Term Refinancing Operations (LTROs) and banks had used much of this credit to buy sovereign bonds. Thus, the risk to banks of sovereign default was rising. Public discussions often focused on the so-called "vicious circle" in which risk to banks threatened sovereigns and risk to sovereigns threatened banks.

The euro area heads of state choose to address this issue at the June 2012 summit. The part of the statement that relates to this issue is only one paragraph in length and is worth quoting in full:[9]

> *We affirm that it is imperative to break the vicious circle between banks and sovereigns. The Commission will present Proposals on the basis of Article 127(6) for a single supervisory mechanism shortly. We ask the Council to consider these Proposals as a matter of urgency by the end of 2012. When an effective single supervisory mechanism is established, involving the ECB, for banks in the euro area the ESM could, following a regular decision, have the possibility to recapitalize banks directly. This would rely on appropriate conditionality, including compliance with state aid rules, which should be institution-specific, sector-specific or economy-wide and would be formalised in a Memorandum of Understanding. The Eurogroup will examine the situation of the Irish financial sector with the view of further improving the sustainability of the well-performing adjustment programme. Similar cases will be treated equally.*

This statement established a timeline that meant any use of ESM funds for the Irish banking sector would be delayed until the ECB took over as the single supervisor for euro area banks. This process is set to be completed later this year

[9] The summit statement is available at http://www.ecb.europa.eu/ssm/pdf/statement/Euroareasummitstatement2012-06-29EN.pdf

Events Since June 2012

The June 2012 statement was terse and lacking in explicit details relating to how the euro area member states could assist Ireland.

Since the June 2012 statement, a number of governments, such as those of Germany, the Netherlands and Finland, have at times argued that the ESM should not be used to compensate governments for investments made in banks prior to ESM being given this new power.[10] However, formal clarification about how the ESM would be allowed to undertake direct bank recapitalisation came with a set of official guidelines published in June 2013 and these guidelines allowed for the possibility of retrospective use.[11]

Specifically, the ESM guidelines state:

> *The potential retroactive application of the instrument should be decided on a case-by-case basis and by mutual agreement.*

In addition, despite various comments from German government officials objecting to retrospective recapitalisation, it should be remembered that Chancellor Angela Merkel released a joint statement with Taoiseach Enda Kenny on October 21, 2012, which.[12]

> *reaffirmed the commitment from June 29th to task the Eurogroup to examine the situation of the Irish financial sector with a view to further improving the sustainability of the well performing adjustment programme.*
>
> *They recognise in this context, that Ireland is a special case, and that the Eurogroup will take that into account.*

A number of aspects of the guidelines suggest strongly that had the ESM recapitalisation instrument have been available in 2010, that it would have been used for the Irish banks. For example, the guidelines require that ESM can only provide funds for recapitalisation when "*The requesting ESM Member is unable to provide financial assistance to the institutions in full without very adverse effects on its own fiscal sustainability*." There is certainly little doubt that providing full recapitalisation for Ireland's banks had a very adverse effect on fiscal sustainability.

However, there are also a number of aspects of the ESM guidelines which will make it difficult for Ireland to recover all of the money invested in AIB and PTSB. In particular, ESM will only acquire stakes in banks at what is termed "a robust valuation" that will be "*based on the real economic values of the institutions' assets as determined by observable market inputs when possible and realistic and prudent assumptions of future cash flows*." These guidelines would suggest it is unlikely that the Irish government could sell AIB and PTSB to the ESM at values that are much in excess of their current book valuation of these banks.

[10] See, for example, this statement from the finance ministers of these three countries released in September 2012
http://valtioneuvosto.fi/ajankohtaista/tiedotteet/tiedote/en.jsp?oid=365871

[11] These guidelines are available at
http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/137569.pdf

[12] See http://www.thejournal.ie/enda-kenny-merkel-joint-statement-644593-Oct2012/

4. Options for Irish Bank Debt

As of yet, there has been no official follow-up by the euro area member states on the June 2012 commitment to Ireland. This section discusses three different areas where European institutions can take actions that can help to reduce the burden of Ireland's banking-related debt.

The European Stabilisation Mechanism

The most obvious way that Europe can help to improve the sustainability of Ireland's debt is to use funds from the ESM to acquire stakes in AIB and Irish Life and Permanent. Ideally, the Irish state would recover as much as possible of the €23.5 billion that it spent on recapitalising these banks.

There are a number of arguments that Irish politicians can make in favour of this kind of transaction.

- The June 2012 summit statement mentioned both ESM recapitalisation and examining Ireland's debt sustainability within the same paragraph. While the two were not explicitly linked, it is fair to say that a reasonable interpretation of the statement was that ESM recapitalisation could be used for Ireland.

- The sentence "Similar cases will be treated equally" in the June 2012 statement directly followed the sentence about Ireland. A reasonable interpretation of this sentence is that it means Ireland should not lose out because ESM recapitalisation was unavailable when the Irish banks failed. Allowing ESM to provide funds to banks in other countries while ignoring Ireland would be incompatible with this commitment to "similar treatment".

- The June 2012 statement calls on the Eurogroup to examine Ireland's situation. As of yet the Eurogroup has taken no action on this matter. The membership of the Eurogroup is effectively the same as the membership of the ESM board. This again points to a reasonable expectation that what was intended in June 2012 was for the ESM to approve purchases of some of the financial institutions owned by the Irish state.

- While the Irish economy is now performing well and Irish bond yields are low, there is little doubt that during 2010 the Irish banking sector represented a threat to the euro area financial system. This is the kind of threat that would now trigger an ESM intervention, given that the capacity of the Irish to take on the debts of the banking system was seriously questioned. In 2010 and 2011, however, the Irish government agreed to use state funds alone to stabilise the banking sector. Again, fairness and the principle of equal treatment would argue for the use of ESM funds to compensate Ireland.

- The cost of Ireland's bank bailout was substantially increased by a policy of making sure almost all bank creditors got their money back. While this was not an explicit European policy, there is little doubt that the ECB in particular encouraged this approach and contributed to enforcing it during the negotiations of Ireland's EU-IMF programme. With the EU now moving away from bailouts and towards a policy of bailing in creditors, the "similar treatment" argument again points to taking actions to reduce the cost of Ireland's banking bailout.

- In relation to the valuation of AIB, it can be stressed that the Irish banks have been through a far more exhaustive set of evaluations than banks in other countries. In particular, the €10.5 billion valuation of AIB's equity comes after the Central Bank of Ireland has recently carried out an extensive asset quality review. This review is set to be repeated this year as part of the ECB's comprehensive assessment but the new review is unlikely to deliver a very different assessment. Indeed, with the Irish economy recovering and property prices rising again, it could be argued that the book valuation of AIB's equity would represent good value for ESM.

Restructuring Ireland's Banking Sector

Another way that the European policy authorities can assist with reducing the burden of Ireland's bank debt is to provide assistance with restructuring the banking sector.

Despite a huge recapitalisation bill and many years of tight credit, the Irish banking sector is still not fully functioning. One of the problems with the sector is the large quantity of tracker mortgages. AIB and PTSB together have €36 billion worth of tracker mortgages. These mortgages generate a number of problems.

Firstly, they were designed for a world in which banks would have a cost of funding that were only a little bit higher than the ECB's policy rate. This is no longer the case for the Irish banks. At realistic costs of funding, these mortgages are set to be a money loser for the Irish banks for years to come.

Secondly, the low ECB policy rate has kept the interest rate for tracker customers at low levels and there is evidence that default rates on trackers are lower than for standard variable mortgages. However, the current low ECB policy rates are unlikely to be maintained over the longer term, so eventually the interest costs on tracker mortgages could begin to rise and thus trigger a new round of Irish mortgage defaults.

One approach that could help to deal with these problems is to isolate the tracker mortgages from the rest of the Irish banking system. This could be done by setting up a separate vehicle that owns the tracker mortgages and has access to a stable and secure source of funding thus giving it time to work out these loans.

A concrete example would be the following.

- A large portfolio of in tracker mortgages could be transferred from PTSB and AIB to a new institution that would have a full banking license and be eligible to borrow from the ECB but that would be dedicated to winding down the tracker book over time.

- The transferred mortgages would be securitised to create bonds that could be used in regular monetary policy operations from with the ECB.

- The money borrowed from the ECB would then be passed back to AIB and ILP as compensation for transferring the tracker mortgages.

- AIB and ILP would then use these funds to pay off their debts to the ECB and to begin operating normally free of concerns about reliance on ECB funding as well as investor concerns about potential problems due to trackers. The banks could then be prepared for sale to the private sector.

- The tracker mortgage vehicle would be focused on recovering money from trackers to repay its debts to the ECB. The Irish state would provide a guarantee that it will ensure the bank will remain solvent and capable of repaying the ECB in full over time.

While admittedly complex, the benefits of this structure would be the isolation of the trackers from the rest of the banking system and restoring the state-owned banks to their traditional role of providers of credit to the economy.

The IBRC Debt

It also should be recognised that the debt burden stemming from the IBRC is not yet a fully settled matter. It is important that the Central Bank be allowed to sell the bonds it acquired from the IBRC at a measured pace close to the "minimum sales" pace that was set out by the Department of Finance when the bonds were issued. If these bonds have to be sold at a faster pace, it is possible that most of the gains anticipated from last year's IBRC liquidation will be lost.

Achieving a slow pace of IBRC bond sales partly requires Ireland's politicians and the Central Bank of Ireland to continue making a convincing case the ECB Governing Council that the arrangement does not represent monetary financing. All of the money created by the original loans to the IBRC was used to pay off private creditors rather than to finance government deficits and the sale of the bonds will see all of this money paid back to the Central Bank of Ireland and retired from circulation. For these reasons, I believe there is a strong argument against the case that the IBRC bonds represent monetary financing.

At present, it is unclear what types of pressure are going to be brought to bear on the Irish government and on the Central Bank to execute a faster pace of sales. If such pressure does become explicit from either the ECB or various euro area finance ministries, then it will be politically important to remind the Eurogroup of the euro area's commitment to help (rather than hinder) Irish debt sustainability.

5. What Can MEPs Do?

Most of the steps that can be taken to lower the burden of Ireland's banking-related debt do not directly involve the European Parliament.

The finance ministers of the euro area will decide whether retrospective recapitalisation funds can be provided to Ireland. Officials at the European Stabilisation Mechanism may decide on important technical issues such as the approach to be taken to valuing bank equity when the ESM makes investments. The European Central Bank will be crucial to any attempt to isolate tracker mortgages from the rest of the Irish banking system and will play an important role in determining the cost to the Irish public of the newly-issued IBRC bonds.

While MEPs will not be directly involved in these activities, there are three ways in which they can play an important indirect role.

First, there is the role that the Economic and Monetary Affairs committee plays in holding all of the major European policy institutions to account. The President of the ECB is formally required to appear before the committee each year and other important figures such as the head of the Eurogroup and the chief executive of the ESM also appear before the committee on a regular basis. These committee meetings provide an excellent opportunity for Irish MEPs to make the positive case for Ireland receiving assistance in relation to its banking debt and to rebut counter-arguments.

Second, Irish MEPs can play an important role in explaining the Irish case to political groups from other countries. For example, through its role in the Socialist group, the Labour party can make this case in a way that can influence many different governments in the euro area. In particular, MEPs can explain the unique circumstances of Ireland's debt problem and the fact that Europe has yet to deliver on its acknowledgement that Ireland is a "special case". In doing this, it is perhaps important that the scale of major problems facing Ireland is emphasised. One of the factors currently working against a deal on Irish bank debt is the perception that Ireland is now doing fine and does not require any help.

Third, the European Parliament will continue to be involved in passing legislation that will have an impact on how banking union evolves. While the recent agreement on bank resolution was perhaps the most important piece of legislation in this area for the moment, there will undoubtedly be further discussions on this issue as well as related topics such as deposit insurance and bank capital regulations. Irish MEPs can contribute to these discussions by raising the risks for member states caused by banking instability and arguing for the need for further moves towards a full banking union to safeguard the future of the euro.