The IBRC, ELA, Promissory Notes and All That …

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Plan for this Talk

- Well known that Irish state is carrying a large debt burden due to decisions taken to bail out banks, particularly Anglo\INBS (now IBRC).
- But lots of confusion about the form of the debt and what can be done about it.
- Today, I will discuss
  – The IBRC's balance sheet
  – Exceptional liquidity assistance
  – Promissory notes and their potential restructuring

Anglo's Liabilities at End-2007

Components	Amounts
Total Liabilities	€92.6 billion
Deposits	€58.4 billion
Debt Securities	€23.6 billion
Subordinated Debt	€5.3 billion
Other Liabilities	€5.3 billion
Debts to Central Banks	Zero

Anglo's Liabilities at End-2010

Components	Amounts
Total Liabilities	€68.6 billion
Deposits	€12.1 billion
Debt Securities	€6.9 billion
Subordinated Debt	€0.5 billion
Other Liabilities	€3.6 billion
Debts to ECB	€16.9 billion
ELA Debts to Central Bank	€28.1 billion

Anglo's Liabilities at End-2010

Components	Amounts
Total Liabilities	€68.6 billion
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Anglo's Liabilities at 2011:H2

Components	Amounts
Total Liabilities	€50.7 billion
Deposits	€1.2 billion
Debt Securities	€5.7 billion
Subordinated Debt	€0.5 billion
Other Liabilities	€2.6 billion
Debts to ECB	€2.4 billion
ELA Debts to Central Bank	€38.4 billion

INBS’s Liabilities at End-2007

Components	Amounts
Total Liabilities	€14.6 billion
Deposits	€7.3 billion
Debt Securities	€6.7 billion
Subordinated Debt	€0.4 billion
Other Liabilities	€0.1 billion
Debts to Central Banks	Zero

INBS's Liabilities at End-2010

Components	Amounts
Total Liabilities	€12.2 billion
Deposits	€3.7 billion
Debt Securities	€0.6 billion
Subordinated Debt	€0.4 billion
Other Liabilities	€0.2 billion
Debts to ECB	€7.4 billion
ELA Debts to Central Bank	Zero

IBRC Liabilities at End-2007

Components	Amounts
Total Liabilities	€107.2 billion
Deposits	€65.8 billion
Debt Securities	€30.3 billion
Subordinated Debt	€5.6 billion
Other Liabilities	€5.4 billion
Debts to Central Banks	Zero

Guess at IBRC's Balance Sheet: July 2011
Billions of Euros

Assets		Liabilities	
Promissory Notes	28.1	Deposits	1.1
Loans	27.5	Debt Securities	6.3
Other	3.0	Subordinated Debt	0.7
		Other Liabilities	2.3
		Debts to ECB	6.0
		ELA Debts to Central Bank	42.2
Total	58.6	**Total**	58.6

Recent Senior Debt Developments

- IBRC Senior Debt in June 2011 was €6.3 billion. Only €2.9 billion was unguaranteed by the government.
- Since then, various repayments:
  - $1 billion in October 2011
  - €1.25 billion two days ago.
- So probably down to less than €1 billion in senior unsecured unguaranteed senior bonds.
- Could decide to default on guaranteed bonds but this probably would impact AIB and BoI.

What is ELA?

- **Exceptional Liquidity Assistance** provided by the Central Bank of Ireland.
- Legal basis: Section 5B(d) of Central Bank Act of 1942. Provides power to lend against security to credit institutions in pursuit of financial stability objective
- Not part of usual Eurosystem monetary operations.
- ELA loans accepted in return for collateral not accepted in Eurosystem operations.
- Risk falls on CBI, not shared with Eurosystem.

Where Did the ELA Come From?

- Not from borrowing it from the ECB.
- From thin air: This is textbook money creation.
- Money creation is decentralised in the Eurosystem. It is done by national central banks, not the ECB.
- The Central Bank simply credited the reserve accounts of the IBRC banks and this money was then used to pay off depositors and bondholders.

Interest on ELA

- The interest the CB charges the IBRC is top secret.
  - But CB has reported €510 billion in ELA interest in 2010.
  - “Other assets” averaged €21.3 billion in 2010 and was €1.6 billion before Anglo ELA.
  - Gives 2.58%. ECB rate was 1% throughout this period. So, my guess: ECB Refinancing Rate Plus 150bp.
- Is this pure profit for CBI? Not quite.
  - CBI compensates IBRC for its reserve balances.
  - When IBRC bondholders and depositors moved money out of Ireland, this increased CB’s “Target2” liability which it pays the refinancing rate on to Target2 creditors.

Central Bank Balance Sheets

Assets	"Liabilities"
Assets acquired by making loans and buying securities	Money created by making loans and buying securities
Some other stuff	"Central Bank Capital"

- Central Bank capital is the "residual item" – if the value of assets acquired in the process of making loans falls below the value of the money created, then this item will fall in value.

CBI Balance Sheet: Feb 2011 Billions of Euros

Assets		"Liabilities"	
Eurosystem Lending	117	Bank notes	12
Securities, gold, other claims	21	Reserve accounts	9
Other assets (ELA!!)	70	Other Liabilities	185
		Capital and Reserves	2
Total	208	Total	208

CBI Balance Sheet: Dec 2011
Billions of Euros

Assets		"Liabilities"	
Eurosystem Lending	107	Bank notes	13
Securities, gold, other claims	25	Reserve accounts	6
Other assets (ELA!!)	44	Other Liabilities	155
		Capital and Reserves	2
Total	176	Total	176

- Repayment of ELA by Irish banks this year has largely lead to a reduction in "*other liabilities*" (i.e. a reduction in the amount of money that has been created by the Central Bank of Ireland) rather than a big increase in holdings of securities, gold etc.

Why Not Just Write Off the ELA?

- Two knee-jerk answers
  - No: “Because the CBI’s assets will be worth less than it’s liabilities and it will be insolvent”

    …. Dun, dun, dun.

  - Yes: “Let’s do it. Central bank capital isn’t like private bank capital. The liabilities are notional and central bank insolvency is a meaningless idea”

Who's Right?

- The second answer is more correct than the first.
- Nothing bad happens if central bank capital is negative (insolvency isn't a useful word in this case) provided people accept the currency they print.
- **However**, printing money to bail out insolvent banks and then telling them they don't have to pay back could be considered
  - An abuse of the power to print euros (in a common currency area).
  - Very poor precedent (if everyone did it, we'd have higher inflation ….)

The Role of the ECB

- CBI is not free to do as it wishes in relation to ELA.
- Article 14.4 of ECB statute
  - *National central banks may perform functions other than those specified in this Statute unless the Governing Council finds, by a majority of two thirds of the votes cast, that these interfere with the objectives and tasks of the ESCB.*
- Does printing large amounts of money "interfere with the objectives of ESCB"? Some may think so.
- To avoid the two-thirds vote, CBI has to co-ordinate its ELA policies with the ECB Governing Council.

How Will IBRC Repay the ELA?

- IBRC’s legacy assets can cover its debts to the ECB, bondholders and others but cannot cover ELA debt.
- So how is the ELA debt to be repaid?
  - **Promissory notes**. The payment structure on these notes indicates an implicit repayment schedule for ELA that has been agreed with ECB.
  - **Letters of comfort** assuring CBI that the ELA will be repaid.
- “Restructuring promissory notes” to slow payments into IBRC doesn’t matter if ECB insists on ELA being repaid according to current implicit schedule.

Promissory Note Schedule

	Total Interest	Repayments	Total Capital Reduction	Total Amount Outstanding
31/3/2011	0.6	3.1	2.5	28.1
31/3/2012	-	3.1	3.1	25.0
31/3/2013	0.5	3.1	2.6	22.4
31/3/2014	1.8	3.1	1.2	21.2
31/3/2015	1.7	3.1	1.3	19.9
31/3/2016	1.7	3.1	1.4	18.5
31/3/2017	1.5	3.1	1.5	17.0
31/3/2018	1.4	3.1	1.6	15.4
31/3/2019	1.3	3.1	1.7	13.7
31/3/2020	1.2	3.1	1.9	11.8
31/3/2021	1.1	3.1	2.0	9.8
31/3/2022	0.9	3.1	2.2	7.6
31/3/2023	0.7	3.1	2.3	5.3
31/3/2024	0.6	2.1	1.5	3.8
31/3/2025	0.4	0.9	0.5	3.3
31/3/2026	0.4	0.9	0.5	2.8
31/3/2027	0.3	0.9	0.6	2.2
31/3/2028	0.3	0.9	0.6	1.6
31/3/2029	0.2	0.9	0.7	0.9
31/3/2030	0.1	0.9	0.8	0.1
31/3/2031	0.0	0.1	0.0	0.0
TOTALS	16.8	47.9	30.6	

Where Does the Money Go?

Irish Government

Provides Promissory Notes to

IBRC

Which Then Owes ELA debts to

Central Bank of Ireland

who accept repayment of ELA and reduce their stock of money created (effectively burning it)

Does the Interest Element of the Promissory Note Matter? No

- Interest on the promissory notes goes from one part of the state (central exchequer) to another (IBRC).
- Interest over and above interest on IBRC's liabilities provides income that can be retained inside IBRC and handed back to the state at a later date.
- Payment schedule actually implies ELA will be paid off by approx. 2022 and IBRC wound up rather than let accumulate pointless profits from state payments.
- True interest cost is cost of borrowing €3.1 billion per year to put into IBRC.

Parallel Worlds: Eurostat and Reality

- Actual payment schedule
  - €3.1 billion per year until 2023.
  - €2.1 billion in 2024.
  - €0.9 billion from 2025-2030.
  - €0.1 billion in 2031.
- Eurostat, however, book the payments on the national debt as
  - €31 billion in 2010, hence deficit of 32% of GDP.
  - A notional interest schedule every year after 2010.

One Reason the Promissory Note Interest Rate Does Matter

- Irish government and IBRC (and Eurostat) agreed a "holiday" from the notional interest over 2011-2013, reducing its impact on headline GGB deficit.
- This holiday ends in 2013 and interest booked will be €1.8 billion in 2014.
- Relative to this year, an extra €1.8 billion in cuts and tax hikes required just to keep 2014 GGB on track.
- Perhaps call the travel agent again in 2013?

A Concrete Proposal

1. Leave IBRC to use its existing resources to pay off bondholders, ECB, other creditors and as much ELA as it can, including the interest payments.
2. Restructure promissory notes to begin slowly repaying remaining ELA debts when the country recovers from crisis according to some quantitative criteria.
3. Request consideration of this proposal by ECB Governing Council.