Central Bank & Financial Services Authority of Ireland

Annual Report

Report of the Central Bank and Financial Services Authority of Ireland
for the year ended 31 December 2005

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Central Bank and Financial Services Authority of Ireland

28 June 2006

Dear Minister,

I have the honour to enclose herewith the Activities and Annual Accounts of the
Central Bank and Financial Services Authority of Ireland for the year ended 31 December 2005.

Yours faithfully,

John Hurley,
Governor

The Minister for Finance

Board of Directors

John Hurley
Governor

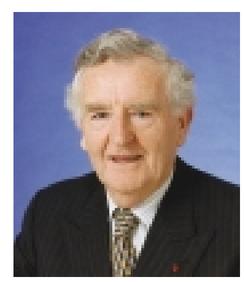
Liam Barron

David Begg

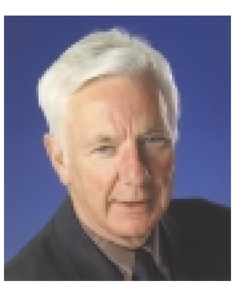
Tom Considine

Gerard Danaher

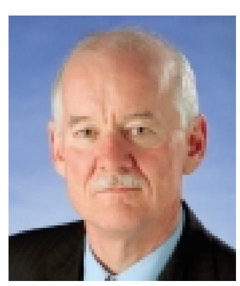
Friedhelm Danz



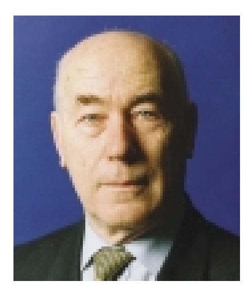
Roy Donovan



John Dunne

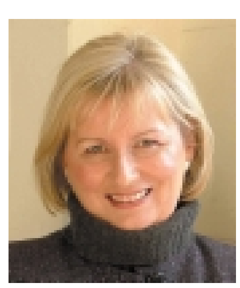


Patrick Neary

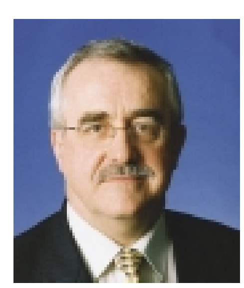


Martin O'Donoghue

Brian Patterson



Deirdre Purcell



Brian Halpin
Secretary

The Board of Directors and Management of the Central Bank and Financial Services Authority of Ireland

John Hurley, *Governor*

Liam Barron	David Begg	Tom Considine
Gerard Danaher	Friedhelm Danz	Roy Donovan
John Dunne	Martin O'Donoghue	Patrick Neary
Brian Patterson	Deirdre Purcell	

	Function	**Head of Function**
Director General		
Liam Barron	– *European Monetary Affairs and International Relations*	– John O'Leary
Deputy Director General and Secretary		
Brian Halpin	– *Corporate Services*	– Hugh O'Donnell
	– *Financial Control*	– Mary Sheehy
	– *Human Resources and Planning*	– Jim Cummins
	– *Information Systems*	– Pádraig Ó Conaill
	– *Internal Audit*	– Donal Cahalane
Assistant Director General		
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	– *Insurance Supervision*	– Patrick Brady
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Mary O'Dea	– *Consumer Information*	– Sharon Donnery
	– *Consumer Protection*	– Bernard Sheridan
	– *Planning and Finance*	– Patricia Moloney

Peter Charleton is on secondment to the International Monetary Fund as Alternate Executive Director from June 2005.

Contents

Abbreviations

BIS	Bank for International Settlements
CBFSAI	Central Bank & Financial Services Authority of Ireland
ECB	European Central Bank
EFC	Economic and Financial Committee
EMU	Economic and Monetary Union
EPC	Economic Policy Committee
ESCB	European System of Central Banks
EU	European Union
FR	Financial Regulator
FSC	Financial Stability Committee
GDP	Gross Domestic Product
GNP	Gross National Product
HICP	Harmonised Index of Consumer Prices
IMF	International Monetary Fund
IRIS	Irish Real-time Interbank Settlement
LTROs	Longer-Term Refinancing Operations
MROs	Main Refinancing Operations
NCBs	National Central Banks
OECD	Organisation for Economic Cooperation and Development
RTGS	Real-Time Gross Settlement
TARGET	Trans-European Automated Real-Time Gross Settlement Express Transfer

Foreword

In 2005 the international economic environment was generally benign with world economic growth estimated to have increased by 4.8 per cent with a notably strong performance in the US and Asia. In the euro area the pace of economic activity gained momentum in the first three quarters of the year, although growth eased back, apparently temporarily, in the final quarter of the year. For 2006, the IMF estimates that world growth will be marginally higher than last year, i.e., 4.9 per cent. The principal risks to continuing economic growth internationally are uncertaintities regarding oil prices and also exchange rates arising from continuing large global imbalances. On the domestic front, the Irish economy continued to perform strongly in 2005 and the prospects for 2006 are for growth of about 5 per cent in both GNP and GDP. Downside risks to the economy include the recent acceleration in house price increases and the continued strong growth in credit. Developments in the international and domestic economy are discussed in more detail in the Economic Overview chapter.

The past year has seen the continuation of the good working relationship within the Central Bank and Financial Services Authority of Ireland (CBFSAI) since the restructuring of the organisation in May 2003. The Financial Regulator has been in place within the reorganised CBFSAI since then. Both entities have continued to work in close partnership in particular on financial stability issues as well as the utilisation of shared services.

As a member of the Eurosystem, the principal core objectives of the Central Bank are to ensure price stability by contributing to the formulation and implementation of monetary policy, to promote financial stability through analysis of key issues and potential vulnerabilities in the Irish financial system, to maintain a safe and reliable payments system, to manage our investment assets to achieve a maximum return for the Exchequer, and to provide sufficient quantities of notes and coin to meet demand. These objectives form the basis of the Bank's three-year Strategic Plan. Progress on the implementation of the plan through its second year is published in this Report.

Apart from the ongoing work in progressing these objectives, significant developments in 2005 included progress in the improvements to the payment system through development work on TARGET2 (the Irish banking community is scheduled to migrate to TARGET2 in 2008); the publication of a second extensive stand-alone Financial Stability Report which allowed the Bank to expand greatly the coverage of financial stability issues; and the distribution of an educational information pack, covering monetary policy and price stability issues, to 750 secondary schools in Ireland.

The Annual Accounts are presented later in the Report. The Bank‘s profits from its operations during the year amounted to €122 million, an increase from last year‘s figure of €106.9 million. The Bank‘s investment portfolio increased by €1,346 million on the 2004 figure to a total of €10,751 million, the increase being mainly due to increased holdings of euro assets and the reinvestment of dividends and interest.

In conclusion, I would like to thank the Board of Directors for their assistance, commitment and leadership during another busy year for the organisation. I would like to offer my thanks in particular to Liam O'Reilly who retired in early 2006 from the post of Chief Executive of the Financial Regulator. Liam had a major role in establishing the Financial Regulator and in building it into an effective organisation. I would also like to pay tribute to all the staff in the Central Bank and Financial Services Authority of Ireland for their help and dedication during the year. I look forward to their continuing support in the coming year.

John Hurley
Governor

Economic Overview

International and Euro Area Economy

The global economy continued its robust expansion in 2005, slowing only slightly from the very strong rates of growth seen in 2004. The strength and resilience of global growth last year exceeded expectations, with the international economy largely weathering the sharp increase in oil prices. Activity continued to benefit from still favourable financing conditions and strong corporate profit growth, which boosted investment and employment. Once again, the pace of expansion in 2005 was strongest in the US and emerging Asia, with growth in the former relatively resilient to the devastation caused by hurricanes and the disruption to oil supplies. Significantly, however, recovery became well established in Japan, while economic activity strengthened in the euro area from the middle of last year. These developments helped to narrow some of the divergence in economic performance across the major regions that had been evident in recent years. Nevertheless, with the US still the main locomotive for the global economy in 2005, the pattern of growth continued to exacerbate global imbalances, which continued to widen and remain an ongoing risk to the global outlook. Looking ahead, the outlook for the global economy remains favourable and the latest forecasts from the major international economic institutions suggest that global growth should continue to withstand most of the dampening influence of higher oil prices. Consequently, the global economy is projected to grow in 2006 at a broadly similar rate as last year.

Despite the strength of oil prices and the resilience of economic activity, the rise in global inflation has remained relatively contained. While higher oil prices have pushed up headline rates of inflation, there is little evidence as yet to suggest that this has become embedded. So far, there has not been much evidence of transmission of higher energy costs to the prices of non-energy goods and services. Higher oil prices did not have much effect on wage behaviour in 2005, while a wide range of indicators suggest that medium to long-term inflation expectations remained well contained. As a result, while headline rates of inflation have accelerated, core inflation rates — which exclude the effects of food and energy price changes — remained broadly stable in most countries.

In the euro area, there were signs of a gradual improvement in growth performance and prospects in 2005. Euro area economic recovery had been slow to take off in recent years. The problem was that the normal sequence of recovery, which tends to run, first, from a pick-up in export growth, then to a recovery in investment and finally, on to a strengthening of consumer spending, was not operating. While the external engine was firing strongly, the domestic engine was not. Over the course of 2005, however, developments became more encouraging. Following moderate growth between mid-2004 and mid-2005, signs have emerged that euro-area growth is gathering some momentum. While quarterly growth rates were somewhat volatile in the second-half of last year, the bulk of the evidence suggests that economic performance has improved. While external trade continues to provide a significant impetus to growth in the euro area, there are now also signs of an improvement in domestic demand. Business confidence has strengthened significantly since last summer, contributing to a welcome recovery in investment. The improvement in investment reflects not only the favourable external stimulus, but also the impact of improved business balance sheets and efficiencies, as well as rising profitability. However, progress remains slow in relation to consumer spending — the main element of domestic demand. While consumer confidence has picked up more recently, consumer spending growth remains somewhat subdued, though there are some signs of improvement.

There are, however, some risks to the outlook for growth and inflation which lie ahead. Oil prices remain high and volatile, threatening to slow growth and raising the risk of higher inflation. In this regard, it is essential to ensure that second-round effects on wage and price-setting behaviour are avoided. In the longer term, it is difficult to say how the price of oil might evolve. However, recent oil price strength would appear to reflect the combination of strong demand, lack of spare production capacity and uncertainties surrounding supply. This makes it likely that higher oil prices will persist for some time yet and there is an ongoing risk that oil prices could rise further and potentially combine with other negative factors to cause more protracted problems for the global and euro-area economies.

Oil prices are not the only external factor complicating the outlook. There are also the risks posed by widening global current account imbalances, which show no signs of abating. These continue to pose challenges for the adjustment process. At present, the large US current external deficit has, as a principal counterpart, large surpluses of Asian and oil-exporting countries. Different perspectives on the issue point to a number of elements as being a necessary part of the process to promote adjustment without undue disruption — higher spending including investment activity in parts of Asia, stronger growth in the euro area, lower dissaving in the US and exchange rate changes, among others.

Notwithstanding these risks, however, conditions are broadly in place for ongoing economic expansion in the euro area. A favourable external environment should continue to provide support for exports. Investment should also benefit from what are still very favourable financing conditions, improved business balance sheets and gains in corporate earnings. On the consumer side, spending is likely to grow gradually and broadly in line with developments in incomes. Forecasts from the major international institutions point to an improved euro-area growth outlook for this year and next compared with the past two years, with economic growth of around 2 per cent projected for both 2006 and 2007, compared with 1.4 per cent last year. While it has taken time, slowly the euro-area economy is returning towards its trend growth rate.

Domestic Economy

Turning to the domestic scene, the Irish economy continued to perform well last year. The increase in Gross National Product (GNP) amounted to 5.4 per cent, a notable pick-up on the increase of 4 per cent in 2004. The increase in Gross Domestic Product (GDP) was 4.7 per cent, marginally up on the corresponding figure for 2004. Indeed, since the effect of the Information Technology shock of 2001 has worn off, the growth of both GNP and GDP has been satisfactory and relatively stable with fairly limited volatility. These growth rates are close to the economy's estimated potential growth rate and, with unemployment at a consistently low rate of about $4\frac{1}{4}$ per cent, the economy would also seem to be operating close to capacity. Little change in this picture seems likely this year, with economic growth projected to be of the order of 5 per cent.

Based on the latest National Accounts data, last year and, to only a slightly lesser extent in the immediately preceding few years, economic growth has been driven mainly by employment increases with a correspondingly weaker productivity performance. Productivity increases in the aggregate economy in the past two years have been running at a rather modest 1 per cent a year. This compares with average productivity increases in the second half of the 1990s of about $3\frac{1}{4}$ per cent a year. While these latter increases were above what could be sustained over the medium-term, productivity increases of 1 per cent a year as in the past two years are relatively modest and would need to be improved upon.

This recent growth has been driven mainly by domestic demand directed primarily towards the more labour-intensive sectors in the economy — construction and services — which are characterised by relatively low productivity improvements from one year to the next. Employment in the construction sector last year increased by more than 14 per cent spurred on by another record number of housing units completed, substantial activity in the housing improvements sub-sector as well as by a strong performance in the non-residential construction sector. The construction sector now accounts for nearly 13 per cent of total employment, an exceptionally high fraction by international standards. Employment in services activities also increased strongly by 5.3 per cent last year in response to a notable step-up in consumption spending which increased by over $5\frac{1}{2}$ per cent last year.

A related factor that reflected the somewhat unbalanced nature of growth and that also contributed to relatively weak overall productivity last year was the modest performance of the industrial sector. The manufacturing sector in particular is often seen as a major driver of productivity. The output of the manufacturing sector increased by a relatively modest 3.1 per cent last year, albeit an improvement on the almost static position of the previous year. This compares with output increases in double figures in the latter half of the past decade and related strong productivity increases. The marked deceleration in growth in this sector mainly reflected the effects of the ICT shock in 2001 together with a significant deterioration in competitiveness associated with relatively high inflation here and a sharp strengthening of the euro through mid-2003. In the face of these developments, the performance of the more modern sub-sectors of manufacturing has been more volatile than that of all other sub-sectors. However, from the latter part of last year through the early part of this year, the manufacturing sector, particularly the more traditional sub-sectors, has been registering a somewhat improved performance.

The contribution of different sectors to growth last year from an output perspective reflects the relative strength of different types of spending in the economy. As stated, domestic spending was relatively strong with both consumption spending picking up and the demand for housing remaining buoyant. On the other hand, exports of goods and services increased by less than 2 per cent compared with the overall growth in world trade of more than 7 per cent. While on a price comparison basis, the competitiveness of Irish exports did not appear to change much last year, the cost base in the Irish economy worsened substantially relative to elsewhere. Cost-based measures are arguably a better indicator of competitiveness insofar as a relatively small player such as Ireland on the world stage has very limited pricing power in its export markets so that it has to accept the going price. In the light of this, price competitiveness indicators may vary relatively little and so may not be so informative. The key issue is whether Irish exporters can profitably produce for export markets in the light of the development of domestic costs. With unit labour costs in the Irish economy increasing by about $4\frac{1}{2}$ per cent a year in each of the last two years compared, for example, with 1 per cent in the euro-area economy, the competitive position of the export sector has worsened. This would seem to explain, at least in part, the relatively weak export side of the economy for some time. With strong domestic demand and these competitiveness pressures, the balance of payments deficit widened from 1 per cent of GNP in 2004 to an estimated $2\frac{3}{4}$ per cent of GNP last year.

On the back of relatively strong growth in the global economy, as indicated earlier, and with world trade forecast to grow by close to 10 per cent a year for the next two years, the prospects for the Irish economy remain generally good with economic growth expected to be of the order of 5 per cent a year. Domestic demand is expected to remain buoyant. Supported by the maturing of the state-supported personal savings schemes, consumer spending may register somewhat higher growth — perhaps about 6 per cent — than last year's strong performance, although the growth in building and construction may ease back somewhat while still operating at very high levels of activity. In spite of competitiveness pressures, exports of goods and services are expected to recover from their recent weak patch with growth of the order of 5 per cent a year envisaged for the next few years.

While the overall prospects for the economy remain good, there are a number of risks and vulnerabilities. As indicated earlier, the principal external risks centre round the uncertainties relating to oil prices and the possibility of sharp changes in exchange rates that could arise from continuing large global imbalances. Apart from oil-producing countries, all countries have been adversely affected by the sharp increase in oil prices in recent years. While the energy intensity of the Irish economy is relatively low, Ireland's dependence on oil as a primary energy source is substantially higher than most other advanced economies. Accordingly, the Irish economy is more vulnerable than most other economies to oil price increases with consequential adverse implications for competitiveness. In addition, amongst euro-area countries since a relatively small proportion of our exports — 40 per cent — go to other euro-area countries, the Irish economy is more exposed to sharp exchange rate movements than most other countries. The fairly long period of relative stability of the euro against sterling and the US dollar has been followed recently by a weakening of the US dollar. This will present challenges of adaptability and flexibility for exporters to the US.

There are also a number of domestic issues facing the economy. The first relates to the need to avoid excessive reliance on domestic demand relative to exports. Over the past four years, domestic demand has increased at an average rate of 5 per cent a year compared with a more modest increase in exports of less than $3\frac{1}{2}$ per cent a year. The consumption component of domestic demand seems likely to remain strong and may even see accelerated growth over the next two years. On the other hand, developments in domestic investment, in particular in the residential construction sector, are more problematic. The demand for housing remains strong supported by a growing population and rising incomes, although most assessments suggest that the current rate of house-building is running well ahead of what will be required over the medium term. The increase in interest rates since December together with the expectation of further increases over time could be expected to dampen the softer part of housing demand in time. The challenge will be to ensure that a downsizing of the house construction sector can be managed through a redeployment of labour to infrastructure projects, where significant needs still exist, as well as to other sectors of the economy.

Easier domestic demand conditions would limit the extent of domestic inflation and cost pressures and make for a more favourable context for an improvement in exports. A more sustainable evolution of domestic demand would also promote an environment where pay increases develop in a manner consistent with price stability and trend productivity. Fiscal policy also has a useful role to play in this regard. With the economy growing at a rate close to its potential, there is little need for fiscal policy to impart a stimulus to demand. Indeed, the Government's budgetary position, the General Government balance, has been in surplus since 2002. Although a deficit was envisaged for 2006 at the time of the Budget, developments so far this year as well as revised forecasts by Government suggest that the deficit may be small and could even end in surplus. It is appropriate that, in good times, the Government finances should be in surplus in order to provide a buffer at times of weaker economic growth. This is reinforced by the fact that the Exchequer has benefited substantially for some time from the very strong property market; in due course, it will be necessary to cope with reduced revenue flows from this sector.

A further area of risk that has been of concern for some time is that of house prices and the related large increases in borrowing. The easing in house price increases that was evident towards the middle of last year has not persisted. Since then, house price increases have resumed a strong upward trend with annual increases averaging about 12 per cent in the first four months of this year. Before this recent acceleration in house price inflation, prices were already at very stretched levels. Currently the ratio of new house prices to average incomes in the country is very high by both historical and international standards. These recent price increases are well in excess of construction cost changes which have increased at a much slower pace for many years. The acceleration in house price inflation has increased the risk of an overvaluation in house prices and, as a consequence, has clearly increased the probability of a sharp correction.

Related to the high level of housing construction and the re-acceleration of house price inflation, residential mortgage lending has picked up to annual rates of increase of the order of 30 per cent in the early part of this year. This is equivalent to over four times the rate of increase in nominal GNP. Although non-mortgage credit has grown more slowly, the household sector's debt to income ratio continues to increase strongly, and is now amongst the highest of advanced countries. While affordability criteria would still seem to be broadly met by borrowers, this increased indebtedness is likely to bear heavily on the more leveraged segment of borrowers. Although the increases in interest rates since the end of last year have had little apparent impact on house prices or borrowing, they should, along with market expectations of further increases in interest rates, be a restraining factor on both house prices and borrowing. This would confer much-needed beneficial stabilising effects on the economy.

Activities of the Central Bank and Financial Services Authority of Ireland

Introduction

Reporting Requirement

The Bank is required, in accordance with Section 6 (I) of the *Central Bank Act, 1942* (as inserted by Section 7 of the *Central Bank and Financial Services Authority of Ireland Act, 2003*) to prepare and send to the Minister for Finance, within six months of the end of the year, a report of its activities during the year. The report is laid by the Minister before each House of the Oireachtas.

Structure of Chapter

This chapter reports on the Bank's activities for 2005 and describes the main areas of responsibility of a National Central Bank as a member of the Eurosystem. The Bank's role in contributing to the formulation of monetary policy within the euro area together with its implementation is first outlined. Secondly, the conclusions from the second stand-alone Financial Stability Report, published in November 2005, are summarised. Subsequent sections of this report review work done in the area of Economics, Research and Statistics; how the Bank's investment assets are managed; progress in the wholesale payments system (TARGET2); and developments in the production and issue of notes and coins. The chapter concludes with an overview of the various international organisations and committees in whose work the Bank participates.

Price Stability and Monetary Policy

Monetary policy in the euro area is determined by the Governing Council of the ECB (the Council) which comprises the Governors of each of the twelve participating Member States' central banks (including the Governor of the Central Bank & Financial Services Authority of Ireland) and the six members of the Executive Board of the ECB.

Primary Objective

Price Stability

The primary objective of monetary policy is the maintenance of price stability in the euro area. The ECB announced its monetary policy strategy in May 1998, which it confirmed and clarified in May 2003. The strategy comprises a quantitative definition of price stability and two analytical perspectives (i.e. an economic analysis which assesses short- to medium-term determinants of price developments and a monetary analysis which focuses on a longer-term horizon, exploiting the long-run link between money and prices) for assessing inflation risks. Price stability has been defined as a year-on-year increase in the Harmonised Index of

Consumer Prices (HICP) for the euro area of below but close to 2 per cent. This underlines a commitment to guard against the risk of deflation and it also addresses the possible presence of a measurement bias in the HICP and the implications of inflation differentials within the euro area. The ECB is focused on assuring price stability over a medium-term time horizon and does not attempt to fine-tune price developments in the short term. This medium-term orientation allows monetary policy to take into account concerns about output fluctuations. The decision to publish a quantitative definition of price stability fosters transparency and accountability, and also provides a benchmark for stable inflation expectations in the euro area.

Analysis of Risks

Two Perspectives

Monetary policy decisions are based on a comprehensive analysis of the risks to price stability, organised on the basis of two complementary perspectives on the functioning of the economy. These perspectives centre around an ''economic analysis'' and a ''monetary analysis.'' The former aims at assessing short- to medium-term determinants of price developments, focusing mainly on the assessment of current economic and financial developments and the implied risks to price stability. This includes an analysis of shocks hitting the euro-area economy and projections of key macroeconomic variables. The latter ''monetary analysis'' approach assesses medium- to long-term trends in inflation in view of the close long-run relationship between money and prices. Monetary analysis takes into account developments in a wide range of monetary indicators including M3 and its components and counterparts, especially credit, and various measures of excess liquidity. In this context, the Council has adopted a reference value for the annual growth rate of euro-area broad money stock (M3) and it monitors the actual growth of M3 relative to this value. The reference value is a medium-term concept and, accordingly, short-term deviations of M3 growth from the reference value do not necessarily have implications for future price developments. Consequently, as the Council has stressed, such deviations do not automatically require a policy response.

Governor Briefing and ESCB Committees

Interest Rate Stance

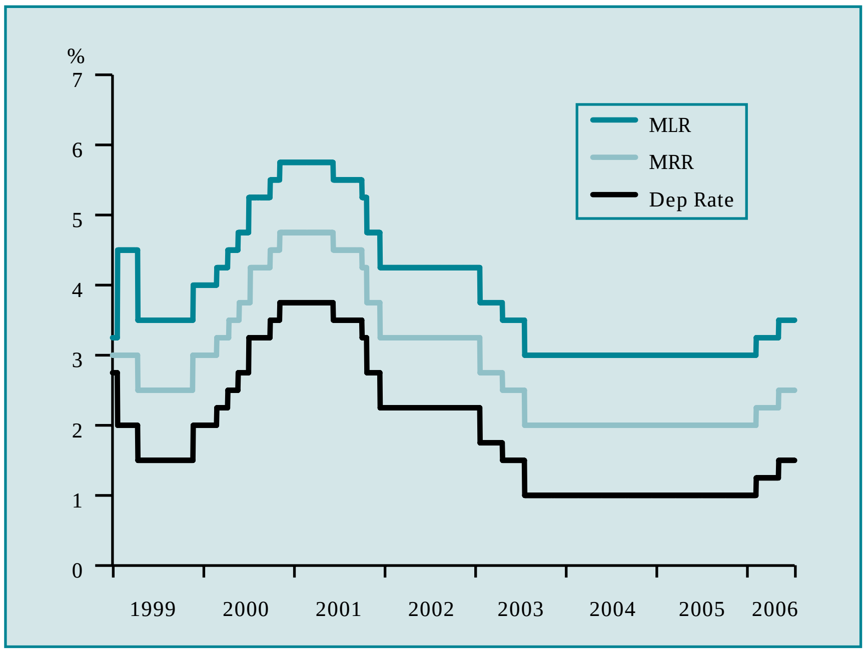
The Governor is fully briefed by Bank staff for all meetings of the Council. For monetary policy discussions, the briefing includes an assessment under both pillars of the monetary policy strategy leading to a judgement on the appropriate interest rate stance for the euro area. Information is also supplied relating to other monetary-policy related matters addressed by the Council, including issues concerning the implementation of monetary policy and the financial statistics of the Eurosystem. Discussion of issues at the Governing Council is informed by preparatory work by the committees of the ESCB, on each of which the Bank is represented. One of these is the Monetary Policy Committee (MPC). The MPC is involved in the preparation of macroeconomic projections for the euro area, and these constitute a major input to the Council's deliberations. In addition, the MPC conducts specific tasks at the request of the Governing Council. In 2005 these included analytical work on the Stability and Growth Pact and a number of technical issues relating to the Eurosystem's macroeconomic projections. In 2005, as in previous years, the MPC also worked on a number of regular reports prepared for the Governing Council, including a report on structural issues dealing with competitiveness and the export performance of the euro area, and a report on public finance examining the fiscal position of EU countries.

Interest Rates

Increase in Rates

Having maintained official interest rates unchanged since June 2003, the ECB announced increases of 0.25 of a percentage point in each of its three key rates on 1 December last year. This move brought the main refinancing operations rate to 2.25 per cent. This was followed by a further similar increase in March 2006, bringing the main refinancing rate to 2.5 per cent. These increases were considered to be warranted to adjust the stance of the ECB's monetary policy to take into account somewhat increased risks to price stability. Reflecting this increase in official rates, the average standard variable mortgage rate in Ireland increased to over 3.6 per cent by the end of 2005, having been steady for some time at a little under 3.5 per cent. Following the further increase of the main refinancing rate in March, the average standard variable mortgage rate increased to just under 3.9 per cent.

Chart 1: ECB Official Interest Rates



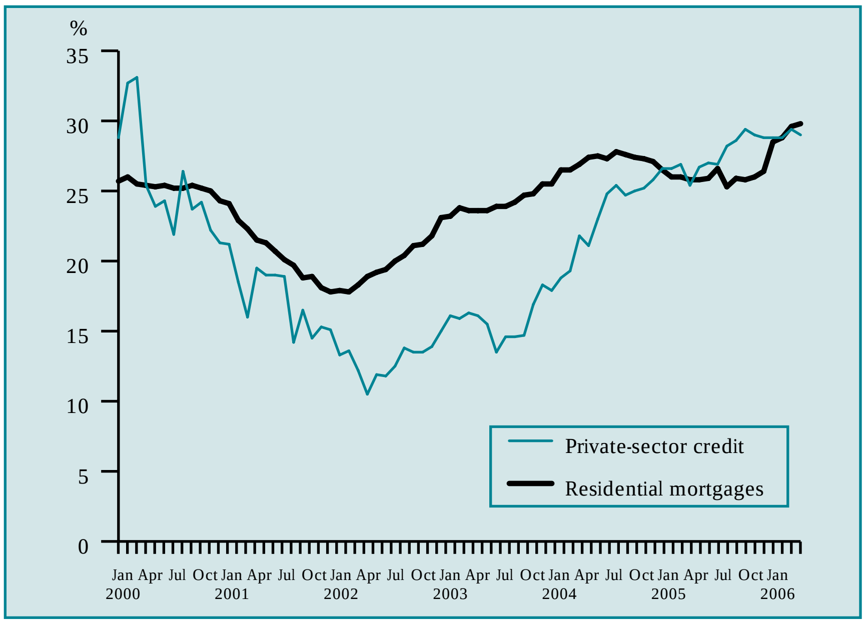
Credit Growth in Ireland

Rate of Growth

Against the background of this monetary policy setting for the euro area, monetary and credit aggregates in Ireland continued to grow strongly. The underlying annual adjusted rate of private-sector credit growth has maintained a steady upward trend since the middle of 2003.[1] Although the rate of increase decelerated somewhat around mid-2004, the rate of increase reached its highest level since the spring of 2000 in February 2006. The average increase for last year was 27.7 per cent, compared with 23.5 per cent in 2004 and just under 16 per cent in the previous year. By end-March 2006, the underlying annual adjusted growth rate for private sector credit reached 29 per cent. Residential mortgage loans account for around 37 per cent of total private-sector credit at end-March 2006. In 2005, these accounted for a similar proportion of the increase in private-sector credit, a somewhat smaller share than in previous years. The declining contribution of mortgage lending to credit growth reflects the pick-up in non-mortgage credit growth in recent years. However, the underlying rate of residential mortgage growth[2] accelerated steadily from early 2002 to mid-2004; thereafter, the underlying annual growth rate[3] tended to fluctuate in a range of 25-27 per cent, but it increased to 28.5 per cent in December of last year. The average underlying growth rate was 26.4 per cent in 2005, similar to the 26.2 figure for the previous year, but up on the 24.2 rate in 2003. The underlying rate of residential mortgage growth has continued to increase in the early part of 2006, reaching a record rate of 29.8 per cent in March.

Mortgage Lending

Chart 2: Underlying Annual Adjusted Growth Rates for Credit



1 Private-sector credit figures are adjusted for the effect of non-bank lending to IFSC entities and for valuation effects due to exchange rate movements. In addition, the underlying rate takes account of the fact that annual growth rates for credit growth and residential mortgage lending were boosted in the period from July 2004 to June 2005 by the impact of the relocation to an Irish credit institution of residential mortgages previously recorded on the balance sheet of the non-resident parent institution.

2 Adjusted for securitisations.

3 Adjusted for the exceptional item referred to in footnote 1.

Non-Mortgage Credit

As mentioned, non-mortgage credit has accounted for an increasing share of private-sector credit. The annual rate of growth in non-mortgage credit has been on a steadily rising trend since the middle of 2003, rising from a rate of around 8 per cent to around 30 per cent towards the end of last year. The average annual growth rate increased from almost 20 per cent in 2004 to just under 27 per cent last year. The annual rate of growth in non-mortgage credit has moderated in the first quarter of 2006, and stood at 28.1 per cent at end-March. However, the sectoral breakdown of credit growth suggests that much of the increase in non-mortgage credit growth to the private sector is due to non-mortgage property-related lending, i.e. lending to the construction sector and to real estate activities, which both grew strongly in 2005. Property-related lending, both to households and businesses, dominates private-sector credit and has also accounted for most of the total increase in credit in recent years. At end-2005, property-related lending accounted for about 58 per cent of total private-sector credit, and it contributed to almost 70 per cent of the increase in credit last year. However, non-property related lending, having recorded little growth in the two years to 2003, increased by some 13 per cent in 2004, and advanced by an additional 21 per cent last year. The increase in non-property related lending was spread across a number of sectors. The largest contributor was lending to the category ‘Financial Intermediation’, although much of this reflected lending to non-bank IFSC entities. In addition, there was also strong growth in non-housing lending to the personal sector, lending to hotels and restaurants, and lending to the retail sector.

Pupils from St. Vincent’s Secondary School, Dundalk at the launch of the ECB schools pack on price stability

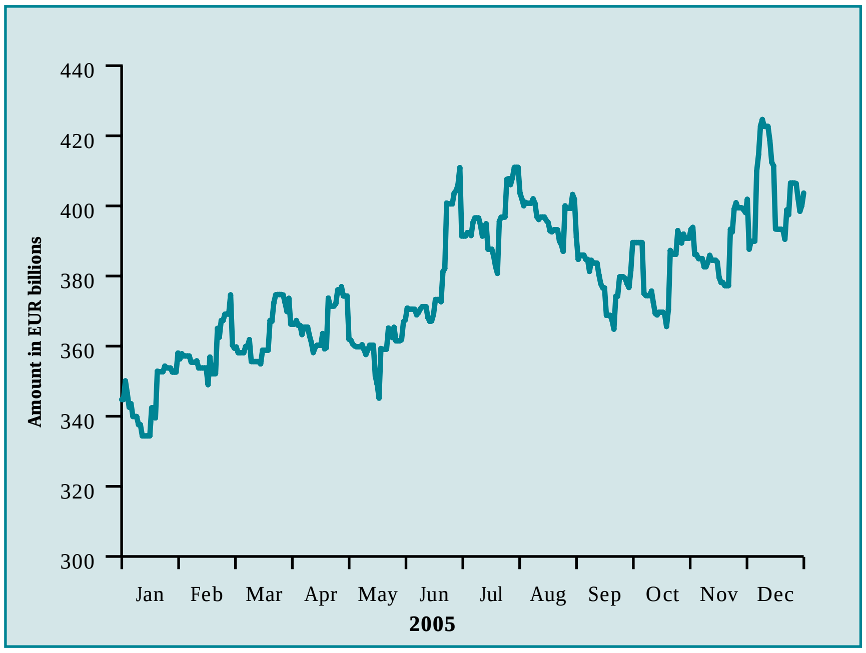
Monetary Policy Implementation

Decentralised Structure

The implementation of monetary policy in the euro area is conducted on a decentralised basis i.e. by the individual NCBs. Within this framework, financial institutions in Dublin submit tenders for Main Refinancing Operations (MROs), Longer-Term Refinancing Operations (LTROs) and Fine-Tuning Operations (FTOs) directly to the Bank, and allotments or absorptions of liquidity — the amounts having been determined by the ECB — are carried out by the Bank and reflected on its balance sheet. Overnight standing deposit and lending facilities are also provided by the Bank to financial institutions on their own initiative on behalf of the Eurosystem, while the minimum reserve deposits[4] of credit institutions in Ireland are also maintained at the Bank.

In 2005, the total refinancing needs of the banking system in the euro area (the liquidity shortage) continued to increase sharply, reaching almost €400 billion on a daily average basis at the end of the year (see Chart 3). The main factor behind this rise was the circulation of banknotes, which increased by some 15 per cent in 2005 and reached an all-time high of €568 billion in December.

Chart 3: Evolution of Euro-Area Liquidity Shortage



The banking system in Ireland continued to take a disproportionately high share of monetary policy lending to euro-area banks, reflecting the importance of Dublin as a financial centre. Such lending in 2005 represented over 60 per cent of

4 Credit institutions in the euro area are required to hold deposits on account with the NCBs, called minimum or required reserves. The main function of the minimum reserves system and its averaging provision is to stabilise money market rates by smoothing the effect of daily liquidity fluctuations. It also enlarges the structural liquidity shortage. The minimum reserve requirement for each credit institution is calculated on the basis of selected liabilities (the reserve base) and reserve balances are remunerated at an average of the MRO rates. Where an institution fails to meet its requirement sanctions may be imposed by the ECB.

the assets on the Bank's balance sheet compared with around 50 per cent in 2004.

Monetary Policy Operations in 2005

MROs

Main Refinancing Operations (MROs) — weekly liquidity providing operations with a maturity of one week — have been conducted using a variable rate tender system[5] since 2000, with a minimum bid rate pre-announced by the ECB. The intention of the minimum bid rate is to signal the Eurosystem's monetary policy stance. As in previous years and consistent with the General Documentation on Monetary Policy Instruments and Procedures, the bulk of refinancing to the banking system (around 77 per cent) was provided by the Eurosystem through the weekly MROs. On average, the Eurosystem provided €290 billion each week through MROs during 2005, compared with €220 billion during 2004. Reflecting these developments, Eurosystem financing provided by the Bank to financial institutions in Ireland averaged €19.4 billion in 2005 compared with €15.8 billion in 2004, with credit institutions in Ireland bidding for and being allotted record volumes during the year.

Eurosystem Financing

To help credit institutions to prepare their bids in the MROs, the ECB continued in 2005 to publish each week a forecast of the daily average autonomous factors that affect liquidity and the benchmark allotment amount[6]. The purpose of this communication policy was to avoid misperceptions in the market as to whether or not the allotment decisions in MROs aim to balance liquidity conditions.

In October 2005, the ECB communicated its uneasiness with regard to the drift upwards in the spread between the marginal rate and the minimum bid rate that began in the second half of 2005. To counter this phenomenon, it initiated a policy (the ''loose allotment policy'') of allotting slightly more than the benchmark amount in the MROs, while still aiming for balanced conditions at the end of the reserve maintenance period. This helped to stabilise the spread between the marginal rate and the minimum bid rate at 4-5 basis points.

''Loose Allotment Policy''

LTROs

Longer term refinancing operations (LTROs) — monthly liquidity providing operations with a maturity of three months — continued to be conducted using a variable rate tender procedure with no minimum bid rate[7]. The Eurosystem provided €30 billion in LTRO funding to the financial sector each month

5 Under the variable rate tender procedure participants bid for the amount of liquidity they require as well as the rate they are prepared to pay for funds. Amounts bid *in excess* of the lowest (marginal) rate accepted by the ECB in a given MRO are satisfied in full, at the rate bid, while bids *at* the lowest rate accepted are filled on a pro-rata basis.

6 The benchmark allotment is the amount that allows for neutral liquidity conditions. The market can now compare the actual allotment with this benchmark allotment.

7 In contrast to the MROs, the LTROs are not used to signal the Eurosystem's monetary policy stance.

in the course of 2005. In January 2006, the Governing Council decided to increase LTRO funding to €40 billion per month, in order to maintain the LTRO percentage of the expected refinancing to the euro-area banking sector in 2006.

Chart 4: Monetary Policy Related Lending to Credit Institutions in Ireland

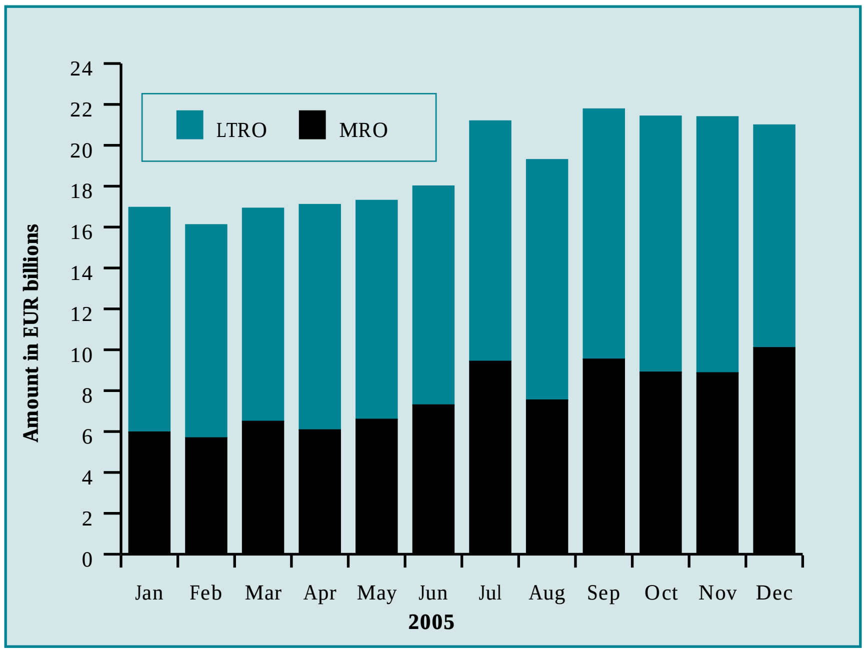


Chart 4 shows the total monetary policy lending to financial institutions in Ireland in 2005, composed of MROs and LTROs. As in previous years, banks in Ireland were above average users of LTRO funding in 2005.

Number of Counterparties Participating in MROs and LTROs

Participation Levels Stabilise

During 2005, the average number of counterparties (financial institutions) participating in each MRO in the Eurosystem was 351, broadly similar to that in 2004 after changes to the operational framework were implemented.[8] In Ireland, an average of 16 counterparties participated in each MRO in 2005, compared with 13 the previous year. This increase reflects the participation of some new counterparties during 2005, together with increased participation by counterparties that had not been active in MROs for a couple of years. LTRO participation in the euro area as a whole was broadly stable with, on average, 151 banks taking part in each operation compared with 159 in 2004. The average number of domestic counterparties participating in LTROs in Ireland increased slightly in 2005, rising to 12 compared with 10 in 2004, again as a result of increased participation from counterparties that had been inactive in recent years.

8 In March 2004 several innovations were made to the operational framework for the conduct of Eurosystem monetary policy. Details of the measures introduced are outlined in the 2004 Annual Report.

Fine-Tuning Operations

Beginning in November 2004 and throughout 2005, the frequency of **Fine-Tuning Operations (FTOs) —** ad hoc operations carried out to smooth the effects of unexpected liquidity fluctuations — increased compared with previous years. To even out liquidity imbalances at the end of reserve maintenance periods, nine FTOs were conducted in 2005. In March, June, July, August, October and December excess liquidity was absorbed by fixed-term overnight deposits; in January, February and September overnight reverse liquidity-providing transactions were conducted to inject liquidity into the market.

Increased Use of Fine-Tuning Operations

Minimum Reserves

The average level of minimum reserve requirements of credit institutions in Ireland during 2005 was €6.1 billion, compared with €5.1 billion the previous year. On average, institutions in Ireland held balances on their minimum reserve accounts at the Bank that were €20.2 million in excess of requirement; in 2004, such surplus balances averaged €9.6 million.

Minimum Reserve Levels

The Bank, on behalf of the ECB, monitors compliance of credit institutions in Ireland with the minimum reserve requirement system. In 2005, there were eight occasions when sanctions were imposed for breach of obligations, compared with thirteen in 2004. In 2005, all but one of the sanctions imposed was less than €1,000. The size of a sanction is linked to the average shortfall in minimum reserve holdings over a maintenance period.

Eligible Assets

All Eurosystem credit operations must be fully collateralised by assets approved by the ECB. This is to protect the Eurosystem against incurring losses in its monetary policy and payment system operations. The Bank assesses and accepts a wide variety of assets as eligible collateral in Eurosystem credit operations (see box below).

Types of Collateral

Under the current collateral framework, a distinction is made between two categories of assets eligible for Eurosystem credit operations, ‘‘Tier One’’ and ‘‘Tier Two’’. Tier One assets consist of marketable debt instruments fulfilling uniform eligibility criteria specified by the ECB, and encompasses a very broad spectrum of high-quality assets denominated in euro and issued (or guaranteed) by entities established in the European Economic Area. A substantial part of Tier One assets is made up of issues by general government and Pfandbriefe-type securities (i.e. issued by credit institutions and backed by either public sector debt or residential mortgages). Other types of asset in Tier One include asset-backed securities and issues by international and supranational institutions. Tier Two collateral consists of assets (marketable or non-marketable) that are of particular importance to national financial markets and banking systems and for which eligibility standards are established by the NCBs subject to ECB approval.

Collateral Assessment

Eligibility

The Bank is responsible for reporting to the ECB eligible Tier One assets listed on the Irish Stock Exchange and mortgage-backed promissory notes (MBPNs) — which are eligible for Tier Two — as these are issued. Assets are considered eligible for credit operations only when they are included on the list of eligible assets published by the ECB. Over the course of 2005, the Bank assessed a wide range of debt instruments for Tier One eligibility. By the end of 2005, the Bank was responsible for over 290 assets being included on the Tier One list of eligible collateral. The Bank continues to deal with a large number of queries on eligible assets from counterparties, lead managers and the public via the dedicated Eligible Assets Unit e-mail address (www.eligibleassets@centralbank.ie).

Collateral usage levels were higher in 2005 against the background of a further increase in the aggregate euro-area liquidity deficit. Credit institutions in Ireland, and in the Eurosystem generally, continued to use primarily Tier One eligible assets to collateralise Eurosystem operations. Mortgage-backed promissory notes (MBPNs), which are included on the Tier Two list of eligible assets, remained an important source of collateral for the local market.

Developments in Eurosystem's Collateral Policy

Amended Eligibility Criteria

During the year, there were a number of important developments with regard to the Eurosystem's collateral policy. For instance, the Eurosystem undertook a review of the eligibility criteria for asset-backed securities (ABS) and decided to amend these criteria in order to bring about greater transparency regarding the types of ABS that are accepted by the Eurosystem, particularly as this asset class is becoming an increasingly important source of collateral in Eurosystem operations. The amended criteria, which were announced in January 2006, took effect from May 2006. Any ABS that is currently on the list of eligible assets but does not comply with the new criteria will lose its eligibility status from October 2006.

Minimum Credit Standard

The Eurosystem also published the minimum credit standard that it applies when accepting assets as collateral — namely, at least a ‘‘single A’’ credit rating from one of the three international rating agencies. The ‘‘single A’’ credit rating is equivalent to a long-term rating of at least A — from Standard & Poor's or Fitch

Ratings or at least A3 from Moody's. It was also clarified that this requirement applies in the same way to private and public sector issuers.

Progress towards Establishing a Single List of Collateral

Towards a Single List

During 2005, progress was also made towards establishing a single list of collateral to gradually replace the present two-tier collateral system. As a first step, euro-denominated debt instruments issued by entities established in those G10 countries that are not part of the European Economic Area (EEA), i.e. United States, Canada, Japan and Switzerland, became eligible for the first time on 1 July 2005.

As a second (and final) step towards the creation of a single list, the Governing Council announced in February 2005 that bank loans (including mortgage-backed promissory notes, which will be incorporated into a new asset class called non-marketable retail mortgage-backed debt instruments) would become eligible as collateral for Eurosystem credit operations from 1 January 2007. In June, the Bank held an information session for counterparties on the Eurosystem's framework for accepting bank loans as collateral. In July, the Governing Council approved the general eligibility criteria that bank loans will have to meet and, towards the end of the year, also approved the core elements of the Eurosystem credit assessment framework (ECAF). The Bank provided these core elements to its counterparties in January 2006.

Documentation on Monetary Policy Instruments and Procedures

Contents

The 2005 edition of the Bank's Documentation on Monetary Policy Instruments and Procedures was circulated to counterparties in May 2005; this version was also published on the Bank's website. It was prepared by the Bank in conformity with the revised ECB Guideline on the *Implementation of Monetary Policy Instruments and Procedures* of 2005. Its content was verified by the ECB. The Bank's Documentation contains the contractual terms and conditions applicable to counterparties for conducting monetary policy operations with the Bank. It includes a Master Repurchase Agreement, *pro forma* procedures, relevant legal texts, a glossary, and the Bank's Framework Agreement (including a Deed of Floating Charge), which provides for the mobilisation of Mortgage-Backed Promissory Notes as collateral.

The main changes to the Documentation were as follows:

1. The majority of the changes relate to the introduction of the first step of the ''Single List'' of collateral into the Eurosystem monetary policy framework and the related changes in the rules for eligible assets. These changes include the following measures:

(a) Introducing in Tier One a new category of previously ineligible collateral, namely, euro-denominated debt instruments issued by the entities established in those Group of Ten (G10) countries that are not part of the European Economic Area (EEA);

(b) Refining the standards with which non-regulated markets have to comply to be acceptable to the Eurosystem; and

(c) Withdrawing equities from the Tier Two lists of those countries where they are currently eligible.

2. A more extensive definition of the characteristics of eligible guarantees for assets has been included.
3. The definition of the situations of ‘‘close links’’ for counterparties has been changed.
4. The timeframe of the quick tender has been increased to 90 minutes.

Liquidity Forecasts

The Bank provides daily forecasts of the liquidity needs of the domestic market as an input to the ECB's liquidity management decisions. Arrangements with the NTMA for managing the Exchequer account at the Bank, which facilitate more accurate forecasts of domestic money market liquidity conditions, continued to work well in 2005.

Developments in the Exchange Rate Mechanism (ERM II)

Four More Currencies join ERM11

On 2 May 2005, three more currencies joined ERM II : the Cyprus pound, the Latvian lat and the Maltese lira, while on 25 November 2005 the Slovakian koruna also became an ERM II member. This brings the number of participating currencies, apart from the euro, to eight (the Danish krone has been an ERM II member since 1999 while the Estonian kroon, the Lithuanian litas and the Slovenian tolar joined in June of 2004).

For each currency participating in the mechanism, a central rate against the euro and a standard band of ±15 per cent are defined. The relevant ERM II central bank, the ECB and euro-area National Central Banks (including the Bank) stand ready to conduct intervention operations at the margin, in principle automatically and for unlimited amounts, with eligible market participants, at the initiative of the latter. However, the ECB and the participating non-euro area NCBs could suspend automatic intervention if this were to conflict with the Eurosystem's primary objective of maintaining price stability.

Financial Stability

Definition of Financial Stability

Financial stability exists where the various components of the financial system (financial markets, payment and settlement systems and financial intermediation) function smoothly and without interruption, with each component resilient to shocks. If financial institutions run into difficulties, then other banks, businesses and consumers could be negatively affected. There have been many examples of financial crises in the past in various countries that have proved to be very costly in terms of economic disruption and lost growth. The incidence of these crises seems to have grown over time in the wake of financial market deregulation and innovation. This explains why central banks are now more concerned with this issue than in the past.

Mandate and Objectives

The Central Bank's mandate to contribute to the overall stability of the Irish financial system derives from its statutory duty under the *Central Bank and Financial Services Authority of Ireland Act, 2003*, and also from the mandate of the European System of Central Banks, which requires that the European Central Bank and National Central Banks contribute to financial stability in the euro area. To meet this mandate the Bank conducts analysis of financial stability issues, including asset price movements, household and corporate indebtedness and financial market developments. These studies allow an in-depth analysis of potential vulnerabilities in the Irish financial system, providing much of the background analysis that is drawn upon in compiling the Bank's annual Financial Stability Report. The primary aim of financial stability analysis is to try to identify any factors that might lead to crises in the future. This is a major task as each crisis tends to be different from the previous one. The Central Bank must also be prepared to deal with a potential crisis in the financial system and to have procedures in place to deal with crisis resolution.

Analysis of Issues

Stand-alone Financial Stability Report

The Bank published its first stand-alone Financial Stability Report in 2004 which analysed the systemic health of the financial system in Ireland. This was the fourth report that had been published on financial stability issues but previously these analyses had been published as a chapter in the Annual Report. In 2005, the second extensive stand-alone report was published and has allowed the Bank to expand greatly the coverage of financial stability issues. The publication of an extensive annual Financial Stability Report in itself is a contribution towards the promotion of financial stability. It is intended to increase awareness among participants in the financial system of the various important issues at stake to ensure the continued health of that system.

Fourth Report

Analysis

Types of Research

In an effort to identify potential vulnerabilities in the Irish financial system, analytical work is conducted by the Bank on topics such as household and corporate indebtedness, housing market developments, the financial strength of the Irish banking system, and the domestic and international macroeconomic environment and outlook. The main areas of research addressed in the 2005 FSR included the following:

- The growth in mortgage indebtedness in Ireland
- The implications of a major slowdown in the construction sector in Ireland
- The role of liquidity in financial stability and recent developments in liquidity and asset prices
- An assessment of interest rate risk
- Developments in the regulation of banks' capital
- The decline in the volatility of output growth and the financial stability implications.

Assessment of Financial Stability in Ireland

Healthy Banking System

The overall conclusion of the Financial Stability Report 2005 was that the Irish banking system continues to be in a good state of health. Our central expectation, based on our assessment of the risks facing both the household and non-financial corporate sectors, as well as the current shock absorption capacity of the banking system, is that this current state of health will not be compromised over the medium-term horizon. There are, as always, risks to the outlook which could cause the outturn to be somewhat different to this central expectation. While the 2004 Report focused on the risks arising from strong house price growth and the possibility of a sudden and unanticipated fall in the level of house prices accompanied by an increase in the default rate among borrowers as the key risk facing the banking sector, the 2005 Report gave major consideration to the risks posed by the growth in indebtedness in Ireland.

Governor Hurley and President Trichet, European Central Bank

Briefings for the Governor

The Governor is regularly briefed for financial stability discussions at the ECB's Governing Council. The briefing includes an assessment of risks to financial stability across the euro area with particular emphasis on developments in the euro-area banking sector. The Bank liaises with the ECB on financial stability matters principally through membership of the Banking Supervision Committee. The Bank provides the Irish input into the ECB's financial stability report — the first of which was published in 2004.

External Meetings

Meetings Attended

There is substantial interest from many different external sources in the state of financial stability in Ireland. These contacts offer an opportunity for relevant parties to enhance their understanding of the issues with respect to financial stability. During 2005, meetings were held with the major credit ratings agencies, the IMF and other public and government departments. As part of a regular on-going dialogue, the Bank also met with the credit institutions with the objective of arriving at a common understanding of any developments that might suggest a risk to the stability of the financial system.

Co-operation with the Financial Regulator

Co-operation with Financial Regulator

While the Central Bank has overall responsibility for financial stability, the Financial Regulator is responsible for overseeing the prudential health of individual financial institutions. There is the closest co-operation between the Central Bank and the Financial Regulator on matters relating to financial stability. A joint committee, the Financial Stability Committee (FSC), is an important element in this co-operation. The FSC is chaired by the Director General and it includes senior personnel from the Central Bank and the Financial Regulator. The FSC is supported by an interdepartmental Financial Stability Working Group, comprising experts from both organisations. The co-operation between the Central Bank and the Financial Regulator is underpinned by a Memorandum of Understanding.

Economics, Research and Statistics

Focus of Work

The monitoring, analysis and projection of short-term developments in the Irish and euro-area economies continued to be an important focus of economics work in the Bank during 2005. In addition, research was conducted into longer-term structural issues. Much of this work was carried out in co-operation with other Eurosystem National Central Banks and the ECB through a system of Committees and Working Groups. This work supported the Governor of the Bank and other members of the ECB Governing Council in formulating policy during 2005.

The work undertaken during the year is summarised in the following paragraphs under a number of broad headings: economic intelligence and forecasting, inflation and competitiveness, monetary issues, economic modelling, public finances and structural issues.

Economic Intelligence and Forecasting

Economic Analysis

The domestic economy was kept under review last year against an uncertain but generally favourable economic background. Growth in external markets remained reasonably strong but somewhat unbalanced. The main areas of concern in the international economy were the persistence of global current account imbalances and high and volatile oil prices. Overall growth in the Irish economy last year was mainly driven by domestic demand, with very little contribution from net exports.

Scenario Analysis

An area of particular concern in the analysis of the domestic economy last year was the increasing reliance on the construction sector for output and employment growth. In this context, scenario analysis, using the Bank's macroeconomic model addressed the implications of a 'correction' in the construction sector whereby house building levels revert back to medium-term requirements. In addition, preparatory work was undertaken for a financial sector stress testing exercise in early 2006, which focused on the implications of a sharp correction in the housing market. Other model-based scenario analyses carried out in co-operation with the Eurosystem focused on the effects of increased inflation on the economy as a result of higher oil prices, indirect taxes and less wage moderation.

A coincident indicator of economic activity was developed in the Bank last year. This composite index can be used to identify peaks and troughs in Irish economic activity and is currently undergoing real-time testing. Work in this area also continues with a view to constructing a leading indicator that could supplement the existing model and judgemental approaches to short-term economic projections.

Economic Forecasting

Six forecasting exercises were completed during the year, with two of these conducted within the context of the Eurosystem's Broad Macroeconomic Projection Exercises and the other four for publication in the Bank's Quarterly Bulletin.

The more formal approaches to economic analysis were supplemented by assessments of business sentiment based on contacts with key firms in various sectors across the economy. The results of these contacts were reported to the Board of the Bank on a number of occasions during the year.

Inflation and Competitiveness

Forecasts Published

Developments in domestic prices, costs and competitiveness were monitored closely during the year, with assessments and forecasts published in the Quarterly Bulletins. In addition, four inflation projection exercises using agreed assumptions were produced, and submitted to the ECB as part of a co-ordinated Eurosystem exercise. A number of reports on various aspects of economic competitiveness were prepared for the Board of the Bank, including an analysis of Irish export performance and competitiveness which was published in the Bank's Quarterly Bulletin.

A Bank economist lecturing to a group of 6th year students from Waterford.

In addition to papers published in the Bank's Technical Paper series, research work on inflation carried out in the Bank was published or accepted for publication in high-profile international journals including the *Journal of Monetary Economics* and the *American Economic Review*. One paper, which reviewed models of inflation dynamics, was presented to a conference on inflation at the Federal Reserve Board in Washington.

At the euro-area level, the Bank continued its participation with other National Central Banks in the Eurosystem Inflation Persistence Network. This co-operative work focussed on identifying and explaining inflation dynamics in a European context. Among the topics covered were the impact of staggered labour market contracts on inflation persistence and the evolution of inflation persistence over time.

Monetary Issues

Research work was carried out on the impact of monetary policy decisions on financial markets. One such study, published in the Bank's technical paper series was concerned with the stock market response to unexpected changes in UK and euro-area interest rates.

Econometric Modelling

Macroeconomic Model

The Bank's macroeconometric model continued to be used for forecasting and scenario analysis both in stand-alone mode for the analysis of the Irish economy and as part of a system of linked country models for the analysis of the euro-area economy. The model was extensively revised and updated last year. Details of this revision together with a general description of the structure of the model and a discussion on simulating the model were presented in a technical paper during the year.

Public Finances

Bank Role

Public finance developments continued to be reviewed last year as part of the Bank's role in assessing domestic economic policy. The Bank actively participated in various ESCB working groups, in the ESCB's assessment and projection of public finances in the euro area and the EU 25. Background research covered a range of topics including the possibility of non-Keynesian effects in fiscal consolidation and the impact of population ageing on pensions expenditure.

Structural Reform, Productivity

Issues of structural reform at a national and EU level were examined extensively through participation in the Economic Policy Committee of the EU. The Bank also participated in an ESCB Task Force on Competition,Productivity and Prices in the Euro Area Services Sector, whose report was subsequently published as part of the ECB Occasional Paper Series. Work on the determinants of productivity continues and it is planned to present results from this research at an international conference to be hosted by the Bank in autumn 2006.

Statistics — Monetary, Financial, Balance-of-Payments and Prudential Data

Reporting Requirements

The Bank continued to meet its statistical reporting obligations at national and international levels during 2005. The large and growing volume of ECB requirements for money and banking, balance-of-payments and financial accounts data were fully addressed. Progress was also made on the development of data for regulatory purposes in the context of the requirements of the Financial Regulator.

An amending ECB Regulation concerning the consolidated balance sheet of MFIs came into force on 1 January 2005 on the reporting of data on deposits and loans at nominal values[9]. Further progress was made on achieving better consistency between money and banking and other areas of statistics and on compliance with statistical reporting standards. In addition, preparations continued regarding the development of statistical reporting for Other Financial Intermediaries (OFIs), concentrating mainly on the OFI sub-categories of investment funds and special purpose entities.

9 Regulation (EC) No.2181/2004 of the European Central Bank of 16 December 2004 amending Regulations (EC) No 2423/2001 and (EC) No 63/2002 (ECB/2001/18).

Liaison with Central Statistics Office

As in previous years, the Bank worked closely with the CSO, the national balance-of-payments compiler, to ensure that ECB requirements in the field of balance of payments continued to be met in full. Both institutions worked closely together on the development of a new balance of payments reporting system, in line with the latest ECB Guideline (ECB/2004/15)[10]. The Bank and the CSO also reviewed the collection and compilation of Financial Statistics, as part of an initiative by the National Statistics Board to develop business and environmental statistics to meet policy needs. Further progress was also made on the development of a centralised securities database within the ESCB. This database is essential for the compilation of portfolio investment statistics on a security-by-security basis, as required by the Guideline (ECB/2004/15).

Regarding quarterly financial accounts, estimates for selected series were provided to the ECB in association with CSO for all quarters from Q4 1997 to Q2 2005. Good progress has been made in ongoing work to reduce the compilation period for quarterly results to 90 days from the end of the quarter as required by the ECB Guideline (ECB/2005/13)[11]. The Bank also provided financial sector results to CSO, for use in the compilation of annual financial accounts.

Motor Insurance Statistics

The Statistics Department is now responsible for carrying out statistical analysis of motor insurance data on behalf of the Financial Regulator. The first report covering the year 2002, was published in December 2005. It examined trends in premium income, accident frequency and claims costs, and presented analysis of market share and pricing.

10 Guideline of the European Central Bank of 16 July 2004 on the statistical reporting requirements of the ECB in the field of balance of payments and international investment position statistics, and the international reserves template (ECB/2004/15).

11 Guideline amending Guideline ECB/2002/7 on the statistical reporting requirements of the European Central Bank in the field of quarterly financial accounts (ECB/2005/13).

Management of Investment Assets

Bank's Investment Assets

Bank's Portfolio

At end-December 2005, the Bank's investment portfolios comprised US dollar reserves of €477 million and euro-denominated assets of €10,274 million, together amounting to a total of €10,751 million. This total represents an increase of €1,346 million on the comparable figure at end-December 2004. The increase is accounted for mainly by increased holdings of euro assets and the reinvestment of dividends and interest. The Bank's euro portfolio derives partly from sales of foreign currency assets in the context of portfolio restructuring since 2002 and partly from its holdings, prior to January 1999, of EMU legacy currencies.

Management of Portfolio

The parameters within which the Bank's investment portfolio is managed are determined by the Board of the Bank: these include the currency composition of the non-euro reserves, the choice of investment instruments, and the overall degree of risk that the Bank considers appropriate for its investment activities. The risks inherent in managing the Bank's investment portfolio are managed by a comprehensive system of controls, limits and procedures. The organisation of asset management activities at the Bank is as follows:

- An Investments Committee of the Board reviews investment policy and performance.
- This is supported by the Bank's Investment Assets Committee, which considers policy issues and strategy relating to the investment portfolio. This Committee, under the chairmanship of the Assistant Director General, includes senior staff of Financial Markets Department, Financial Control Department and the Risk Monitoring Function.
- A Standing Investments Committee, comprising management of Financial Markets Department, senior dealers and senior analysts, meets weekly to formulate short-term policy.
- The Bank's Investment Desk carries out the day-to-day dealing activities that are required to implement decisions and to ensure that the Bank's investment assets are fully invested.
- Risk monitoring and performance measurement are carried out independently of the Financial Markets Department.

Transfer of Reserves

Under the Statute of the ESCB, one of the basic tasks of the System is to hold and manage the official reserves of Member States. Thus, the Bank's foreign currency holdings form part of the foreign reserves of the Eurosystem. The Treaty on European

Union (the Maastricht Treaty) provided for the initial transfer by NCBs of up to €50 billion of foreign reserve assets to the ECB (the Bank's portion amounted to €0.4 billion). Moreover, under the EU Treaty, further calls of foreign currency assets may be effected by the ECB from NCBs' foreign-exchange reserves.

Portfolio Restructuring

HTM Portfolio

The Bank continued to restructure its portfolio during 2005 (see Table 1 below for changes since December 1998). The focus was on minimising the impact of movements in exchange rates on the value of the investment assets and on reducing the volatility of returns. Thus, the Bank continued to hedge the majority of the exchange-rate exposure arising from the Bank's holdings of US dollar-denominated assets; and the Danish krone portfolio was eliminated with the proceeds invested in the euro portfolio. In addition the Bank added to its euro-denominated Held-to-Maturity (HTM) portfolio[12], which was €2.01 billion as at the end of 2005. In the course of 2005 covered bonds issued under Irish, French and Luxembourg legislation were added to the list of eligible instruments which includes government, quasi-sovereign, supranational, Pfandbriefe and Danish mortgage bond issues. The duration of the US dollar and euro portfolios was maintained at their low levels in order to avoid some of the capital losses that would be associated with rising yields.

Table 1: Currency composition (%) of the investment portfolio since EMU

	Dec '98	Dec '99	Dec '00	Dec '01	Dec '02	Dec '03	Dec '04	Dec '05
Euro	29	28	27	28	43	68	80	95.5
Non-euro	71	72	73	72	57	32	20	4.5

Return on Investment Assets

Rate of Return

Total earnings (income and capital gains) on the investment portfolios amounted to €240.4 million in 2005 compared with €249.2 million in 2004. In rate-of-return terms, earnings on the investment portfolios in 2005 were 2.37 per cent compared with 2.81 per cent in 2004. The lower return in 2005 is largely attributable to the effect of rising bond yields in the second half of 2005.

The investment portfolio is invested in a wide range of instruments — deposits, other money market instruments, government bonds and other high-quality fixed-income securities. The objective is to maximise return within pre-defined risk parameters. Within this framework, the Bank employs a number of strategic and tactical investment

12 A HTM portfolio, because it is not traded during its life, is not subject to mark-to-market accounting rules; rather the return is spread evenly over the life of the assets included in the portfolio.

methodologies and techniques. On a day-to-day basis, the investment strategy involves positioning the portfolio to take advantage of opportunities to enhance returns in the international money and capital markets. Exposure to foreign currency risk is kept to a minimum.

Over the year, the Bank managed its investment assets (both foreign currency and euro denominated) by reference to benchmark portfolios created by Merrill Lynch on behalf of the Bank. These benchmark portfolios incorporate the Bank's preferences for liquidity, risk and return. The active management of the Bank's assets in 2005 produced results in excess of the return on the benchmark portfolios.

Gold Holdings

Gold Deposits

The Bank holds a small portion of its assets in gold – gold holdings were valued at €84.0 million as at end-December 2005. With the exception of coin stocks held in the Bank, gold is normally held in the form of gold deposits. The Bank did not purchase or sell any gold during 2005.

ECB Pooled Reserves

Transfer to ECB

In January 1999 the Governing Council of the ECB decided that €39.5 billion – that is, €50 billion adjusted downwards for the shares of the countries (UK, Sweden and Denmark) not participating in the euro area – should be transferred to the ECB at the commencement of EMU. Each NCB's contribution to the ECB reserves was in proportion to its shareholding in the ECB, which, in turn, is a function of each Member State's shares of the euro-area's GDP and population. In January 2001 further reserves were transferred to the ECB on the occasion of the Bank of Greece joining EMU. The foreign reserves transferred to the ECB are managed in a decentralised manner by the NCBs. The size of the portfolio managed by the Bank on behalf of the ECB was €538.6 million at the end of 2005.

The basic objectives of ECB investment policy are to protect the value of the ECB's reserves and to ensure that their assets are sufficiently secure and liquid to support the ECB's monetary policy. When foreign exchange intervention takes place, the foreign reserve assets of the ECB are used. At the end of 2005, the ECB's net foreign reserve assets amounted to €43.2 billion compared with €36.3 billion at the end of 2004. The rise in the value of the portfolio reflects primarily the strengthening of the US dollar over the year.

Reserve Management

The ECB determines the investment parameters, makes policy decisions, including setting performance benchmarks, approving counterparties and setting permitted risk levels, and performs control and monitoring functions. The benchmarking framework is set at both strategic and tactical levels and each NCB's performance is measured against the tactical benchmark and against the other NCBs. Within this framework, each NCB undertakes management and settlement functions associated with their portion of the ECB reserves. NCBs act on behalf of the ECB on a disclosed agency basis so that market participants can differentiate between operations carried out on behalf of the ECB and those undertaken on NCBs' own reserves. The Central Bank enters trades onto the ECB reserve management system, which permits the ECB to monitor positions and exposures and to carry out performance measurement.

Currency Specialisation

On the 15 December 2005 the Governing Council of the ECB approved amendments to the framework for the management of the foreign reserves of the ECB, effective from January 2006. The new framework involves currency specialisation, according to which euro-area NCBs will no longer necessarily participate in the operational management of both a US dollar and a Japanese yen portfolio on behalf of the ECB. The changes to the framework have been introduced as a step towards achieving the objective of rationalising and making more efficient the decentralised implementation of foreign reserves management within the Eurosystem, particularly in view of the future enlargement of the euro area. The changes are internal to the Eurosystem and thus have no market impact.

Risk Management

Code of Conduct

The risk control policy framework governing the Bank's asset management and monetary policy operations is established by the Board of the Bank and is reviewed regularly. The framework consists of various risk policies, procedures and limits. The Bank's code of conduct for dealers, settlement staff and decision makers covers potential conflicts of interest, private financial accounts, insider trading, dealing limits and related issues.

The Bank's Risk Management Unit, a formal autonomous unit, is responsible for the measurement, monitoring and reporting of the Bank's risk exposures and for monitoring and reporting compliance with limits etc. The Unit also measures the return on the Bank's investment portfolios. The measurement of performance involves the attribution of return across portfolios, sectors and instruments. The Bank's performance in terms of the return achieved on its portfolios is measured against a notional benchmark portfolio that is compiled externally by Merrill Lynch.

The Risk Management Unit is operationally independent of the dealing function and presents regular reports to the relevant decision making bodies of the Bank including the Board, the Audit Committee, the Investment Committee and the Management Board. In addition to the work performed by the Risk Unit, the Bank's asset management and monetary policy operations are audited by the Bank's Internal Audit Department, by the Bank's external auditors – the Comptroller and Auditor General, Deloitte and Touche and by the ECB's external auditors, KPMG.

Types of Risk

The main risks associated with managing the investment portfolio are currency risk, market risk, credit risk, liquidity risk and operational risk (including settlement risk).

Currency Risk is the risk of capital losses as a consequence of fluctuations in exchange rates. This risk is managed by minimising the Bank's holdings of volatile foreign assets while taking Eurosystem obligations into account. The currency distribution of the portfolio is reviewed periodically using quantitative techniques such as currency optimisation models, Value at Risk (VaR) and stress testing as well as a variety of qualitative factors. At end-December 2005, the Bank managed portfolios denominated in euro and US dollars (hedged against the euro).

Interest Rate Changes

Market risk relates to the impact of changes in interest rates on the value of the investment portfolio. The management of market risk in the Bank is primarily based on duration although Value at Risk and stress testing techniques are also used. The duration of a portfolio determines its sensitivity to interest rate changes – the higher the duration the more risk is assumed. Global economic conditions, bond yields, views of market participants, and liquidity requirements are all factors that are taken into account in setting the duration for the investment portfolios.

Table 2 below sets out the Value at Risk (VaR) on the investment portfolio.

Table 2: Value at Risk Analysis of Investment Portfolio

€m	Interest Rate Risk	Foreign Exchange Risk	Total Risk
31 December 2005	126.9	2.6	126.6
31 December 2004	106.9	6.2	104.7

Credit Risk relates to the possible loss in asset value due to the default of counterparty banks, issuers of securities or other counterparties. Credit risk is managed by confining exposures to high quality instruments and to counterparties with high credit ratings. All approved counterparties and issuers must have an acceptable credit rating from at least one of the international credit rating agencies. For deposits, maximum limits are set for each counterparty according to its credit rating and the maturity of the deposit. The Bank's exposure to banks and issuers of securities analysed by credit rating is shown in Table 3.

Table 3: Exposure of Investment Portfolio by Credit Rating

% of Investment Portfolio	Aaa	Aa1	Aa2	Aa3	A1	A2	A3	Total
End-December 2005	55	16	16	12	–	1	–	100
End December 2004	53	14	18	14	–	–	1	100

Liquidity Risk refers to the possible losses or difficulties that could arise in converting assets into cash. This risk is managed by ensuring that the investment portfolio reserves are is invested in instruments for which deep and active markets exist, such as securities issued by governments and other high quality issuers, and by applying maximum exposure limits.

Operational Risk is the possibility of direct or indirect losses, or of reputational damage, arising from inadequate or failed internal processes, people and systems or from external events. This risk is managed by the segregation of the dealing, settlement and risk management functions; by restricted physical access to the dealing and settlements areas; and by a comprehensive body of controls and procedures aimed at minimising the risk of unauthorised trading.

Regular Reviews

The Risk Management Unit has primary responsibility for operational risk across all functions. A high-level committee, chaired by the Deputy Director General, oversees the management of operational risk in the Bank. The operations of each function are reviewed regularly to ensure that potential exposures are identified and that appropriate controls are implemented. A full review of operational risk is furnished to the Board on an annual basis.

Payments and Settlements

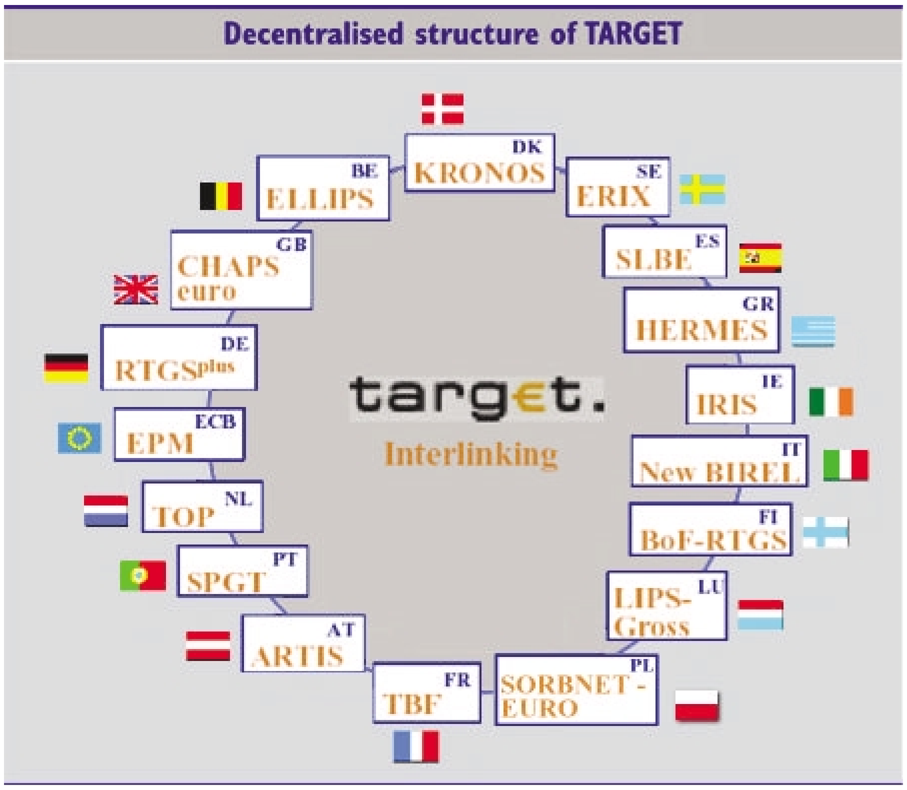
Real Time Gross Settlement/TARGET

RTGS/TARGET

The Irish Real-time Interbank Settlement Company Limited (IRISCo) was incorporated on 30 May 1995 to facilitate the development of a real-time gross settlement (RTGS) system in Ireland. This RTGS system (known as IRIS — Irish Real-time Interbank Settlement) enables payments between banks, made either on their own behalf or on behalf of customers, to be settled individually, in real time and with finality. It became operational in March 1997 and is now the domestic component of the Trans-European Automated Real-time Gross settlement Express Transfer (TARGET) system for the settlement of euro transactions. The total value of payments processed by the RTGS system is significantly higher than that processed through the domestic retail clearing system, although the corresponding number of transactions is much lower.

The RTGS system is managed and operated by the Bank and is interlinked with the TARGET system. TARGET, which commenced operations on 4 January 1999, is the mechanism used to effect real-time cross-border payments in euro and to facilitate monetary policy implementation. At end-2005, TARGET consisted of the national RTGS systems of the 12 euro-area countries and of the ECB Payment Mechanism. In addition, the national euro RTGS systems of Denmark, Poland, Sweden and the United Kingdom are connected to TARGET.

The decentralised structure of TARGET is shown below.



Source: European Central Bank

TARGET 2

In October 2002, the ECB Governing Council decided on the long-term strategy for TARGET (TARGET2) which envisaged technical consolidation of the TARGET system, a harmonized service level for users of the system and a single price structure. Following consultation with the TARGET user community, the Governing Council approved, in July 2004, the *General Functional Specifications* for this Single Shared Platform (SSP), which is to replace the individual national RTGS platforms and constitute the TARGET2 system. Despite the centralisation of RTGS processing, the existing business relationship and contacts between National Central Banks and their banking communities will continue.

Single Shared Platform

In December 2004, the Governing Council accepted a joint offer made by the Banca d'Italia, Banque de France and Deutsche Bundesbank to build and operate the platform. Of the current members of the TARGET system, the Bank of England and the Sveriges Riksbank have decided not to participate in TARGET2. All euro-area National Central Banks have confirmed their intention to participate in the SSP. The Bank participates in the various Eurosystem Committees and Working Groups that are defining the specifications of the SSP, developing the necessary legal arrangements and preparing for system training and testing.

The major innovations arising from the TARGET2 system will be:

- Replacement of the current decentralised TARGET structure with the Single Shared Platform (SSP).
- Availability of state-of-the-art liquidity management tools, such as prioritisation of payments, liquidity reservation, definition of sender limits and active queue management.
- The possibility for users to submit timed transactions.
- The possibility for euro-area users to group individual RTGS accounts held with different euro-area central banks and pool the available intraday liquidity for the benefit of all members of the group of accounts.
- Interaction with ancillary systems: the provision of settlement services for all kinds of ancillary systems, including retail payment systems, large-value payment systems, foreign exchange.
- Enhanced reliability and resilience, and sophisticated business contingency arrangements.
- Access for users to comprehensive online information and easy-to-use liquidity control measures.


Meeting of Settlement Managers Sub-Group, Potsdam, Germany, June 2005.

TARGET2

In February 2005, the ECB's Governing Council published a *TARGET2 Progress Report* in which it provided information on a number of issues, including liquidity management and pooling, settlement arrangements for ancillary systems, pricing of the TARGET2 core services and migration to the SSP.

This was followed in October 2005 by a *Second Progress Report on TARGET2* which clarified the 'go live' date of the SSP and the dates for migration of the various national banking communities, with the Irish banking community scheduled to migrate to the TARGET2 platform on 18 February 2008.

Table 4: Composition of Migration Groups and Changeover Dates

Group 1 **19 Nov. 2007**	**Group 2** **18 Feb. 2008**	**Group 3** **19 May 2008**	**Group 4** ***15 Sep. 2008***
Austria	Belgium	Denmark	
Cyprus	Finland	Estonia	
Germany	France	ECB	*Reserved*
Latvia	Ireland	Greece	*for*
Lithuania	Netherlands	Italy	*contingency*
Luxembourg	Portugal	Poland	
Malta	Spain		
Slovenia			

The *Second Progress Report* also presented a pricing scheme for the core services to be provided by TARGET2 with the final pricing scheme to be decided following discussion with the banking community. It also provided information on pricing of the intraday liquidity pooling feature and ancillary system settlement, night-time settlement in TARGET2, and contingency arrangements.

Testing and Training

In November 2005, having worked closely with the user community in developing the system features, the Eurosystem published the final version of the TARGET2 *User Detailed Functional Specifications* (UDFS), in order to provide TARGET users with the information required to initiate TARGET2 technical development and implementation work. It is envisaged that testing and training with users will commence in May 2007 for those in the first migration window.

Timely communication with the various user communities is of primary importance to the success of the TARGET2 project and is carried out both at Eurosystem and National Central Bank level. Accordingly, on a regular basis throughout 2005, the Bank provided updates on TARGET2 developments to the Board of IRISCo, the owner of the local RTGS system, and also to its Operations Committee. It also arranged presentations on developments to the wider local banking community, when appropriate.

Traffic in 2005

Increased Volume of Transactions

In 2005, as indicated in Table 5, TARGET as a whole processed a total of 76.2 million payments with a total value of €489 trillion. This corresponds to a daily average of 296,000 payments with a value of €1.9 trillion. The growth in the volume of transactions from 2004 was mainly due to an increased number of customer payments, reflecting a further migration of commercial payments from correspondent banking to interbank systems such as TARGET.

Value of Transactions

In excess of one million payments were processed through IRIS during 2005 with the value of those payments amounting to approximately €5,607 billion. The average daily number of transactions initiated by IRIS participants during 2005 was 4,274, up 8 per cent on the 2004 figure, with an average daily value of €21.8 billion.

Transactions processed by IRIS represented 1.1 per cent by value and 1.4 per cent by volume of total transactions processed by the TARGET system in 2005.

Availability and Service Level

The overall availability of TARGET was 99.83 per cent in 2005, compared with the minimum availability requirement of 99.44 per cent. Availability of the IRIS system was 99.93 per cent.

Table 5: TARGET Traffic

	2005	2004
Volume of transactions for year (million)	76.2	69.2
Volume of transactions per day	296,000	267,000
Value of transactions for year (trillion)	489	445
Value of transactions per day (€ trillion)	1.9	1.7
Average Daily Transactions via IRIS		
Volume of transactions per day		
Domestic	2,619	2,360
Cross-border (TARGET)	1,658	1,584
Total	4,277	3,944
Value *of transactions per day (€ billion)*		
Domestic	10.8	9.4
Cross-border (TARGET)	11.0	9.7
Total	21.8	19.7
Target Availability and Service Level		
Overall availability of TARGET (per cent)	99.83	
Minimum availability requirement	99.44	
IRIS availability	**99.93**	

Collateral Management

Under the terms of Article 18.1 of the ESCB statute, all credit operations conducted by counterparties with the Bank must be based on adequate collateral provided to the Bank by its counterparties.

Risk control measures are applied to collateral underlying monetary policy and intra day operations in order to protect the Eurosystem against the risk of financial loss if such collateral has to be realised in the event of default of a counterparty. The risk control measures entail the application to individual assets of a ''valuation haircut'' which varies on the basis of the nature of the asset concerned and the liquidity category into which it falls. Application of the ''valuation haircut'' entails the value of the underlying asset being calculated as the market value of the asset less a certain percentage (i.e., the haircut).

Valuation of Assets

The Bank values assets put forward by its counterparties, both at the time of nomination of assets as collateral for a particular credit operation and subsequently on a daily basis until maturity of that operation. If the value of the underlying assets falls below a certain level, the Bank requires the counterparty to pledge additional assets (i.e., a margin call). Similarly, if the value of the underlying assets, following their revaluation, exceeds a certain level, the Bank releases excess assets to the counterparty on request.

Cross-Border Use of Eligible Assets

Counterparties may use eligible assets on a cross-border basis, i.e., they may obtain funds from the Bank by making use of eligible assets located in another Member State. In the Bank's case all Irish Government Bonds provided to the Bank as collateral are delivered into its account in the Euroclear system. The Bank also uses its account in the Euroclear system to hold other securities issued into Euroclear and which are provided to the Bank as collateral. The other mechanisms which are available to counterparties to mobilise assets on a cross-border basis are the Correspondent Central Banking Model and Links between Securities Settlements Systems.

Correspondent Central Banking Model (CCBM)

The CCBM was developed by the National Central Banks and by the ECB to ensure that eligible assets may be used on a cross-border basis irrespective of country of issue. Under this model, central banks act as custodians (correspondents) for each other in respect of securities accepted in their local depository or settlement system.

Links between Securities Settlement Systems (SSSs)

Eligible links between EU SSSs can also be used for the cross-border transfer of securities, subject to those links having been approved by the ECB. A link between two SSSs allows a participant in one SSS to hold securities issued in another SSS without being a participant in that other SSS. Across the Eurosystem, the use of links for delivery of collateral on a cross-border basis is very much less than the use of the CCBM.

Use of Assets

During 2005, the Bank's counterparties continued to make extensive use of assets on a cross-border basis as collateral for monetary policy and intraday credit operations conducted with the Bank. At end-December 2005, assets delivered on a cross-border basis accounted for 80 per cent of the total collateral used by the Bank's counterparties for such credit operations, up from 77 per cent in 2004. The main issuers of these assets were credit institutions which accounted for 44 per cent of the total (mainly bonds and medium-term notes) and corporate issuers which accounted for 32 per cent (bonds, medium-term notes and asset-backed/mortgage-backed securities).

Following approval from the ECB in 2004 to use its account in the Euroclear system to hold securities other than Irish Government bonds, the use of eligible links by counterparties for the delivery of collateral increased significantly in 2005. At end-December, securities held via links accounted for 7 per cent of collateral delivered to the Bank on a cross-border basis with assets held via the CCBM accounting for the remainder.

Bond Register

Bank's Role

Irish Government Bonds (and other bonds for which the Bank acts as registrar) are settled in Euroclear. The Bank maintains the register of bonds issued on the domestic market by the National Treasury Management Agency, the Housing Finance Agency, the European Investment Bank and Ulysses Securitisation plc. Ulysses Securitisation is a state-sponsored financing vehicle, which was incorporated following the passing of the *Securitisation (Proceeds of Certain Mortgages) Act, 1995*.

The Bank, in its role as registrar, effects dividend and redemption payments to account-holders, including Euroclear (on behalf of relevant participants in the Euroclear system). The total of all holdings of Euroclear participants in each bond is recorded in an omnibus account on the Bank's register in the name of Euroclear Nominees Limited. Transactions between Euroclear participants are effected within the Euroclear system without affecting the Bank's Register, while transactions between registered holders and Euroclear participants necessitate updating of the Register.

Value of Bonds

At the end of 2005, the nominal value of bonds on the Register amounted to €31.9 billion, a marginal increase over the value outstanding at end-2004. Two bonds matured during 2005 resulting in redemption payments of €1.2 billion. There were no new Irish Government bond issues by the NTMA in 2005. Tranches in existing bonds account for the overall increase in the nominal amount outstanding at the end of the year. At end-December 2005 there were 2,983 accounts on the Register, down from 3,475 at end-2004.

In order to fulfill its obligations under the European Union Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments, the Bank will commence, in 2006, notification to the Revenue Commissioners of interest payments made during 2005 and subsequently, to individuals resident in other Member States and other relevant territories.

Payment Systems Policy and Oversight

The Objectives of Payment Systems Oversight

Aim of Oversight

Oversight (or regulation) of payment systems is aimed principally at promoting the orderly functioning of such systems. It aims to minimise systemic risk and to protect the banking system as a whole from the possible 'domino effects' that could occur if one or more of the credit institutions participating in a payment system were to encounter credit or liquidity problems. The focus of this oversight is on the systems rather than on the individual participating credit institutions.

Statutory Basis for Regulation

Under the provisions of the *Central Bank Act, 1997*, the Bank is empowered to regulate payment systems. This Act provides for the authorisation by the Bank of all payment systems operating in the State, and for the approval of the rules under which they operate. It also provides for the imposition of conditions on, and the revocation of, such approvals.

In addition to its domestic mandate, the legal basis for the Bank's oversight role is enshrined in the Treaty establishing the European Community and also in the Statute of the European System of Central Banks and the European Central Bank: Article 105 (2) of the Treaty and Article 3 of the Statute state that '' . . *the basic tasks to be carried out through the ESCB shall be . . . to promote the smooth operation of payment systems.*'' This is reflected in Section 7 of the *Central Bank and Financial Services Authority of Ireland Act, 2003*, which includes the objective of '*promoting the efficient and effective operation of payment and settlement systems*'.

Fair and Equitable System

In exercising its oversight role, the Bank promotes a payment systems environment in the State which is safe, effective and efficient, ensuring that all credit institutions with a requirement to do so can access these systems on a fair and equitable basis. The Bank further seeks to ensure that Ireland's payment systems themselves do not cause, or add to, instability in the operation of the country's financial markets. The efficient and effective operation of payment systems is a core requirement for maintaining financial stability, and for meeting both the business needs of the economy generally and the personal banking requirements of the public at large.

The Bank's role in relation to payment systems also has a wider aspect by virtue of Ireland's membership of the Eurosystem, which has as its focus the definition and implementation of a single monetary policy that will ensure price stability throughout the euro area and the stability of the financial system generally, thereby maintaining public confidence in the euro as a sound currency. The fact that payment systems are the transmission channel for the Eurosystem's monetary policy operations — in other words, the means by which its monetary policy is implemented — ensures that regulation of payment systems will remain a key task for the ECB and the euro-area National Central Banks.

Payment Systems Regulation

The Bank's Policy and Oversight Unit monitors payment systems developments, both domestically and at a European level.

Domestic Oversight

On the domestic front, the Bank holds regular review meetings with the Irish Payment Services Organisation (IPSO), which acts as the representative body for the payments industry in Ireland; the Bank attends board meetings of IPSO in its capacity as payment systems overseer. The Bank also attends board meetings of the Irish Paper Clearing Company Limited (IPCC), the Irish Retail Electronic Payments Clearing Company Limited (IRECC) and the Irish Real-time Interbank Settlement Company Limited (IRIS). IPCC handles all retail paper payment instruments (e.g., cheques and credit transfers), and IRECC has overall responsibility for the clearing and settlement of all retail electronic payments. The third company, IRIS, is responsible for the Irish RTGS system (see below).

ESCB Aspects

At the European level, the Bank participates in the ESCB's Payment and Settlement Systems Committee and its associated sub-groups. Through these bodies, the Bank contributes to the work of the ECB's Payment Systems and Market Infrastructure Directorate.

Regulation of Securities Settlement Systems

The Bank is represented on the joint ESCB-CESR Working Group (CESR — Committee of European Securities Regulators) that is adapting the *"Recommendations for Securities Settlement Systems"*, published by CPSS/IOSCO in 2001, to the European environment. CPSS and IOSCO (i.e., the Committee on Payment and Settlement Systems of the central banks of the G10 countries, and the International Organization of Securities Commissions) are the international standard-setting bodies in the field of securities settlement. Bank representation on this working group arises from the fact that it is seen as essential for central banks and securities regulators to ensure that the clearing and settlement infrastructure for securities transactions functions smoothly. In October 2004, the ESCB/CESR Working Group published a report entitled ‘‘Standards for securities clearing and settlement in the European Union’’. It is envisaged that these standards will be used as a common oversight tool by Eurosystem securities systems overseers.

The Bank also co-operates with the National Bank of Belgium in relation to the oversight of Euroclear, in accordance with the provisions of a Memorandum of Understanding agreed in this regard in 2002. The Bank’s role in this area stems from the fact that settlement of transactions in Irish Government bonds take place in the Euroclear system.

RTGS System

Due to its systemic importance, the domestic Real-time Gross Settlement (RTGS) system continues to be the Bank’s primary concern from an oversight perspective.

Minimise Risk

This system, known as IRIS, aims to minimise overall systemic risk in the country’s payment systems by providing a mechanism for participants to effect all large-value interbank payments in Ireland, both on participant banks’ own accounts and on behalf of their customers, in real-time (i.e. continuously throughout the day), gross (i.e. on an individual basis) and in central bank money.

All monetary policy and intra day liquidity transactions in IRIS are governed by the terms of a Master Repurchase Agreement signed by the Bank and each of its counterparties, and all liquidity provided to banks participating in IRIS is fully collateralised as required by ECB regulations, with funds only being advanced on the transfer of sufficient collateral to the Bank.

Criteria for Approval

Participation by any credit institution in IRIS requires the approval of the Bank. In deciding whether or not to issue such approval, the Bank takes an applicant’s financial strength into account, and also its technical ability to meet the requirements of the system. IRIS is linked to TARGET, thereby allowing payments to be made on a cross-border basis in real-time. The system is subject to regular ESCB risk analysis and its security features are also reviewed on a regular basis.

Payment Systems Policy/Oversight — Significant Developments in 2005

Domestic Developments

Throughout 2005, the Bank continued to monitor the work of IPCC and IRECC and the related clearing systems in its capacity as payment systems overseer. The Bank has also continued to administer the daily interbank settlement process for the clearing companies, which takes place via the IRIS system across the participating banks’ settlement accounts.

Following publication in 2004 of its *''Study of Competition in the Provision of Non-investment Banking Services in Ireland''*, the Competition Authority issued its final report and recommendations in this regard in June 2005. The Authority's recommendations in relation to the retail payment systems operated by IPCC and IRECC concentrated on two main issues: cheque truncation and the provision of automated clearing house (or ACH) functionality in the Irish clearing system for electronic retail payments.

Recommendations

Introducing cheque truncation would dispense with the need for cheques to be physically transferred between banks, as in a truncated environment only data and/or electronic images of cheques would be exchanged. The Competition Authority recommended that IPSO should prepare and publish a cost/benefit analysis of available options for the use of this type of technology.

As regards ACH functionality, the Authority recommended that IPSO should engage in a 'Request for Information/Request for Proposals' (RFI/RFP) exercise with relevant suppliers of this type of facility, leading to the preparation and publication of a cost/benefit analysis of the available options.

IPSO, via the clearing companies, IPCC and IRECC, and in consultation with the Bank, is currently progressing the foregoing issues raised by the Authority in line with its suggested deadlines.

A full review by the Bank of both the IPCC and IRECC systems against the CPSS Core Principles for Systemically Important Payment Systems[13] was concluded in August 2005 with the publication of a report by the ECB covering all euro-area retail payment systems. Some shortcomings were identified in IPCC and IRECC in the course of the assessment exercise (relating to the completion of settlement in the unlikely event of the default of a participant), and these are currently in the course of being addressed by the Bank and the clearing companies.

Review Conducted

With effect from 19 September 2005, the Irish clearing cycle for electronic retail payments was shortened from three days to two, under what was termed the 'NDV Initiative' (i.e. 'Next-Day-Value'). Following the change, participating banks exchange files of electronic retail payment transactions in a 'window' ending at 4.00 p.m. daily, with the resulting interbank liabilities being settled on the following day, on which day both payers' and payees' accounts are also debited and credited.

13 The 'Core Principles for Systemically Important Payment Systems', which provide guidelines for the safe and efficient operation of such systems, were published by the Bank for International Settlements (BIS) in January 2001. The Governing Council of the ECB has adopted these 'Core Principles' as part of the Eurosystem's oversight standards to be applied to all systemically important payment systems in the euro area.

Eurosystem Developments

At the European level, the principal oversight-related issues addressed during 2005 included the following:

Issues Addressed

- TARGET2, the replacement for the current TARGET system (see separate section on TARGET), including oversight issues in relation to the new system;
- finalisation of a TARGET oversight manual;
- oversight both of large-value and retail payment systems;
- assessment of retail payment systems in the Eurosystem (including IPCC and IRECC) against the CPSS Core Principles for Systemically Important Payment Systems (see above);
- assessment of securities settlement systems against the ESCB standards for use of such systems in ESCB credit operations.

SEPA (Single Euro Payment Area)

Since the introduction of euro notes and coins, there has been an expectation by the ECB and the EU Commission (and by public authorities generally) that retail payments made in euro throughout the euro area should become as easy to make for the consumer, and as efficient, as their domestic equivalents. The ECB, together with the National Central Banks of the countries that have adopted the single currency, has been working to bring about a situation in which euro-area commercial banking communities collectively make the changes to the payment systems infrastructure necessary to achieve this end. This initiative has come to be known by the acronym SEPA (i.e., Single Euro Payments Area), and a deadline of 31 December 2010 has been set for its full implementation.

National SEPA Plan

The euro-area commercial banks have formed the European Payments Council (EPC) to provide a governance framework for ensuring the collective delivery of SEPA by the national banking communities within the specified timeframe. All such communities are represented on the EPC; in the case of Ireland, this representation is provided by IPSO. IPSO and the Irish banks have at this stage drawn up the ‘Ireland National SEPA Plan’, and this was delivered to the EPC by the agreed 31 December 2005 deadline. An IPSO SEPA Implementation Task Force has now been set up to implement the measures outlined in the national plan, and the Bank is represented on this Task Force.

The ECB published its ‘4th Progress Report’ on SEPA in February 2006, and this was followed by an EU Commission consultation paper on ‘SEPA Incentives’ in March 2006.

Consultation Papers

Two consultation papers were posted in 2005 on the '*Consultations*' home-page link on the Bank's website. The first related to a public consultation on SWIFT and the second related to an issues paper on 'Payment Systems Business Continuity'.

Currency Production and Issue

Duties

The main task of the currency function in the Bank is to provide the public with banknotes and coin in the quantities and denominations which best suits their needs. The function is also responsible for the receipt and processing of used notes, for the re-issue of good quality banknotes and for the destruction of banknotes unfit for circulation.

Banknote Production and Processing

111 Million Banknotes

The Bank produced 111 million banknotes during 2005 of the €10 denomination under the pooled production arrangements of the ECB. In addition, some banknotes were received from and supplied to other euro-area NCBs. The Bank supplied the retail banks with 116 million new banknotes and 276 million re-issuable banknotes in 2005.

Table 6: Note Issues

	€5	€10	€20	€50	€100	€200	€500	Total
No. of Notes (m)	42.19	38.88	148.34	161.26	1.38	0.07	0.15	392.27
Value €m	210.93	388.76	2,966.86	8,063.04	137.67	14.68	73.05	11,854.99

Lodgments of euro banknotes by the banks totalled 350 million in 2005. A total of 395 million euro banknotes were sorted during the year and of these 195 million were sorted as reissuable.

Coin Production

310 Million Coins Produced

A total of 310 million coins were produced by the Mint in 2005. Demand for coin increased slightly in 2005 relative to 2004. The Bank issued 400 million coins during the year.

The details of the coins issued in 2005 were as follows:

Table 7: Coin Issues

	1c	2c	5c	10c	20c	50c	€1	€2	Total
No. of Coins (m)	109	87	90	54	34	9	7	10	400
Value €m	1.1	1.7	4.5	5.4	6.8	4.7	6.5	20.7	51.4

Collector Coins

In April 2005, a €10 collector coin was issued to mark the bicentenary of the birth of Sir William Rowan Hamilton, one of Ireland's greatest scientists. A total of 30,000 silver proof coins were produced. In November 2005, the 2006-dated circulating coin set was launched and, in keeping with the concept of featuring national heritage sites, the set features Glenveagh National Park and Castle in County Donegal.

Counterfeits

The number of counterfeits received by the National Analysis Centre increased slightly in 2005 relative to 2004. Within the Eurozone as a whole the number of counterfeits discovered in 2005 decreased slightly on the figure for 2004. The majority of counterfeits discovered were of relatively low quality.

Mr. Batt O'Keefe, Minister of State at the Department of the Environment, Heritage and Local Government with Brian Murphy, Currency Centre and Mr. Joe Gatins, Regional Manager, Glenveagh National Park at the launch of the 2006 coin set.

Withdrawal of Irish Banknotes and Coin

The process of withdrawing Irish banknotes and coin continued throughout 2005. Irish banknotes to the value of £5.3 million were withdrawn from circulation during the year.[14] By the end of the year, 94 per cent of the banknotes by value and 66 per cent of the value of coins had been withdrawn from circulation.

14 The quantity of Irish coin withdrawn during the year has not yet been sent for destruction. Accordingly, the figures in Table A4 of the Quarterly Bulletin are the same as last year. The circulation figures for coin in the table are not amended until the coin has been certified as destroyed.

Participation in International Activities

ESCB Activities

Governing Council

As indicated earlier, the Governing Council is assisted in its work by ESCB committees (the role of each committee is described in Appendix 1). During 2005 the Governing Council considered a wide range of matters pertaining to monetary policy and other issues. As outlined in the Governance and Organisation chapter, the Governing Council addressed a number of issues in the market operations, payment and settlement systems and banking supervision areas.

Work of ESCB Committees

As well as the above, important **legal issues** dealt with by the Governing Council in 2005 included the legal framework for the introduction of the euro in the new Member States, legal issues in future ECB Convergence Reports, the preparation of a guide to consultations of the ECB by Member States' authorities on proposed draft legislation falling within the fields of competence of the ECB, matters relating to the Eurosystem's collateral framework, and the future procurement of euro banknotes. The Governing Council adopted seventeen ECB legal acts and instruments during 2005, together with sixty-one Opinions on consultations of the ECB by the EU Council and Member States' authorities relating to proposed draft legislation.

During 2005, following the request of the Governing Council, procedures of the Single European Tender Process relating to the future procurement of euro **banknotes** were further developed. Also at the request of the Governing Council, the **Internal Auditors Committee** established good practices for the selection and functioning of External Auditors and carried out a review on previous IAC recommendations during 2005.

Risk Provision Mechanism

The Governing Council mandated the preparation by the **Accounting and Monetary Income Committee**, in co-operation with LEGCO, of a detailed framework for the new risk provisioning mechanism for the ECB, which was carried out in 2005. The main work on the forthcoming update of the ECB Guidelines of the legal framework for accounting and financial reporting in the ESCB and on the annual accounts of the ECB was also completed in 2005. The setting and monitoring of the annual ECB Budget by the Governing Council was conducted in accordance with well-established timetables and procedures.

In the **statistics** area, the Governing Council approved the ECB Guideline on Quarterly Financial Accounts and the list of national derogations and the project closure document for Phase 1 of the Centralised Securities Database. A merits and costs assessment on data collection from investment funds as part of the development of statistics on Other Financial Intermediaries is near completion and will be submitted shortly for approval to the Governing Council.

IT Task Force Launched

The Council Task Force of the Governing Council, of which the Governor is a member, launched an IT Task Force to undertake an in-depth analysis of the IT function throughout the Eurosystem with a view to examining the scope for efficiency. The IT Task Force presented its report in March 2006. The recommendations in the report could have a significant impact on the work of the **Information Technology Committee** (ITC).

Educational Information Pack

In the area of **communications**, the Governing Council approved the production and distribution of an educational information pack which was distributed to 50,000 schools throughout the euro area, including all 750 secondary schools in Ireland. The Governing Council adopted the Eurosystem Mission Statement, which refers to the Eurosystem's strategic intents and a set of organisational principles.

Governor Hurley with Mary Hanafin, Minister for Education and Caroline McHale, President BSTAI at the launch of the schools pack on price stability

Other EU Fora

The Governor, together with the Minister for Finance, attends informal meetings of the Ecofin Council. The Bank also participates in the work of high-level EU committees, namely, the Economic and Financial Committee, the Economic Policy Committee and the Eurostat Committee on Monetary, Financial and Balance of Payments Statistics. The main developments in these fora are set out below, while their remits are described in Appendix 2.

Ecofin

The spring Informal Ecofin meeting in Luxembourg on 13-14 May discussed the ''Memorandum of Understanding'' on the management of financial crises in the European Union; a European strategy for the financing of development and the alleviation of the debt burden of heavily indebted countries; how euro coins should reflect the enlarged Union ahead of the arrival of new entrants to the euro zone; and the Broad Economic Policy Guidelines for the Member States and the Community. Under the UK Presidency, the autumn Informal Ecofin took place in Manchester on 9-10 September. The issues discussed included how best to respond to the challenges of globalisation, specific proposals for development financing, and key aspects of financial stability.

Economic and Financial Committee

Main Issues Considered

Following the introduction of new working methods in 2005, central bank members attend EFC meetings only where their expertise and competence is required. In 2005, the main issues discussed at EFC meetings in full composition were the review of the Stability and Growth Pact (SGP), debt relief and development financing issues, legal and practical issues related to the euro and preparations for the IMF/World Bank spring and annual meetings.

The formal review of the SGP concluded with the adoption of two new Council Regulations on 27 June 2005, while, in October, the Ecofin Council also endorsed a revised Code of Conduct, which contains guidelines for the implementation of the Pact. In terms of implementation, ten Member States in 2005 were deemed to have excessive deficits and were subject to the Excessive Deficit Procedure (EDP). In terms of preparing for the IMF/WB spring and annual meetings, an important objective was to agree, where possible, EU common positions: in 2005 the key issues were the IMF's strategic review and debt relief and developing financing, where EU Member States led the way in increasing overseas aid and debt relief[15]. The EFC also dealt with legal and practical issues related to the euro, with Ecofin endorsing the Commission Recommendation concerning authentication of euro coins and the handling of coins unfit for circulation.

EU Economic Policy Committee

Work of EPC

During 2005, the EPC considered a wide range of long-term and structural issues including the sustainability and quality of public finances, with particular emphasis on ageing-related expenditure; strengthening the single market and meeting the challenges of globalisation; advancing better regulation in Europe; energy efficiency and energy security in the EU and other product and labour market reforms. During 2005 the Bank also participated in the EPC country reviews of National Reform Programmes (NRPs). These reviews focussed in particular on the ambition, coherence and quality of programmes outlined in NRPs in the context of the need to increase employment and productivity growth in Member States. The Bank was responsible in 2005 for the peer review of the NRP of the Netherlands. The EPC country review report served as an input into the Commission's assessment for its Annual Progress Report on the revamped Lisbon strategy.

The Bank also continued to participate in the work of the Economic Policy Committee of the OECD during 2005. The Committee, which met twice during the year, discussed the current situation and prospects for the global economy, together with the major policy issues arising from this.

EU Committee on Monetary, Financial and Balance-of-Payment Statistics

In 2005, the main focus was on fiscal governance within the context of the Excessive Deficit Procedure (EDP), including new

15 The EU Member States' target is to provide 0.7 per cent Gross National Income (GNI) for overseas aid and development by 2015.

administrative arrangements underpinning the compilation and integrity of national data. There were also active discussions on how to account for unfunded pension liabilities, defining institutional units, such as special purpose entities, for statistical purposes and on the development of quarterly European accounts by institutional sector.

IMF-Related Activities and Issues

Input into IMF Review

The IMF conducted its annual Article IV review of the Irish economy in May 2005, and undertook a second Financial Sector Assessment Programme (FSAP) in March 2006[16]. The CBFSAI provided statistics, analysis and opinions on the economic and financial issues raised by the IMF mission teams.

The Governor and Director General attended the IMF/World Bank Annual Meetings in October in Washington, and the Bank was also represented at the spring meetings. These meetings were dedicated to debating recent global economic developments; reviewing ways to strengthen crisis prevention and improve the IMF's capacity to deal with them; assessing initiatives to support low income countries and reflecting on the governance and structure of the Fund. One of the most important issues discussed was the IMF's Strategic Review, the aim of which is to set medium-term priorities for the work of the IMF. Important issues raised in the Review include IMF surveillance, the institution's role in emerging market economies and effective representation in the Fund of the latter and of low income countries. In future, the IMF is likely to focus not only on bilateral surveillance of exchange rate issues, but also on international spillover effects that could emanate from national policy measures. It may also have to address the concern voiced by a number of countries, particularly in Asia, that their quotas do not adequately reflect their growing weight in the world economy. Moreover, the IMF's role in emerging market economies (EME) is also changing, with many EME countries moving from a debtor based relationship with the Fund to one based more on surveillance.

Other International Activities

Mediterranean Seminar

The Bank participated in a Eurosystem Mediterranean seminar organised jointly by the Banque de France and the ECB in Cannes on 8-9 February 2005. It was attended by the President of the ECB and by governors and high-level representatives of Eurosystem and Mediterranean National Central Banks. The seminar focussed on recent economic and financial developments in the Mediterranean countries, the growth and development implications of workers' remittances and central bank independence.

16 Ireland was among the first set of countries to participate in the IMF's pilot scheme on FSAP reviews, and the first review was conducted in 2000.

The Governor attended a high-level seminar between the Eurosystem and the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) co-organised by the ECB and the Bank of Indonesia on 8-9 November 2005 in Frankfurt. The seminar was attended by the President of the ECB and the governors of the 11 EMEAP central banks and Eurosystem NCBs. The issues discussed included the links in the two regions between structural reform and balanced economic growth, the role of regional surveillance and financial assistance and regional and global dimensions to cross-border financial integration.

Management and Support Services

The Joint Management Board (JMB), which includes members of the Executive Board of the Financial Regulator and the Management Board of the Central Bank, oversee and coordinate central services (human resources, information systems, premises and other corporate services) which are shared within the CBFSAI.

Human Resources and Planning

Staffing

Increase in Staff Numbers

Permanent staff numbers increased by 10 (full-time equivalent) or 1.1 per cent to reach 963.5 at end-December 2005. The increase in staff numbers reflects an increase of 19.5 in the Financial Regulator to meet its regulatory and consumer responsibilities and small decreases in staff numbers in Central Bank Operations and Shared Services. In 2005 turnover of permanent staff increased to 6.5 per cent from 4.3 per cent in 2004.

Of the staff employed at year-end, 318 were assigned to Central Banking operations, 318 to the Financial Regulator and 320.5 to Shared Services. A further 7 staff were assigned to the Investor Compensation Company (ICCL) Limited. Staff employed comprised 725 clerical, professional and management staff and 238.5 industrial, technical and service staff.

The breakdown of staff numbers over the three main divisions within the organisation is set out in Figure 1.

Employment Policies

The Bank is an equal opportunities employer with the majority of staff being permanent full time employees on open contracts. Remuneration policy is based on appropriate comparators in the Public Sector and/or by reference to the relevant industry norms. The terms of National Pay Agreements are applied to all categories of staff.

Figure 1: Staff Breakdown by Division

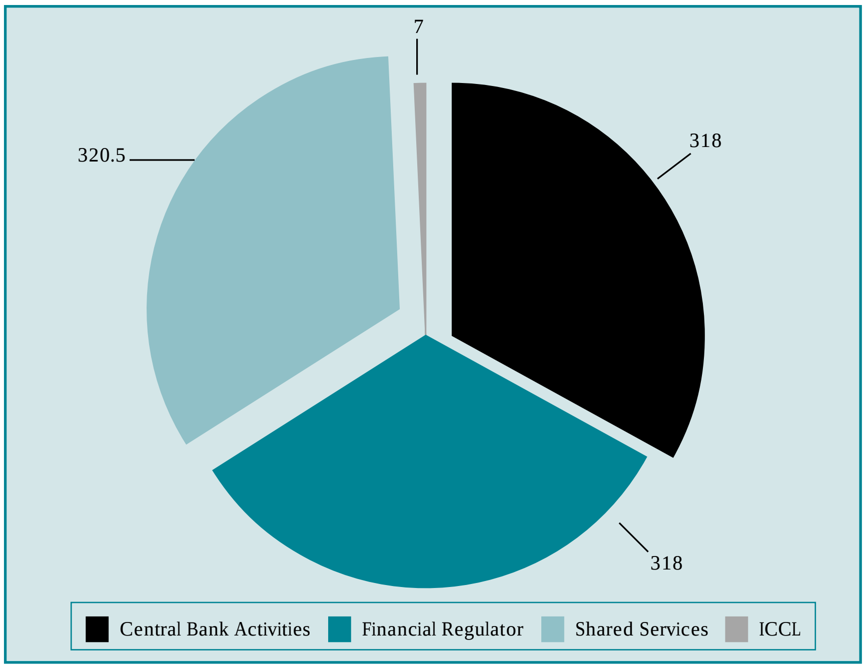


Table 8: Staff Serving at Year End (*Full time equivalent*)

	Department	2004	2005
Central Bank			
	Governor & Management Board	6	6
Financial Operations	Payments and Securities Settlements	39	35.5
	Financial Markets	25.5	26
Economic Services	European Monetary Affairs & International Relations	11.5	12.5
	Economic Analysis, Research and Publications	25.5	24.5
	Statistics	30.5	30.5
	Monetary Policy & Financial Stability	17	18
Currency Services	Currency Issue	104	105
	Currency Production	64.5	60
Central Bank Operations	Total	**323.5**	318
Shared Services	Human Resources and Planning	38.5	39
	Information Systems	49.5	49.5
	Financial Control	51.5	50.5
	Corporate Services	144.5	143.5
	Press Office	5	5
	Engineering Services	26	25
	Internal Audit	9	8
Shared Services Total		**324**	320.5
Central Bank Total		**647.5**	638.5
Financial Regulator			
Chief Executive Officer's Office	Chief Executive Officer and Executive Board	3.5	3
	Legal and Finance	28	25
	Planning & Project Co-ordination	0	5
	Registrar of Credit Unions	16	17
Prudential Division	Banking Supervision	46.5	45
	Financial Institutions & Funds Authorisation	53.5	65
	Securites and Exchanges Supervision	42.5	46.5
	Insurance Supervision	18	26
Consumer Division	Consumer Protection	51	53
	Consumer Information	26.5	32.5
	Secondments	13	0[17]
	Total — Financial Regulator	298.5	318
	ICCL	7.5	7
	TOTAL CBFSAI	953.5	963.5

Human Resources Strategy

Strategic Goals

Early in 2005, the Board formally approved a HR Strategy, covering the period 2005 to 2007. This strategy was developed against the background of the wider organisation development process and an existing comprehensive HR policy framework. The strategy identifies seven high-level HR strategic goals, which now guide the work programme of the Human Resources department particularly in the areas of performance management, training and recruitment. A programme to review a wide range of existing HR policies and procedures over the lifetime of the strategy has been developed.

Work is continuing on the enhancement and extension of the Performance Management System for all categories of staff. The development of a Partnership Model, aimed at allowing increased staff participation in change processes is planned following the

17 Of the 13 staff on secondment from the Department of Enterprise Trade and Employment (DETE) to the Financial Regulator at the end of 2004, 7 returned to DETE while the remaining 6 took up permanent employment in the Financial Regulator.

transposition into Irish law of the European Directive on Information and Consultation, now expected in 2006.

Training and Development

During the year the Bank continued to strengthen management development in the organisation with the provision of a wide range of internal and external courses in management development, soft skills and technical training. The Academic and Professional Training Scheme continued to provide opportunities for staff to gain academic, professional and technical qualifications.

Staff participated in a number of joint ESCB training programmes in 2005. As part of these programmes the Bank hosted a one-week management skills programme for senior professionals from National Central Banks. Staff also attended training programmes hosted by the European Central Bank, Deutsche Bundesbank, Oesterreichische Nationalbank and the Federal Reserve Bank in New York.

Technical Assistance

In 2005, the Bank hosted training and information visits by officials from the Central Bank of Zambia, the Central Market Authority of Saudi Arabia and Russian Banking Supervisors. These visits covered areas such as banking supervision, central operations and enforcement, legislation and procedure.

Organisational Development

1. Organisation Development Programme

Change Units

The organisation development programme, initiated following the reorganisation in 2003, continued through 2005. Dedicated Change Units located in the Central Bank and the Financial Regulator continued to support the Joint Management Board in developing and implementing this programme.

2. ESCB Organisational Development

In January 2005 the Governing Council published a Eurosystem Mission Statement, Strategic Intents and Organisation Principles. These publications will form the basis for future organisational development initiatives across the Eurosystem. During 2005, the Governor continued to participate in an ECB Governing Council Task Force, which was formed to consider issues related to the organisational development of the Eurosystem. This task force is responsible for preparing proposals, for discussion at the Governing Council, on issues related to the role, objectives, functions and operational issues of the Eurosystem.

Media and External Communications

Focus on Education

There was an increased focus on education-related activities during 2005. As indicated, new Eurosystem-wide education materials focusing on monetary policy and price stability were developed. These materials were distributed to all secondary schools in Ireland and were also simultaneously translated and produced in Irish.

The level of media enquiries handled by the Press Office on behalf of both the Central Bank and the Financial Regulator remained high during 2005 with 1,280 media queries handled and 227 media interviews arranged and facilitated. There was an emphasis on highlighting the role and the work of the Financial Regulator to regional audiences during the year. Communication with regulated firms was also enhanced through the production of four issues of a new industry publication, *Regulatory Connection*, along with two issues of a similar publication aimed at credit unions.

Media relations for the ECB and ESCB were coordinated and managed on a domestic basis. New public information materials on the security features of banknotes and coins were produced and launched during the year. In addition, the Central Bank also participated with the Department of Finance in a European Commission twinning programme to develop communications strategies for the introduction of the euro in Cyprus and Malta.

Delegates at the EU sponsored twinning programme between Cyprus, Malta and Ireland on communication aspects of EMU and the introduction of the euro.

Appendix 1: Role of ESCB Committees

Monetary Policy Committee

The Monetary Policy Committee (MPC) assists in the fulfilment of the ESCB's statutory tasks as regards monetary policy in the euro area and the exchange rate policy of the Community. To this end, the MPC is involved, *inter alia*, in assessing strategic and other longer-term issues relating to monetary policy; preparing a set of economic forecasts for the euro area; assessing the operational framework for the implementation of monetary policy; fiscal policy issues and structural issues relating to the euro area; and international monetary developments, particularly the international role of the euro.

Statistics Committee

The Statistics Committee covers areas such as the development, compilation and dissemination of relevant statistics to support the conduct of monetary policy. It also advises on conceptual and methodological issues relating to statistics, provides opinions when the ECB is consulted on statistical matters, and promotes the harmonisation and adoption of best practices in the compilation of statistics.

Market Operations Committee

The Market Operations Committee assists in the fulfilment of the ESCB's statutory tasks related to the implementation of the single monetary policy and foreign exchange operations as well as the management of the ECB foreign reserves. It also contributes to assessing and reporting on financial market developments within and outside the EU.

Payment and Settlement Systems Committee

The Payment and Settlements Systems Committee's role is to promote the smooth operation of payment systems and, in particular, to advise on the operation and maintenance of the Trans-European Automated Real-time Gross settlement Express Transfer (TARGET) system and the Correspondent Central Banking Model for the cross-border use of collateral. It also advises on general payment systems policy and oversight issues, and on issues of interest in the field of securities settlement and clearing.

Legal Committee

The Legal Committee (LEGCO) provides legal support for the statutory tasks of the ESCB, assisting in the work of its decision-making bodies – the Governing Council and the Executive Board – and reporting to the Governing Council. In this regard, the activities of LEGCO include, *inter alia*, preparing ECB legal acts, instruments and contracts and contributing to reviews of the implementation of this legal framework; providing legal advice to other ESCB committees on request; and monitoring legal developments in the euro area relating to the ECB's field of competence and to financial markets. LEGCO also promotes the exchange and co-ordination of views between legal experts of NCBs and the ECB in areas of common interest.

International Relations Committee

The International Relations Committee monitors and formulates ESCB positions on international economic, financial and monetary issues, including international financial architecture matters.

Banking Supervisory Committee

The primary task of the Banking Supervisory Committee (BSC) is to contribute to monitoring and assessing developments in the euro-area/EU banking and financial sector from a financial stability perspective. It also contributes to the design of financial regulation and supervisory tools from a macro-prudential perspective and promotes co-operation between central banks and banking supervisors on issues of common interest.

External Communications Committee

The ESCB External Communications Committee (ECCO) assists in designing both external and intra-system communications policies. This includes developing and co-ordinating communications in order to inform the public on the various tasks and actions of the Eurosystem/ESCB. It also helps to develop ways to present the Eurosystem to its staff.

Information Technology Committee

The Information Technology Committee supports and maintains the IT infrastructure and common business applications and services of the ESCB.

Banknote Committee

The Banknote Committee assists in the fulfilment of the ESCB's responsibilities with respect to banknotes including business continuity aspects. It also contributes, within its area of competence, to the preparatory work for enlargement of the euro area.

Internal Audit Committee

The Internal Audit Committee assists in developing co-operation between the ECB and the NCBs in the field of internal audit, particularly in the area of joint ESCB projects.

Accounting and Monetary Income Committee

The fulfilment of the ESCB's responsibility in the accounting area, including accounting policies, principles and techniques, comes under the remit of the Accounting and Monetary Income Committee.

Budget Committee

The Budget Committee, chaired by the Director General of the Bank, assists the Governing Council in matters related to the ECB's Budget; it evaluates and monitors the ECB's annual expenditure budget.

Cost Methodology Committee

The Cost Methodology Committee has a mandate to develop common standards for, and provide advice on, costing and management accounting principles for the Eurosystem. The Director General of the Bank chairs this committee.

Appendix 2: Role of Other EU Fora

Ecofin Council

The Council for Economic and Financial Affairs (ECOFIN) is a formation of the Council of the EU, the EU's principal decision-making body. It comprises the ministers responsible for economic affairs and finance in EU countries. It normally meets about ten times a year and covers a broad range of economic, structural and tax policy issues, in addition to financial market and EU budgetary issues.

Informal Ecofin

In addition to the regular ECOFIN meetings, the Council also holds 'informal' meetings once every six months in the country occupying the EU Presidency. The Informal ECOFIN meetings represent a forum for open and informal policy dialogue between the Governors of the NCBs, economic and finance ministers, the ECB and the Commission.

The **Eurogroup** is an informal structure which brings together the Ministers of the euro area Member States. It meets normally the day before the Ecofin meeting and deals with issues relating specifically to Economic and Monetary Union. In the course of the Informal Ecofin at Scheveninge, the Netherlands in September 2004, it was decided that the President of the Eurogroup should hold office for a period of two years rather than on a six-month rotating basis. The current Eurogroup President, from 1 January 2005 to 31 December 2006, is Jean-Claude Juncker, Prime Minister and Finance Minister of Luxembourg.

Economic and Financial Committee

This EU committee consists of representatives from Member States' economic affairs and finance ministries, central banks, the Commission and the ECB. Its main task, conferred on it by the Treaty, is to act as an advisory body to the ECOFIN Council and to the Commission on relevant economic and financial issues. This function includes monitoring the economic and financial situation of Member States, assessing the international, economic and financial environment and monitoring financial and other relations with third countries and international institutions. While the ECB is represented at all EFC committee meetings, national central bank members attend meetings only for the discussion of topics requiring their expertise, such as the international economic situation, IMF and related matters and financial stability issues; the latter are dealt with at meetings of the EFC's high-level Financial Stability Table.

Economic Policy Committee

The Economic Policy Committee (EPC) comprises representatives from Member States' economic affairs and finance ministries, central banks, the European Commission and the ECB. The committee assists in the preparation of the work of the Ecofin Council, with particular focus on long-term and structural issues. The EPC, which meets formally around twelve times every year, also supports the Economic and Financial Committee (EFC) in keeping under review the short and medium term macroeconomic developments in the Member States and the European Union.

Committee on Monetary, Financial and Balance of Payments Statistics

The CMFB is a high-level Eurostat committee, with members from all EEA[18] central banks, national statistical offices and the ECB. It assists the European Commission in drawing up and implementing work programmes concerning monetary, financial and balance of payments statistics and advises on a wide range of issues especially the measurement of debt and deficits for Stability and Growth Pact purposes. The CMFB is an independent committee with advisory functions; it has no legislative powers.

This is given under the seal of the Central Bank and Financial Services Authority of Ireland.

The 28th day of June, 2006.

John Hurley, Governor

Brian Halpin, Secretary

18 The European Economic Area (EEA) constitutes the 25 EU Member States and three EFTA (European Free Trade Association) States, namely, Iceland, Liechtenstein and Norway.

Governance and Organisation

Legislation

Under the *Central Bank and Financial Services Authority of Ireland Act, 2003*, the Central Bank of Ireland became the Central Bank and Financial Services Authority of Ireland (the Bank). The Act established the Irish Financial Services Regulatory Authority (Financial Regulator) as a constituent part of the Bank with statutory responsibilities for financial sector regulation and consumer protection. Six of the twelve members of the Board of the Bank are appointed by virtue of being members of the Authority.

Governor's Responsibilities

The Governor is Chairperson of the Board of the Bank and is a member of the Governing Council of the European Central Bank. He has sole responsibility for the performance of the functions imposed on the Bank by or under the Treaty of Rome or the ESCB Statute.

The legislation empowers the Minister to request the Governor, the Board or the Financial Regulator to consult with him, in relation to their respective functions, and also to request the Governor to inform the Minister with respect to the price stability objective. The Governor and the Board are required to comply with this, insofar as the request is consistent with the Rome Treaty, the ESCB Statute or any law of the State.

Objectives

As a member of the European System of Central Banks (ESCB), the statutory objectives of the Bank are laid out in Section 6 of the *Central Bank and Financial Services Authority of Ireland Act, 2003*, as follows:

> ''6.—(1) The Bank shall perform all functions imposed, and exercise all powers conferred, on the Bank by or under the Rome Treaty or the ESCB Statute.
>
> (2) The Bank also has the following objectives:
>
> (a) contributing to the stability of the financial system;
>
> (b) promoting the efficient and effective operation of payment and settlement systems; and
>
> (c) discharging such other functions, duties and powers as are conferred or imposed on it by the Rome Treaty, the ESCB Statute or any enactment''.

Board Structure

Board of Directors

Responsibility for the administration of the Bank is vested in the Board, which comprises the Governor, the Director General of the Central Bank, the Secretary General of the Department of

Finance, the Chairperson of the Financial Regulator, the Chief Executive of the Financial Regulator and seven other non-executive Directors appointed by the Minister for Finance. Of these seven other Directors, four are appointed by virtue of their membership of the Financial Regulator. Ex-officio Directors are members of the Board for as long as they hold office. Non-executive Directors are appointed by the Minister for renewable fixed terms of five years. Total fees due to Directors in 2005 in respect of membership of the CBFSAI amounted to €101,579. The sole shareholder of the Bank is the Minister for Finance.

Governor

Role of Governor

The Governor is appointed by the President, on the advice of the Government, for a term of seven years. Mr. John Hurley, the current Governor was appointed with effect from 11 March 2002. The Governor as an ex-officio member of the Governing Council of the European Central Bank (ECB) has sole authority and responsibility for the performance by the Bank of functions in relation to the ESCB. The total remuneration paid to the Governor for service during 2005 was €320,771. Superannuation benefits attaching to the Governor's salary are in accordance with the terms of the CBFSAI's Superannuation Scheme. The Governor was also provided with the use of a car.

Members of the Board, as at 31 May 2006, were:

Name	Occupation	Date first Appointed	Date Last Appointed
John Hurley (Chairman)	Governor	11.03.02	11.03.02
Liam Barron	Director General, CBFSAI	01.05.03	01.05.03
David Begg	General Secretary, Irish Congress of Trade Unions	12.05.95	01.05.03
Tom Considine	Secretary General, Department of Finance	11.03.02	01.05.03
Gerard Danaher	Senior Counsel	15.10.98	01.05.03
Friedhelm Danz	Company Chairman	01.02.96	01.05.03
Roy Donovan	Former Member of the Economic & Social Comm. of the EU	01.12.89	01.05.03
John Dunne	Chairman, IDA	01.05.03	01.05.03
Martin O'Donoghue	Emeritus University Professor	01.07.98	01.05.03
Patrick Neary	Chief Executive Officer, Financial Regulator	01.02.06	01.02.06
Brian Patterson	Chairman, Financial Regulator	01.05.03	01.05.03
Deirdre Purcell	Author	01.05.03	01.05.03

Liam O'Reilly ceased to be a member of the Board on 1 February 2006 on his retirement as Chief Executive of the Financial Regulator.

Board Procedures

The Board, which meets on a monthly basis with the exception of August, is chaired by the Governor. By law, a quorum requires the attendance of four Directors and the Governor may exercise a casting vote.

Board Meetings

Agenda and Board papers are approved by the Governor for circulation to the Directors one week in advance of meetings. Additional Board meetings may be called by the Governor at short notice either on his own initiative or at the request of any two Directors. Minutes of all Board meetings are kept by the Secretary of the Bank.

The agenda for meetings typically includes:

- Reports on monetary and financial developments;
- Reports on various issues relating to the Irish economy, the European economy and the international economy;
- Regulatory issues which require a decision by the Board or are circulated for the purpose of keeping the Board fully informed of developments at a general policy level or relating to specific institutions;
- Management of the investment assets of the Bank;
- Substantial financial contracts to be placed by the Bank for the procurement of goods and services;
- General management and budgetary issues;
- Quarterly and annual financial statements and results.

Powers Delegated to Governor

The Governor is an executive member of the Board. As provided for in the *Central Bank Act, 1942*, it is the Board's practice generally to delegate powers to the Governor for the exercise and performance of all functions, powers and duties of the Bank with the exception of those powers which it would either not be possible or appropriate to delegate. These include provisions relating to the Governor's position or that are specified to be Board responsibilities or which require the formulation of an opinion by the Bank.

Board Sub-Committees

The Board established three sub-committees on 30 June 1994 as follows:

- The Audit Committee
- The Remuneration and Budget Committee
- The Investments Committee

Terms of Reference of Sub-Committees

Board regulations detail the terms of reference of each sub-committee and membership in each case comprises three Directors — of whom one is appointed as Chairman — and an observer who is also a member of the Financial Regulator. The

Secretary of the Bank, or a nominee, minutes all meetings of the sub-committees and, when approved, these minutes are circulated to the full Board.

The members of the sub-committees, as at 31 May 2006, were as follows:

Audit Committee	David Begg (Chair), Martin O'Donoghue, Deirdre Purcell,* Alan Ashe**
Remuneration & Budget Committee	Roy Donovan (Chair), John Dunne,* Martin O'Donoghue, Dermot Quigley,** Liam Barron (Director General), Patrick Neary* (Chief Executive Officer, Financial Regulator)
Investments Committee	Friedhelm Danz (Chair), Liam Barron, Gerard Danaher, Jim Farrell**

*Members of both the Board and the Authority.
**Members of the Regulatory Authority who are not also members of the Board but who participate at meetings of the above CBFSAI Board committees with observer status.

Codes of Practice for Directors and Staff

The Governor is prohibited by law from holding shares in, or being a Director of, any bank or other credit institution, financial institution or insurance undertaking.

Code Updated

A Code of Practice for disclosure of interest by members of the Board has been in operation since 23 April 1992. This Code was updated during 2002, in accordance with the Government's 2001 Code of Practice for the Governance of State Bodies, and was adopted by the Board on 19 September 2002. The Code contains a wide range of requirements with which Directors are obliged to comply.

Ethics in Public Office Act, 1995 and Standards in Public Office Act, 2001

Disclosure of Interests

The Ethics in Public Office Regulations, 1997, have prescribed membership of the Board of the Bank as a designated directorship for purposes of the *Ethics in Public Office Act, 1995* and the *Standards in Public Office Act, 2001*. In accordance with this, members of the Board submit annual statements of interests to the Public Offices Commission and to the Secretary of the Bank. The statements are requested by the Commission for completion in January, in respect of the preceding year.

The Ethics in Public Office Regulations also prescribe executive positions in the Bank at or above the Professional 1 level as designated positions. The Secretary of the Bank submits annual statements of interests to the Governor, and the other holders of designated positions submit annual statements of interests to the Secretary of the Bank.

All members of the Board and staff of the Bank are subject to the provisions of the *Prevention of Corruption Acts, 1906* and *1916*. The Bank has a written code of conduct for staff.

Code of Conduct

On 28 November 2002, the Board of Directors adopted a Code of Conduct for Board Members to record the standards of conduct and integrity expected of each member in the performance of his or her functions as a member of the Board of the Bank. The Code of Conduct contains a wide range of requirements with which Directors are obliged to comply.

Accountability

Audit of Accounts

As required by Section 61 of the *Central Bank Act, 1942*, the Bank must prepare a report of its operations during the year and present this report to the Minister for Finance within six months after the end of each financial year. Copies of this report are laid before each House of the Oireachtas. Section 6H of the *Central Bank Act, 1942* requires the Bank to prepare and transmit to the Comptroller and Auditor General a Statement of Accounts for the year concerned. The Comptroller and Auditor General audits, certifies and reports on the Statement of Accounts and remits both his/her report and the Statement of Accounts to the Minister. Copies of both of these documents are also laid before each House of the Oireachtas. The Bank's accounts are also audited by independent external auditors as required by Article 27 of the ESCB/ECB Statute.

Within the terms of the *Central Bank Act, 1998*, the Governor meets with the Minister from time to time to keep him informed regarding the Bank's performance of its statutory duties.

Subject to the requirements of the Maastricht Treaty and the confidentiality provisions imposed by law, the Governor appears before Joint Committees of the Oireachtas on request. This practice was put on a statutory basis in the *Central Bank Acts, 1997* and *1998*.

Internal Audit

Audit Programme

During 2005, the Internal Audit function continued to place emphasis on understanding and addressing the risks to the achievement of the CBFSAI's strategic and organisational objectives. The audit programme for 2005 was informed by discussions with key departments and by the outcome of the Operational Risk Framework in the organisation. The plan also included ESCB audit assignments established by the ECB Internal Auditors Committee in its audit programme for 2005.

Audit Services

The range of audits undertaken in 2005 represented a balance between domestic and ESCB audits. Regular reports on the outcome of audit work were provided to the Audit Committee and the Management Board. Reports were also made to the ECB Internal Auditors Committee on the outcome of ESCB audit assignments undertaken during the year. To fulfil its role and complete the ambitious audit programme, significant resources were devoted to staff training, a review of the register of outstanding control issues was undertaken and procedures for the management of the register were put in place. In addition, procedures to improve the efficiency and effectiveness of audit procedures were established including the integration of quality assurance into all audit work. The Audit function participated in the organisation of the tender to appoint a new external auditor pursuant to Article 27.1 of the ECB Statute.

ESCB Governance

The Eurosystem and European System of Central Banks

Responsibilities of Eurosystem

The Eurosystem consists of the European Central Bank and the National Central Banks of the euro-area Member States. Responsibility for monetary policy, the primary objective of which is price stability, resides within the Eurosystem. Other tasks of the Eurosystem relate to foreign exchange operations, reserves management, the operation of payments systems, prudential supervision and financial stability.

The European System of Central Banks consists of the ECB and the National Central Banks of all EU Member States.

ECB Decision-Making Bodies

The **Governing Council** comprises the six members of the Executive Board of the ECB and the Governors of the National Central Banks of the euro-area countries. As the primary decision-making body of the ECB, it is responsible for the formulation of the single monetary policy for the euro area and the setting of guidelines for its implementation. It meets twice a month, with monetary policy discussions and interest rate decisions being generally reserved for the first monthly meeting. Other issues discussed include foreign exchange operations; external reserves management and payment systems; currency production and issue; and operational areas, such as budgetary and legal matters. (The role of the ESCB committees is described in Appendix 1).

The main tasks of the **Executive Board** (the second decision making body of the ECB), which consists of the ECB's President, Vice-President, and four other members, are to prepare the meetings of the Governing Council and to implement monetary policy in accordance with the guidelines and decisions laid down by the Governing Council. The President of the ECB chairs both the Governing Council and the Executive Board.

The **General Council** (the third decision-making body of the ECB) comprises the President and the Vice-President of the ECB and the Governors of the National Central Banks of all EU Member States. Its work includes contributing to the advisory and coordinating functions of the ECB and tasks relating to the National Central Banks of non-euro area Member States.

The Governor and the Director General of the Bank attend meetings of both the Governing and General Councils.

International Monetary Fund

IMF Participation

Ireland's relations with the IMF are handled by the Central Bank and Financial Services Authority of Ireland (CBFSAI) in association with the Department of Finance. The *Board of Governors of the IMF*[1] is the highest decision-making body of the organisation, consisting of one Governor and one Alternate Governor for each member country. The Board of Governors meets once a year at the IMF/World Bank Annual meetings; twenty four Governors sit on the International Monetary and Finance Committee[2], which meets twice each year. In Ireland's case, the Minister for Finance is a Governor and the Governor of the CBFSAI is an Alternate Governor of the IMF. The CBFSAI works closely with the Department of Finance to coordinate Irish policy advice on IMF issues and Ireland's operational interests at the Fund[3].

1 The Governor is appointed by the member country and is usually the Minister of Finance or the Governor of the central bank. All powers of the IMF are vested in the Board of Governors. The Board of Governors may delegate to the Executive Board all except certain reserved powers. The Board of Governors normally meets once a year.

2 The IMFC acts as an advisory committee to the Board of Governors on matters relating to the Board of Governors' functions in supervising the management and adaptation of the international monetary and financial system. This includes reviewing developments in global liquidity and transferring resources to developing countries.

3 The CBFSAI acts as Ireland's fiscal agent within the framework of operations with the IMF, holding the IMF accounts through which Ireland's quota payment is passed.

2005 Progress Report on Implementation of Central Bank Three-Year Strategic Plan

1. Introduction

Mission

Our mission is to maintain price stability, contribute to financial stability and efficient and effective payments and currency systems, manage our investment assets, and so contribute to long-run sustainable economic development.

Principal Objectives

There are four principal objectives which evolve from the mission and which reflect the responsibilities of the Bank. These are to:

1. *Participate fully in Eurosystem policy-making and implementation, for price and financial stability.*
2. *Contribute to national economic policy-making.*
3. *Provide and promote effective payment systems and currency services.*
4. *Optimise the returns on the investment assets of the CBFSAI and the ECB reserves.*

In July 2004, the Bank published its first Strategic Plan. The Plan reflected our significant new responsibilities in the Eurosystem and our continuing responsibility to influence domestic policy makers in contributing to price and financial stability.

The main responsibilities of the Bank are set out in Figure 1.

Figure 1: Main Responsibilities of the Central Bank

As a member of the Eurosystem, the Central Bank's main responsibilities include:

- ***Contributing to the maintenance of price stability (low inflation) and a stable financial system;***
- ***Ensuring safe and reliable payment and settlement systems, to enable firms and individuals to make payments to each other;***
- ***Producing and distributing euro banknotes and coins and ensuring the security and integrity of the euro currency;***
- ***Managing foreign exchange assets on behalf of the European Central Bank.***

The **domestic** responsibilities of the Central Bank include:

- ***Contributing to the maintenance of a stable financial system in Ireland, in co-operation with the Financial Regulator;***
- ***Overseeing the domestic payment and settlement systems;***
- ***Ensuring the provision and integrity of banknotes and coins; and***
- ***Managing the Bank's investments assets on behalf of the State.***

In addition, the Central Bank is also responsible for:

- ***Providing advice and guidance on Irish economic policies;***
- ***Serving the public interest in all areas within its competence.***

Within the strategic framework we have specified a range of action plans, which are incorporated into the annual planning and budgetary cycle. Monitoring the implementation of these actions is carried out through regular reports to the senior management in the Bank and through an integrated strategic and annual planning process.

While the Activities Section in this Report gives a detailed account of the work in the Bank, this report provides an overview of the main initiatives to achieve the objectives in the Strategic Plan, and includes:

- Tasks/projects undertaken and completed in 2005:
- Areas where significant work was undertaken in 2005 for projects which have completion dates in 2006 and 2007.

2. Main Achievements under the Principal Objectives

1. Participate fully in Eurosystem Policy Making and Implementation, for Price and Financial Stability

The primary goal of the Eurosystem is to maintain the inflation rate below but close to 2 per cent in the euro area over the medium term. This is achieved by **designing** a monetary policy strategy which signals early risks to inflation and by **implementing** monetary policy decisions on a common decentralised basis in each of the twelve euro-area countries. The Bank is also charged with contributing to financial stability in both Ireland and the euro area, in co-operation with the Financial Regulator.

Figure 2 sets out the major initiatives in the Strategic Plan in 2005 to meet this objective.

Figure 2.

	Commitments
Enhancing our input into monetary policy setting	• Providing an enhanced input to ECB Governing Council meetings, based on more in-depth research.
Specialising in economic niches	• Identify and develop appropriate competencies in economic and operational areas.
Developing strategic relationships	• Identifying appropriate strategic partners for relevant economic and operational projects. • Develop relationships through interactions with other National Central Banks.
Operations	• Develop improved communications procedures with local market participants to identify their requirements. • Assess our allotment, settlement, collateral, reserve management and monitoring systems to mitigate risk and improve efficiency. • Further developing and refining operational risk indicators.
Financial Stability	• Seeking to increase the influence of the Central Bank on financial participants, through consultation and publications. • Identifying areas of risk concentrations.

Monetary Policy

Input into monetary policy formulation continued to be enhanced and new monetary policy indicators were developed during 2005 based on monetary aggregates and real interest rates. These and other measures are now being used routinely in briefing the Governor on the stance of the ECB's monetary policy and it is considered that they will also play a role in future financial stability analysis. Separate briefing notes are also produced on euro area and international economic developments.

High-level contacts have been initiated with a number of central banks outside the euro area to promote alternative perspectives on various aspects of monetary policy.

A new version of the Bank's macro-model of the Irish economy was constructed during 2005 and this is embedded in the ECB's system of econometric models used for forecasting and scenario analysis.

A set of short-term indicators of euro-area, German and French GDP was developed during 2005. While less advanced, work on a set of short-term inflation indicators was also progressed.

During 2005 the Governor participated on a Governing Council Task Force on Monetary Policy Preparation. The Task Force undertook a fact-finding exercise on the processes of monetary policy preparation in Eurosystem and some selected non-Eurosystem central banks.

Significant progress was also achieved in identifying and initiating ''niche'' projects on growth and productivity and some of the early results from this research include analysis on Foreign Direct Investment (FDI), measurement issues in assessing productivity and Irish and euro-area potential output growth. Measures of potential growth are of key importance for monetary policy formulation to indicate a ''speed limit'' for economic growth. In addition to research on inflation, an active research programme on a range of issues related to monetary policy and its macroeconomic and financial effects was maintained. Several papers on these topics were published in a range of international economic journals.

A wide range of relevant and specific issues on the relationship between monetary policy and financial stability were addressed in detail in the 2005 Financial Stability Report.

Operations

The main focus in 2005 was on implementing monetary policy decisions efficiently and effectively. Along with other NCBs, the

Central Bank is responsible for the operational aspects of monetary policy, such as the provision of liquidity to the banking sector on a weekly and monthly basis; ensuring compliance with minimum reserve requirements; assessing collateral for eligibility in monetary policy operations, and updating the General Documentation governing monetary policy instruments and procedures.

During 2005:

- A series of meetings was held with the Irish Bankers' Federation (IBF) together with issuers of Mortgage-Backed Promissory Notes (MBPNs) to consider an appropriate credit assessment methodology for the use of MBPNs in the Single List of Collateral.
- Preparation commenced for the introduction of bank loans as collateral for Eurosystem monetary policy operations, with meetings being held with the IBF as well as an information session for the market.
- The General Documentation on Monetary Policy Instruments and Procedures (MPIPs) (i.e., the legal document underlying the Bank's monetary policy operations *vis-à-vis* counterparties) was revised.
- New eligibility criteria for asset-backed securities (ABS) were drafted and an assessment of all existing ABS against these new criteria is currently being undertaken.

The Eurosystem Operations Committee (EOC)[1] also identified areas of priority in the Eurosystem policy framework. These included:

- developing specific competencies in relation to Ireland as a financial centre;
- establishing better communications procedures with the local market;
- implementing monetary policy efficiently and effectively to reduce risk; and
- determining the Bank's responsibility for Business Continuity Planning in the financial community as a whole.

Financial Stability

The Bank published its second stand-alone Financial Stability Report in 2005 which included conjunctural commentary, a thematic piece on mortgage indebtedness on Ireland along with a number of special articles dealing with the operation of the payments and settlements system, the role of liquidity generally, and, specifically, its links with asset markets, the falling volatility

1 This is a cross-functional internal committee with responsibility for coordinating the implementation of the Strategic Plan in relation to Eurosystem Operations.

of output growth internationally, the risks of a ''correction'' in the construction sector in Ireland and the move to the new Basle II framework for credit institutions.

The Bank's first internal financial crisis management simulation exercise was successfully completed. Preparation of the next simulation exercise, which will involve the Department of Finance, was also completed. This work has been paralleled at an international level by the Bank's participation in the first Eurosystem stress test exercise in June as well as in the design and testing of the EFC's 25-country simulation exercise in April 2006.

The Bank continued to hold discussions with senior representatives from major financial institutions, to develop dialogue and information sharing, and to highlight any concerns on financial stability matters.

2 Contribute To National Economic Policy Making

As monetary and exchange rate policy are no longer set on the basis of economic conditions in Ireland, the Bank must use its economic and financial expertise to help to ensure that other domestic policy-makers have the tools and analysis to take decisions which support inflation and growth objectives. The Bank, through its work on promoting financial stability and low inflation, and developing and overseeing efficient payment and securities settlement systems, promotes a positive economic and business environment within which the financial services industry can operate effectively. Figure 3 below sets out the major strategic initiatives in 2005 to meet this objective.

Figure 3.

	Commitments
Inform and Educate Stakeholders	• Develop and implement methods for increasing our influence on stakeholders' agenda. • Expand our channels of communication through hosting conferences, increasing our publications and disseminating research papers. • Extend qualitative analysis to include industry surveys and other consultation processes.
Statistics	• Develop and conduct surveys of bank lending and financial derivatives. • Develop insurance sector and credit union data for the Financial Regulator. • Review the use and effectiveness of data provided in existing publications, website and other media.

Inform and Educate Stakeholders

As part of the programme to influence domestic policy-makers, policy advice and projections were published in the Quarterly Bulletins.

Research carried out on inflation was published or accepted for publication in high-profile journals such as the *Journal of*

Monetary Economics, *Journal of Money, Credit and Banking*, and in the *Review of Economics and Statistics*. A paper has also been accepted for publication in the *American Economic Review*. In total, ten papers were published in the *Technical Paper* series in 2005 on a range of research topics.

The Bank held several meetings during 2005 with international organisations. A number of meetings were also held with international ratings agencies. Contacts with the business community were also enhanced, through further developments of the selective survey of business sentiment, with an increased number of contacts being canvassed. Deeper links with academia were fostered through the organisation of an ''Invited Speaker'' seminar series, in which leading academics and staff from the ECB and the Federal Reserve System visited the Bank to present their work. There were 10 such speakers in 2005. In addition, a number of research projects were undertaken in collaboration with academics from both Irish and foreign universities.

Statistical Analysis and Collection

Considerable progress was achieved in meeting the statistical needs of domestic stakeholders in 2005. In a follow-up to recommendations made by the National Statistics Board (NSB), a number of high-level meetings were held with the Central Statistics Office (CSO), to identify areas where statistical collection might be rationalised.

Some of the major initiatives undertaken to enhance our domestic statistical analysis and expertise included:

- Launching an expanded credit card statistical exercise
- Upgrading of the comment in the *Monthly Statistics*
- Preparing for a new web-based publication to provide comment and data on the sectoral distribution of lending by credit institutions.

The results of a readership survey revealed a high level of reader satisfaction with the Bank's publications and a number of suggestions were received which are being followed up.

3 Provide and Promote Effective Payment Systems and Currency Services

The Central Bank promotes the stability, reliability and efficiency of financial and payments systems in Ireland, through the development and oversight of payments and settlement systems, on the one hand, and the provision of high-quality banknotes and coins, on the other. Figure 4 below sets out the major strategic initiatives for completion or initiation in 2005 to meet this objective.

Figure 4.

	Commitments
Payments	• Contribute to the preparations for the enhanced TARGET2 payment system. • Review the stability and effectiveness of domestic payment and settlement systems on a continuing basis • Engage in consultations with stakeholders on payment initiatives including electronic payments.
Currency	• Maintain efficient production and quality control systems in line with Eurosystem and ISO requirements. • Prepare for the introduction of the second series of euro banknotes in 2007-08. • Develop our collector coins function to meet increased demand. • Review banknote and coin handling practices of the retail banks and the public.

Payments

TARGET

The Bank participated in various Eurosystem committees and working groups that are defining the specifications of the Single Shared Platform (SSP) of TARGET2, developing the necessary legal arrangements, and preparing for system training and testing. The SSP will provide an upgraded single platform RTGS[2] system for domestic and cross-border payments in euro and is scheduled to 'go live' in November 2007. Phased migration dates for the various national banking communities have been agreed, with the Irish banking community scheduled to migrate to the TARGET2 platform on 18 February 2008.

Communication with the various user communities is carried out both at Eurosystem and National Central Bank level. Throughout 2005, the Bank provided updates on TARGET2 developments to the Board of IRISCo, the owner of the local RTGS system, and also to its Operations Committee. Presentations on developments to the wider local banking community, when appropriate, were arranged.

As the Bank of England and the Sveriges Riksbank have decided not to participate in TARGET2, discussions have been held with the Bank of England and CREST concerning future arrangements for settlement of euro-denominated transactions in Irish equities.

Payment Systems

A full review of both the paper and electronic clearing systems against the Core Principles for Systemically Important Payment Systems[3] was concluded in August 2005 and the outcome presented in a report by the ECB covering all euro-area retail

2 Real Time Gross Settlements.

3 The 'Core Principles for Systemically Important Payment Systems', which provide guidelines for the safe and efficient operation of such systems, were published by the Bank for International Settlements (BIS) in January 2001. The Governing Council of the ECB has adopted these 'Core Principles' as part of the Eurosystem's oversight standards to be applied to all systemically important payment systems in the euro area.

payment systems. With effect from 19 September 2005, the Bank approved the reduction in the clearing cycle for electronic retail payments from three days to two.

Following publication in 2004 of its ‘‘Study of Competition in the Provision of Non-investment Banking Services in Ireland’’, the Competition Authority issued its final report and recommendations in June 2005. The Authority’s recommendations in relation to the retail payment systems operated by the Irish Paper Clearing Company Limited (IPCC) and Irish Retail Electronic Payments Clearing Company Limited (IRECC) concentrated on two main issues: cheque truncation and the provision of automated clearing house (or ACH) functionality in the Irish clearing system for electronic retail payments. The Bank is monitoring how the clearing companies are progressing the issues raised by the Authority.

SEPA (Single Euro Payment Area)

Since the introduction of euro banknotes and coins, there has been an expectation by the ECB and the EU Commission, that making retail payments in euro throughout the euro area should become as easy and as efficient for the consumer as making payments domestically. The Eurosystem has been working to develop a situation in which euro-area commercial banking communities collectively make the changes to the payment systems infrastructure necessary to achieve this end. This initiative has come to be known as SEPA (Single Euro Payments Area), and a deadline of 31 December 2010 has been set for its full implementation.

The euro-area commercial banks have formed the European Payments Council to provide a governance framework for ensuring the collective delivery of SEPA by the national banking communities within the specified timeframe. IPSO and the Irish banks have drawn up the ‘Ireland National SEPA Plan’, which has been approved by the Bank. The Bank is represented on a SEPA Implementation Task Force established by IPSO to implement the measures outlined in the national plan.

Regulation and Oversight of Payment Systems

Oversight (or regulation) of payment systems is aimed principally at promoting the orderly functioning of such systems. It aims to minimise systemic risk and to protect the banking system as a whole from the possible ‘domino effects’ that could occur if one or more of the credit institutions participating in a payment system were to encounter credit or liquidity problems. During 2005, the Bank continued to monitor payment systems developments, both domestically and at a European level. On the domestic front, regular review meetings were held with the Irish Payment Services Organisation (IPSO). The Bank also attended board meetings of the RTGS and the paper and electronic clearing companies.

Currency

To maintain efficient production facilities and quality control systems in line with the requirements of ISO and the Eurosystem, two ISO quality systems audits were successfully carried out in both the Printing works and the Mint during 2005.

The ECB performed a security audit in April 2005, which concluded that the physical security of the Currency Centre was of the highest quality. The annual ECB quality audit concluded that a good working quality system is being maintained in the Mint.

The Printing works continues to monitor technical developments with the planned second series of euro banknotes through attendance at relevant ECB meetings.

A study to establish ways of improving the quality of banknotes in circulation was undertaken during the year.

A proposal to comply with the EU Commission's 2005 Recommendation (EC No. 974/98) on the authentication of euro coin and handling of euro coin unfit for circulation was presented in July 2005. New Banknote Security Features Materials were launched in December 2005. Presentations on counterfeit recognition were given to Professional Cash Handlers throughout the country.

As part of the development of our collector coin function a silver commemorative coin to celebrate the 200th anniversary of Sir William Rowan Hamilton was issued in May and the 2006 Coin Set was launched in November. A design competition and a tender for the production of the 2006 collector coin programme which includes 35,000 silver coins and 20,000 gold coins to mark the centenary of Samuel Beckett was completed.

4 Optimise the Returns on the Investment Assets of the CBFSAI and on the ECB reserves

In managing the investment assets, the Bank aims to achieve the highest return for the Exchequer while taking a prudent approach to investment risks. The Bank also manages a portfolio on behalf of the ECB.

	Commitments
Overall Investment Strategy	• Review the overall investment strategy taking into account risk versus the potential increase in returns. • Assess the use of new investment instruments and the possible use of external managers. • Implement proposed changes as necessary. • Develop and implement proposals for improved risk management systems.
Managing ECB Reserves	• Assess reserve management approaches in other National Central Banks and implement revised procedures as necessary.

Overall Investment Strategy

Considerable work was undertaken in 2005 on reviewing the Bank's overall investment strategy. A particular focus was placed on minimising the impact of movements in exchange rates on the value of the investment assets and on reducing the volatility of returns. With the elimination of the interest rate differential enjoyed by the Danish kroner *vis-à-vis* the euro, the case for continuing to hold this portfolio disappeared. The Bank divested itself of the Danish kroner portfolio in October 2005 and placed the proceeds in euro financial assets; in addition, the continued hedging of the US dollar portfolio ensured that exchange rate risk on the investment assets remained negligible.

The implementation of the Hold-to-Maturity (HTM) portfolio was completed in April 2005. This portfolio, which has a medium-term focus, aims to benefit from the normal upward sloping shape of the yield curve; it will also produce a more stable income flow over the life of the portfolio's assets. Results to date have been favourable.

Substantial progress was made in 2005 in formulating the future investment strategy for the Bank's financial assets. As part of this process, the Bank's investment staff visited a number of comparable central banks during the year and also organised a conference in Dublin for five smaller NCBs to discuss investment strategy. This work confirmed the view that the Bank's policies are very much in line with that of its peer central banks in that the approach to risk-taking, the instruments in which the assets are invested and the investment horizon adopted are all broadly similar. A number of these central banks also use HTM portfolios. In addition, comprehensive studies have been conducted by the Bank of instruments such as corporate bonds, asset-backed and mortgage-backed securities and their relevance for the Bank's portfolio is currently being assessed. With a view to increasing income, an additional service provider was given a mandate to participate in the Bank's securities lending programme.

Preparations for the development of the Bank's risk management and financial operations systems continued during 2005. As a preliminary to the formal establishment of the project in July 2006, a detailed analysis was carried out of the entire process of implementing the Eurosystem's monetary policy.

Managing the ECB Reserves

In its management of the ECB reserves, the Bank outperformed the relevant benchmarks in 2005. On a cumulative basis, the Bank's performance has compared favourably with that of other NCBs.

Risk Management

The risk control policy framework governing the Bank's asset management and monetary policy operations was established by the Board and is reviewed regularly. The framework consists of various risk policies, procedures and limits. The Bank's code of conduct covers potential conflicts of interest, private financial accounts, insider trading, dealing limits and related issues.

The Bank's Risk Management Unit is responsible for the measurement, monitoring and reporting of the Bank's risk exposures and for monitoring and reporting compliance with limits etc. The Unit also measures the return on the Bank's investment portfolios.

3. Development of Strategic Actions

The *Values* adopted by the Bank are central to the delivery of the high standards we seek to achieve in all our operations. Significant time was spent during 2005 in discussing our Values and in seeking to embed them throughout the organisation. This work will continue in the coming years.

To underpin our strategies, we are continuously striving to improve our practices and procedures. To this end, a number of Business Process Reviews (BPR) were completed across the organisation during 2005. The aim of such reviews is to examine individual processes with a view to implementing improvements, which would result in greater efficiencies.

With an aim to remain among the most cost effective National Central Banks, we have strengthened our Value For Money (VFM) culture in the organisation. A number of VFM audits were carried out during the year and relevant recommendations are being implemented.

We are committed to providing a high level of service to the public and this continued to be achieved in 2005 through

- continuing to redeem Irish banknotes and coin and the sale of collector coins, and
- the provision of educational information to schools and other bodies.

4. Review

The three-year strategy framework is subject to ongoing review and revision where necessary to facilitate changing priorities and responsibilities and to ensure consistency with the strategic objectives of the Eurosystem and the Financial Regulator.

Financial Operations

Accounting Policies

It is the Bank's policy in preparing its financial statements to follow, as far as possible, generally accepted accounting principles (GAAP). However, because of the unique nature of some of its operations as a central bank, and as a member of the Eurosystem, certain deviations from GAAP are necessary. All such deviations from GAAP are clearly identified in the statement of the Bank's Accounting Policies, which is provided as part of the Statement of Accounts.

Auditing and Reporting Standards

Under the *Central Bank and Financial Services Authority of Ireland Act*, 2003, the Bank is required to prepare and submit its Statement of Accounts to the Comptroller and Auditor General within six months of every year-end. The Comptroller and Auditor General must in turn audit and report on the Statement of Accounts to the Minister for Finance who is required to lay them before both houses of the Oireachtas.

Under Article 27 of the Statute of the European System of Central Banks (ESCB), the Accounts of the Bank must be audited by an independent external auditor recommended by the Governing Council of the ECB and approved by the European Council. Deloitte & Touche were appointed as independent external auditor of the Bank for 2005.

As a member of the Eurosystem, the Bank complied with regular extensive reporting requirements to the ECB, comprising both statistical and financial data.

Sharing of Monetary Income

As a member of the Eurosystem, the income the Bank earns from the assets backing currency in circulation and bank deposit liabilities, forms part of the total income of the Eurosystem. Under Article 32 of the Statute of the ESCB, this income, described as ‘‘monetary income’’, is to be pooled by all the National Central Banks (NCBs) and then redistributed according to each NCB's share in the capital of the ECB.

From 2002 onwards, a revised system for monetary income allocation was required as national banknotes are no longer issued. Euro banknotes are issued by NCBs on behalf of the Eurosystem as a whole and circulate freely throughout the Euro area and externally. Because NCBs could be expected to undergo significant changes in their relative income positions following the issue of euro banknotes on which monetary income is earned, the Treaty provided for a gradual progression to the ultimate situation where monetary income on banknotes outstanding would be allocated according to each NCB's share of the capital of the ECB. Each NCB's share of capital of the ECB is based on national population and Gross Domestic Product. The agreed scheme provides for a six-year adjustment period extending from 2002-2007.

Financial Results for 2005

Profit for the year to 31 December 2005 amounted to €122.0 million after applying Financial Reporting Standard (FRS) 17 relating to retirement benefits, compared with a restated profit of €106.9 million in 2004, as summarised in Table 1 below.

There was an increase in interest income of €122.5 million to €693.3 million, mainly attributable to increases in interest receivable on larger holdings of securities of €79.2 million and of €80.8 million on monetary policy-related lending to credit institutions. These were offset somewhat by higher premiums paid on securities of €26.3 million. Interest payable rose by €91.1 million to €485.1 million primarily reflecting increases in interest payable on intra-Eurosystem liabilities of €52 million. In summary, net interest income was €31.4 million greater than in 2004.

There was a net loss from financial operations of €3.0 million in 2005 compared to a net gain of €24.9 million during 2004. There were net realised exchange rate and capital gains of €10.2 million (€37.5 million in 2004), mainly due to capital gains on securities less unrealised exchange rate and capital losses of €13.2 million (€12.6 million in 2004), the latter arising as yields rose in anticipation of increasing interest rates.

Other income amounted to €5.9 million compared with a deficit of €13.2 million in 2004, with the net benefit of €19.2 million due mainly to a lower charge arising from the net result of pooling of Eurosystem Monetary Income, as the ECB had withheld some €17 million of the Bank's share of this income in 2004 to meet its own financial losses in that period.

Total operating costs of €89.1 million, comprising pay, non-pay, banknote raw materials and depreciation, charged against profit increased by €7.5 million, or 9.2 per cent in 2005. Staff costs including pay increased by €5.3 million (9.4 per cent), while other operating costs increased by €2.2 million (8.6 per cent). A detailed analysis of the Bank's operating costs is given in Note 8 of the Statement of Accounts.

After transfers to reserves and adjustments related to the recognition of the Bank's pension liability as required under FRS

17, the Bank's Surplus Income amounted to €109.2 million which accrues to the Exchequer.

Table 1: Summary Profit and Loss Account

€million	**31 Dec 2005**	**31 Dec 2004** Restated	**Change**
Interest Income	693.3	570.8	122.5
Interest Expense	485.1	394.0	(91.1)
Net Interest Income	**208.2**	**176.8**	**31.4**
Net result of financial operations	(3.0)	24.9	(27.9)
Other Income	5.9	(13.2)	19.1
Total Net Income	**211.1**	**188.5**	**23.0**
Staff expenses	61.4	56.1	(5.3)
Administrative expenses	18.6	17.5	(1.1)
Banknote raw materials	3.2	2.4	(0.8)
Depreciation	5.9	5.6	(0.3)
Total Operating Costs	**89.1**	**81.6**	**(7.5)**
Profit (income ***less*** operating costs)	**122.0**	**106.9**	**15.1**

Figures may not sum due to rounding.

Table 2: History of Profit 1998-2005

	1998	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
€million	224.7	248.0	520.5	563.0	828.6	69.0	106.9	122.0

Bank profit levels in the years 2000-2002 were unusually high primarily due to realised exchange rate and capital gains and the windfall profit in 2002 from Irish banknotes (see Table 2 above). These exceptional items no longer arise and the ongoing level of profits will reflect the prevailing interest rate environment.

Balance Sheet Developments

Total balance sheet assets as at 31 December 2005 were €33.0 billion, which is €4.5 billion more than the corresponding figure for 31 December 2004. Arising primarily from the restructuring of the investment portfolio, which chiefly consisted of the sale of the Bank's holdings of Danish krone, claims on non-euro area residents denominated in foreign currency decreased by €1,750 million. Holdings of euro-denominated securities issued by euro area residents rose by €1,814 million, primarily as a consequence of the sale of foreign currency assets for euros and an increase in the Bank's share of net financial assets agreed by the ECB. The balance outstanding in respect of Monetary Policy Lending operations increased by €3,550 million.

At end-year, the Bank's liability for euro banknotes in circulation amounted to €6,706 million, which represented an increase of €759 million on the previous year and reflects a general increase in the value of euro banknotes outstanding worldwide. Liabilities to euro area credit institutions (commercial banks) increased by

€3.9 billion. These deposit balances can vary depending on the individual credit institutions scheduling of their average minimum reserve requirements. Liabilities to other euro area residents denominated in euro, essentially Government deposits, increased by €362 million. Intra-Eurosystem net liabilities to the ECB decreased by €294 million. This comprised a reduction of €2,172 million in the Bank's liability to other central banks of the Eurosystem in respect of cross-border payments made by domestic financial institutions in euro through the ESCB's large-value payment system — TARGET[1] — and an increase of €1,878 million in the value of the net issue by the Bank of euro banknotes over and above its capital key share of the total euro banknote issue. As at 31 December 2005, the Bank's pension liability stood at €388 million, an increase of €114 million over the previous year. Capital and Reserves decreased by €58 million primarily as a result of the recognition of pension liabilities, as required under FRS17.

Redemption of Irish Banknotes

Irish banknotes ceased to be legal tender with effect from 9 February 2002. As at 31 December 2002, notes to the value of €299.7 million were outstanding. A provision of €60 million was created at that time in respect of unredeemed Irish notes. During 2005, an amount of €6.8 million was redeemed (compared to €11.0 million in 2004) leaving €256.7 million Irish banknotes still outstanding and a balance on the provision account of €17.0 million at end-December 2005.

Proceeds of Coin

Under Irish legislation, the benefit from the coin issued by the Bank on behalf of the Minister for Finance accrued over the years since 1943 to the ''Currency Reserve'' of the Bank. To coincide with the introduction of euro coin from 1 January 2002, and to bring the position into line with general practice in other EU States, legislation was passed in March 2002 to permit the proceeds from the issue of coin to be transferred directly to the Exchequer. In 2005, a total of €45.0 million in respect of the net proceeds of coin issued was paid to the Exchequer (€42.4 million in 2004). During the year, the value of euro coin issued was €51.3 million (€48.6 million in 2004). Irish coin redeemed totalled €1.2 million (compared with €1.6 million in the previous year). Full details are incorporated in Note 33 of the Statement of Accounts.

Prompt Payment of Accounts 2005

The Bank is obliged to comply with the provisions of the European Communities (Late Payment in Commercial Transactions) Regulations, 2002, which provides that penalty

1 Trans-European Automated Real-time Gross settlement Express Transfer system.

interest will become payable if payments for commercial transactions are not met within 30 days, unless otherwise specified in a contract or agreement. The regulations do not apply where the interest penalty is less than €5. The rate of interest applicable to late payments is the ECB main refinancing rate plus 7 percentage points, with the relevant rate at 1 January and 1 July each year applying for the six-month period after these dates. In 2005, interest was payable at a rate of 9 per cent per annum.

The following is a summary of interest payments made to suppliers during 2005 in accordance with the provisions of the Regulations referred to above.

• Total number of late payments	53
• Total value of all late payments (A)	€503,019.59
• Total value of all payments (B)	€29,430,327.71
• A as % of B	1.71%
• Total amount of interest paid on late payments	€1,543.11

Statement of Accounts of the Central Bank and Financial Services Authority of Ireland for the year ended 31 December 2005

Statement of Directors' Responsibilities

The main statutory provisions relating to the role and duties of the Directors are covered in Sections 5, 5A and 6 of the *Central Bank Act*, 1942, (as substituted by Sections 4,5 and 6 of the *Central Bank and Financial Services Authority of Ireland Act*, 2003) and Section 22A of the *Central Bank Act*, 1942 (as inserted by Section 18 of the *Central Bank and Financial Services Authority of Ireland Act*, 2003). Moreover, under Section 6 of the *Central Bank Act*, 1942 (as inserted by Section 7 of the *Central Bank and Financial Services Authority Act*, 2003), the Bank is responsible for the maintenance of proper accounting records. This responsibility also extends to the preparation and presentation to the Comptroller and Auditor General of a Statement of Accounts within six months of the end of each financial year and the appointment of external auditors as required by Article 27 of the Statute of the European System of Central Banks and of the European Central Bank.

The Board has overall responsibility for the system of internal financial control in the Bank, which is designed to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities. To discharge this responsibility, the Board has established an appropriate organisational structure. In this regard, the Audit Committee of the Board meets periodically with the Internal and External Auditors and members of the Management of the Bank to discuss control issues, financial reporting and related matters. The Internal and External Auditors have full access to the Audit Committee.

The Board is satisfied that generally accepted accounting principles and standards, adapted to suit the nature of central banking activity and both domestic and European System of Central Banks' statutory provisions which apply to the Bank, have been consistently applied and are supported by reasonable and prudent judgements and estimates.

John Hurley, Governor

David Begg, Director

23 June 2006

Statement on the System of Internal Financial Controls

On behalf of the Board, I acknowledge the Board's responsibility for ensuring that the Bank maintains effective systems of internal financial control and reviewing their effectiveness on an ongoing basis. The Board has formally adopted a code of conduct which requires each Director to ensure that the Bank has in place an effective system of internal controls including financial controls, operational controls, risk management and fraud prevention.

The systems of control in place provide reasonable but not absolute assurance of the safeguarding of assets against unauthorised use or disposition, the maintenance of proper financial records and the reliability of the financial information provided and published. In essence, these systems are designed to manage rather than eliminate inherent financial risks.

The systems of control include:

- A clearly defined organisation structure with specified authorisation limits and reporting requirements to senior management and the Board;
- Appropriate terms of reference for the Board and management committees with responsibility for core policy areas;
- A comprehensive financial and budgeting management information system which incorporates:
    - Approval of annual plan and detailed expenditure budgets by the Board
    - Quarterly reporting to the Board on financial and budgetary performance
    - Regular reporting to the Board on capital expenditure;
- Detailed policies and procedures relating to financial controls.

An operational risk framework has been developed for the whole organisation. Each business area is responsible for the management of risk and the implementation of appropriate controls and procedures aimed at minimising and monitoring such risks. An Operational Risk Committee, which comprises senior management, has responsibility for the oversight of the management of operational risk. A full review of operational risk is furnished by the Bank Audit Committee to the Board on an annual basis. To assist departments in the ongoing assessment of risk, an operational risk database has been developed.

Details of the risk controls deployed in respect of the management of investment assets are outlined in the Activities Chapter under Risk Management and in Note 36 to the Statement of Accounts.

The Internal Audit Department independently and systematically reviews the controls in place and reports to the Board Audit Committee on a regular basis. The Audit Committee approves the Internal Audit Plan and work programme. In addition, the Audit Committee meets with and receives reports from both external auditors. The Chairman of the Audit Committee reports to the Board on all significant issues considered by the Committee and the minutes of meetings of the Audit Committee are circulated to the Board for consideration at subsequent meetings of the Board.

The Board-level Committee structures have been designed so that the Board and the Irish Financial Services Regulatory Authority work closely together to ensure that their respective obligations in relation to the control of expenditure and the management of operational risk are managed within a consistent and complete framework.

I can confirm that the Board reviewed the effectiveness of the system of internal financial controls during the year ended 31 December 2005.

John Hurley, Governor

23 June 2006

Accounting Policies

(a) Form of Presentation of Accounts

In preparing the accounts, the Bank as a participating member of the ESCB[1] has a policy of following the accounting policies which the Governing Council of the ECB considers to be appropriate to the nature of central banking activity, and the statutory provisions[2] which apply to the Bank.

The accounts have been prepared (i) on the historical cost basis of accounting, modified to include market valuations of securities, unmatured contracts and gold and all assets and liabilities denominated in foreign currency and (ii) in accordance with accounting standards generally accepted in Ireland in as far as it is considered applicable to a participating member of the ESCB. Accounting standards generally accepted in Ireland in preparing accounts giving a true and fair view are those published by the Institute of Chartered Accountants in Ireland and issued by the Accounting Standards Board.

The accounting unit is the euro.

Having regard to the role and activities of a central bank the Bank is of the opinion that a cash flow statement would not provide any additional or useful information to users of the accounts. Therefore such a statement is not included as part of these accounts.

The accounts have been prepared pursuant to Section 6H of the *Central Bank Act*, 1942 (as inserted by Section 7 of the *Central Bank and Financial Services Authority of Ireland Act*, 2003).

Throughout the Statement of Accounts the term 'Bank' where used refers to the Central Bank and Financial Services Authority of Ireland (CBFSAI).

(b) Income Recognition

The accruals concept in accounting for income and expenses has been adopted.

(c) Fixed Assets

(i) *Measurement*

Fixed assets are stated at cost and are not revalued.

(ii) *Depreciation*

All fixed assets are depreciated on a straight line basis over their anticipated useful lives as follows:

Freehold Premises (excluding site costs)	—	50 years
Plant and Machinery	—	5 to 15 years
Other	—	5 years

1 Throughout this document the use of the term the European System of Central Banks (ESCB) refers to the twenty-five National Central Banks (NCBs) of the Member States of the European Union on 31 December 2005 plus the European Central Bank (ECB). The term 'Eurosystem' refers to the twelve NCBs of the Member States participating in the Monetary Union, plus the ECB on the same date.

2 The principal statutory provisions are: *Treaty on European Union*, 1992, *Central Bank Acts* 1942-1998, *Central Bank of Ireland (Surplus Income) Regulations*, 1943, *Coinage Act*, 1950, *Decimal Currency Acts* 1969-1990, the *Economic and Monetary Union Act*, 1998 and the *Central Bank and Financial Services Authority of Ireland Act*, 2003.

(d) Superannuation

Under the Bank's superannuation scheme permanent Bank staff obtain the same superannuation benefits as established civil servants. The Bank pays these benefits out of current income as they fall due. For the year ended 31 December 2005 the Bank has adopted Financial Reporting Standard (''FRS'') 17 ''Retirement Benefits'' in full recognising the cost of providing pensions over the period during which it benefits from the employees' services.

Scheme liabilities are measured using the projected unit method, which takes account of projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. These cash flows are discounted at the interest rate applicable to high-quality corporate bonds of the same currency and term as the liabilities. The current service cost and any past service costs are charged to the profit and loss account within staff expenses and to the Currency Reserve in respect of mint staff. Actuarial gains and losses are recognised in the appropriation account.

In determining the value of scheme liabilities assumptions are made as to price inflation, dividend growth, pension increases, earnings growth and employees. The assumptions underlying the 2005 liabilities and pension cost are set out in Note 35 to the financial statements.

The effect of this change of accounting policy on the profit and loss account has been to reduce other income (Note 7) by €13.1 million (2004 – €11.4 million) and to increase expenditure by €3.3 million (2004 €4.2 million). Profit before unrealised gains has been reduced by €16.4 million (2004 €15.6 million). A liability of €387.6 million (2004 €273.5 million) has been recognised on the balance sheet by a transfer from the Bank's Reserves and Revaluation Accounts and additional charges to the Profit and Loss Account in 2005 (See Note 35).

(e) Coin Provision and Issue

Proceeds and expenses relating to the provision and issue of coin are transferred directly to the Currency Reserve under the provisions of the *Coinage Act*, 1950, the *Decimal Currency Acts* 1969-1990 and the *Economic and Monetary Union Act*, 1998. The cost of production of coin is charged to the Currency Reserve in the year in which it is incurred. Proceeds from the issue of coin are credited to the Currency Reserve in the year they are received. Section 14A of the *Economic and Monetary Union Act*, 1998 (as inserted by Section 137 of the *Finance Act*, 2002) which came into operation on 25 March 2002 provides for the net proceeds from the issue of coin, from 1 January 2002 to be passed directly to the Exchequer as directed by the Minister.

(f) Foreign Currency Transactions

Accounting transactions denominated in foreign currency are converted to euro equivalents at exchange rates prevailing at the settlement date of transaction.

(g) Amortised Income

Premiums and/or discounts arising on securities are treated as net interest income and amortised on a straight-line basis over the period to their maturity and accounted for through the Profit and Loss account.

(h) Valuation Policy

Assets and liabilities denominated in foreign currency, unmatured investment and foreign currency contracts outstanding and shares in the Bank for International

Settlements (BIS) are valued at mid-market closing exchange rates at year-end (Note 32). The exchange rate valuation of assets and liabilities is performed on a currency-by-currency basis.

Gold is valued at the closing market price and securities at mid-market closing prices at year-end. The valuation of securities is performed on a security-by-security basis.

Securities held in long term investment portfolios are not valued but are held at cost in the Balance Sheet until maturity.

(i) Recognition of Gains and Losses

Realised gains and losses arising from sales of foreign exchange, gold and securities are accounted for through the Profit and Loss account. Foreign exchange realised gains and losses are calculated by reference to average cost, commencing 1 January 1999, with the foreign currency valuation at that date becoming opening cost.

Unrealised gains identified at the end of every financial year in accordance with the Bank's valuation policy (Accounting Policy (h)) are accounted for through the Profit and Loss account and transferred therefrom to the Revaluation Accounts.

Unrealised losses are accounted for through the Profit and Loss account to the extent that they exceed revaluation gains since 1 January 1999. Unrealised losses accounted for through the Profit and Loss account in this manner may not be reversed in subsequent years against future unrealised gains.

As all gains and losses are recognised through the Profit and Loss account it is not considered necessary to include a separate Statement of Total Recognised Gains and Losses.

Prior to 1 January 1999, gains and losses arising from the sale or valuation of foreign currency assets and gold were taken directly to reserves. At 1 January 1999, a transfer was made from the General Reserve to the Revaluation Accounts representing realised and unrealised gains and losses previously accounted for through that Reserve.

(j) Repurchase Agreements

Under a Sale and Repurchase Agreement the Bank sells securities from its portfolio for cash and simultaneously agrees to repurchase them at an agreed price on a set date. These agreements to repurchase are reflected on the liability side of the Bank's balance sheet (Note 26) and also lead to an interest expense in the Profit and Loss account (Note 2). At all times the Bank remains the beneficial owner of the securities which remain on its balance sheet.

Under a Reverse Repurchase Agreement the Bank buys securities for cash and simultaneously agrees to sell them back to the counterparty at an agreed price on a set date. These agreements to sell are recorded on the asset side of the balance sheet (Note 11 (iv)), but are not included in the Bank's holdings of securities. At no time during the term of the agreement does the Bank acquire beneficial ownership of the underlying securities. These agreements give rise to interest income in the Profit and Loss account (Note 1).

Repurchase agreements may be transacted in both euro and other currencies.

(k) Intra-ESCB Balances

All NCBs of the Eurosystem maintain accounts with each other for the purpose of making bilateral payments including cross-border payments through the TARGET[3] system. All bilateral balances at the close of business each day are netted by means of a multilateral netting process and replaced by a single outstanding debt-obligation to the ECB by each NCB or vice versa as appropriate. At end-2005 three of the non-participating countries (U.K., Denmark and Sweden) were included in the multilateral netting process.

Intra-Eurosystem balances arising from the allocation of euro banknotes within the Eurosystem are included as a liability under Intra-Eurosystems liabilities (net): ''Liabilities related to the allocation of euro banknotes within the Eurosystem'' (Accounting Policy (m)).

(l) ESCB Capital Key

The capital key is essentially a measure of the relative national size of member countries and is a 50:50 composite of GDP and population size. The key is used as the basis of allocation of each NCBs' share capital in the ECB and must be adjusted every five years under ESCB statute.

On 1 January 2004, the Bank's key was 1.0254 per cent. Following the accession of ten countries on 1 May 2004, the key changed to 0.9219 per cent and remained so at year-end. There was no such change to the key in 2005.

The Bank's share of the total key held by Eurosystem members was 1.2895 per cent at 31 December 2005 (1.2895 per cent as at 31 December 2004) and this is used as the basis of allocation for a series of important items including monetary income, banknotes in circulation and the sharing of the ECB's profit/loss.

(m) Banknotes in Circulation

The ECB and the 12 participating NCBs, which together comprise the Eurosystem, have issued euro banknotes as from 1 January 2002[4]. The total value of euro banknotes in circulation is allocated on the last working day of each month in accordance with the banknote allocation key[5].

From the beginning of 2002 the ECB has been allocated a share of 8 per cent of the total value of euro banknotes in circulation, whereas the remaining 92 per cent has been allocated to NCBs according to their weightings in the ESCB key (Accounting Policy (l)). The share of banknotes allocated to each NCB is disclosed under the balance sheet liability item ''Banknotes in circulation''.

The difference between the value of euro banknotes allocated to each NCB in accordance with the banknote allocation key and the value of the euro banknotes that it actually puts into circulation gives rise to remunerated intra-Eurosystem balances. These claims or liabilities, which incur interest[6], are disclosed in the balance sheet under ''Intra-Eurosystem: Liabilities (net)'' (Accounting Policy (k)).

3 Trans-European Automated Real-time Gross settlement Express Transfer system.

4 Decision of the European Central Bank of 6 December 2001 on the issue of euro banknotes (ECB/2001/15), OJ L 337, 20.12.2001, pp. 52-54.

5 The banknote allocation key refers to the percentages that result from taking into account the ECB's share of the total euro banknote issue and applying the ESCB capital key to the NCBs' share of such total.

6 Decision of the European Central Bank of 6 December 2001 on the allocation of monetary income of the National Central Banks of participating Member States from the financial year 2002 (ECB/2001/16), OJ L 337, 20.12.2001, pp. 55-61.

From 2002 until 2007 the intra-system balances arising from the allocation of euro banknotes are adjusted in order to avoid significant changes in NCBs' relative income positions as compared to previous years[7]. The adjustments are effected by taking into account the differences between the average value of banknotes in circulation of each NCB in the period from July 1999 to June 2001 and the average value of banknotes that would have been allocated to them during that period under the ESCB capital key. The adjustments will be reduced in annual stages until the end of 2007, after which income on banknotes will be allocated fully to the NCBs according to their weighting in the ESCB capital key.

The interest income and expense on these balances is cleared through the accounts of the ECB and is disclosed under ''Net interest income''.

The Governing Council of the ECB has decided that the seigniorage income of the ECB arising from the 8 per cent share of euro banknotes allocated to the ECB shall be distributed separately to the NCBs in the form of an interim distribution of profits[8] (Note 5). It shall be so distributed in full unless the ECB's net profit for the year is less than its income earned on euro banknotes in circulation and subject to any decision by the Governing Council to reduce this income in respect of costs incurred by the ECB in connection with the issue and handling of euro banknotes.

(n) Off-Balance Sheet Items

Profits and losses arising from off-balance sheet instruments are recognised and treated in a similar manner to on-balance sheet instruments. Unrealised (valuation) gains are not recognised as income but are accounted for through the Profit and Loss account and transferred therefrom to a Revaluation Account. Unrealised (valuation) losses are taken to the Profit and Loss account when exceeding previous revaluation gains registered in the Revaluation Account. Unrealised trade date gains/losses on foreign exchange forward contracts are recorded under ''other assets/liabilities'' in accordance with ESCB guidelines having been accounted for through the Profit and Loss account as outlined above. This method is used for foreign exchange forwards and these techniques cover the most significant off-balance sheet financial instruments which have been identified for possible use by the ESCB i.e. foreign exchange forwards, foreign exchange swaps, interest rate futures, interest rate swaps and forward rate agreements.

(o) Restatement of Previous Year Figures

The prior figures have been restated to reflect the effect of implementing FRS 17. The restated surplus for 2004 is presented for comparison purposes only. The actual surplus for 2004 (€103.0 million), as shown in the accounts for that year, was paid over to the Exchequer.

7 Decision of the European Central Bank of 6 December 2001 on the issue of euro banknotes (ECB/2001/15), OJ L 337, 20.12.2001, pp. 52-54.

8 Decision of the European Central Bank of 21 November 2001 on the distribution of the income of the European Central Bank on euro banknotes in circulation to the National Central Banks of the participating Member States (ECB/2002/9) the *Official Journal of the European Union* L 323, pp. 49-50.

Profit and Loss and Appropriation Account for year ended 31 December 2005

	Note	2005 €000	2004 Restated €000
Interest income	1	693,280	570,789
Interest expense	2	(485,056)	(393,954)
NET INTEREST INCOME		**208,224**	**176,835**
Net realised gains arising from financial operations	3	10,207	37,470
Write-downs on financial assets and positions	3	(13,207)	(12,615)
Net result of financial operations, write-downs and risk provisions		**(3,000)**	**24,855**
Income from fees and commissions	4	**1,581**	**1,402**
Income from equity shares and participating interests	5	**2,276**	**2,171**
Net result of pooling of Monetary Income	6	**(5,697)**	**(24,865)**
Other income	7,42	**7,676**	**8,136**
TOTAL NET INCOME		**211,060**	**188,534**
Staff expenses	8	**(61,361)**	**(56,075)**
Other operating expenses	8	**(18,633)**	**(17,569)**
Depreciation	8	**(5,929)**	**(5,590)**
Banknote raw materials	8	**(3,166)**	**(2,373)**
PROFIT FOR THE YEAR BEFORE UNREALISED GAINS		**121,971**	**106,927**
Net movement in unrealised gains	32	11,952	7,518
Transfers (to)/from revaluation account	32	(11,952)	(7,518)
Transfers from Reserves/Revaluation Accounts	32,33	95,917	53,201
Transfers to Reserves	33	**(12,790)**	**(19,452)**
Transfers to Pension Liability	35	**(95,917)**	**(53,201)**
SURPLUS INCOME	9	**109,181**	**87,475**

The accounting policies together with Notes 1 to 43 form part of these accounts.

Banc Ceannais agus Údarás Seirbhísí Airgeadais na hÉireann

John Hurley, Governor

23 June 2006

Brian Halpin, Deputy Director General

Balance Sheet as at 31 December 2005

ASSETS	Note	2005 €000	2004 Restated €000
Gold and gold receivables	10	83,967	62,091
Claims on non-euro area residents in foreign currency	11	658,182	2,399,273
Claims on euro area residents in foreign currency	12	51,426	82,077
Claims on non-euro area residents in euro	13	2,408,936	1,783,000
Lending to euro area credit institutions related to monetary policy operations in euro	14	20,990,407	17,439,631
Other Claims on euro area credit institutions in euro	15	949,303	757,959
Securities of euro area residents in euro	16	6,778,802	4,964,292
Intra-Eurosystem claims		570,283	570,283
Participating interest in ECB	17	*57,276*	*57,276*
Claims equivalent to the transfer of foreign reserves	18	*513,007*	*513,007*
Items in course of settlement	19	76,091	6,104
Other assets	20	395,371	394,114
Total Assets		32,962,768	28,458,824

The accounting policies together with Notes 1 to 43 form part of these accounts.

Banc Ceannais agus Údarás Seirbhísí Airgeadais na hÉireann

23 June 2006

John Hurley, Governor

Brian Halpin, Deputy Director General

Balance Sheet as at 31 December 2005

LIABILITIES	Note	2005 €000	2004 Restated €000
Banknotes in circulation	22	6,706,288	5,947,414
Liabilities to euro area credit institutions related to monetary policy operations in euro	23	8,252,363	4,342,414
Liabilities to other euro area residents in euro	24	4,239,926	3,877,559
Liabilities to non-euro area residents in euro	25	10,714	16,060
Liabilities to non-euro area residents in foreign currency	26	0	332,549
Counterpart of special drawing rights allocated by the IMF	27	105,581	99,445
Intra-Eurosystem liabilities (net)		11,447,830	11,742,029
Liabilities related to the allocation of euro banknotes within the Eurosystem	28	*6,939,066*	*5,061,478*
Other Liabilities within the Eurosystem (net)	29	*4,508,764*	*6,680,551*
Other liabilities	30	631,078	551,184
Pension Liability	35	387,644	273,496
Provision	31	16,982	41,368
Revaluation accounts	32	65,067	78,183
Capital and reserves	33	1,099,295	1,157,123
Total Liabilities		32,962,768	28,458,824

The accounting policies together with Notes 1 to 43 form part of these accounts.

Banc Ceannais agus Údarás Seirbhísí Airgeadais na hÉireann

John Hurley, Governor

23 June 2006

Brian Halpin, Deputy Director General

Notes to the Accounts

Note 1 Interest Income

	2005	2004
	€000	€000
Deposit Income	64,212	57,749
Coupons on Securities	250,416	171,218
Reverse Repurchase Agreements (i)	10,102	22,616
(Premiums)/Discounts on Securities (ii)	(47,863)	(21,567)
Monetary Policy Operations (iii)	412,045	331,239
Income from Transfer of Foreign Reserve Assets to ECB (Note 18)	9,158	8,933
Other	(4,790)	601
Total	**693,280**	**570,789**

(i) See Accounting Policy (j).

(ii) See Accounting Policy (g).

(iii) This relates to lending to credit institutions by the Bank as part of the Eurosystem's monetary policy operations (Note 14).

Note 2 Interest Expense

	2005	2004
	€000	€000
Government	112,265	98,143
Credit Institutions	136,256	110,714
Intra-Eurosystem Balances (i)	114,654	107,042
Remuneration of Liability in respect of Euro Banknotes in circulation (ii)	119,311	74,972
Repurchase Agreements (iii)	2,570	3,083
Total	**485,056**	**393,954**

(i) The interest income/expense on these balances, which are remunerated at the short-term refinancing rates of the Eurosystem, is calculated by the ECB at the end of each day.

(ii) See Accounting Policies (k) and (m).

(iii) See Accounting Policy (j).

Note 3 Net Realised Gains arising from Financial Operations

	2005	2004
	€000	€000
Net Realised Price Gains on Securities	12,964	16,540
Net Realised Exchange Rate Gains/(Losses)	(2,757)	20,930
Total	**10,207**	**37,470**

Write Downs on Financial Assets and Positions

	2005	2004
	€000	€000
Unrealised Price Losses on Securities	(13,200)	(648)
Unrealised Exchange Rate Losses	(7)	(11,967)
Total	**(13,207)**	**(12,615)**

Note 4 **Income from Fees and Commissions**

	2005	2004
	€000	€000
Service Fees and Charges	772	749
Security Lending	694	571
Other	115	82
Total	**1,581**	**1,402**

Note 5 **Income from Equity Shares and Participating Interests**

	2005	2004
	€000	€000
Share of ECB Profits (i)	–	–
BIS Dividend (ii)	2,276	2,171
Total	**2,276**	**2,171**

(i) This item represents Ireland's share of the ECB's distributable profit (Note 17). In 2005, the ECB paid no dividends in accordance with a decision of the Governing Council. (Accounting Policy (m)).

(ii) Dividend received on shares in the Bank for International Settlements (Note 20).

Note 6 **Net Result of Pooling of Monetary Income**

The amount of each Eurosystem NCB's monetary income is determined by measuring the actual annual income that derives from the earmarkable assets held against its liability base. The liability base consists of the following items: banknotes in circulation; liabilities to credit institutions related to monetary policy operations denominated in euro; intra-Eurosystem liabilities resulting from TARGET transactions; intra-Eurosystem liabilities related to the allocation of euro banknotes within the Eurosystem. Any interest paid on liabilities included within the liability base is to be deducted from the monetary income to be pooled. The earmarkable assets consist of the following items: lending to euro area credit institutions related to monetary policy operations denominated in euro; intra-Eurosystem claims equivalent to the transfer of foreign reserve assets to the ECB; intra-Eurosystem claims resulting from TARGET transactions; intra-Eurosystem claims related to the allocation of euro banknotes within the Eurosystem; a limited amount of each NCB's gold holdings in proportion to each NCB's capital key. Gold is considered to generate no income. Where the value of a NCB's earmarkable assets exceeds or falls short of the value of its liability base, the difference shall be offset by applying to the value of the difference the average rate of return on the earmarkable assets of all NCBs taken together.

In the event of the ECB incurring a loss, the loss can be offset against the ECB's general reserve fund, and if necessary, by a decision of the Governing Council, against the monetary income of the relevant financial year in proportion and up to the amount allocated to the NCBs. At its meeting on 13 January 2005 the Governing Council decided in principle to also offset the ECB's loss against monetary income. The final decision on the matter was taken at a Governing Council meeting on 17 March 2005. The Bank's share of this loss was €17.5 million (See Note 31).

Note 7 **Other Income**

	2005	2004 Restated
	€000	€000
Financial Regulator Levies	20,366	19,100
Interest on Pension liabilities	(13,150)	(11,400)
Other	460	436
Total	**7,676**	**8,136**

Note 8 Expenses

€000	Dame Street*		Currency Centre (Excl. Coin) (i)		Total (Excl. Coin) (i)*		Coin (i)		Total (i)	
	2005	2004 Restated	2005	2004 Restated	2005	2004 Restated	2005	2004 Restated	2005	2004 Restated
Salaries/Allowances (ii)	40,823	36,445	9,073	8,337	49,896	44,782	692	974	50,588	45,756
PRSI	2,503	2,083	530	473	3,033	2,556	49	76	3,082	2,632
Pensions (Note 35(b))	7,223	7,498	1,209	1,239	8,432	8,737	94	65	8,526	8,802
Staff Expenses	**50,549**	**46,026**	**10,812**	**10,049**	**61,361**	**56,075**	**835**	**1,115**	**62,196**	**57,190**
Training, Recruitment & Other Staff Costs	2,103	1,617	386	357	2,489	1,974	7	11	2,496	1,985
Maintenance of Premises	1,285	1,195	1,093	1,111	2,378	2,306	2	3	2,380	2,309
Energy	549	456	513	454	1,062	910	–	–	1,062	910
Rent & Rates	976	1,059	448	432	1,424	1,491	–	–	1,424	1,491
Equipment, Stationery and Requisites	1,559	1,609	140	161	1,699	1,770	5	3	1,704	1,773
Post and Telecommunications	477	460	93	91	570	551	3	3	573	554
Investment Services and Bank Charges	1,285	1,388	15	17	1,300	1,405	–	1	1,300	1,406
Business Travel	1,577	1,502	182	179	1,759	1,681	13	17	1,772	1,698
Publishing & Media Relations	2,838	2,001	67	51	2,905	2,052	–	3	2,905	2,055
Professional Fees (iii)	1,593	1,449	41	43	1,634	1,492	14	5	1,648	1,497
Works Machine Maintenance	–	–	516	495	516	495	166	191	682	686
RTGS System Costs	452	463	–	–	452	463	–	–	452	463
Miscellaneous	433	949	12	30	445	979	–	6	445	985
Other Operating Expenses	**15,127**	**14,148**	**3,506**	**3,421**	**18,633**	**17,569**	**210**	**243**	**18,843**	**17,812**
Raw Materials	**–**	**–**	**3,166**	**2,373**	**3,166**	**2,373**	**4,519**	**4,560**	**7,685**	**6,933**
Depreciation	**2,581**	**2,350**	**3,348**	**3,240**	**5,929**	**5,590**	**320**	**323**	**6,249**	**5,913**
Total Expenses	**68,257**	**62,524**	**20,832**	**19,083**	**89,089**	**81,607**	**5,884**	**6,241**	**94,973**	**87,848**

(i) Expenses relating to the provision and issue of coin are charged directly to the Currency Reserve under the provisions of the *Coinage Act*, 1950, the *Decimal Currency Acts* 1969-1990 and the *Economic and Monetary Union Act*, 1998 and not to the Profit and Loss account (Accounting Policy (e)).

(ii) Total fees paid to Directors of CBFSAI and members of the Financial Regulator in respect of 2005 were €247,764 (2004: €247,764). This is allocated as follows:

	2005(€)	2004(€)
CBFSAI	101,579	101,579
Financial Regulator	146,185	146,185

(iii) Auditors fees for 2005 in respect of both the Comptroller and Auditor General and Deloitte and Touche amounted to €185,548 (2004: €205,981).
Deloitte and Touche non-audit services for 2005 amounted to €13,541.

*The expenses of the Financial Regulator are included in this section. Details of the Financial Regulator's income and expenses in 2005 are shown in Note 42.

Note 9 Surplus Income

Surplus Income of €109.2 million was payable to the Exchequer in respect of the year ended 31 December 2005. The amount payable to the Exchequer in respect of 2004 was €103.0 million. The restated 2004 amount (€87.5 million) is disclosed only to reflect the implementation of FRS 17.

A payment on account of €40.6 million (2004: €40.6 million) of Surplus Income was made during 2005 leaving a balance of €68.6 million (2004: €62.4 million) (Note 30). These arrangements are in accordance with Section 6G of the *Central Bank Act*, 1942 (as inserted by Section 7 of the *Central Bank and Financial Services Authority of Ireland Act*, 2003), which provides that the Bank may at any time pay into the Exchequer such sums on account of Surplus Income as may be agreed upon by the Minister for Finance and the Bank.

Under Section 6J of the *Central Bank Act*, 1942, (as inserted by Section 7 of the *Central Bank and Financial Services Authority of Ireland Act*, 2003) the Bank is exempt from Corporation Tax, Income Tax and Capital Gains Tax.

Note 10 Gold and Gold Receivables

With the exception of coin stocks held in the Bank, gold holdings consist of deposits with foreign banks. The change in value is due mainly to the change in the value of gold during the year.

Note 11 Claims on Non-Euro Area Residents in Foreign Currency

	2005	2004
	€000	€000
Receivables from the IMF (i)	223,700	372,118
Balances with banks and security investments, external loans and other external assets (iv)	434,482	2,027,155
Total	**658,182**	**2,399,273**

(i) Receivables from the International Monetary Fund (IMF)

	2005	2004
	€000	€000
Quota	1,015,563	954,405
Less IMF Holdings of euro	(866,449)	(647,620)
Reserve Position in IMF (ii)	**149,114**	**306,785**
SDR Holdings (iii)	**74,586**	**65,333**
Total	**223,700**	**372,118**

(ii) *Reserve Position in IMF:*
This asset represents the difference between Ireland's Quota in the IMF and IMF holdings of euro. Ireland's Quota is its membership subscription, twenty five per cent of which was paid for in foreign currencies and the balance in euro. The holdings of euro by the IMF, which initially were equal to seventy five per cent of the Quota, have changed from time to time as a result of instructions received from the IMF regarding its lendings to member countries.

(iii) *Special Drawing Rights (SDRs):*
The SDR is an international reserve asset which was created by the IMF and allocated to member countries in the early 1970s and the early 1980s in order to increase international liquidity. The SDR is defined in terms of a basket of currencies. Its value is determined as the weighted sum of exchange rates of four currencies (US dollar, sterling, yen and euro).

(iv) Balances with Banks and Security Investments, External Loans and Other External Assets

	2005	2004
	€000	€000
Balances with Banks	291,128	671,222
Security Investments	143,354	841,746
Reverse Repurchase Agreements (v)	–	514,187
Total	**434,482**	**2,027,155**

Maturity Profile	2005	2004
	€000	€000
0-3 months	310,172	1,483,625
3 months-1 year	66,385	39,763
1-5 years	57,925	503,767
Total	**434,482**	**2,027,155**

(v) See Accounting Policy (j).

Note 12 Claims on Euro Area Residents in Foreign Currency

	2005	2004
	€000	€000
Balances with Banks	24,582	68,329
Security Investments	26,844	13,748
Total	**51,426**	**82,077**

Maturity Profile	2005	2004
	€000	€000
0-3 months	1,687	68,329
3 months-1 year	32,561	—
1-5 years	17,178	13,748
Total	**51,426**	**82,077**

Note 13 Claims on Non-Euro Area Residents in Euro

	2005	2004
	€000	€000
Balances with Banks	1,180,913	903,634
Security Investments	957,663	552,996
Reverse Repurchase Agreements (i)	270,360	326,370
Total	**2,408,936**	**1,783,000**

Maturity Profile	2005	2004
	€000	€000
0-3 months	1,496,179	1,258,651
3 months-1 year	119,104	28,241
1-5 years	696,213	479,362
5-10 years	97,440	16,746
Total	**2,408,936**	**1,783,000**

(i) See Accounting Policy (j).

Note 14 Lending to Euro Area Credit Institutions related to Monetary Policy Operations in Euro

	2005	2004
	€000	€000
Main Refinancing Operations (i)	10,099,000	6,453,000
Longer Term Refinancing Operations (ii)	10,891,407	10,986,631
Marginal Lending Facility (iii)	—	—
Total	**20,990,407**	**17,439,631**

These consist of advances to local credit institutions and reflect the Bank's participation in Eurosystem monetary policy operations. All the advances are fully secured by collateral approved by the Eurosystem.

(i) The Main Refinancing Operations comprise weekly tenders for funds with a maturity of one week and at rates close to market rates.

(ii) The Longer Term Refinancing Operations comprise monthly tenders with a maturity of three months and at rates close to market rates.

(iii) This is an automatic overnight standing facility described as the Marginal Lending Facility (MLF) available to counterparties to the monetary policy operations. The MLF rate is generally above market rates.

Note 15 Other Claims on Euro Area Credit Institutions in Euro

	2005	2004
	€000	€000
Balances with Banks	550,303	350,012
Reverse Repurchase Agreements (i)	399,000	407,947
Total	**949,303**	**757,959**

These items have a maturity of less than 3 months.

(i) See Accounting Policy (j).

Note 16 Securities of Euro Area Residents in Euro

These securities comprise debt issued by specified euro area and supranational issuers.

Maturity Profile	2005	2004
	€000	€000
0-3 months	1,214,221	808,273
3 months-1 year	1,899,353	1,720,140
1-5 years	2,701,779	2,054,232
5-10 years	963,449	381,647
Total	**6,778,802**	**4,964,292**

Note 17 Participating Interest in ECB

This represents the Bank's contribution to the capital of the European Central Bank.

Note 18 Claims Equivalent to the Transfer of Foreign Reserves

The *Treaty on European Union*, 1992 and Section 5A of the *Central Bank Act*, 1942, (as inserted by Section 4 of the *Central Bank Act*, 1998) as substituted by Section 5B(o) of the *Central Bank and Financial Services Authority of Ireland Act*, 2003 provides that the Bank has the power to ''transfer assets, income or liabilities to the European Central Bank where required under the ESCB Statute''. Accordingly the Bank transferred an amount equivalent to €425 million to the ECB in January 1999 and received in turn a corresponding claim on the ECB equivalent to this amount. As a result of the Capital Key changes an additional €88 million was transferred on 1 January 2004 and €300,000 was transferred on 1 May 2004. There were no such changes in 2005. The resulting claim on the ECB is remunerated at rates based on euro short-term market rates (Note 1).

Note 19 Items in Course of Settlement

Items in the course of settlement represent a claim on credit institutions in respect of cheques lodged in the Bank by its customers on the last business day of the year and presented to the banks on the first business day of the new year.

Note 20 Other Assets

	2005 €000	2004 €000
Shares in the Bank for International Settlements (i)	17,250	11,396
Stocks of Materials for Note Production	1,700	1,273
AIB plc/ICAROM Interest Bearing Loan (ii)	123,020	133,172
Accrued Interest Income	152,787	110,780
Prepayments	718	374
Fixed Assets (Note 21)	66,153	68,708
Other	33,743	68,411
Total	**395,371**	**394,114**

(i) The Bank holds 8,564 shares (2,564 paid up) in the Bank for International Settlements (BIS).

(ii) Under arrangements, which commenced in 1993 for the financing of the administration of ICAROM plc (formerly Insurance Corporation of Ireland plc), €11.1 million per annum until 2012 is being collected from Allied Irish Banks plc and passed on to the Administrator of ICAROM plc. The mechanisms used to collect these monies are (i) a back-to-back loan and deposit arrangement between Allied Irish Banks plc and the Bank and (ii) the reduction of interest paid on the minimum reserve balances held with the Bank. The matching back-to-back deposit is shown in Other Liabilities (Note 30).

Note 21 Fixed Assets

€000	Premises		Plant and Machinery		Computer Equipment		Other Equipment		Furniture Fixtures & Fittings		Total Fixed Assets	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
At Cost – 1 January	49,409	45,157	46,761	45,794	11,016	9,072	6,109	5,580	8,252	6,718	121,547	112,321
Acquisitions (+)	405	4,252	253	967	634	1,944	1,679	578	724	1,534	3,695	9,275
Disposals	–	–	–	–	–	–	–	(49)	–	–	–	(49)
At Cost – 31 December	49,814	49,409	47,014	46,761	11,650	11,016	7,788	6,109	8,976	8,252	125,242	121,547
Accumulated Depreciation at 1 January	9,283	8,330	24,959	21,855	7,598	6,597	4,906	4,560	6,093	5,633	52,839	46,975
Depreciation for Year (i)	992	953	3,206	3,104	988	1,001	424	395	640	460	6,250	5,913
Disposals	–	–	–	–	–	–	–	(49)	–	–	–	(49)
Accumulated Depreciation at 31 December	10,275	9,283	28,165	24,959	8,586	7,598	5,330	4,906	6,733	6,093	59,089	52,839
Net Book Value at 31 December	**39,539**	**40,126**	**18,849**	**21,802**	**3,064**	**3,418**	**2,458**	**1,203**	**2,243**	**2,159**	**66,153**	**68,708**

(i) Of the total of €6.2 million (2004: €5.9 million) depreciation charge, €0.3 million (2004: €0.3 million) in respect of Mint machinery was charged to the Currency Reserve (Accounting Policy (e)).

Note 22 Banknotes in Circulation

This item consists of the Bank's share of euro banknotes issued in the Eurosystem. The total value of euro banknotes in circulation is allocated on the last working day of each month in accordance with the banknote allocation key (Accounting Policy (m)).

Note 23 Liabilities to Euro Area Credit Institutions related to Monetary Policy Operations in Euro

Credit institutions in the euro area are required to hold minimum average reserve deposits with their respective NCBs. The purpose of these reserve requirements is to maintain a structural liquidity shortage. Interest is paid on these deposits at rates close to short-term market interest rates (Note 14). These accounts are also used as current/settlement accounts through which transactions across the Irish RTGS/TARGET system are settled.

Note 24 Liabilities to Other Euro Area Residents in Euro

	2005	**2004**
	€000	**€000**
General Government (i)	4,239,828	3,877,461
Other	98	98
Total	**4,239,926**	**3,877,559**

These items have a maturity of less than one year.

(i) Included under this heading are deposits totalling €497,296 held by the Official Assignee in Bankruptcy under the provisions of the *Bankruptcy Act*, 1988.

Note 25 Liabilities to Non-Euro Area Residents in Euro

	2005	**2004**
	€000	**€000**
Central Banks	60	152
International Financial Institutions	14	21
EU Agencies	10,640	15,887
Total	**10,714**	**16,060**

These items have a maturity of less than one year.

Note 26 Liabilities to Non-Euro Area Residents in Foreign Currency

Liabilities arising from sale and repurchase agreements are shown under this heading (Accounting Policy (j)). These items have a maturity of less than one year.

Note 27 Counterpart of Special Drawing Rights Allocated by the IMF

This is the liability of the Bank to the IMF in respect of the allocation of SDRs to Ireland. The Bank's SDR assets can change as a result of IMF lending operations or exchanges of SDRs for foreign currency with the IMF itself, IMF members and other official holders of SDRs. SDR holdings may also change as a result of interest payments made by the IMF on the Bank's Reserve Position in the IMF and on the Bank's SDR holdings net of SDR allocations.

Note 28 Net Liabilities related to the Allocation of Euro banknotes within the Eurosystem

This item consists of the liability of the Bank *vis-à-vis* the Eurosystem in relation to the allocation of euro banknotes within the Eurosystem (Accounting Policies (k) and (m), Note 22).

Note 29 Other Liabilities within the Eurosystem

This item represents the net liability to the ECB as a result of euro cross-border payments transacted over the TARGET system by all NCBs participating in the ESCB (Accounting Policy (k)).

Note 30 Other Liabilities

	2005	2004
	€000	€000
AIB plc/ICAROM Deposit (Note 20)	123,020	133,172
Profit & Loss Appropriations (i)	68,549	62,390
Deposit Protection Accounts (ii)	337,207	273,065
Interest Accruals	84,276	65,605
Other Accruals	3,747	2,020
Other	14,279	14,932
Total	**631,078**	**551,184**

(i) See Note 9 on Surplus Income.

(ii) These are balances placed by credit institutions with the Bank as part of the Irish deposit protection scheme. The Irish deposit protection scheme is funded by credit institutions which are authorised by the Financial Regulator.

Note 31 Provision

In December 2002 a provision of €60 million was created to meet unredeemed Irish pound banknotes. At 31 December 2005 the provision stood at €16.9 million (2004: €23.8 million) (Note 34).

A provision of €17.5 million was established in 2004 against the Bank's share of the ECB's loss for the year. This amount was paid to the ECB on 31 January 2005 (Note 6). No such provision was required in 2005.

Note 32 Revaluation Accounts

	Pre EMU €000	Post EMU €000	Total €000
Opening Balance at 1 January 2005 as previously reported	223,722	53,115	276,837
Prior year Adjustment (Note 35(e))	(198,654)	–	(198,654)
At 1 Jan 2005 Restated	25,068	53,115	78,183
Revaluation Surplus	–	11,952	11,952
Actuarial Loss on pension liability	(25,068)	–	(25,068)
Balance at 31 December 2005	**–**	**65,067**	**65,067**

Prior to 1 January 1999, gains and losses from the sale or valuation of foreign currency assets and gold were taken directly to reserves. At 1 January 1999, a transfer was made from the General Reserve to the Revaluation Accounts representing realised and unrealised gains and losses previously accounted for through this reserve. Since 1999, the Bank has adopted the approach of retaining these net gains in the revaluation reserve, even though some of these net gains have been realised. A prior year adjustment of €198.6 million was charged to the pre-EMU Reserve as at 1 January 2005 in respect of the pension liability. The remaining balance in the pre-EMU reserve of €25.1 million was transferred to the pension liability during 2005. This €25.1 million and the transfer from the General Reserve of €70.8 million (€95.9 million) covers the actuarial loss on the pension liability in 2005.

In accordance with ESCB guidelines, foreign exchange realised gains and losses are calculated by reference to average cost, commencing 1 January 1999, with the foreign currency valuation at that date becoming opening cost.

The foreign exchange rates used *vis-à-vis* the euro for the end-year valuations are as follows:–

	2005	2004
Currency	**Rate**	**Rate**
US dollar	1.1797	1.3621
Japanese yen	138.90	139.65
Australian dollar	1.6109	1.7459
Sterling	0.6853	0.7050
Swiss franc	1.5551	1.5429
Norwegian krone	7.9850	8.2365
Danish krone	7.4605	7.4388
Swedish krona	9.3885	9.0206
Cyprus pound	0.5735	0.5800
Canadian dollar	1.3725	1.6416
SDR	0.8265	0.8775
The gold prices used were:		
US dollars per fine ounce	513.00	438.00

Note 33 Capital and Reserves

€000	Capital (a)	General Reserve (b)	Super-annuation Reserve (c)	Currency Reserve (d)	Total
At 1 Jan 2005 as previously reported	**30**	**805,432**	**74,842**	**351,661**	**1,231,965**
Prior year Adjustment* (Note 35(e))			(74,842)		(74,842)
At 1 Jan 2005 restated	**30**	**805,432**	**—**	**351,661**	**1,157,123**
Retained profit for the year		12,790			12,790
Transfer to Pension Liability				(136)	(136)
Net Proceeds of Coin Issue				45,367	45,367
Transfer to the Exchequer				(45,000)	(45,000)
Actuarial loss on Pension Liability		(70,849)			(70,849)
At 31 December 2005	**30**	**747,373**	**—**	**351,892**	**1,099,295**

**As a result of the adoption of the Financial Reporting Standard (FRS) 17 — Accounting for retirement benefits and the recognition of the Bank's pension liability in the Balance Sheet as at 31 December 2004, the following prior year adjustments were made to the reserves and Revaluation Accounts (see note 32) in respect of 2004:*

	€000
Adjustments to Opening Reserves/Revaluation Account at 1 January 2004	*203,439*
Adjustment to Profit and Loss account for the year ended 31/12/2004	*15,553*
Adjustment in respect of Employee Contributions	*1,303*
Adjustment to total recognised gains and losses for the year ended 31/12/04	*53,201*
Total Prior Year Adjustment (Note 35(e))	***273,496***

(a) Capital: The authorised capital of the Bank is fixed under Section 9(1) of the *Central Bank Act*, 1942 at €50,970. Issued and paid up capital is €30,474 all of which is held by the Minister for Finance. The balance is payable as agreed by the Board and the Minister.

(b) General Reserve: Under the Central Bank of Ireland (Surplus Income) Regulations, 1943, the Board approved a transfer from the Profit and Loss Appropriation account to the General Reserve of €12.8 million and a transfer from the General Reserve to the Pension Liability Account of €70.8 million.

(c) Superannuation Reserve: Under Central Bank of Ireland (Surplus Income) Regulations, 1943, the Board may approve transfers to the Superannuation Reserve. No such transfer was made in 2005. A prior year adjustment €74.8 million was charged to the Superannuation Reserve in respect of the pension liability as at 1 January 2005.

(d) Currency Reserve: Under the provisions of the *Coinage Act*, 1950, the *Decimal Currency Acts* 1969-1990 and the *Economic and Monetary Union Act*, 1998, income and expenses related to coin are transferred directly to the Currency Reserve (Accounting Policy (e), Note 8). As a result of the *Finance Act*, 2002, the Bank is permitted to transfer the net proceeds from the issue of coin directly to the Exchequer. In 2005, net proceeds of coin issue amounting to €45 million were transferred to the Exchequer. Details of net proceeds for the year are included in the table below:

Net Proceeds of Coin Issue

	2005 €000	2004 €000
Coin issued into circulation	51,332	48,564
Specimen Coin Sets	1,071	1,788
Withdrawn Irish coin	(1,175)	(1,630)
Proceeds from smelted coin	23	88
Total	**51,251**	**48,810**
Less Operating Costs (Note 8)	**(5,884)**	**(6,238)**
Net Proceeds	**45,367**	**42,572**

The transfer to the pension liability account of €136,000 is in respect of interest on pension liability for staff involved in the provision and issue of coin. The current service cost of €94,000 for such staff is included in the operating cost.

Note 34 Contingencies

The Bank has a contingent liability in respect of 6,000 shares held in the Bank for International Settlements (BIS) (Note 20(i)).

Under Article 28 of the Statute of the ESCB the Bank may be called upon in the future, along with all other participating NCBs, to provide further injections of capital to the ECB (Note 17).

The Bank has a contingent liability in relation to Irish pound banknotes that are no longer legal tender and that may be presented at a future date. At 31 December 2005, there was €256.7 million of Irish pound banknotes still outstanding (Note 31).

Note 35 Superannuation Liabilities

The pension entitlements of past and current permanent Bank staff arise under a defined benefit pension scheme. Under the scheme Bank staff receive the same entitlements as established civil servants. The Scheme is operated on a non-contributory basis for staff employed before 6 April 1995, with the exception of contributions made to the Spouses' and Children's Pension Scheme and payments received from eligible staff for the purchase and transfer of notional added service. In the case of staff employed on or after 6 April 1995 contributions are also payable in respect of the main scheme. The Bank operates a pay-as-you-go system in that assets are not separately identified to provide for the Bank's pension liabilities. Instead, pension liabilities are met out of the Bank's total resources.

The Bank has adopted Financial Reporting Standard (''FRS'') 17 ''Retirement Benefits'' in full for the year ended 31 December 2005. The corresponding details in respect of year ended 31 December 2004 have been restated to reflect these requirements.

The *Central Bank and Financial Services Authority of Ireland Act*, 2003, included a provision for the Bank to establish a funded pension scheme. In 2005, preliminary work progressed on the establishment of such a funded arrangement. It is intended that a funded pension scheme will be in place by end 2006.

The policy of the Bank is to arrange an independent actuarial valuation of superannuation liabilities every three years. The latest valuation to take account of the requirements of FRS 17 was carried out as at 31 December 2005 by independent actuaries Coyle Hamilton Willis using the Projected Unit Method. Certain member categories of the post-retirement schemes are either closed to new members or the age profile of the active membership is rising significantly. For these categories, under the projected unit method the current service cost will increase as the members of the scheme approach retirement.

(a) <u>FRS17 Disclosure</u>

The major assumptions used for FRS 17 purposes were:

	2005	2004	2003
	%	%	%
Rate of increase in salaries	3.50	3.50	3.50
Rate of increase in pensions	3.50	3.50	3.50
Discount Rate	4.25	4.75	5.50
Rate of price inflation	2.00	2.00	2.00

The following amounts were measured in accordance with the requirements of FRS 17 — Retirement Benefits:

	2005	2004	2003
	€000	€000	€000
Present value of the scheme liabilities	(387,644)	(273,496)	(203,439)

(b) Amount charged to Profit and Loss Account/Currency Reserve

Profit and Loss Account

	2005	2004	2003
	€000	€000	€000
Expected return on pension scheme assets	–	–	–
Interest on pension scheme liabilities	13,286	11,400	10,190
Net charge debited to other finance income (Note 7)	**13,150**	**11,400**	**10,190**
Net charge debited to Currency Reserve (Note 33)	**136**	**–**	**–**
Current service cost	9,322	6,509	5,457
Past service cost	899	3,646	–
Employee Contributions	(1,695)	(1,353)	(999)
Total	**8,526**	**8,802**	**4,458**
Net charge debited to Staff Expenses (Note 8)	8,432	8,737	–
Net charge debited to Currency Reserve (Note 33)	94	65	–
Total pension cost of defined benefit scheme	**21,812**	**20,202**	**14,648**

(c) Movement in deficit during the year

	2005	2004	2003
	€000	€000	€000
Deficit as at 1 January	(273,496)	(203,439)	(182,174)
Movement in year:			
Current service cost	(9,322)	(6,509)	(5,457)
Past service cost	(899)	(3,646)	–
Pensions paid	5,276	4,699	4,020
Interest on pension scheme liabilities	(13,286)	(11,400)	(10,190)
Actuarial Loss Recognised in Appropriation Account	(95,917)	(53,201)	(9,638)
Deficit at 31 December	(387,644)	(273,496)	(203,439)

(d) History of experience losses and changes in actuarial assumptions

	2005	2004	2003
	€000	€000	€000
Experience losses arising on the pension scheme liabilities	(37,345)	(972)	(8,692)
Percentage of the scheme liabilities	*(9.6%)*	*(0.4%)*	*(4.3%)*
Changes in assumptions underlying the present value of the pension scheme liabilities	(58,572)	(52,229)	(946)
Percentage of the scheme liabilities	*(15.1%)*	*(19.1%)*	*(0.5%)*
Total amount recognised in the Appropriation Account	(95,917)	(53,201)	(9,638)
Percentage of the scheme liabilities	*(24.7%)*	*(19.5%)*	*(4.7%)*

(e) Effect of Change in Accounting Policy

	2005		Prior Years
	€000		€000
Transfer from Revaluation Accounts (Note 32)	25,068		198,654
Transfer from Superannuation Reserve (Note 33)			74,842
Transfer from General Reserve (Note 33)	70,849	95,917	–
Additional charge to Profit for the year		16,400	–
Additional Charge to Currency Reserve		136	–
Employee Contribution		1,695	–
Total		**114,148**	**273,496**

Note 36 Management of Financial Risk

The liabilities and assets of the Bank are primarily determined by the nature of the Bank's statutory functions, rather than commercial considerations. At the same time the Bank actively manages the market risks associated with its investment portfolio (i.e. holdings of foreign currency and euro-denominated assets).

The parameters within which the Bank's investment portfolio is managed are determined by the Board of the Bank; these include the currency composition of assets, the choice of investment instruments and the overall degree of risk that the Bank considers appropriate for its investment activities.

The risks (i.e. currency, market, credit, liquidity and operational) inherent in the investment portfolio are managed by a comprehensive system of limits and procedures. An Investment Committee of the Board reviews investment policy and performance, and is supported by the Bank's Investment Assets Committee which considers policy issues and strategy relating to the investment of the reserves. This committee, under the chairperson of the Member of Management Board responsible for Financial Operations, consists of management and senior staff of the Financial Markets, Payments and Securities Settlement and Financial Control Departments. A Standing Investment Strategy Committee, comprising Financial Markets management and dealers meet weekly to formulate short-term investment strategy.

An Investment Desk comprising a team of dealers carries out the day-to-day dealing activities that are required to implement decisions and to ensure that the portfolios are fully invested. A separate Risk Management Unit is responsible for the measurement, monitoring and reporting of the Bank's risk exposures and for monitoring and reporting compliance with limits etc. The Unit also measures the return on the Bank's investment portfolios.

The Bank is exposed to operational risk, which is the possibility of direct or indirect losses, or of reputational damage, arising from inadequate or failed internal processes, people and systems or from external events. This risk is managed by the segregation of the dealing, settlement and risk management functions; by restricted physical access to the dealing and settlement areas; and by a comprehensive body of controls and procedures aimed at minimising the risk of unauthorised trading. Each business area has responsibility for management of its operational risk. The operations of each business area are reviewed regularly to ensure that potential exposures are identified and that appropriate controls are implemented. A high-level committee, chaired by the Deputy Director General, oversees the management of operational risk in the Bank.

Note 37 Investor Compensation Act, 1998

Under Section 10 of the *Investor Compensation Act*, 1998, the Bank has formed and registered 'The Investor Compensation Company Limited', a company limited by guarantee. The Company administers the investor compensation scheme to reimburse the clients of failed investment firms. The Bank provides administrative and other services to the Company, the costs of which are recovered from the Company. The Company prepares its own Annual Report and audited Statement of Accounts.

Note 38 Unmatured Contracts in Foreign Exchange

Unmatured Foreign Exchange Contracts at 31 December 2005 were as follows:

	Unmatured Purchases	Unmatured Sales	Unmatured Purchases less Sales
		'000s of currency units	
Euro	512,574	54,283	458,290
US dollar	–	553,000	(553,000)
GBP	–	212	(212)

Note 39 Unmatured Contracts in Securities

As a result of commitments made in December 2005 there were unmatured net forward purchases of nominal US dollar 3.9 million and unmatured net forward sales of euro 547.4 million.

All contracts had matured by 6 January 2005.

Total net forward sales valued at mid-market closing exchange rates of 31 December had a nominal value of €544.0 million.

Note 40 Related Parties

(a) The Bank provides several services to the Minister for Finance, its sole shareholder, and to other government departments and bodies.

The main services during the year to 31 December 2005 were:

- provision of banking services including holding the principal accounts of Government;
- provision and issue of coin;
- holding and maintaining the register of Irish Government securities.

(b) As a participating member of the ESCB, the Bank has ongoing relationships with the other NCBs and the ECB.

Note 41 Post-Balance Sheet Events

There were no post-balance sheet adjusting events.

Note 42 The Irish Financial Services Regulatory Authority

The Irish Financial Services Regulatory Authority (the Financial Regulator) was established in May 2003 under the terms of the CBFSAI Act 2003. It is a constituent part of the CBFSAI and is responsible for the regulation of the financial services industry in Ireland. The following is a summary of the income and expenditure of the Financial Regulator for the year ended 31 December 2005 together with comparatives for the year ended 31 December 2004.

Irish Financial Services Regulatory Authority — Statement of Income and Expenditure for 2005

Income

	2005 €000	**2004 €000**
Industry Funding		
Credit Institutions	6,713	6,022
Insurance Undertakings	4,270	3,701
Intermediary Firms	2,954	2,855
Securities and Investment Firms	1,438	2,106
Collective Investment Schemes and Service Providers	3,963	3,678
Credit Unions	1,057	1,005
Moneylenders	109	119
Approved Professional Bodies	38	87
Exchanges	95	90
Bureaux de Change	19	19
Total Funding	**20,656**	**19,682**
Less: Provision/Write Offs	290	600
Net Industry Funding (i)	**20,366**	**19,082**
Excess of Income over Expenditure c/f from 2004	1,686	—
Subvention from Central Bank and Financial Services Authority of Ireland (ii)	20,364	17,643
	42,416	36,725
Other Income (iii)	1,003	—
Total Income	**43,419**	**36,725**
Expenses		
Direct Expenses (iv)	26,630	22,603
Shared Services (v)	13,676	12,436
	40,306	35,039
Other Expenses (iii)	1,003	—
Total Expenses	**41,309**	**35,039**
Excess of Income over Expenditure for Year (vi)	**2,110**	**1,686**

(i) Net Industry Funding

Net Industry Funding income is included in the Statement of Accounts under Other Income. This figure comprises income from levies issued to the above industry categories (net of appeals and adjustments) under the *Central Bank Act*, 1942 (Sections 33 J and 33 K) Regulations 2005 and other income in respect of fees and charges. An amount of €290,000 in respect of provision/write-offs has been offset against total funding income to arrive at Net Industry Funding. Outstanding levy amounts are being pursued as part of the ongoing debt recovery process.

The provision/write-offs are as follows:

	2005 €000	2004 €000
Opening Provision for Unpaid Levy Notices	600	–
Less: Write-Offs 2004 Levy (Including default levy amounts)	325	–
Less: Write-Offs 2005 Levy (Including default levy amounts)	352	–
Add: Charge to Income & Expenditure Account — Provision/Amounts Written Off	**290**	**600**
Closing Provision for Unpaid Levy Notices	**213**	**600**

(ii) Subvention from Central Bank and Financial Services Authority of Ireland

By agreement with the Minister for Finance in April 2004, over the three-year period 2004-2006 approximately 50 per cent of the total costs of the Financial Regulator are to be met by the imposition of levies on the industry. The balance of the total annual costs is being provided by the Board of the CBFSAI in accordance with Section 33 (L) of the *Central Bank Act*, 1942 (as inserted by Section 26 of the *Central Bank and Financial Services Authority of Ireland Act*, 2003).

(iii) Other Income/Other Expenses

In 2005 the Irish Stock Exchange collected €1,002,600 in fees payable to the Financial Regulator in accordance with Regulation 109 of the Prospectus (Directive 2003/71/EC) Regulations 2005. In accordance with Part 17(h) of the Prospectus Directive and Market Abuse Directive Delegation agreements entered into by the Financial Regulator with the Irish Stock Exchange, the Financial Regulator confirmed to the Irish Stock Exchange that it could retain the sum of €1,002,600 to put towards the costs that it had incurred in undertaking the delegated functions under the delegation agreements.

(iv) Direct Expenses

Direct expenses (excluding the pension provision of €2.595 million) are included in the Statement of Accounts as set out in Note 8 on Expenses.

Direct Expenses

	2005 €000	2004 €000
Salaries/Allowances	17,703	15,354
PRSI	1,239	975
	18,942	16,329
Pension Provision*	2,595	2,237
Staff Expenses	**21,537**	**18,566**
Training, Recruitment & Other Staff Costs	313	278
Equipment, Stationery and Requisites	353	358
Business Travel	727	662
Publishing & Media Relations	2,563	1,715
Professional Fees	986	869
Miscellaneous	151	155
Non-Pay Operating Expenses	**5,093**	**4,037**
Total Direct Expenses	**26,630**	**22,603**

* This represents estimated actuarial pension liabilities of the CBFSAI in respect of Financial Regulator staff serving in 2005. This provision does not form part of the CBFSAI's expenses for 2005.

(v) Shared Services

Shared services (excluding the pension provision of €1.0 million) are included in the Statement of Accounts of the CBFSAI as set out in Note 8 to those accounts.

The Financial Regulator receives various services including premises, human resources administration, accounting, internal audit, statistical and information technology services from the Central Bank. The cost of these services in 2005 was €13.7 million (2004: €12.4 million).

The costs involved have been determined by the application of a cost allocation methodology which has been reviewed by independent external consultants. Allocation is based on well-recognised industry practice including occupied floor space, PC numbers and headcount (staff numbers) as appropriate. The main components of the above costs are as follows:

	2005 €000	2004 €000
Corporate Services incl. Premises	6,173	5,556
Information Technology Services	2,844	2,722
Human Resources	2,127	1,810
Other Services[9]	2,532	2,348
Total	13,676	12,436

(vi) Excess of Income over Expenditure

This represents the amount of levies and other income collected from industry in 2005 in excess of the 2005 funding requirement. The 2005 funding requirement is the total of direct expenses and shared service (€40.306 million) less the subvention from the CBFSAI. The excess of income over expenditure has been carried forward and the calculation of the amount of industry levies for 2006 has been adjusted to take account of this excess.

Note 43 Approval of Accounts

The Board of Directors approved the Statement of Accounts on 23 June 2006.

9 This includes accounting and other administrative services (€1.2 million), statistical services (€0.4 million) and estimated actuarial pensions costs (€1.0 million) in respect of Central Bank staff engaged in the provision of services to the Financial Regulator.

Report of the Comptroller and Auditor General for Presentation to the Houses of the Oireachtas

I have audited the Statement of Accounts of the Central Bank and Financial Services Authority of Ireland (‘‘the Bank’’) for the year ended 31 December 2005 under the Central Bank Act, 1942, as amended by the Central Bank and Financial Services Authority of Ireland Act, 2003.

The Statement of Accounts, which has been prepared under the accounting policies set out therein, comprise the Accounting Policies, the Profit and Loss and Appropriation Account, the Balance Sheet and the related notes.

Respective Responsibilities of the Directors of the Bank and the Comptroller and Auditor General

The Directors’ responsibilities for preparing the Statement of Accounts in accordance with applicable law are set out in the Statement of Directors’ Responsibilities. The Directors are also responsible for ensuring the regularity of transactions.

My responsibility is to audit the Statement of Accounts in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

I report my opinion as to whether the Statement of Accounts gives a true and fair view and has been properly prepared on the basis described in paragraph (a) of the Accounting Policies. I also report whether in my opinion proper books of account have been kept. In addition, I state whether the Statement of Accounts is in agreement with the books of account.

I report any material instance where moneys have not been applied for the purposes intended or where the transactions do not conform to the authorities governing them.

I also report if I have not obtained all the information and explanations necessary for the purposes of my audit.

I review whether the Statement on Internal Financial Control reflects the Bank’s compliance with the Code of Practice for the Governance of State Bodies and report any material instance where it does not do so, or if the statement is misleading or inconsistent with other information of which I am aware from my audit of the Statement of Accounts. I am not required to consider whether the Statement on Internal Financial Control covers all financial risks and controls, or to form an opinion on the effectiveness of the risk and control procedures.

Basis of Audit Opinion

In the exercise of my function as Comptroller and Auditor General, I conducted my audit of the Statement of Accounts in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and by reference to the special considerations which attach to State bodies in relation to their management and operation. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures and regularity of the financial transactions included in the Statement of Accounts. It also includes an assessment of the significant estimates and judgments made in the preparation of the Statement of Accounts, and of whether the accounting policies are appropriate to the Bank's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations that I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the Statement of Accounts is free from material misstatement, whether caused by fraud or other irregularity or error. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the Statement of Accounts.

Opinion

In my opinion, the Statement of Accounts, which has been properly prepared on the basis described in paragraph (a) of the Accounting Policies, gives a true and fair view of the state of the Bank's affairs at 31 December 2005 and of its surplus income for the year then ended.

In my opinion, proper books of account have been kept by the Bank. The Statement of Accounts is in agreement with the books of account.

John Purcell
Comptroller and Auditor General
23 June 2006

Report of Deloitte & Touche

Independent auditors' report to the Board of Directors of the Central Bank and Financial Services Authority of Ireland

We have audited the Statement of Accounts on pages 99 to 128.

Respective responsibilities of directors and auditors

The directors, as described on page 101, are responsible for preparing the Statement of Accounts.

Pursuant to the requirements of Article 27 of the Statute of the European Central Bank, we have been appointed to audit the Statement of Accounts of the Central Bank and Financial Services Authority of Ireland ('the Bank'). Our responsibilities, as independent auditors, are established by Article 27 of the Statute of the European Central Bank and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Bank's Board of Directors as a body in accordance with Article 27 of the Statute of the European Central Bank and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the Statement of Accounts gives a true and fair view and is properly prepared on the basis described in paragraph (a) of the accounting policies. We state whether we have obtained all the information and explanations we consider necessary for the purposes of our audit and whether the Statement of Accounts is in agreement with the accounting records. We also report to you our opinion as to whether the Bank has maintained proper accounting records. We are not required to form an opinion on the effectiveness of the Bank's system of internal financial controls.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Statement of Accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the Statement of Accounts, and of whether the accounting policies are appropriate to the Bank's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Statement of Accounts is free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Statement of Accounts, the basis of which is described in paragraph (a) of the accounting policies.

Opinion

In our opinion the Statement of Accounts has been properly prepared on the basis described in paragraph (a) of the accounting policies and, on this basis, the Statement of Accounts gives a true and fair view of the state of the Bank's affairs as at 31 December 2005 and of its profit for the year then ended.

We have obtained all the information and explanations we consider necessary for the purposes of our audit. In our opinion, proper accounting records have been kept by the Bank. The Statement of Accounts is in agreement with the accounting records.

Deloitte & Touche
Chartered Accountants and Registered Auditors
Dublin

23 June 2006

Economic and Financial Papers Published by Bank Staff since 2005

Annual Report 2004, July 2005

Articles in Central Bank Quarterly Bulletin

1. ‘‘Debt Instruments and Eurosystem Eligible Assets — Some Developments from an Irish Perspective’’ by David Doran and Diarmaid Murphy, February 2005.
2. ‘‘Education, Demographics, and the Irish Economic Miracle’’ by Robert Hamilton, May 2005.
3. ‘‘Re-Estimation of the Trade Block in the Bank’s Model’’ by Nuala O’Donnell, July 2005.
4. ‘‘Over-the-Counter Derivatives Markets in Ireland — An Overview’’ by Aisling Reilly, July 2005.
5. ‘‘Export Performance and Competitiveness of the Irish Economy’’ by Mark Cassidy & Derry O’Brien, July 2005.
6. ‘‘Information in Financial Market Indicators — An Overview’’ by Gerard O’Reilly, October 2005.
7. ‘‘Housing in the Euro Area — Twelve Markets, One Money’’ by Jenny Osborne, October 2005.
8. ‘‘An Overview of Recent Progress in Macroeconomic Modelling in the Central Bank’’ by Nuala O’Donnell, October 2005.
9. ‘‘An Assessment of the Implications of EU Enlargement for FDI and Jobs in Ireland’’ by Alan Murphy, January 2006.
10. ‘‘Measurement Issues and International Comparisons of Output and Productivity Growth’’ by Martina Lawless, April 2006.
11. ‘‘Financial Integration and the Market for Short-Term Paper’’ by David Doran, April 2006.

Articles in Central Bank Financial Stability Report

1. ‘‘The Role of Liquidity in Financial Stability’’ by Frank Browne & Anne Marie McKiernan, 2005.
2. ‘‘Recent Developments in Asset Prices and Liquidity in the Context of an Evolving Relationship’’ by Frank Browne, David Cronin & Edward O’Brien, 2005.
3. ‘‘The Decline in the Volatility of Output Growth: Its Causes and Consequences for Financial Stability’’ by Frank Browne, David Cronin & Bernard Kennedy, 2005.
4. ‘‘Assessing Interest-Rate Risk from the Rate’s Constituent Components’’ by Frank Browne & Mary Everett, 2005.

5. ''Regulatory Developments in the Capitalisation of Banks: A Financial Stability Perspective'' by Caroline Gavin & Rebecca Stuart, 2005.
6. ''The Implications of a 'Correction' in the Residential Construction Sector'' by Maurice McGuire & Diarmaid Smyth, 2005.
7. ''Large-Value Payment Systems: An Introduction to Operation, Design and Risk Mitigation'' by Paul O'Brien, 2005.

Monthly Statistics

Compendium of Irish Economic Statistics, July 2005

Technical Papers

1. ''Employment and Inflation Responses to an Exchange Rate Shock in a Calibrated Model'' by Colin Bermingham, April 2005.
2. ''Measuring Bank Profit Efficiency'' by Trevor Fitzpatrick & Kieran McQuinn, May 2005.
3. ''An Economic Activity Index for Ireland: The Dynamic Single-Factor Method'' by Alan Murphy, August 2005.
4. ''A New Mean Standard Deviation Utility Function and the Behaviour Towards Risk of Specialist Irish Agricultural Producers: 1988-1997'' by Gerry Boyle, Denis Conniffe & Kieran McQuinn, November 2005.
5. ''Firm Export Participation: Entry, Spillovers and Tradability'' by Martina Lawless, November 2005.
6. ''Modelling Inflation Dynamics: A Critical Review of Recent Research'' by Jeremy Rudd & Karl Whelan, November 2005.
7. ''Testing Parameter Stability: A Wild Bootstrap Approach'', by Gerard O'Reilly & Karl Whelan, December 2005.
8. ''A Macro-Economic Model for Ireland'' by Kieran McQuinn, Nuala O'Donnell & Mary Ryan, December 2005.
9. ''European Monetary Policy Surprises: The Aggregate and Sectoral Stock Market Response'' by Don Bredin, Stuart Hyde & Gerard O'Reilly, December 2005.
10. ''Geography and Firm Exports: New Evidence on the Nature of Sunk Costs'', by Martina Lawless, March 2006.
11. ''Testing for Long Memory and Nonlinear Time Series: A Demand for Money Study'' by Derek Bond, Michael Harrison & Edward O'Brien, April 2006.
12. ''Some Empirical Observations on the Forward Exchange Rate Anomaly'' by Derek Bond, Michael Harrison, Niall Hession & Edward O'Brien, April 2006.

Journal Articles

1. ‘‘Cost Efficiency in UK and Irish Credit Institutions’’ by Trevor Fitzpatrick & Kieran McQuinn, *Economic and Social Review*, Volume 36, Issue 1, Spring 2005.
2. ‘‘Does Labor’s Share Drive Inflation?’’ by Jeremy Rudd & Karl Whelan, *Journal of Money, Credit, and Banking*, Volume 37, April 2005.
3. ‘‘Dynamics Factor Demands in a Changing Economy: An Irish Application’’ by Kieran McQuinn, *Economic and Social Review*, Volume 36, Issue 2, Summer/Autumn 2005.
4. ‘‘Knowledge Accumulation, and Productivity: Evidence from Planet-Level Data for Ireland’’ by Mark Cassidy, Holger Gorg & Eric Strobl, *Scottish Journal of Political Economy*, Volume 52, Issue 3, July 2005.
5. ‘‘Do Equity Index Industry Groups Improve Forecasts of Inflation and Production?’’ by Frank Browne & David Doran, *Applied Economics*, Volume 37, Issue 15, August 2005.
6. ‘‘New Tests of the New-Keynesian Phillips Curve’’ by Jeremy Rudd & Karl Whelan, *Journal of Monetary Economics*, Volume 52, September 2005.
7. ‘‘US Monetary Policy Announcements and Irish Stock Market Volatility’’, by Don Bredin, Caroline Gavin & Gerard O’Reilly, *Applied Financial Economics*, Volume 15, Issue 17, November 2005.
8. ‘‘Has Euro-Area Inflation Persistence Changed Over Time?’’ by Gerard O’Reilly & Karl Whelan, *Review of Economics and Statistics*, Volume 87, November 2005.
9. ‘‘On the Relationships Between Real Consumption, Income, and Wealth’’ by Michael Palumbo, Jeremy Rudd & Karl Whelan, *Journal of Business and Economic Statistics*, Volume 26, January 2006.
10. ‘‘Empirical Proxies for the Consumption-Wealth Ratio’’ by Jeremy Rudd & Karl Whelan, *Review of Economic Dynamics*, Volume 9, January 2006.
11. ‘‘Rural Land Use: Traditional Agriculture or Forestry?’’ by Jasmina Behan, Kieran McQuinn & Maurice J. Roche, *Land Economics*, Volume 82, Issue 1, February 2006.
12. ‘‘Employment and Inflation Responses to an Exchange Rate Shock in a Calibrated Model’’, *Economic and Social Review*, by Colin Bermingham, Volume 37, Issue 1, Spring 2006.
13. Can Rational Expectations Sticky-Price Models Explain Inflation Dynamics?’’ by Jeremy Rudd & Karl Whelan, *American Economic Review*, Volume 96, March 2006.