PAC-R-143

Correspondence 3.16
Meeting – 10/11/2011

Gníomhaireacht Bainistíochta an Chisteáin Náisiúnta
National Treasury Management Agency

8 November 2011

Mr Ted McEnery
Principal Clerk
Committee of Public Accounts
Leinster House
Dublin 2

Dear Mr McEnery

I refer to my meeting with the Committee of Public Accounts on 6 October last. There were a number of issues on which I undertook to revert to the Committee and these are discussed below.

(i) Promissory Notes

The Exchequer issued promissory notes to Anglo Irish Bank (€25.3 billion), INBS (€5.3 billion) and EBS (€0.3 billion) in 2010. The promissory notes will be redeemed on a phased basis to lessen the funding impact on the Exchequer; the Exchequer is committed to annual payments of 10% of their initial capital value or €3.1 billion. The first instalment was paid in 2011. Payments will continue on an annual basis until the full value of the notes, including interest, has been paid. These annual payments are similar to an annuity and include both a principal and an interest element. The discussion below is based on the promissory notes issued to the combined entity of Anglo Irish Bank and INBS, namely the Irish Bank Resolution Corporation (IBRC).

An interest holiday was inserted into each of the promissory notes which means that between 1 January 2011 and 31 December 2012 no interest is payable (other than interest accrued in 2010 which was paid in March 2011). Absent the interest holiday the weighted average interest rate on these promissory notes would have been 5.8%. However, as a result of the insertion of the interest holiday the weighted average interest rate from 1 January 2013 is 8.2%.

An aggregated schedule of capital repayments and interest payments on the promissory notes is set out below:

Treasury Building, Sráid na Canálach Móire, Baile Átha Cliath 2. • Treasury Building, Grand Canal Street, Dublin 2.
T: (+353 1) 664 0800 • F: (+353 1) 664 0890 • info@ntma.ie • www.ntma.ie • Swift: NTMAIE2D

Promissory Note Schedule - Anglo and INBS *

€bn	Total interest Paid: A	Total Capital Reduction: B	Repayments: A + B
31/03/2011	0.55	2.51	3.06
31/03/2012	-	3.06	3.06
31/03/2013	0.49	2.57	3.06
31/03/2014	1.84	1.22	3.06
31/03/2015	1.75	1.31	3.06
31/03/2016	1.65	1.41	3.06
31/03/2017	1.55	1.51	3.06
31/03/2018	1.44	1.62	3.06
31/03/2019	1.32	1.74	3.06
31/03/2020	1.19	1.87	3.06
31/03/2021	1.06	2.00	3.06
31/03/2022	0.91	2.15	3.06
31/03/2023	0.75	2.31	3.06
31/03/2024	0.57	1.52	2.09
31/03/2025	0.45	0.47	0.91
31/03/2026	0.39	0.52	0.91
31/03/2027	0.33	0.58	0.91
31/03/2028	0.26	0.65	0.91
31/03/2029	0.19	0.73	0.91
31/03/2030	0.10	0.81	0.91
31/03/2031	0.01	0.05	0.05
	16.8	30.6	47.4

* These numbers may not tot exactly as a result of rounding

The Committee raised the issue of the benefits that might accrue to the Exchequer if the promissory notes were replaced by funding from the EFSF. Under this approach, the promissory notes would be redeemed by settling in full with cash funded by borrowing from the EFSF. This EFSF funding would have a single repayment meaning that the Exchequer's short and medium term funding position would be improved as it would no longer have to borrow the €3.1 billion annually to fund the promissory notes – although it would have to fund the interest payments on the EFSF borrowing and it would have to fund the repayments of EFSF borrowings at the end of the loan period. A very broad comparison of the interest amounts that might be payable under the two approaches is set out below for illustrative purposes.

Interest paid on an EFSF alternative to the promissory notes is a function not only of the interest rate on the loan but also of the maturity profile of the loan. Assuming a 20 year loan the annual interest payment to the EFSF would be in the order of €1.1 billion[1] and total interest paid over the 20 year period would be some €23.1 billion. Under the promissory note approach, the total interest paid over the 20 year period to IBRC is €16.8 billion. However to compare on a like-for-like basis the timing of cashflows and the impact of the cost of funding under each scenario has to be taken into account. Taking these factors into account gives a total cash saving in the order of €10 billion from replacing the promissory notes with an

[1] For the purpose of this illustration, the full amount of €30.6bn is used, i.e., the exercise is carried out on the notes over their full life per the table above.

EFSF loan. I stress that these figures represent a very broad estimate and are only for indicative purposes.

The Minister for Finance has stated that he wishes to have the promissory notes examined to see if they can be re-engineered in a better way for the State, that this re-engineering would have to be completed in a manner which does not impact on the bank's capital position and that this may or may not be feasible. I understand that these issues are currently under discussion between the Department of Finance, the European Commission, the European Central Bank and the IMF.

(ii) Sources of funding to end 2013.

The Committee also raised the question of the schedule of planned annual drawdowns under the EU/IMF programme and how these drawdowns are sufficient to cover both Exchequer deficits and debt maturities to end 2013.

The table below is purely for illustrative purposes only. It is consistent with the assumptions underlying the Medium Term Fiscal Statement published by the Department of Finance last week. It shows that the State has sufficient funding under the EU/IMF Programme to cover all its financing requirements until the end of 2013. It remains the stated intention of the NTMA to return to the debt markets before this point and as soon as market conditions permit.

IRELAND's FINANCING REQUIREMENTS 2011-2013

	2011 Year	2012 Year	2013 Year	2011-2013 Total
FINANCING NEEDS (€bn)				
A. Gross financing needs	30.8	22.9	19.8	73.5
Exchequer cash deficits (excluding net bank recapitalisation)	*18.9*	*17.3*	*13.8*	*50.0*
Long-term debt securities, maturing	*4.9*	*5.6*	*6.0*	*16.5*
Short-term debt, maturing	*7.0*	*0.0*	*0.0*	*7.0*
B. Retail funding (to end September 2011)	1.2	0.0	0.0	1.2
C. Net financing needs (after retail funding) (A-B)	29.5	22.9	19.8	72.3
D. Current expectation of net bank recapitalisation	16.5	0.0	0.0	16.5
TOTAL FINANCING NEEDS (C+D)	**46.0**	**22.9**	**19.8**	**88.8**
FINANCING SOURCES				
E. Use of Ireland's financial assets ("-" is increase)	12.1	-0.3	9.5	21.3
F. EU-IMF loan disbursement	33.9	23.2	10.3	67.5
TOTAL FINANCING SOURCES (E+F)	**46.0**	**22.9**	**19.8**	**88.8**
MEMO ITEM				
Ireland's financial assets at end of period	10.2	10.5	1.0	1.0

Source: Department of Finance and NTMA
Note that rounding may affect totals.

In an extreme scenario where no new market funding is available between 2011 and 2013, taking account of the EU/IMF programme funding and the liquid reserves available to the NTMA, it is estimated that all of Ireland's funding needs until late 2013 would be met.

(iii) National Pensions Reserve Fund.

The Committee requested additional information comparing the returns and costs of the NPRF with those of international peer funds.

Regarding performance, a comparison of NPRF returns with those of peer sovereign and pension funds is set out in the table below.

	2010	2009	2008	2007	2006	2005
	%	%	%	%	%	%
NPRF	11.7	20.6	-30.4	3.3	12.4	19.6
Dutch ABP Fund	13.5	20.2	-20.2	3.8	9.5	12.8
Finnish State Pension Fund	11.7	16.4	-15.8	1.8	7.0	14.9
French FRR	4.2	15.0	-25.0	4.8	11.2	12.4
Norwegian Government Fund	9.6	25.6	-23.4	4.2	7.8	11.0
Canada's CPPIB	9.5	7.7	-14.5	3.1	14.7	13.3
New Zealand Super Fund	15.2	18.9	-26.2	5.7	16.8	16.3

Within the above group there are differences in terms of maturity profiles as some are currently making payments from their existing asset base while others are in the early stages of an asset accumulation phase. The NPRF fell into the latter category and therefore throughout the period from 2005 to 2010 maintained, consistent with its longer term investment time horizon, a larger allocation to equities and other real assets which are expected to have higher long term returns but which also display higher volatility in the shorter term.

Regarding operating costs the NPRF participates each year in a survey run by an independent Canadian firm, CEM Benchmarking Inc (CEM), which measures total operating costs of pension funds relative to their peers. Total asset management costs incurred by the NPRF in 2010 (including the costs of the NTMA) amounted to €60.7 million, equivalent to 36.3 basis points of fund value (a basis point is 0.01%). This compares with a benchmark cost of 39.7 basis points as measured by CEM, reflecting the costs of a customised peer group of 20 funds with a median size similar to the NPRF's and selected by CEM as an appropriate comparator for the NPRF. According to CEM the difference of 3.4 basis points between costs incurred by the NPRF and the cost benchmark equates to €5.6m.

(iv) Assets and Liabilities Note

Finally, I would also note that Committee members stated that they found the Government Assets and Liabilities Note on the NTMA website useful and suggested that it be updated. We plan to do so in early January following the conclusion of the budget process and publication of end year numbers.

I trust the above is of assistance to the Committee. Please do not hesitate to contact me if the Committee has any further queries.

Yours sincerely

John C Corrigan
Chief Executive