

**Davy New York Equity Conference
New York, January 2007**

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Introduction

Good morning everyone. It's good to be here again at the annual Davy January discount sales of Irish equities and to see lots of familiar faces.

Slide 1 Agenda

Most of you know Irish Life & Permanent and have a pretty good idea of our investment story, so I don't propose to go through that here this morning in the short time available. Instead I want to use the time to talk to a number of specific issues which are current and topical and which probably anticipate some of the questions you might have for me.

Firstly, I want to say a few words on trading for 2006 as detailed in our recent trading statement. I will then look at the market environment including SSIA's, recent competitive developments and the outlook for the housing market. That leads on to some comments on credit quality and to our new joint venture in the sub-prime mortgage market. And finally on capital I will update on developments on Basel 2 for the bank and comment on a debt capital issuance for the life company.

Slide 2 2006 Trading Update

In mid-December we issued our trading statement for 2006 ahead of the closed period which we are now in. That was a very positive trading update and was well received by the market. The principal features were:

- Expected growth in life sales for the year of circa 30%
- Bank new lending also expected to increase by about 30%
- Over 80,000 new current accounts opened, and
- Pre-tax operating profits for the group anticipated to increase by over 20%

Clearly our businesses are trading very strongly and maximising on the opportunities in what are very buoyant market conditions. We are continuing to win market share in both the mortgages and life sectors and all of this therefore leaves us very confident going into 2007.

Slide 3 SSIA's - Intentions

A contributor to that buoyancy in the financial services market has been SSIA's with some €6 billion of funds maturing in 2006. However the overall impact is probably a bit less important than expected. Strong economic growth, job creation and record housing market activity have been the main drivers of growth. We saw this very clearly in the first half of 2006 when only a small proportion of SSIA's matured but volume growth was extremely strong in both life and banking. The SSIA's have

definitely boosted consumer and investor confidence and have increased activity levels but haven't so far resulted in a spending or indeed an investment binge! Rather SSIA's have been the icing on an already attractive cake!

In our most recent survey [Nov 2006] of the intentions of SSIA holders whose accounts had not yet matured some 52% said that they would retain their lump sum in some form of investment – be it retaining their existing deposit or equity account, switching into another investment product or using it to buy property. Another 32% said they intended to spend their lump sum on home improvements, holidays and cars being the main targets. Asked about their intention to continue with their regular saving some 64% said that they did intend to continue.

That's a pretty positive picture for our business but to what extent do the good intentions become reality?

Slide 4 SSIA's – Experience to date

Our experience to date has in fact been very positive overall.

- On the life side we are succeeding in retaining a product relationship with around 60% of the holders of the SSIA lump sums; they are either staying with the existing fund or switching into a new product, e.g. pensions
- In **permanent tsb** our lump sum retention rate is about 70% which is excellent
- On the continuing to save front the actual experience is working out to be behind customers' stated intentions but is well ahead of our assumptions.
- In Irish Life those continuing in the existing contracts and those switching into new savings or pensions contracts amount to about 55% which is an excellent result.
- In **permanent tsb** the regular savings habit is being maintained in about 30% of cases. This would be behind the two main banks AIB and BOI but ahead of or on par with the experience of other banks. This largely reflects the different sales priorities in different institutions and the decision of the main banks to retain customers with high interest rate, loss leading accounts.

Overall we are very happy with our performance. We have a very successful contact and advice process – with some 80%+ of SSIA customers contacted and appointments with between 50-60%. We are selling a wide range of products based on customer needs. We are achieving high retention and cross-sell rates, lower continue to save rates but we have no loss leading products.

A big challenge in 2007 will be managing capacity for the surge in redemptions in April / May but that's a quality problem we can live with!

Slide 5 Housing Market

The housing market for 2006 will show new build completions of over 90,000 units – an increase of about 5% in the housing stock. This is likely to be the peak with completions forecast to come back to around the mid 80,000s for 2007. This continues to constitute a phenomenal level of demand – driven by our demographics and by increased levels of immigration. There are some welcome signs however that price pressures in the sector are easing and the **permanent tsb** / ESRI house price

index released in December recorded a reduction in the rate of growth for the sixth successive month and in the case of new house prices there was actually a modest fall in prices in October.

There is no doubt that rising rates and property price appreciation has squeezed out some first time buyers and also dampened demand for buy-to-let properties. An added feature over the last quarter was uncertainty over stamp duty tax on property sales which caused buyers to hold off until after the December Budget. While we have seen a definite slowdown in the last quarter of the year we would expect this to pick up again from Q2 2007 given the strong underlying fundamentals. We are factoring in house price appreciation of 5% for 2007.

Slide 6 Competition - Banking

So in our view the short and long term outlook for the mortgage market is very positive and clearly a lot of other banks think so too and have been anxious to get a piece of the action.

We have had Halifax Bank of Scotland in Ireland since 1999 busily and noisily trying to grab market share. While they have made good progress in the SME market they have found it a lot tougher in mortgage lending. They are in the middle of rolling out their new branch network and re-branding their mortgage operation using the Halifax brand. This in principle puts them in a better position to compete but they still face a major challenge in acquiring customers particularly when they don't yet have a current account offering.

The other new entrant into the mainstream mortgage market is Danske Bank and they have recently launched an aggressively priced mortgage offering directed at low LTV mortgages encouraging them to switch. The offering doesn't extend to the broker market as the pricing is too tight to allow brokers to be remunerated. This excludes some 50% plus of the market. Nor does it apply to first time buyers who typically have LTVs of over 80% or to buy-to-let investment properties.

To date their impact has been modest. Our redemption levels are actually down in 2006 and we are certainly not seeing a haemorrhage of customers to Danske or indeed any other players. That only underlines the fact that price is not the only determinant of success in the market and distribution reach, brand and service are also critically important.

The other development in the residential mortgage market has been the entry of new specialist lenders over the past couple of years and I will come back to this in a few minutes.

Slide 7 Competition - Life

Sticking with competition but looking at the life side we can see the market concentrating with two clear winners – ourselves and BOI. The losers have been AIB and Aviva and clearly the acquisition by Aviva of AIB's life subsidiary, Ark, is an attempt to reverse that trend. That will take some time and inevitably they have been experiencing some teething problems in their marriage which we have taken full advantage of. In 2006 we will have further increased our market share.

Do we see new entrants coming into the market? It's obviously possible but in my view highly unlikely. If they do they will have to acquire distribution and that would present any new entrant with a major obstacle unless they took out an existing player.

Slide 8 Competition – Life (2)

Broadening our distribution reach and increasing the productivity of our distribution have been key drivers in building our competitive advantage – in particular in the area of bancassurance. Having created a top class bancassurance operation in our own **permanent tsb** network we have been successfully exporting the model into virtually every other branch network in Ireland apart from those of AIB and BOI. In 2006 both the EBS – with over 100 branches and agencies – and Halifax BOS tied exclusively to us. The challenge for us is to fully realise the bancassurance opportunity in these networks which are now only at the early stages of development.

Slide 9 Credit Quality

Moving back to banking a recurrent concern in a rapidly growing mortgage market has been that lenders have been playing fast and loose with credit quality to generate more and more business.

And while there has in fact been some easing of credit criteria in the last year – in particular with the introduction of the 100% LTV mortgages – this has not translated into increased arrears, notwithstanding the increase in interest rates over the same period.

The figures speak for themselves. Repayments of one month or more in arrears represent 0.12% of our Irish residential mortgage book and repossessions in Ireland are negligible and in most cases arise from breakdowns in relationships rather than financial difficulties per se. Our UK mortgage book is primarily in the buy-to-let market and while it has, as you would expect, a higher arrears profile than the Irish book its arrears are running at about half the average level for the UK buy-to-let sector overall.

In reality in Ireland the real risk is not new lending LTVs – although the figures here are very robust in any event with on average 1/3rd equity provided in overall new lending. The issue is whether we are likely to be faced with an interest rate spike and / or a big increase in unemployment in Ireland. Neither event seems likely and lending based on sensible affordability criteria should avoid significant defaults and impairments as, indeed has been the case to date.

Slide 10 Specialist Mortgage lending

This brings me to an emerging aspect of the mortgage market in Ireland, that is specialist or sub-prime / near-prime lending depending on your sensibilities. Essentially the market is made up of borrowers with current or historic arrears, or those who have irregular income or just don't fit the standard criteria. In the UK this segment would amount to somewhere between 12-15% of the prime market. The Irish sub-prime market is currently probably only about €1 billion in new lending per annum but we think that over time this could grow to around €3 - €4 billion over the next 4 to 5 years.

As I indicated earlier on there have been a number of new entrants into the Irish market focused on this sector, notably Kensington with Start Mortgages and GE Money.

Historically **permanent tsb** has not been in this specialist sector and these developments present us with both a threat and an opportunity. New players entering the specialist mortgage market could over time migrate into the main mortgage market and take some share there. Equally by us not participating in this area we are potentially missing an opportunity to leverage our market knowledge and distribution capability.

In response then we are proposing to shortly launch a joint venture with Merrill Lynch's **Mortgages plc** targeted at the sub-prime market in Ireland. This will be a 50/50 venture with us providing management and distribution capability and ML providing product knowledge and pricing expertise as well as experience in credit and collections. Processing and servicing will be outsourced. The venture will be very distinct from the **permanent tsb** offerings and will be separately branded and indeed regulated. In terms of funding the intention would be for the vehicle to originate, warehouse for a period and then have a rolling securitisation programme in tranches of €250m +.

Slide 11 Capital - Banking

This neatly brings me on to my final topic – capital.

Looking firstly at the bank the key development in 2007 is the finalisation of preparations for Basel 2. This work is well advanced and we, like all the Irish banks, are gearing up to adopt the internal ratings based approach or IRB required by the Irish regulator.

Applying the IRB framework to our mortgage book produces outcomes which are not at all surprising. Based on historic data and outcomes over the past ten years the expected losses on our residential mortgage book are *de minimis* and correspondingly the capital requirement would be greatly reduced. The regulator, not surprisingly, has major reservations allowing a significant release of capital from the sector which these results would appear to warrant. In a recent announcement the Regulator fired a couple of warning shots to signal its intent:

- It announced increases from the current risk weightings for certain categories of mortgages for those adopting the standard approach under Basel 2, and
- It said that it considered “that some degree of intervention into the workings of the IRB approach is necessary to prevent a significant reduction in capital required to support residential and commercial real estate lending”.

The regulator is proposing to adopt a “super-equivalent override” to limit any capital release but exactly what that is or how it will work we don't know. If the Irish market was a closed market we could live with that outcome even if we didn't like it. However we are an open market and overseas competitors can lend across borders into the Irish market. That creates the opportunity for regulatory arbitrage which could put local Irish banks at a disadvantage. Ultimately we believe this will force the regulators hand and we expect that the transitional period 2007 to 2009 will be used to calibrate a capital regime with the right prudential / competitive balance.

Slide 12**Capital - Life**

Finally, to finish, a comment on life capital. As I am sure you are aware by now – having repeated it *ad nauseum* – we have a very strongly capitalised life business whether that is measured in terms of regulatory capital or by reference to rating agency criteria.

We are holding life capital at around 1.7 times the regulatory minimum and all of it is Tier 1. On S&P's rating methodology for assessing capital adequacy we fall comfortably into their triple A category and clearly our economic capital requirement is well below our current regulatory requirement.

That said our rate of growth in both life and banking means we have a strong appetite for capital to support that growth, To date we have operated by the life business providing the capital for its own growth from earnings thrown off from its existing book and any surplus goes to the parent company, the bank.

To date all of our debt capital has been raised within the bank. However with greater depth and liquidity in the insurance debt market we have decided to rebalance the debt funding across the group and in the next month will be raising some €200m subordinated debt in the life company. This will rank as Tier 2 in the life company and will allow an equivalent amount of distributable reserves to be passed up to the bank as Tier 1 capital.

This just demonstrates that when it comes to capital we are starting from a position of strength and have lots of options and lots of flexibility to support a very fast growing group and business. Capital will not be a constraint for us.

Slide 14 Thank you

That was a quick run through some current issues which I hope was of interest. I am happy to take any questions you may have.

Thank you.