EU/IMF

Programme of Financial Support

For Ireland

28 July 2011

The contents of this document are:

The Letters of Intent to the EU Authorities and the IMF respectively request:

- **completion of the quarterly review for the end of the second quarter 2011 under Council Implementing Decision 2011/77/EU on granting Union financial assistance to Ireland; and**

- **completion of the third review under the Extended Arrangement with the IMF;**

on the basis of our performance to date under the Programme and the policies we set out in the Letters of Intent and the attached documents.

The completion of the Reviews based on the attached documents will be considered by the IMF Executive Board, Eurogroup and ECOFIN in due course.

An Roinn Airgeadais
Department of Finance

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Dublin, 28 July 2011

Mr. Jean-Claude Juncker
Eurogroup President
Ministère des Finances
3, rue de la Congrégation
L-1352
Luxembourg

Mr. Olli Rehn
Commissioner for Economic and Financial Affairs
European Commission
BERL 10/299
B-1049 Brussels
Belgium

Mr. Jan Vincent Rostowski
Minister of Finance
Ul Swietokrzyska 12
PL-00-916 WARSZAWA
Poland

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

Dear Messrs. Juncker, Rehn, Rostowski and Trichet,

1. The Irish Government reaffirms its commitment to making this programme a success. Our track record to date is strong. We have met and in some important cases exceeded our commitments under the EU/IMF supported programme both in terms of policy reforms as well as quantitative targets. (MEFP Tables 1 and 2). This has been the case from the outset of the programme. Furthermore we note that the commitments undertaken in Budget 2011 are on track and that after three years of decline economic growth has turned positive this year. Our ambitious financial sector reforms are also proceeding satisfactorily. However, despite this strong start financial market conditions for Irish Government paper have deteriorated, particularly in recent months. The widespread uncertainty surrounding the Euro area has been a significant factor in this. In this regard, the recent moves to strengthen Euro Area

financial assistance mechanisms are welcomed as a significant positive step which could lead to a much more favourable assessment of the medium term prospects for programme countries generally and Ireland specifically. These developments also reflect the policy position that has been pursued by the Irish Government on a number of occasions in relation to design changes that are required particularly in the areas of pricing and flexibility of the funding instruments available. We welcome the significant progress achieved to date in that regard. We also welcome your continued strong support for these initiatives.

2. Policy implementation since the review conducted last spring has been determined. We have met (and in some cases exceeded) all our commitments under the EU/IMF-supported programme, and are well on track to meet the programme's remaining quantitative and reform milestones:

- The cumulative deficit for the first six months of the year was well below the adjusted programme ceiling, and the net central government debt was below the programme's indicative ceiling. We are on track to observe, and indeed overachieve, the programme target on the overall deficit for 2011 as a whole of 10.6% of GDP.
- The recapitalisation of Allied Irish Banks, Bank of Ireland, Irish Life and Permanent and EBS Building Society will be completed (net of the remaining liability management exercises and disposal of ILP's insurance arm).
- The Government has established the Irish Fiscal Advisory Council to provide an independent assessment of public finances.
- The credit unions were inspected between July 2010 and March 2011 to complete an assessment of their loan portfolios.
- The legal merger of Allied Irish Banks and EBS Building Society was completed on 1 July 2011, well ahead of the end September 2011 schedule.
- The merger of Anglo Irish Bank and Irish Nationwide Building Society to form the Irish Bank Resolution Company (IBRC) was completed on 1 July 2011, well ahead of its scheduled end December 2011 deadline.
- A joint restructuring plan for Anglo and INBS (now the IBRC) has been submitted to and approved by the European Commission
- A plan to recapitalise Irish Life & Permanent has been finalised, again ahead of schedule and the Irish Life subsidiary has been already offered for sale again in advance of the October 2011 deadline.
- The Central Bank (Supervision and Enforcement) Bill 2011 will be submitted to the Oireachtas by 31 July 2011.

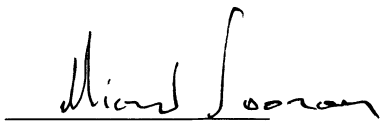
3. In the attached Memorandum of Economic and Financial Policies (MEFP) and Memorandum of Understanding on Specific Economic Policy Conditionality (MoU), we set out our plans to further advance towards meeting the objectives laid out in our programme supported by the EU and the IMF. Based on the strength of these policies, and in light of our performance under the programme and our continued commitment, we request the

completion of the third review. Overall financing needs have not changed. We request the release of the third EU instalment of EUR 5.5 billion. This would include the planned disbursement of EUR 2.5 billion in the third quarter and enable EUR 3 billion to be disbursed during the first half of the fourth quarter before finalisation of the fourth review, allowing the disbursement of EUR 7.2 billion previously agreed to be spread over that quarter.

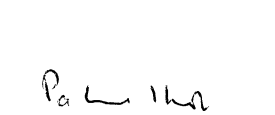
4. We are confident that the policies set forth in the Letters of Intent of 3 December 2010, on 28 April 2011, and in this letter are adequate to achieve the objectives of our programme. We stand ready to take any corrective actions that may become appropriate for this purpose as circumstances change. We will continue to consult with the Fund, the European Commission and the ECB on the adoption of such actions in advance of necessary revision of policies contained in this letter and the attached Memorandum.

5. This letter is being copied to Ms Lagarde.

Sincerely,



Michael Noonan, T.D.
Minister for Finance



Patrick Honohan
Governor of the Central Bank of Ireland

IRELAND

MEMORANDUM OF UNDERSTANDING
ON
SPECIFIC ECONOMIC POLICY CONDITIONALITY

(SECOND UPDATE)

28 July 2011

With regard to Council Regulation (EU) n° 407/2010 of 11 May 2010 establishing a European Financial Stabilisation Mechanism (EFSM), and in particular Article 3(5) thereof, this second update of the Memorandum of Understanding on Specific Economic Policy Conditionality (MoU) details the general economic policy conditions as embedded in Council Implementing Decision 2011/77/EU of 7 December 2010 on granting Union financial assistance to Ireland.

The quarterly disbursement of financial assistance from the European EFSM[1] will be subject to quarterly reviews of conditionality for the duration of the programme. Release of the instalments will be based on observance of quantitative performance criteria, respect for EU Council Decisions and Recommendations in the context of the excessive deficit procedure, and a positive evaluation of progress made with respect to policy criteria in the Memorandum of Economic and Financial Policies (MEFP) and this updated MoU, which details and further specifies the criteria that will be assessed for the successive reviews up to the end of 2013. If targets are (expected to be) missed, additional action will be taken.

For the duration of the EU/IMF financial assistance programme the Irish authorities will take all the necessary measures to ensure a successful implementation of the programme and minimise the costs to the taxpayers. In particular, they commit to:

- Rigorously implement fiscal policy consistent with the requirements of the excessive deficit procedure. In particular, the Department of Finance and the Department of Public Expenditure and Reform will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to ensure that the primary deficit target in cash (see Table 1 of MEFP and the Technical Memorandum of Understanding, TMU) and the general government nominal budget deficit on ESA95 basis as set out in the EU

[1] On 28 November 2010 Eurogroup and ECOFIN Ministers issued a statement clarifying that euro-area and EU financial support will be provided on the basis of the programme which has been negotiated with the Irish authorities by the Commission and the IMF, in liaison with the ECB. Further to the Union support from the EFSM, loans from the EU and its Member States will include contributions from the European Financial Stability Facility (EFSF) and bilateral lending support from the United Kingdom, Sweden, and Denmark. The Loan Facility Agreements on these financing contributions will specify that the disbursements there under are subject to the compliance with the conditions of this Memorandum.

Council Recommendation on excessive deficit procedures are achieved. Any additional unplanned revenues must be allocated to debt reduction. Moreover, the nominal value of Social Welfare pensions will not be increased.

- Continuously monitor financial markets to exploit opportunities to return to commercial funding as soon as possible.
- Ensure that no further exemptions to the competition law framework will be granted unless they are entirely consistent with the goals of the EU/IMF Programme and the needs of the economy.
- Consult with the European Commission, the ECB and the IMF on the adoption of policies that are not included in this Memorandum but that could have a material impact on the achievement of programme objectives.

To facilitate programme monitoring, the authorities will provide the European Commission, the ECB and the IMF with:

- All information required to monitor progress during programme implementation and to track the economic and financial situation.
- A compliance report on the fulfilment of the conditionality prior to the release of the instalments
- Reliable and regular availability of budgetary and other data as detailed in annex 1.

1. Actions for the fourth review (actions to be completed by end Q3-2011)

i. Fiscal consolidation

- Government will review the achieved and projected savings arising from efficiency-enhancing administrative measures and from reductions in public service numbers and present appropriate adjustment measures, including to the overall public service wage bill, to ensure consistency with the fiscal adjustment targets over the programme horizon.

ii. Financial sector reforms

- The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it with the European Commission, the ECB and the IMF.

Recapitalisation

- The Irish authorities will ensure that the capital needs of Bank of Ireland (BoI), Allied Irish Banks (AIB), Educational Building Society (EBS) and Irish Life & Permanent (IL&P), as identified in the 2011 Prudential Capital Assessment Review (PCAR) have been fully met by 31 July 2011, subject to appropriate adjustments for asset sales of IL&P and for pending Liability Management Exercises for BoI and IL&P. These adjustments reduce the amount to be injected by 31 July 2011 by EUR 1.1 billion for IL&P and EUR 0.5 billion for BoI.

Deleveraging

- The Irish authorities will ensure that the banks covered by the Prudential Liquidity Assessment Review (PLAR) will have identified the separation of their core and non-core assets and have implemented the appropriate governance structure for the deleveraging of non-core assets.

- In the area of asset disposal monitoring, in the near term focus will be on assessing bank targets for the quantum of asset disposal requirements, derived from their deleveraging programmes established to meet the PLAR target loan to deposit ratios (LDRs), which will be closely monitored. In line with the monitoring system set up, actual and forecast LDRs and asset disposals shall be reported by the banks to the Central Bank of Ireland every six months (first report by 31 July 2011). Such reports will include (i) progress achieved towards interim target; (ii) forecast of LDR for the end of the next period; (iii) a detailed plan of action to meet the next interim target; and (iv) actual and planned asset disposals. If actual or forecast asset disposals fail to meet the interim targets, the Irish authorities will inform the European Commission, IMF, and ECB within 14 days of becoming aware of such failure. The Central Bank will then oversee the remedial actions to be taken by any bank in question including a prompt timetable for their implementation. In addition to providing the six-monthly report, the Irish authorities will update the European Commission, the IMF and the ECB on progress in the intervening quarters.

- The Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of Net Stable Funding Ratios (NSFR) and the Liquidity Coverage Ratios (LCR) of the banks in order to ensure convergence to Basel 3 standards by the relevant dates.

Financial Supervision

- The Irish authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it with the European Commission, the ECB and the IMF.

- Building on the restructuring undertaken to date, the Irish authorities will submit restructuring plans to the European Commission by 31 July 2011 in accordance with EU competition rules, taking into account the outcomes of the PCAR and PLAR and covering a period of 5 years. These plans will also be made available to the IMF and the ECB. Except where otherwise agreed with the European Commission, commitments already undertaken by the Irish authorities in the context of EU competition decisions will be maintained.

- Government will, by 31 July 2011, introduce legislation (titled "The Central Bank (Supervision and Enforcement) Bill 2011") strengthening the ability of the Central Bank of Ireland to impose and supervise compliance with regulatory requirements and to undertake timely prudential interventions. The Bill will provide the Central Bank of Ireland with greater access to information and analysis and will underpin the credible enforcement of Irish financial services legislation in line with international best practice.

- The Department of Finance will submit to the Minister for Finance proposals to enhance the quality and availability of credit information available to credit providers by 30 September 2011.

iii. Structural reforms

Labour market reforms

- Government will report on reforms to strengthen the labour market activation system and its links to unemployment support schemes in the fight against long-term unemployment.

- Government will discuss with European Commission Services the main findings of the independent reviews of Registered Employment Agreements (REAs) and Employment Regulations Orders (EROs) arrangements, and present a time-bound comprehensive action plan to follow up on its recommendations, taking into consideration the implications of the 6 July 2011 High Court ruling which found that sections of legislation governing wage-setting mechanisms in EROs are unconstitutional.

To increase competition

- Government will introduce legislative changes to remove restrictions to trade and competition in sheltered sectors including:
    - the legal profession, establishing an independent regulator for the profession and implementing the recommendations of the Legal Costs Working Group and outstanding Competition Authority recommendations to reduce legal costs.
    - medical services, eliminating restrictions on the number of general practitioners (GPs) qualifying and removing restrictions on GPs wishing to treat public patients as well as restrictions on advertising.

- Government will introduce legislation to strengthen competition law enforcement in Ireland by ensuring the availability of effective sanctions for infringements of Irish competition law and Articles 101 and 102 of the Treaty on the Functioning of the European Union as well as ensuring the effective functioning of the Competition Authority, which will be merged with the National Consumer Agency

- The Irish authorities will agree with European Commission Services a time-bound action plan to implement the recommendations of the study on the economic impact of eliminating the cap on the size of retail premises with a view to enhancing competition and lowering prices for consumers.

- An independent assessment of the electricity and gas sectors will commence taking due account of the EU regulatory context for these sectors.

iv. Structural fiscal reforms

To underpin medium-term ceilings and identify savings and efficiencies

- The Irish authorities will complete a comprehensive review of expenditure (CRE) which will form the basis for the allocation of binding multi-year expenditure ceilings by

expenditure vote group consistent with the aggregate expenditure envelope underpinning the government's fiscal targets under the EU/IMF financial assistance programme and the Stability and Growth Pact provisions.

To put the public service pension system on a more sustainable basis

- Pension entitlements for new entrants to the public service will be reformed with effect from 2011. This will include a review of accelerated retirement for certain categories of public servants and an indexation of pensions to consumer prices. Pensions will be based on career average earnings. New entrants' retirement age will also be linked to the Social Welfare pension retirement age.

To facilitate better government at a local level

- Government will ensure that effective measures are in place to cap the contribution of the local government sector to general government borrowing at an acceptable level. The mechanisms in place to underpin this position will be kept under close review, in consultation with the European Commission Services. The review will also consider how to provide data on the financial position including assets and liabilities of the sector on a timely basis.

2. Actions for the fifth review (actions to be completed by end Q4-2011)

i. Fiscal consolidation

- Following the conclusion of the CRE, government will, by end-October 2011, present the Pre-Budget Outlook to the Dáil, setting out a medium-term fiscal consolidation plan for 2012 – 2015 outlining the overall composition of revenue and expenditure adjustments for each year, consistent with the targets set out in the Council Recommendation in the context of the excessive deficit procedure. Moreover, by 2012 Budget day in early December 2011, Government will anchor this consolidation plan in binding medium-term expenditure cash ceilings and will set out revenue and expenditure measures to deliver the needed adjustment.

- Government will propose a budget for 2012 aiming to further reduce the general government deficit in line with the fiscal targets set out in the Council Recommendation in the context of the excessive deficit procedure and including the detailed presentation of consolidation measures amounting to at least €3.6bn. The EU/IMF Programme of Financial Support for Ireland agreed in December 2010 provides for the following commitments in relation to measures for 2012:
    - Revenue measures to yield EUR1,500m[2] in a full year will be introduced, including:
        - A lowering of personal income tax bands and credits.
        - A reduction in private pension tax reliefs.
        - A reduction in general tax expenditures.
        - A property tax.

[2] Inclusive of 2011 carryover

- A reform of capital gains tax and acquisitions tax.
- An increase in the carbon tax.

o Expenditure reduction of EUR 2,100m including:

- Social expenditure reductions.
- Reduction of public service numbers and public service pension adjustments.
- Other programme expenditure, and reductions in capital expenditure.

The CRE will be completed in September 2011. The budgetary measures outlined above will be examined by the government in the light of the findings of the CRE and the Programme for Government. Based on the CRE and in consultation with the European Commission, the IMF and the ECB, the government will introduce budgetary changes which will aim to fully realise efficiencies identified, while remaining fiscally neutral

ii. Financial sector reforms

- Government will ensure that the originally agreed recapitalisation of BoI is completed, including by providing public funds for any remaining capital needs net of the burden sharing in BoI. (See section 1.ii above). If the sale of IL&P's insurance arm is completed, any remaining capital needs in IL&P will be provided for (to be reviewed in October 2011).

- The Irish authorities will report on the evolution of the capital within the banks covered by the PCAR.

Deleveraging

- An update on progress of the banks' implementation of their deleveraging plans under the PLAR 2011 and any related actions will be discussed with the European Commission, the ECB and the IMF. In addition, the Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

Reorganisation

- The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions on the basis of the restructuring plans and discuss it with staff of the European Commission, the ECB and the IMF.

- The Irish authorities, in consultation with the External Partners will review the restructuring plan for IL&P due by end July and, as necessary, set out by end October the relevant follow-on actions.

Credit unions

- The Irish authorities will implement the strategy to underpin the solvency and viability of the credit union sector. Steps will be taken to deal with weaknesses in the most troubled institutions, including restrictions on their operations where appropriate. Commencing in this quarter, the authorities will take all the necessary actions to restructure the sector and address difficulties in individual credit unions while minimising any fiscal cost, and will identify solutions within the sector, as well as specify additional funding arrangements in case they are needed to complete this process. This restructuring process will take account of the interim report of the Commission on Credit Unions.

- The Irish authorities will submit legislation to the Dáil to strengthen the regulatory framework for credit unions including more effective governance and regulatory requirements.

Financial supervision

- The Irish authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it with the European Commission, the ECB and the IMF.

- The Central Bank of Ireland will issue guidance to banks for the recognition of accounting losses incurred in their loan book. Specifically, the Central Bank of Ireland will begin requiring the banks: (i) on core assets, to increase the consistency and conservatism in their impairment triggers and provisioning model inputs including *inter alia*: period of arrears, emergence periods, cure rates and collateral value, and treatment of restructured loans and forbearance; (ii) on non-core assets (assets under deleveraging) to provision to reflect losses arising from their planned disposal, taking account as appropriate of the PLAR/PCAR analysis. The Central Bank of Ireland will develop these new requirements with assistance of an internationally recognised auditing firm to ensure consistency with International Financial Reporting Standards (IFRS).

- The Central Bank of Ireland will publish new guidelines for the valuation of collateral for bank loans by end December 2011.

iii. Structural reforms

To prepare for the introduction of water charges

- Government will prepare proposals for implementation of the recommendations of the independent assessment of transfer of responsibility for water service provision from local authorities to a water utility in consultation with European Commission Services with a view to starting charging during the EU/IMF Programme period.

To better target social support expenditure

- The Department of Social Protection will build on their recent studies on working age payments, child income support and disability allowance with a view to producing, after consultation with stakeholders, a comprehensive programme of reforms that can help better target social support to those on lower incomes, and ensure that work pays for welfare recipients. To this end, the Department will submit a progress report by end-December 2011.

iv. Structural fiscal reforms

To reinforce the credibility of the budgetary process

- Government will introduce a Fiscal Responsibility Bill consistent with the economic governance framework at the EU level, including provisions for a medium-term budgetary framework, fiscal rules and the Fiscal Advisory Council. This will give a statutory basis to the Council and ensure its independence with due regard to the role that nomination and appointment/dismissal procedures can play and to medium-term budget allocations.

To further reform key sectors of the economy

- Government will consider options for an ambitious programme of asset disposals, based on the Programme for Government and the report of the Review Group on State Assets and Liabilities. Government will prepare a draft programme of asset disposals in this context and discuss it with the staff of the European Commission, the IMF and the ECB by end-December 2011 in advance of taking final decisions on the programme to be pursued. The draft programme will include the identification of the potential assets to be disposed, any necessary regulatory changes and a timetable for implementation.

3. Actions for the sixth review (actions to be completed by end Q1-2012)

i. Fiscal consolidation

- Finance Bill 2012 will contain necessary provisions to bring into effect the already signalled VAT increases in 2013 and 2014.

ii. Financial sector reforms

- The Irish authorities will agree the terms of reference for the PCAR 2012.

- Asset disposal monitoring – as per requirement under Financial Sector Reforms in 4th Review (Q3 – 2011).

- The Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

- The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.

- The Irish authorities will present a comprehensive report on progress in implementing the Central Bank action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the ECB and the IMF.

iii. Structural reforms

- Government will introduce legislation to reform the personal debt regime to the Houses of the Oireachtas with the objective of lowering the cost and increase the speed and efficiency of proceedings, while at the same time mitigating moral hazard and maintaining credit discipline.

To better target social support expenditure

- The Department of Social Protection will submit to government the comprehensive programme of reforms that can help better targeting of social support to those on lower incomes, and ensure that work pays for welfare recipients.

4. Actions for the seventh review (actions to be completed by end Q2-2012)

i. Financial sector reforms

- The PCAR for 2012 will be completed. Before publication, the results of the PCAR for 2012 will be assessed, together with European Commission, the ECB and the IMF. The results and methodology used will then be published in detail and on a bank-by-bank basis by 30 June 2012. Based on these results, the authorities will ensure that banks are adequately capitalised.

- An update on progress of the banks' implementation of their deleveraging plans under the PLAR 2011 and any related actions will be discussed with the European Commission, the ECB and the IMF. In addition, the Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

- The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.

- The Irish authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the ECB and the IMF.

ii. Structural reforms

To assist in covering financing needs and to increase competition

- Based on the results of the assessment of the efficiency of the electricity and gas sectors, the authorities will further strengthen the regulatory and market reform programme in consultation with European Commission Services, with a view to increase efficiency, improve governance, strengthen competition and improve these sectors' ability to contribute

towards covering Ireland's financing needs and improving its growth potential and economic recovery.

5. Actions for the eighth review (actions to be completed by end Q3-2012)

i. Financial sector reforms

- Asset disposal monitoring – as per requirement under Financial Sector Reforms in 4th Review (Q3 – 2011).
- The Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.
- The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.
- The Irish authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the ECB and the IMF.
- Government will present to Dáil Éireann legislation to establish a statutory credit risk register.

6. Actions for the ninth review (actions to be completed by end Q4-2012)

i. Fiscal consolidation

- Government will propose a budget for 2013 aiming at a further reduction of the general government deficit in line with the fiscal targets set out in the Council Recommendation in the context of the excessive deficit procedure and including the detailed presentation of consolidation measures amounting to at least EUR 3,100m. The EU/IMF Programme of Financial Support for Ireland agreed in December 2010 provides for the following commitments in relation to measures for 2013:
  - Revenue measures to raise at least EUR 1,100m[3] in the full year will be introduced, including:
    - A lowering of personal income tax bands and credits
    - A reduction in private pension tax relief.
    - A reduction in general tax expenditures.
    - An increase in property tax.
  - Expenditure reductions of no less than EUR 2,000m, including:
    - Social expenditure reductions.

[3] Inclusive of carryover from 2012.

- Reduction of public service numbers and public service pension adjustments.
- Other programme expenditure, and reductions in capital expenditure.

The budgetary measures outlined above will be examined by the government in the light of the findings of the CRE and the Programme for Government. Based on the CRE and in consultation with the European Commission, the IMF and the ECB, government will introduce budgetary changes which will aim to fully realise efficiencies identified, while remaining fiscally neutral.

ii. Financial sector reforms

- The Irish authorities will report on the evolution of the capital within the banks covered by the PCAR.
- An update on progress of the banks' implementation of their deleveraging plans under the PLAR 2011 and any related actions will be discussed with the European Commission, the ECB and the IMF. In addition, the Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.
- The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.
- The Irish authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the ECB and the IMF.

7. Actions for the tenth review (actions to be completed by end Q1-2013)

i. Financial sector reforms

- The Irish authorities will agree the terms of reference for the PCAR 2013.
- Asset disposal monitoring – as per requirement under Financial Sector Reforms in 4th Review (Q3 – 2011).
- The Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.
- The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.
- The Irish authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the ECB and the IMF.

8. Actions for the eleventh review (actions to be completed by end Q2-2013)

ii. Financial sector reforms

- The PCAR for 2013 will be completed. Before publication, the results of the PCAR for 2013 will be assessed, together with European Commission, the ECB and the IMF. The results and methodology used will then be published in detail and on a bank-by-bank basis by 30 June 2013. Based on these results, the Irish authorities will ensure that banks are adequately capitalised.

- An update on progress of the banks' implementation of their deleveraging plans under the PLAR 2011 and any related actions will be discussed with the European Commission, the ECB and the IMF. In addition, the Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

- The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.

- The Irish authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the ECB and the IMF.

9. Actions for the twelfth review (actions to be completed by end Q3-2013)

i. Financial sector reforms

- Asset disposal monitoring – as per requirement under Financial Sector Reforms in 4th Review (Q3 – 2011).

- The Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

- The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.

- The Irish authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the ECB and the IMF.

10. Actions for the thirteenth review (actions to be completed by end Q4-2013)

ii. Financial sector reforms

- The Irish authorities will report on the evolution of the capital within the banks covered by the PCAR.

- A final report of the banks' implementation of their deleveraging plans under the PLAR 2011 and their compliance with the LDR target will be discussed with the European Commission, the ECB and the IMF. In addition, the Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

- The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.

- The Irish authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the ECB and the IMF.

Annex 1. Provision of data

During the programme, the following indicators and reports shall be made available to the European Commission, the ECB and the IMF staffs by the authorities on a regular basis. The External Programme Compliance Unit (EPCU) of the Department of Finance will coordinate and collect data and information and forward to all external programme partners.

To be provided by the Department of Finance in consultation with the Department of Public Expenditure and Reform as appropriate		
Ref.	Report	Frequency
F.1	Monthly data on adherence to budget targets (Exchequer statement, details on Exchequer revenues and expenditure with information on Social Insurance Fund to follow as soon as practicable).	Monthly, 10 days after the end of each month
F.2	Updated monthly report on the Exchequer Balance and General Government Balance outlook for the remainder of the year which shows transition from the Exchequer Balance to the General Government Balance (using presentation in Table 1 and Table 2A of the EDP notification).	Monthly, 20 days after the end of each month
F.3	Quarterly data on main revenue and expenditure items of local government.	Quarterly, 90 days after the end of each quarter
F.4	Quarterly data on the public service wage bill, number of employees and average wage (using the presentation of the Pay and Pension Bill with further details on pay and pension costs of local authorities).	Quarterly, 30 days after the end of each quarter
F.5	Quarterly data on general government accounts, and general government debt as per the relevant EU regulations on statistics.	Quarterly accrual data, 90 days after the end of each quarter
F.6	Updated annual plans of the general government balance and its breakdown into revenue and expenditure components for the current year and the following four years, using presentation in the stability programme's standard table on general government budgetary prospects.	30 days after EDP notifications
F.7	Data on short- and medium- /long-term debt falling due (all instruments) over the next 36 months (interest and amortisation) for Non-Commercial State Agencies	Quarterly , 30 working days after the end of each quarter
F.8	Data on short- and medium- /long-term debt falling due (all instruments) over the next 36 months (interest and amortisation) for local authorities	Quarterly , 30 working days after the end of each quarter
F.9	Data on short- and medium- /long-term debt falling due (all instruments) over the next 36 months for State- owned commercial enterprises (interest and amortisation)	Quarterly, 30 working days after the end of each quarter
F.10	Assessment report of the management of activation policies and on the outcome of job seekers' search activities and participation in labour market programmes.	Quarterly, 30 working days after the end of each quarter.
F11	Report on progress achieved towards interim PLAR targets and actual and planned asset disposals.	Quarterly, 10 working days after the end of each quarter.
To be provided by the NTMA		
N.1	Monthly information on the Government's cash position with indication of sources as well of number of days covered	Monthly, next working day

N.2	Data on below-the-line financing for central government.	Monthly, no later than 15 days after the end of each month
N.3	Data on public debt and new guarantees issued by central government to public enterprises and the private sector.	Monthly, 30 working days after the end of each month
N.4	Data on short-, medium- and long-term debt falling due (all instruments) over the next 36 months (interest and amortisation) for central government.	Monthly , 30 working days after the end of each month
N.5	Updated estimates of financial sources (bonds issuance, other financing sources) for the banking and government sectors in the next 12 months	Monthly, 30 working days after the end of each month
To be provided by the Central Bank of Ireland		
C.1	The Central Bank of Ireland's balance sheet.	Weekly, next working day
C.2	The Central Bank will provide details on the aggregate monetary balance sheet of all Irish authorised credit institutions, EEA and non-EEA branches on a monthly basis.	Monthly, on the last working day of the following month
C.3	Individual maturity profiles (amortisation only) for each of the domestic banks will be provided as of the last Friday of each month.	Monthly, 30 working days after each month end.
C.4	Consolidated balance sheet information for the domestic banks (collected through the FINREP reporting system)	Monthly, 30 working days after each month end.
C.5	Balance sheet information, based on products rather than categories (as in FINREP).	Quarterly, 30 working days after the end of each quarter
C.6	Detailed information on deposits for the last Friday of each month.	Monthly, 30 working days after each month end.
C.7	Data on liabilities covered under the ELG Scheme for each of the Covered Institutions.	Monthly, 30 working days after each month end.
C.8	Certain financial stability indicators on a monthly basis, including capital adequacy ratios, liquidity ratios, loan to deposit ratios and sectoral distribution of loans	Monthly, 30 working days after each month end.
C.9	Additional financial stability indicators including details on non performing loans, provisions, return on assets, return on equity, interest margin and income.	Quarterly, 30 working days after the end of each quarter.

Oifig an Aire
Office of the Minister

An Roinn Airgeadais
Department of Finance

Sráid Mhuirfean Uacht, Baile Átha Cliath 2, Éire.
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Teileafón / Telephone: 353-1 604 5626
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Dublin, 28 July 2011

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Lagarde:

1. The Irish Government reaffirms its commitment to making this programme a success. Our track record to date is strong. We have met and in some important cases exceeded our commitments under the EU/IMF supported programme both in terms of policy reforms as well as quantitative targets. (MEFP Tables 1 and 2). This has been the case from the outset of the programme. Furthermore we note that the commitments undertaken in Budget 2011 are on track and that after three years of decline economic growth has turned positive this year. Our ambitious financial sector reforms are also proceeding satisfactorily. However, despite this strong start financial market conditions for Irish Government paper have deteriorated, particularly in recent months. The widespread uncertainty surrounding the Euro area has been a significant factor in this. In this regard, the recent moves to strengthen Euro Area financial assistance mechanisms are welcomed as a significant positive step which could lead to a much more favourable assessment of the medium term prospects for programme countries generally and Ireland specifically. These developments also reflect the policy position that has been pursued by the Irish Government on a number of occasions in relation to design changes that are required particularly in the areas of pricing and flexibility of the funding instruments available. We welcome the significant progress achieved to date in that regard. We also welcome your continued strong support for these initiatives.

2. We have made important progress in both the financial sector and fiscal reforms. All structural benchmarks for this review have been implemented on or before the required deadlines:

- The recapitalisation of Allied Irish Banks, Bank of Ireland, Irish Life and Permanent and EBS Building Society will be completed (net of the remaining liability management exercises and disposal of ILP's insurance arm).

- The Government has established the Irish Fiscal Advisory Council to provide an independent assessment of public finances.

- The credit unions were inspected between July 2010 and March 2011 to complete an assessment of their loan portfolios.

- The legal merger of Allied Irish Banks and EBS Building Society was completed on 1 July 2011, well ahead of the end September 2011 schedule.

- The merger of Anglo Irish Bank and Irish Nationwide Building Society to form the Irish Bank Resolution Company (IBRC) was completed on 1 July 2011, well ahead of its scheduled end December 2011 deadline.

- A joint restructuring plan for Anglo and INBS (now the IBRC) has been submitted to and approved by the European Commission.

- A plan to recapitalise Irish Life & Permanent has been finalised, again ahead of schedule, and the Irish Life subsidiary has been already offered for sale again in advance of the October 2011 deadline.

- The Central Bank (Supervision and Enforcement) Bill 2011 will be submitted to the Oireachtas by 31 July 2011.

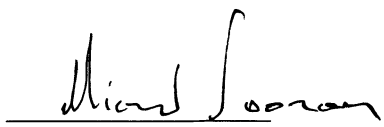
3. In the attached Memorandum of Economic and Financial Policies (MEFP), we set out our plans to further advance towards meeting the objectives laid out in our programme supported by the Extended Arrangement and by the EU. Based on the strength of these policies, and in light of our performance under the programme and our continued commitment, we request the completion of the third review under the Extended Arrangement. We also request that the third purchase in an amount equivalent to SDR 1.319 billion becomes available at the time of completion of the review.

4. We propose that quantitative performance criteria under the arrangement be established for 31 December 2011, as set out in the attached MEFP. As detailed below, we also propose new structural benchmarks against which to measure progress under the programme (MEFP Table 3). The Technical Memorandum of Understanding (TMU) explains how programme targets are measured.

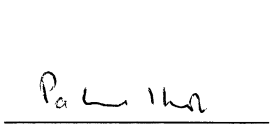
5. We are confident that the policies set forth in the Letters of Intent of 3 December 2010, on 28 April 2011, and in this letter are adequate to achieve the objectives of our programme. We stand ready to take any corrective actions that may become appropriate for this purpose as circumstances change. As is standard under Fund-supported programmes, we will consult with the Fund, the European Commission and the ECB on the adoption of such actions in advance of necessary revision of policies contained in this letter and the attached Memorandum.

6. This letter is being copied to Messrs. Juncker, Rehn, Rostowski and Trichet.

Sincerely,



Michael Noonan, T.D.
Minister for Finance



Patrick Honohan
Governor of the Central Bank of Ireland

Memorandum of Economic and Financial Policies

Recent Economic Developments and Outlook

1. **The economy is on track to return to positive growth this year.** GDP stabilised on an annual basis in the first quarter of 2011. Strong exports, aided by progress in recovering lost competitiveness, are expected to continue driving the recovery, as domestic demand, especially consumption, contracts. The export-led recovery will lead to a further strengthening of the current account, which turned into surplus in 2010. Annual inflation of 1.1 percent in June is primarily due to higher international energy prices, with core inflation turning slightly positive in recent months. Economic activity is expected to strengthen next year and beyond as the recovery broadens out and spills over to the labour market.

Financial Sector Policies

2. **We are continuing to restore the healthy functioning of our domestic financial system so it can contribute to the recovery**. Accordingly, we are taking decisive steps to (i) recapitalise, restructure, and deleverage the domestically owned banks; (ii) reform the business model and strengthen the financial health of the credit union sector; (iii) enhance the existing institutional and regulatory framework, and strengthen the transparency and quality of bank balance sheets.

The Domestically-Owned Banks

3. **Recapitalising the domestic banks by end July, with contributions from the private sector, will represent a key milestone** (structural benchmark)**.** Of the €24 billion required, €4.9 billion has been obtained to date through liability management exercises (LMEs). To allow further burden sharing, the final €0.5 billion step in recapitalising Bank of Ireland will be completed by end 2011 and any further recapitalisation of ILP will be completed following the disposal of the insurance arm. We will review the restructuring plan for ILP due by end July and, as necessary, set out by end October the relevant follow-on actions.

4. **We are strengthening the governance framework for banks.** Our ultimate goal is a robust, profitable, and privately owned banking system, which can support the Irish economy. In the meantime, we are:

- **Renewing the boards and senior management of banks based on fit and proper standards.** Already a number of Board members of credit institutions that have received financial support have departed voluntarily. The Minister has asked the institutions to submit board and management renewal plans. In addition the Central Bank will review any remaining incumbent directors' and senior managers' roles in the lead up to the crisis against the new fitness and probity standards following those standards coming into force.

- **Enshrining arms length governance of pillar banks' core activities.** In order to properly exercise the ownership rights of the state in banks we have strengthened the Banking Unit of the Department of Finance, and the legislation for the delegation to NTMA of these rights has been rescinded. By end October we shall:

    - Publish the mission statement for the new Banking Unit, as well as its lines of responsibility and organisational structure.

    - Develop and publish a memorandum of understanding governing the relationship of the Department of Finance and the Central Bank in relation to banking sector oversight to ensure clarity of responsibility in this area (proposed structural benchmark).

    - Initiate public reporting on the activities of the Banking Unit on a regular basis.

- **Establishing relationship frameworks.** By December 2011 the Minister for Finance shall prepare relationship frameworks with each bank to establish the commercial basis for each bank's operations under Government ownership and a template will be developed for discussion with the External Partners in October 2011. In order to achieve the objectives of the deleveraging process, we will as an exception, exercise more active oversight of banks' activities relating to the non-core assets (as further described below).

5. **We will ensure that the deleveraging process proceeds in a well coordinated and effective manner.** The non-core assets are being deleveraged through a combination of run offs from amortisation or prepayments and a carefully coordinated programme of phased asset disposals. While avoiding fire sales, this will deliver a smaller more robust banking system, with a target loan to deposit ratio of 122.5 percent by end 2013. In the near term, the focus will be on assessing bank targets for the quantum of asset disposal requirements, derived from their deleveraging programmes established to meet the PLAR target loan to deposit ratios, which will be closely monitored. As set out below, we have developed a framework for the governance of deleveraging, which will be kept under review based on experience.

- **Banks have established a framework for asset disposals.** Following the identification of the non-core assets, the banks, with the assistance of international consulting firms, are completing due diligence on their inventories to establish the phasing and pricing of non-core assets identified for sale. Banks have also established deleveraging committees (chaired by a non-executive Director) to make decisions on larger transactions, and will report to the authorities on progress towards the semi-annual interim targets for key liquidity indicators on a quarterly basis.

- **The Banking Unit of the Department of Finance (DoF) will play an active role in driving and overseeing the deleveraging process**. A representative of the DoF will participate in a non-voting capacity in each bank's Deleveraging Committee to promote the observance of agreed goals, report regularly to the DoF Review Committee, and have the authority to refer material transactions to the DoF Review Committee. Any such transactions would automatically be reviewed if the price falls below a certain threshold based on the PCAR/PLAR exercise. The Minister for Finance would use his powers to either enforce or veto transactions with a view to advancing deleveraging while avoiding fire sales.

- **The Central Bank will monitor the process from a financial stability perspective.** The Central Bank has defined the semi-annual interim targets for key liquidity indicators, and will monitor progress against those metrics. Upon receipt of a report from an institution forecasting a breach of an interim target or based on its own assessment the Central Bank will request a remediation plan and may at the same time convert the interim target into a mandatory target. Appropriate application of enforcement actions will be considered if due wholly or partly to the non execution of a deleverage plan transaction.

Strengthening the Credit Union Sector

6. **We are implementing the strategy to underpin the solvency and viability of the credit union sector.** Immediate steps are being taken to deal with weaknesses in the most troubled institutions, including restrictions on their operations where appropriate. Commencing in the fourth quarter we will take all measures necessary to restructure the sector and address difficulties in individual credit unions while minimising any fiscal cost, and will identify solutions within the sector, as well as specify additional funding arrangements in case they are needed to complete this process. This restructuring process will take account of the interim report of the Commission on Credit Unions.

Upgrading the Financial Sector Framework

7. **We are continuing our efforts to strengthen the institutional and regulatory framework underpinning the financial system.** We are making progress in several fronts:

- **A new prudential risk assessment framework is being adopted.** The Central Bank is currently engaged in ongoing development of its new risk framework, Prudential Risk and Impact System (PRISM), which will be implemented by end 2012. By the start of 2012 phase one will be implemented for banks and by March 2012 we expect to have completed our first assessment of the pillar banks' risk profile on the basis of PRISM, and identified a set of mitigating recommendations. We also plan to issue new credit risk standards, including collateral valuations and credit limits by end December 2011. During 2013 we will request the IMF to undertake an independent

assessment under a stand-alone Report on the Observance of Standards and Codes (ROSC) against Basel Core Principles for Effective Banking Supervision.

- **Strengthened banking supervision and enforcement powers.** We plan to publish the Central Bank (Supervision and Enforcement) Bill by end July (structural benchmark). This bill strengthens the ability of the Central Bank to impose and supervise compliance with regulatory requirements and to undertake timely prudential interventions. The bill will provide the Central Bank with greater access to information and analysis and will underpin the credible enforcement of Irish financial services legislation in line with international best practice.

- **Enhanced supervisory transparency.** The Central Bank will over time further increase the level of supervisory disclosure by publishing information concerning the supervisory actions undertaken during the previous year.

- **Steps to establish a credit risk register are being taken**. A proposal to enhance the quality and availability of credit information will be sent to the Minister by end September 2011. Legislation for the establishment of a statutory credit register will be drafted and submitted to the Oireachtas by September 2012.

- **Special resolution regime.** The Central Bank and Credit Institutions (No. 2) (Resolution) Bill is expected to complete Second Stage before the end of the current Dáil session and will proceed to Committee Stage in September 2011 for further discussion and refinement.

8. **We are strengthening the transparency and quality of bank balance sheets:**

- **By December 2011, the Central Bank will issue guidance to banks for the recognition of accounting losses incurred in their loan book (proposed structural benchmark).** Specifically, the Central Bank will begin requiring the banks: (i) on core assets, to increase the consistency and conservatism in their impairment triggers and provisioning model inputs including *inter alia*: period of arrears, emergence periods, cure rates and collateral value, and treatment of restructured loans and forbearance; (ii) on non-core assets (assets under deleveraging) to provision to reflect losses arising from their planned disposal, taking account as appropriate of the PLAR/PCAR analysis. We will develop these new requirements with assistance of an internationally recognised auditing firm to ensure consistency with IFRS.

- **Introduction of new disclosure practices by end 2011.** We will ensure that banks adopt a best practice template that enhance transparency in definition of impairment, measurement process for loan and receivable financial assets, timing of write-offs, collective provisioning methodology, and risk management and portfolio quality disclosure.

- **We will continue to facilitate improvements in the quality of banks' loan books.** In particular, we will review the requirements of the Code of Conduct for Business Lending to SME Enterprises (SME Code) relating to the treatment of SMEs in financial difficulties and facing arrears. By end September 2011 revisions to the existing procedural guidelines (especially relating to those in financial difficulties) will be approved. These are being drafted through a consultative process and will be designed to avoid introducing incentives for strategic defaulting. The Government will continue to review implementation and experience under the Code of Conduct on Mortgage Arrears to encourage early and effective engagement between borrowers and banks and report by the end of October 2011.

- **Reform the personal insolvency regime.** We will continue to facilitate efforts by individuals and lenders to address issues of significant over-indebtedness. We intend to have in place by end December 2011 a strategy covering the key policy issues and parameters for the development of broader legal reforms, including significant amendments to the Bankruptcy Act 1998 and creation of a new structured non-judicial debt settlement and enforcement system (proposed structural benchmark). The objective is to permit efficient and effective insolvency proceedings while minimising moral hazard.

Fiscal Policies

9. **On the back of a €6 billion consolidation effort, we are on track to achieve the programmed deficit reduction in 2011.** The end June 2011 primary exchequer balance target was met with a margin and the end year programme targets remain within reach. The end June central government net debt target was also met, as was the non-accumulation of external arrears requirement. Our strong performance, despite challenging macroeconomic conditions, reflects the government's unwavering commitment to fiscal consolidation, and Ireland's strong institutional capacity in revenue administration and public finance management. Our robust implementation record credibly positions us to deliver the programmed fiscal adjustment of at least €3.6 billion in 2012, and the additional measures in outer years needed to bring the general government deficit below 3 percent of GDP by 2015.

10. **The ongoing comprehensive review of expenditure (CRE) is expected to identify significant scope for sharpening public service delivery.** Instead of cutting around the edges, we are adopting a "programme review" approach to help focus spending on the most effective and high-priority programmes. By end October 2011, following the conclusion of the CRE, we will present the Pre Budget Outlook to the Dáil setting out a medium-term fiscal consolidation plan for 2012–2015 outlining the overall composition of revenue and expenditure adjustments for each year, consistent with the targets set out in the Council Recommendation in the context of the excessive deficit procedure. Moreover, by 2012 Budget day in early December 2011, we will anchor this consolidation plan in binding medium-term expenditure cash ceilings (structural benchmark) and will set out revenue and

expenditure measures to deliver the needed adjustment while protecting the poor and vulnerable.

11. **We are implementing significant pension reforms to help secure Ireland's long-term public finances in the face of high projected increases in ageing-related costs.** Signed into law on June 29, 2011, the reforms provide for step increases in the retirement age for social welfare pensions from 65 to 68 years over 2014-2028. Supplementing this is a package of public service pension reforms for new entrants, to be submitted for Parliamentary approval by end September-2011. Notably, these necessary reforms, which will help brace Ireland against population ageing, are being implemented in a socially-cohesive manner.

12. **As part of our institutional fiscal reform commitments, we have established the Irish Fiscal Advisory Council.** The Council comprises five distinguished economics professionals with strong international expertise, and has received an initial funding provision for the remainder of 2011. The Council will have the mandate to assess and comment on official macroeconomic forecasts and budgetary projections, compliance with fiscal rules, and the appropriateness of the fiscal stance. A Fiscal Responsibility bill, to be submitted to the Houses of the Oireachtas by end December 2011, will give statutory basis to the Council and ensure its independence with due regard to the role that nomination, appointment, and dismissal procedures can play, and medium-term budget allocations (proposed structural benchmark). The bill will also give legal backing to the aforementioned expenditure ceilings, and establish a set of fiscal rules to underpin sound fiscal policy.

13. **We are committed to an ambitious programme of state asset disposals.** We will consider options for asset disposals, based on the Programme for Government and the report of the Review Group on State Assets and Liabilities. We will prepare a draft programme of asset disposals in this context and discuss it with the staff of the European Commission, the IMF and the ECB by end December 2011 in advance of taking final decisions on the programme to be pursued. The draft programme will include the identification of the potential assets for disposal, any necessary regulatory changes, and a timetable for implementation.

Product and Labour Market Reforms

14. **To reform the framework for sectoral wage agreements, the Government is working to develop a time-bound plan of action by end September 2011 having regard to the views of the social partners and other stakeholders.** The reforms aim at increasing employers' willingness to hire, in particular in sectors hard hit by the crisis and to facilitate the necessary cross sector adjustment. They will take into consideration the implications of the 6 July 2011 High Court ruling which found that sections of legislation governing wage-setting mechanisms in EROs are unconstitutional.

15. **We are advancing policies to lower costs in sheltered sectors to boost purchasing power and underpin competiveness improvements.** We have taken steps to reduce margins on pharmaceuticals, and intend to submit legislative changes to Parliament by end September 2011 to reform regulation of the legal profession to promote greater transparency and efficiency, and to reduce barriers to entry to the medical profession. To enhance the enforcement of Irish and EU competition law, we will consider how the effectiveness of the Competition Authority will be strengthened; we will also merge the Competition Authority and National Consumer Agency. Requests for exemptions to the competition law framework will not be accepted unless they are consistent with the goals of the EU / IMF supported programme for Ireland and the needs of the economy.

Programme Financing

16. **The programme remains adequately financed.** Progress is ongoing in finalising loan documentation with our EU bilateral partners. The bilateral agreement with the United Kingdom is in place, with the first of 8 quarterly disbursements due to be made in the context of completion of this review. Loan arrangements with Sweden and Denmark are being finalised and envisage semi-annual disbursements, also linked to future programme reviews.

Programme Monitoring

17. Progress in the implementation of the policies under the programme will continue to be monitored through quarterly and continuous performance criteria, indicative targets, structural benchmarks, and quarterly programme reviews, as envisaged in the Letters of Intent of December 3rd, 2010, April 28, 2011 and this letter. The programme also continues to be in compliance with requirements under the Memorandum of Understanding on Specific Policy Conditionality. The attached Technical Memorandum of Understanding (TMU) defines the quantitative performance criteria and indicative targets under the programme. The Government's targets for the exchequer primary balance are monitored through quarterly performance criteria and net central government debt is an indicative target (Table 2). As is standard in EU/IMF arrangements, there is a continuous performance criterion on the non-accumulation of external payment arrears. Progress on implementing structural reforms is monitored through structural benchmarks (Tables 1 and 3).

18. We authorise the IMF and the European Commission to publish the Letter of Intent and its attachments, and the related staff report.

Table 1. Programme Monitoring

Measure	Date	Status
Quantitative Performance Criteria		
Cumulative exchequer primary balance	End-June 2011	Observed
Indicative Target		
Ceiling on the stock of central government net debt	End-June 2011	Observed
Continuous Performance Criteria		
Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the central government	Continuous	Observed
Structural Benchmarks		
Define the criteria to run stringent stress tests scenarios.	End-December 2010	Observed
Agree on terms of reference for the due diligence of bank assets by internationally recognised consulting firms.	End-December 2010	Observed
The Central Bank will direct the recapitalisation of the principal banks (AIB, BoI and EBS) to achieve a capital ratio of 12 percent core tier 1.	End-February 2011	Not observed[4]
Submit to Dáil Éireann the draft legislation on a special resolution regime.	End-February 2011	Observed [5]
The Central Bank to complete the assessment of the banks' restructuring plans.	End-March 2011	Observed
Complete the diagnostic evaluation of banks' assets.	End-March 2011	Observed
Complete stress tests (PCAR 2011).	End-March 2011	Observed
Complete a full assessment of credit unions' loan portfolios	End-April 2011	Observed
Finalise plans for the recapitalisation of Irish Life and Permanent.	End-May 2011	Observed
Establish a Fiscal Advisory Council.	End-June 2011	Observed
Complete the recapitalisation of Allied Irish Banks, Bank of Ireland, Irish Life and Permanent and EBS Building Society.	End-July 2011	Ongoing
Submit the Supervision and Enforcement Bill to Oireachtas.	End-July 2011	Ongoing
Complete the legal merger procedures of Allied Irish Bank and EBS Building Society.	End-September 2011	Observed
The merger of Irish Nationwide Building Society and Anglo-Irish bank.	End-December 2011	Observed

[4] Central Bank directions were issued within the required timeframe, however completion of the capital injections required was postponed by the Minister for Finance until after the General Election. These directions are now superseded by the Central Bank's PCAR directions of 31 March 2011.

[5] In practice this was submitted to the Seanad as discussed in paragraph 21of the MEFP, as the Dáil was dissolved owing to the elections.

Table 2. Quantitative Performance Criteria and Indicative Targets under the Economic Programme for 2011–12

	March 31, 2011		June 30, 2011		September 30 2011	December 31, 2011	March 31, 2012	June 30, 2012
	Target 1/	Outcome	Target 1/	Outcome	Target	Target	Target	Target
	(In billions of Euros)							
	Performance Criterion		Performance Criterion		Performance Criterion	Performance Criterion	Indicative Target	Indicative Target
1. Cumulative exchequer primary balance 2/	-7.9	-6.3	-10.1	-8.4	-14.2	-15.0	-5.7	-7.4
2. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the central government 3/	0	0	0	0	0	0	0	0
	Indicative Target		Indicative Target		Indicative Target	Indicative Target	Indicative Target	Indicative Target
3. Ceiling on the stock of central government net debt	92.1	88.5	94.6	91.7	98.6	100.4	107.9	112.0

1/ Adjusted.
2/ Measured by the exchequer balance excluding interest payments. Cumulative from the start of the relevant calendar year.
3/ Applies on a continuous basis.

Table 3. Upcoming Structural Benchmarks under the Programme for 2011

Measure	Date	Status
Financial sector policies		
Publish a memorandum of understanding governing the relationship of the Department of Finance and the Central Bank in relation to banking sector oversight (MEFP, ¶4).	End-October 2011	Proposed structural benchmark
Central Bank to issue guidance to banks for the recognition of accounting losses incurred in their loan book (MEFP, ¶8).	End-December 2011	Proposed structural benchmark
Finalise a strategy to guide the development of broader legal reforms around personal insolvency, including significant amendments to the Bankruptcy Act 1998 and the creation of a new structured non-judicial debt settlement and enforcement system (MEFP, ¶8).	End-December 2011	Proposed structural benchmark
Fiscal policies		
Introduce a medium-term expenditure framework with binding multi-annual expenditure ceilings with broad coverage and consistent with the fiscal consolidation targets (MEFP, ¶10).	2012 Budget day in early December 2011[6]	Structural benchmark
Submit to parliament, as part of the Fiscal Responsibility Bill, a legal framework for the Fiscal Advisory Council ensuring its independence (MEFP, ¶12).	End-December 2011	Proposed structural benchmark

[6] Timing advanced from end December 2011.

TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

28 July 2011

1. This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definitions of the indicators subject to performance criteria and indicative targets under the arrangement supported by the Extended Fund Facility (EFF). These performance criteria and indicative targets are reported in Table 1 attached to the Memorandum of Economic and Financial Policies (MEFP). This TMU also describes the methods to be used in assessing the programme performance and the information requirements to ensure adequate monitoring of the targets.

2. For programme purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at "programme exchange rates", with the exception of the items affecting the government fiscal balances, which will be measured at current exchange rates. The programme exchange rates are those that prevailed on November 24, 2010 as shown on the European Central bank web-page, in particular, €1 = 1.3339 U.S. dollar and €1 = 0.86547 SDR.

I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

Floor on the Exchequer Primary Balance

3. The exchequer balance is the traditional domestic budgetary aggregate which measures the net surplus or net deficit position of the Exchequer Account. The Exchequer Account is the single bank account of the Central Fund and is held at the Central Bank of Ireland. The annual audited accounts of the Exchequer Account produced by the Department of Finance are known as the Finance Accounts. An unaudited summary known as the Exchequer Statement is produced at the end of each month. Under the Irish Constitution, all Government receipts are paid in to the Central Fund and all Government expenditure is funded from it, unless provided otherwise by law.[7] The Exchequer balance is the difference between total receipts into, and total expenditure out of, the Exchequer Account. It measures the sum of the current and capital balances. The current balance is defined as current receipts (tax and non-tax revenue) minus current expenditure (voted expenditure and non-voted expenditure charged directly on the Central Fund, including the Sinking Fund). The capital balance is defined as capital receipts (Sinking Fund and other capital receipts) minus capital expenditure (voted and non-voted expenditure). The Sinking Fund provision is a transfer

[7] Receipts of the Central Fund comprise Exchequer tax revenues, non-tax revenues, receipts from the European Union and other capital receipts. Charges on the Central Fund include the expenditure of Government departments and offices, payments related to the servicing of the national debt, payments to the European Union Budget, the salaries, pensions and allowances of the President, judiciary, and Comptroller & Auditor General and the running costs of the Houses of the Oireachtas (Parliament). Extra-budgetary funds (including the National Pensions Reserve Fund), the Social Insurance Fund, semi-state bodies and local governments are not part of the Exchequer system.

from the current account to the capital account to reduce national debt and has no effect on the overall exchequer balance.

4. The performance criteria are set on the exchequer primary balance (the exchequer balance excluding net debt interest payments in the service of the National Debt).[8]

5. For the purposes of the programme, the floor on the exchequer primary balance (quantitative performance criterion) will be adjusted downward by payments for bank restructuring carried out under the programme's banking sector support and restructuring strategy. Such payments may include, inter alia, loans to banks, investments in their equity (requited recapitalisation), unrequited recapitalisation, and purchases of troubled assets, which are carried out in line with programme objectives. Any other financial operation by Government to support banks, including the issuance of guarantees or provision of liquidity, will be reported to EC, IMF, and ECB staffs.

6. The floor on the exchequer primary balance (quantitative performance criterion) in each year will be measured cumulatively from the start of that calendar year.

Cumulative Exchequer primary balance	(In billions of Euros)
From January 1, 2011:	
End-September 2011 (performance criterion)	-14.2
End-December 2011 (performance criterion)	-15.0
From January 1, 2012:	
End-March 2012 (indicative target)	-5.7
End-June 2012 (indicative target)	-7.4

7. The performance criterion on the exchequer primary balance (floor) will be adjusted upward (downward) for the full amount of any over-performance (under-performance) in Exchequer tax revenues, pay-related social insurance contributions (PRSI) and national training fund contributions against the current projection which is listed below: [9]

Cumulative Exchequer tax revenue & other receipts (as outlined in 7. above)	(In billions of Euros)
From January 1, 2011:	
End-September 2011 (projection)	28.6
End-December 2011 (projection)	42.4
From January 1, 2012:	
End-March 2012 (projection)	9.9
End-June 2012 (projection)	19.6

[8] Net debt interest payments are as per the end-month Exchequer Statements.

[9] Exchequer tax receipts are comprised of income tax (including the universal social charge), value added tax (VAT), corporation tax, excise duties, stamp duties, capital gains tax, capital acquisitions tax and customs duties.

8. Any policy changes, including in administration and enforcement of taxes, which impact the revenue projection set out in paragraph 7 will lead to a reassessment of the adjustor in the context of program reviews.

Ceiling on the Stock of Central Government Net Debt

9. The stock of net central government debt, for the purposes of the programme, is defined as the National Debt less liquid assets of the National Pensions Reserve Fund (NPRF). The National Debt is defined as the total outstanding amount of principal borrowed by central government and not repaid as of the test date, less liquid assets available for redemption of those liabilities at the same date. These liquid assets comprise the Exchequer cash balances (including cash in the Capital Services Redemption Account), Exchequer deposits with commercial banks and other institutions, and investments in investment grade sovereign bills. For the purposes of the programme, NPRF liquid assets include the asset classes listed above, and also all marketable securities such as equities, government bonds and other listed investments. NPRF shares in domestic Irish banks are excluded from the definition of liquid assets.

10. For the purposes of the programme, the ceiling on the central government net debt (indicative target) will be adjusted upward by debt arising from payments for bank restructuring carried out under the programme's banking sector support and restructuring strategy. These payments may include, inter alia, loans to banks, investments in their equity (requited recapitalisation); unrequited recapitalisation; and purchases of troubled assets, which are carried out in line with programme objectives. The programme exchange rates will apply to all non-euro denominated debt.

11. The ceiling on the outstanding stock of central government net debt will be adjusted upward (downward) by the amount of any final upward (downward) revision to the stock of end-June 2011 central government net debt.

Central government net debt	(In billions of Euros)
Outstanding stock:	
End-June 2011 (provisional)	91.7
End-September 2011 (indicative target)	98.6
End-December 2011 (indicative target)	100.4
End-March 2012 (indicative target)	107.9
End-June 2012 (indicative target)	112.0

Non-accumulation of External Payments Arrears by Central Government

12. The central government will accumulate no external payments arrears during the programme period. For the purposes of this performance criterion, an external payment arrear will be defined as a payment by the central government on its contracted or guaranteed

external debt that has not been made within five business days after falling due, excluding any contractual grace period. The performance criterion will apply on a continuous basis.

13. The stock of external payments arrears of the central government will be calculated based on the schedule of external payments obligations reported by the National Treasury Management Agency.

II. REPORTING REQUIREMENTS

14. Performance criteria under the programme will be monitored using data supplied to the EC, IMF, and ECB staffs. The Irish authorities will transmit promptly any data revisions in a timely manner.

- The Department of Finance will report the Exchequer balance to the EC, IMF and ECB staff, with a lag of no more than seven days after the test date.

- The National Treasury Management Agency will provide provisional figures on the outstanding stock of net government debt with a lag of no more than seven days after the test date. The revised figures will be provided within three months of the test date.

- The National Treasury Management Agency will provide the final stock of the central government system external payments arrears to the EC, IMF and ECB staff, with a lag of not more than seven days after the arrears arise in accordance with the definition of external payments arrears as set forth in paragraph 12 of this memorandum.