EUROPEAN CENTRAL BANK

EUROSYSTEM

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Jean-Claude TRICHET
President

Mr Brian Lenihan
Tánaiste and
Minister for Finance
Government Buildings
Upper Merrion Street
Dublin 2
Ireland

Frankfurt, 15 October 2010
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Dear Minister,

I refer to our last phone conversation. As you know the ECB greatly appreciates the recent commitment of the Irish government to develop, in close cooperation with the Commission in liaison with the ECB, a multi-annual economic and fiscal adjustment strategy. Given Ireland's convincing track-record in fiscal adjustment, I am confident that your medium-term strategy will be successful in restoring fiscal sustainability and financial sector soundness.

In this context, I would like to draw your attention to a number of issues arising from the *extraordinarily large provision of liquidity by the Eurosystem to Irish banks* in recent weeks. The participation in Eurosystem credit operations is subject to rules. These include the requirement for the Eurosystem to base its lending operations with market participants on adequate collateral. Moreover, the General Documentation on Eurosystem monetary policy instruments and procedures requires our counterparties to be financially sound. In this context, the Eurosystem may limit, exclude or suspend counterparties' access to monetary policy instruments on the grounds of prudence and may reject or limit the use of assets in the Eurosystem credit operations by specific counterparties. The Governing Council indeed carefully monitors the Eurosystem credit granted to the banking system, in the Irish as well as in all other cases, and in particular the size of Eurosystem exposures to individual banks, the financial soundness of these banks, and the collateral they provide to the Eurosystem. The assessment by the Governing Council of the appropriateness of its exposures to Irish banks depends very much on progress in economic policy adjustment, enhancing financial sector capital and bank restructuring.

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Moreover, the provision of *Emergency Liquidity Assistance (ELA)* by the Central Bank of Ireland, as by any other National Central Bank of the Eurosystem, is closely monitored by the ECB's Governing Council as it may interfere with the objectives and tasks of the Eurosystem and the prohibition of monetary financing under the Treaties. Therefore, if ELA is provided in significant amounts, the Governing Council will assess whether there is a need to impose specific conditions in order to protect the integrity of our monetary policy. In addition, in order to ensure compliance with the monetary financing prohibition, it is essential to ensure that the ELA recipient institution continues to be solvent.

Against the background of these principles, I would like to re-emphasize that the current *large provision of liquidity by the Eurosystem and the Central Bank of Ireland to entities such as Anglo Irish Bank should not be taken for granted as a long-term solution*. Given these principles, the Governing Council cannot commit to maintaining the size of its funding to these institutions on a permanent basis.

As I told you, a key element of the monitoring by the Governing Council of Eurosystem exposure to the Irish banking system, and the related decisions the Governing Council may take, will be its assessment of *progress in implementing the four-year economic strategy* that the Irish government envisages to announce in early November. This is not only because significant parts of the Irish banking systems are partially or fully Government owned, but also because an important share of the Eurosystem exposure to Irish credit institutions is collateralised with securities issued or guaranteed by the Irish Government. I trust that the four-year strategy will target a fiscal deficit of below 3% in 2014 and a decline in the public debt-to-GDP ratio from 2012/13 onward, based on cautious real growth forecasts, as well as a strong structural reform programme. Future decisions by the Governing Council of the ECB regarding the terms of liquidity provision to Irish banks will thus need to take into account appropriate progress in the areas of fiscal consolidation, structural reforms and financial sector restructuring.

With my best regards,

Cc.: Mr Olli Rehn, EU Commissioner for Economic and Monetary Affairs
Mr Joaquin Almunia, EU Commissioner for Competition