PAC-R-738

Correspondence 3D.1
Meeting – 22/11/2012

Briefing Note for the Committee of Public Accounts on the National Treasury Management Agency and the National Pensions Reserve Fund

15 November 2012

Summary of Key Developments

Market Re-Entry

The NTMA's working plan through 2012 has been to begin to return to the markets on a phased basis, mainly through shorter-term issuance, while also taking advantage of any opportunities to issue longer-term debt. The EU/IMF programme provides funding to the end of 2013. Coming into 2012 one of the NTMA's primary objectives was to deal with the "funding cliff" represented by a bond of €11.9 billion due to mature in mid-January 2014.

In total, long-term capital markets operations carried out by the NTMA in 2012 including bond switches, the issue of conventional bonds and the issue of new amortising bonds aimed at the domestic pensions industry have effectively reduced the January 2014 funding cliff by 80%, or €9.5 billion from €11.9 billion to €2.4 billion. This has been achieved by (i) reducing the amount due to mature in January by €4.3 billion to €7.6 billion and (ii) increasing the projected end-2013 cash balance by €5.2 billion.

Commencing in July 2012 the NTMA has also returned to the short-term debt markets through the holding of regular Treasury Bill auctions. In the most recent auction, held on 15 November, €500 million of 3-month bills were sold at a yield of 0.55%. The bid to cover ratio was 4.12.

Developments in Government Bond Yields

Ireland has seen a significant decline in bond yields through 2012 to date, most markedly in shorter maturities, restoring the yield curve to a more normal upward slope, compared to the inversion that marked much of 2011. The rally in Irish bond yields has been driven by a number of factors including:

- Ireland's continuing adherence to the troika programme;
- the effective reduction to €2.4 billion of the bond refinancing requirement in mid-January 2014;
- the EU leaders' supportive reference to Ireland in their statement of 29 June 2012 on the necessity to break the link between sovereign and banking debt;
- the Open Market Transactions "OMT" policy initiative by the ECB.

State Claims Agency

The SCA recently announced a new procurement structure requiring barristers to engage in a competitive tendering process under which their fees will be capped at up to 25% below current levels. This is the first time a State agency is procuring barristers for personal injury claims in this way and follows the success of the 2010 solicitors tender which reduced the cost of fees paid to solicitors by 25%.

The Government has decided to establish a Legal Costs Unit within the SCA. The purpose of the Unit will be to deal with third party costs arising from the Mahon and Moriarty Tribunals with a view to ultimately extending the Unit's remit to the Smithwick Tribunal. The NTMA has agreed to establish and operate the Legal Costs Unit on an administrative basis pending the establishment of the Unit on a statutory basis. Recruitment for the Unit is under way.

NewERA

In September 2011 the Government announced the establishment of the New Economy and Recovery Authority (NewERA), initially on a non-statutory basis, within the NTMA. The core functions of NewERA are as follows:

- Undertaking a centralised shareholder advisory role from a financial and commercial perspective in respect of corporate governance matters for 5 commercial semi-state companies: ESB, Bord Gais Eireann, EirGrid, Bord na Mona and Coillte;

- Assisting from a financial perspective in the development and implementation of Government plans for investment in energy, water and next-generation telecommunications; and

- Where requested by Government, carrying out advisory and oversight roles in relation to the possible restructuring or disposal of commercial State company assets.

National Pensions Reserve Fund

The Discretionary Portfolio (the Fund excluding the public policy investments in Bank of Ireland and Allied Irish Banks) was valued at €6.0 billion at 31 October 2012.

From the Fund's inception in April 2001 to 31 October 2012, the annualised performance of the Discretionary Portfolio was +3.6% per annum. This compares over the same period with the performance of the average Irish pension fund (as published by Mercer) of +2.0% per annum and with Irish inflation of +2.3% per annum.

The NPRF has taken a lead role in the development and implementation of a number of investment initiatives in Ireland including the Irish Infrastructure Fund, Innovation Fund Ireland, the Silicon Valley Bank transaction, financing of water meters and the provision of a standby facility to enable the recently announced Schools Bundle 3 PPP project to proceed with EIB financing. In total 20% of the Fund is currently committed to Irish investments. The Minister for Finance has announced that he will propose amendments to the NPRF's statutory investment mandate to enable it focus its investments in Ireland.

National Development Finance Agency

On 9 November 2012, the NDFA awarded the contract for Schools Bundle 3 to BAM PPP PGGM Infrastructure Cooperatie, (a joint venture between BAM PPP and Dutch pension fund administrator PGGM). When completed, the eight schools in Schools Bundle 3 will provide accommodation for approximately 5,700 students in Donegal, Galway, Leitrim, Limerick, Waterford, Westmeath and Wexford.

Construction commenced on 12 November 2012, the design and construction phase will be completed within 18 months and all eight schools will be available for occupancy in 2014. The project is expected to provide employment for up to 1,100 people.

The NDFA was instrumental in securing the €100 million loan from the EIB for the traditional schools capital programme which was drawn down in August 2012. It is also managing the procurement and delivery of 18 school building projects for the Department of Education and Skills as part of this programme.

The NDFA is currently active preparing to procure many of the PPPs announced under the Government's stimulus package.

The NDFA is appearing separately before the Committee on 13 December 2012.

1. NTMA Organisational Structure

The NTMA operates with a commercial remit outside public service structures to provide asset and liability management services to Government. It has evolved from a single function agency managing the National Debt to a manager of a complex portfolio of public assets and liabilities. Businesses managed by the NTMA include borrowing for the Exchequer and management of the National Debt, the State Claims Agency, the New Economy and Recovery Authority, the National Pensions Reserve Fund, the National Development Finance Agency and the National Asset Management Agency.

The NTMA Chief Executive reports directly to the Minister for Finance on the NTMA's funding and debt management and State Claims Agency functions – which have been delegated to it by Government. NewERA has been initially established on a non-statutory basis within the NTMA. Under the legislation which established the NTMA, it does not have a board and it is the Chief Executive's statutory responsibility to carry on and manage and control generally the administration and business of the Agency. The legislation provides for an over-arching Advisory Committee to assist and advise the NTMA on such matters as are referred to the Committee by the NTMA and also for a State Claims Policy Committee to provide advice on policy and procedures relating to the performance of its State Claims Agency functions.

From March 2010 to August 2011 the NTMA's functions included certain banking system functions of the Minister for Finance related to the oversight and management of the State's interest and holdings in those financial institutions covered by the 2008 Government guarantee. The delegation of banking system functions to the NTMA was revoked with effect from 5 August 2011 and the NTMA banking team has been seconded to the Department of Finance.

The National Pensions Reserve Fund, the National Development Finance Agency and the National Asset Management Agency each have their own board. The NTMA acts as the executive in respect of the National Pensions Reserve Fund and the National Development Finance Agency. It assigns staff to NAMA and also provides it with business and support services and systems. Management of NAMA's operations is a matter for the NAMA Board and its Chief Executive Officer who is NAMA's accountable person.

Staff numbers in the NTMA have risen markedly since end 2009 as a result of additional activities which Government has asked the NTMA to carry out over the period; NAMA, banking system functions of the Minister for Finance and NewERA. Numbers have risen from 169 at end 2009 to 500 at end October 2012, of whom 227 were assigned to NAMA.

Other than a small number of staff reassigned from other functions within the NTMA, NAMA staff are employed on the basis of specified purpose contracts - their employment lasts for as long as NAMA requires their particular function. NAMA reimburses the NTMA the costs incurred by the NTMA in assigning staff and providing business and support services to NAMA.

NTMA Staffing 31 October 2012	
Funding and Debt Management	13
Banking Unit (on secondment to Department of Finance)	12
State Claims Agency	69
National Pensions Reserve Fund	13
National Development Finance Agency	41
National Asset Management Agency	227
NewERA	12
Finance, IT and Risk	76
HR and Corporate Services	8
Legal, Control and Compliance	15
Other	14
Total	**500**

2. Funding and Debt Management

(i) Market Re-Entry

The NTMA's working plan through 2012 has been to begin to return to the markets on a phased basis, mainly through shorter-term issuance, while also taking advantage of any opportunities to issue longer-term debt.

The EU/IMF programme, once fully disbursed, provides funding to the end of 2013. Coming into 2012 one of the NTMA's primary objectives was to deal with the "funding cliff" represented by a bond of €11.9 billion due to mature in mid-January 2014. Addressing this funding cliff has been a priority for the NTMA.

The NTMA has carried out a number of capital market operations during the course of the year so far.

- **25 January 2012: Irish Bond switch**: €3.53 billion of the bond maturing in January 2014 was switched into a new bond maturing in February 2015. While no new funds were raised, the debt profile was extended and the re-engagement with capital markets improved sentiment towards Ireland.

- **5 July: 1st Irish Treasury Bill auction** since September 2010: €500 million of bills with 3 month maturity were sold at a yield of 1.80%. Bid to cover ratio: 2.8.

- **26 July: Bond switch and outright sale**: €4.2 billion was invested in a new 5 year bond maturing in October 2017 and in the existing bond maturing in October 2020. A further €1.04 billion was switched from the 2013 and 2014 bonds into the 2017 and 2020 bonds. The 2017 bond carried a yield of 5.9% and the 2020 bond a yield of 6.1% to give a weighted average yield on the combined transaction of 5.95%.

- **23 August: Amortising bonds**: The NTMA issued amortising bonds for the first time, with maturities of 15, 20, 25, 30 and 35 years. A total of €1.021 billion was issued at an average yield of 5.91%, with the bulk of the issue in the three longer dated bonds. The amortising bonds are designed to meet the needs of the Irish pensions industry.

- **13 September: Irish Treasury Bill auction:** €500 million of 3-month bills sold at a yield of 0.70%. Bid to cover ratio: 3.03.

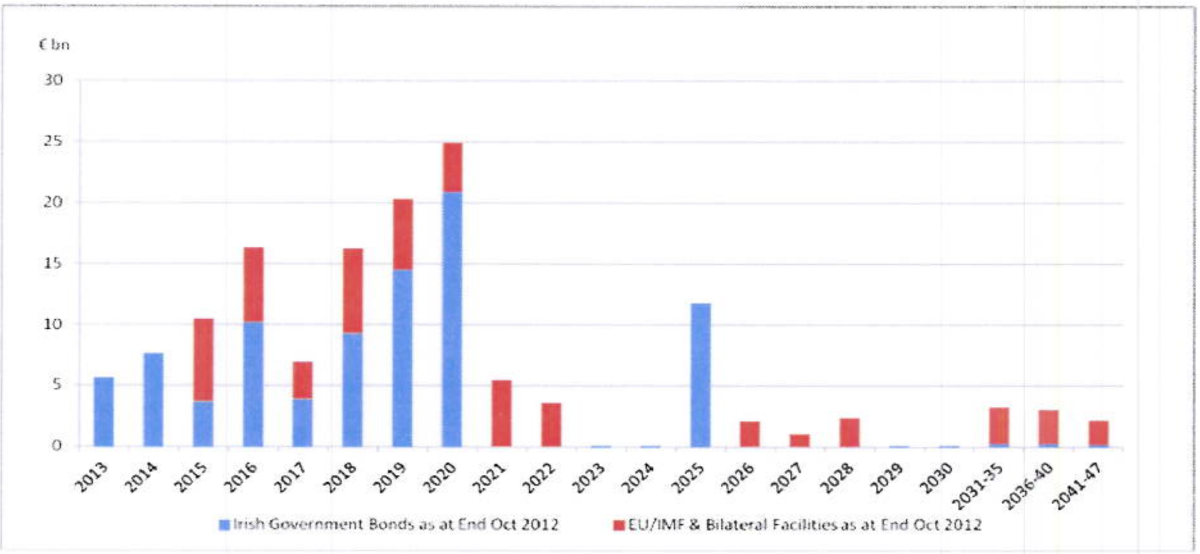
- **18 October: Irish Treasury Bill auction:** €500 million of 3-month bills sold at a yield of 0.70%. Bid to cover ratio: 3.6.

- **15 November: Irish Treasury Bill auction:** €500 million of 3-month bills sold at a yield of 0.55%. Bid to cover ratio: 4.12.

In total, long-term capital markets operations, (i.e. the operations above excluding the Treasury Bill auctions), have effectively reduced the January 2014 funding cliff by 80%, or €9.5 billion from €11.9 billion to €2.4 billion. This has been achieved by (i) reducing the amount due to mature in January by €4.3 billion to €7.6 billion and (ii) increasing the projected end-2013 cash balance by €5.2 billion.

The average interest rate of just under 6 per cent on the recent sales of long-term bonds and amortising bonds is higher than the NTMA would expect to pay on an ongoing basis as it returns to the markets but the primary objective was to tackle the January 2014 "funding cliff". Reducing that to €2.4 billion has removed a major obstacle to full market re-entry and should, in tandem with continued progress on other fronts, help achieve lower yields.

Maturity Profile of Ireland's Long-Term Marketable and Official Debt 31 Oct 2012



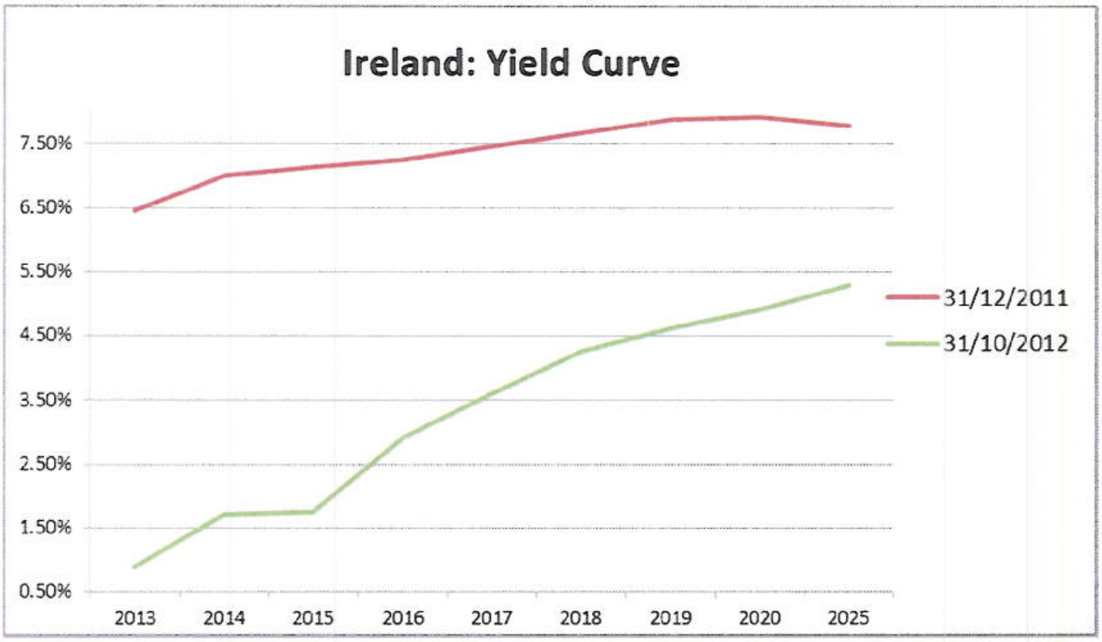
The NTMA continued its intensive investor relations programme in 2012 to help generate renewed interest among international investors in buying Irish Government bonds. That followed up a similar programme in 2011. It conducted non-deal road shows in the US, UK, Europe and Asia in Q1 2012 and again in September/October. The NTMA also visited investors in the UK and mainland Europe at end-June 2012, as well as participating in other events during the year. A series of meetings has also been held with domestic institutional investors.

(ii) Development in Government Bond Yields

Ireland has seen a significant decline in bond yields through 2012 to date, most markedly in shorter maturities, restoring the yield curve to a more normal upward slope, compared to the inversion that marked much of 2011.

Maturity	31/12/2011	31/10/2012	Change bps
2013	6.44%	0.90%	-5.54%
2014	7.00%	1.71%	-5.29%
2015	N/A	1.76%	
2016	7.25%	2.92%	-4.33%
2017	N/A	3.61%	
2018	7.66%	4.26%	-3.40%
2019	7.88%	4.63%	-3.25%
2020	7.92%	4.92%	-3.00%
2025	7.78%	5.30%	-2.48%

(neither the 2015 nor 2017 bonds were in issue at end 2011)



The rally in Irish bond yields has been driven by a number of factors including:

- Ireland's continuing adherence to the troika programme;
- the effective reduction to €2.4 billion (from an original outstanding amount of €11.9 billion) of the bond refinancing requirement in mid-January 2014;
- the EU leaders' supportive reference to Ireland in their statement of 29 June 2012 on the necessity to break the link between sovereign and banking debt;
- the Open Market Transactions "OMT" policy initiative by the ECB.

The yield of the Irish October 2020 bond over the period 1 October 2010 to 31 October 2012 is set out below.

(iii) Debt/GDP Ratio Projections

The General Government Debt-to-GDP ratio projections contained in the Medium Term Fiscal Statement published by the Department of Finance on 14 November 2012 are set out below.

	2012	2013	2014	2015
GGD/GDP Ratio %	118	121	120	117

3. State Claims Agency

The NTMA is designated as the State Claims Agency (SCA) when performing the claims management and risk management functions delegated to it under the *National Treasury Management Agency (Amendment) Act 2000*. The SCA's principal objectives are:

- to ensure that the State's liabilities in relation to personal injury and property damage claims, and the expenses of the SCA in relation to their management, are contained at the lowest achievable level; and

- to implement its employer liability, public liability and clinical risk work programmes, including the minimisation of litigation risk factors in State authorities and healthcare enterprises, and the implementation and audit of risk management systems.

The SCA's remit covers claims against certain State authorities, including the State itself, Government ministers, the Attorney General, health enterprises, the Commissioner of An Garda Síochána, prison governors, community and comprehensive schools and various other bodies. There are 54 State authorities within the SCA's remit.

Claims alleging personal injury in respect of the medicinal products Thalidomide and Nimesulide were delegated to the SCA in April 2012.

At end September 2012 the SCA had 5,509 claims under management compared with 5,306 claims at end 2011. The estimated liability against all active claims at end September 2012 was €1,096.6 million, broken down as follows:

- Clinical Claims €945.3 million (86%)
- ELPLPD[1] Claims €151.3 million (14%)

The SCA has achieved significant savings in the management of clinical claims. While an independent actuarial assessment projected that €106 million would be required to meet the costs of the Clinical Indemnity Scheme in 2011, the actual cost in respect of this scheme was €81 million – a saving of 24 per cent. For 2012, an independent actuarial assessment estimated that €132 million would be required to meet the costs of clinical claims and the Health Service Executive's ELPLPD claims portfolios. The projected outturn is currently €85 million – a saving of 36%.

The SCA endeavours wherever possible to reduce defence legal costs. Having previously tendered for its solicitors panel in 2010 the SCA recently announced a new procurement structure requiring barristers to engage in a competitive tendering process under which their fees will be capped at up to 25% below current levels. This is the first time a State agency is procuring barristers for personal injury claims in this way and follows the success of the 2010 solicitors tender which reduced the cost of fees paid to solicitors by 25%.

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[1] Employer Liability means the liability of an employer to its employees for its negligent acts or omissions, and those of its employees. Public Liability means the liability of an owner/occupier of premises for its negligent acts or omissions affecting members of the public. Property Damage Liability means the liability of an owner/occupier for its negligent acts or omissions leading to damage to a third party's property.

The Government has decided to establish a Legal Costs Unit within the State Claims Agency. The purpose of the Unit will be to deal with third party costs arising from the Mahon and Moriarty Tribunals with a view to ultimately extending the Unit's remit to the Smithwick Tribunal. The NTMA has agreed to establish and operate the Legal Costs Unit on an administrative basis pending the establishment of the Unit on a statutory basis. Recruitment for the Unit is under way.

4. NewERA

In September 2011 the Government announced the establishment of the New Economy and Recovery Authority (NewERA), initially on a non-statutory basis, within the NTMA. The core functions of NewERA are as follows:

- Undertaking a centralised shareholder advisory role from a financial and commercial perspective in respect of corporate governance matters for 5 commercial semi-state companies: ESB, Bord Gais Eireann, EirGrid, Bord na Mona and Coillte:

    - NewERA provides advice to Government Departments in relation to a range of financial activities in these commercial State companies including investment proposals, corporate plans, capital expenditure projects, financial statements, funding proposals and other items as stipulated under the relevant legislation and the Code of Practice for the Governance of State Bodies.

- Assisting from a financial perspective in the development and implementation of Government plans for investment in energy, water and next-generation telecommunications:

    - NewERA is engaging with the Department of Communications, Energy and Natural Resources on a range of potential projects across the telecommunications and renewable energy (including biomass) sectors.

    - NewERA is working closely with the Department of Environment, Community and Local Government in relation to the establishment of a new water utility with NewERA providing guidance in relation to the financial, funding, regulatory and corporate structure aspects of this project.

- Where requested by Government, carrying out advisory and oversight roles in relation to the possible restructuring or disposal of commercial State company assets:

    - NewERA participated in a number of Inter-Departmental Steering Committees to consider a range of State assets as potential candidates for inclusion in the Government programme of asset disposals. NewERA was requested to advise Government on the appropriate valuation to be placed on these assets, the most appropriate method for disposal, where applicable, and the likely timeframe for any such disposal. The disposal processes now being pursued include the disposal of Bord Gais Energy, some of ESB's non strategic power generation capacity and a concession for Coillte harvesting rights. Consideration is also being given to the disposal of the Government's remaining shareholding in Aer Lingus.

    - NewERA's role in these disposal processes is to represent the Government's financial interests and ensure that Government agreed timelines and financial objectives are clearly communicated to the relevant parties. It is also the responsibility of NewERA to ensure that the Government Steering Group overseeing the transactions is kept fully informed of progress and developments with the objective of ensuring that the financial objectives of the process are achieved.

5. National Pensions Reserve Fund

Fund Size

The Discretionary Portfolio (the Fund excluding the public policy investments in Bank of Ireland and Allied Irish Banks (AIB)) was valued at €6.0 billion at 31 October 2012.

The Directed Portfolio (public policy investments made at the direction of the Minister for Finance) was valued at €8.0 billion at 31 October 2012.

The Total Fund size at 31 October 2012 was €14.0 billion.

Discretionary Portfolio

From the Fund's inception in April 2001 to 31 October 2012, the annualised performance of the Discretionary Portfolio was +3.6% per annum. This compares over the same period with the performance of the average Irish pension fund (as published by Mercer) of +2.0% per annum and with Irish inflation of +2.3% per annum.

In light of the Government's stated intention to refocus the Fund's investment towards Ireland, in mid-2011 the Commission determined that management of the Fund should become more focused on capital preservation (to ensure moneys available for investment in Ireland as required were not unduly depleted), while still having the capacity to participate in gains if markets performed well (consistent with the Fund's statutory mandate). This de-risking strategy is being implemented through the purchase of options.

The graph below highlights the Fund's stable upward performance since June 2011. The exceptional volatility experienced over the period by the two main equity indices relevant to the Fund (Eurostoxx 50 and S&P 500) is shown by way of contrast – for example, the Eurostoxx has experienced falls and rises of around 20% to 30% on a number of occasions over that time.

The year-to-date performance of the Discretionary Portfolio to 31 October is +5.5%.

The NPRF has taken a lead role in the development and implementation of a number of investment initiatives in Ireland including the Irish Infrastructure Fund, Innovation Fund Ireland, the Silicon Valley Bank transaction, financing of water meters and the provision of a standby facility to enable the recently announced Schools Bundle 3 PPP project to proceed with EIB financing. In total 20% of the Fund is currently committed to Irish investments. The Minister for Finance has announced that he will propose amendments to the NPRF's statutory investment mandate to enable it focus its investments in Ireland.

The Discretionary Portfolio asset allocation as at 31 October 2012 is set out below:

Asset Allocation 31/10/2012	**(€m)**	**% of Discretionary Portfolio**
Large cap equity	1,229	20.6%
Small cap equity	195	3.3%
Emerging markets equity	487	8.2%
Quoted Equity	**1,911**	**32.1%**
Eurozone government bonds	0	0.0%
Eurozone inflation linked government bonds	122	2.0%
Eurozone corporate bonds	398	6.7%
Cash	1.310	22.0%
Financial Assets	**1,830**	**30.7%**
Private Equity	774	13.0%
Property	471	7.9%
Commodities	268	4.5%
Infrastructure	370	6.2%
Absolute return funds	237	4.0%
Alternative Assets	**2,120**	**35.6%**
Value of €1.3 billion Quoted Equity market protection (put and call options)	95	1.6%
Total Discretionary Portfolio	**5,957**	**100.0%**

Directed Investments

The Fund's ownership in each bank is set out below:

Directed Banking Portfolio 31 October 2012		
Allied Irish Banks	**Value (€bn)**	**Ownership**
Preference shares	2.2	
Ordinary shares	3.9	
Total AIB	**6.1**	**99.8%**
Bank of Ireland		
Preference shares	1.5	
Ordinary shares	0.4	
Total Bank of Ireland	**1.9**	**14.3%**
Total Directed Banking Investments	**8.0**	

Ordinary shares in Bank of Ireland are valued at market price. Ordinary shares in Allied Irish Banks and preference shares in both banks were valued at fair value as at 31 December 2011, in line with advice obtained from Goodbody Corporate Finance. These valuations will be updated as at 31 December 2012.

6. National Development Finance Agency

The NDFA provides financial advice to State authorities undertaking major public investment projects with a capital value of more than €30 million. It also has full responsibility for the procurement and delivery of all PPP projects in sectors other than transport and the local authorities.

On 9 November 2012, the NDFA awarded the contract for Schools Bundle 3 to BAM PPP PGGM Infrastructure Cooperatie, (a joint venture between BAM PPP and Dutch pension fund administrator PGGM). When completed, the eight schools in Schools Bundle 3 will provide accommodation for approximately 5,700 students in Donegal, Galway, Leitrim, Limerick, Waterford, Westmeath and Wexford. Construction commenced on 12 November 2012.

Under the PPP model, the schools will be designed, built, financed and maintained under a 25 year service contract. The debt financing solution comprises Bank of Ireland, the European Investment Bank (EIB) and the National Pensions Reserve Fund (NPRF).

The design and construction phase will be completed within 18 months and all eight schools will be available for occupancy in 2014. The project is expected to provide employment for up to 1,100 people.

The NDFA is also the financial advisor to the National Roads Authority on the N11/Newlands Cross PPP project. This project is expected to reach financial close in early 2013.

The NDFA was instrumental in securing the €100 million loan from the EIB for the traditional schools capital programme which was drawn down in August 2012. It is also managing the procurement and delivery of 18 school building projects for the Department of Education and Skills as part of this programme.

In response to funding difficulties and the need for job creation, the Government announced the Stimulus Package on 17 July 2012 to provide investment in a range of important new projects designed to stimulate economic growth and create employment. The package will involve raising €1.4 billion for investment in public infrastructure PPP projects from the EIB, NPRF, domestic banks and other sources of funding. The financing of these investments will be structured as off balance sheet in line with standard PPP DBFM[2] models. The NDFA will be working closely with the various stakeholders in order to ensure a sufficiently competitive environment to generate value for money for the taxpayer. It has already commenced an intensive market engagement with a view to attracting interest from investors and promoters in Ireland and overseas.

In addition to the above activities, the NDFA was recently assigned responsibility of contract management for existing and future PPPs in the education sector.

The NDFA is appearing separately before the Committee on 13 December 2012.

[2] Design, build, finance, maintain