An Roinn Airgeadais
Department of Finance

Ms Margaret Falsey
Committee of Public Accounts Secretariat
Leinster House
Dublin 2
D02 XR20

19 January 2018

Dear Ms Falsey,

Thank you for your letter, dated 08 January 2018, in relation to the Committee meeting on Thursday 14 December 2017. In your letter you specifically requested the following information;

1. A detailed note on the promissory note, how it differentiates from sovereign debt and bonds and a timeline of payments since 2011.
2. As per figure 2.1 of C&AG Report 81, the total value of loans acquired by NAMA from the five participating banks, a note analysing the loans acquired from each bank in terms of the number of loans involved, the range in value of those loans and the proportion of the total amount acquired represented by the individual loan values.

Specific responses on each of these items are set out in appendix 1 & 2 to this letter.

While not specifically requested in your letter, I would also like to address in this response the issue of the engagement letter between the Department and KPMG in relation to the Special Liquidation of IBRC which was raised by the Committee. I have attached a redacted copy of this engagement letter to this response at appendix 3. This is being supplied to the Committee on the understanding that it will be treated on a confidential basis. As previously indicated by my colleagues at the Committee meeting, there are certain aspects of the engagement letter which are commercially sensitive and we have needed to make a small number of redactions to the letter in order to address this. These elements of the engagement letter are commercially sensitive and the release or disclosure of these conditions may impact on the ability of the Department to achieve best value from similar service agreements, both with this supplier and other service providers, in the future. As indicated at the meeting, the Department is happy to consider the release of any further documentation requested by the Committee in due course.

I would also like to take the opportunity to update the Committee in relation to the proceedings lodged seeking declaratory reliefs against the Minister for Finance with regard to a number of matters pertaining to the terms and conditions of remuneration and expenses of the Special Liquidators, and their oversight by the Department. The CSSO has now entered an appearance on behalf of the Minister in these proceedings and counsel has been appointed however a Statement of Claim has not yet been issued by the Plaintiff. Notwithstanding this,

the Department is in the process of briefing counsel and preparing ahead of responding to the Statement of Claim in due course.

I would like to repeat once again that the Department continues to be disappointed and frustrated that, as a direct result of the proceedings lodged, it has not been possible for the Department to engage with the Committee fully in relation to the costs and oversight of the special liquidation of IBRC at this time. As indicated at the meeting on 14 December, the Department and the Special Liquidators remain committed to appear before the Committee as soon as the litigation is resolved and the Department will also review its position on this matter on receipt of the Statement of Claim in these proceedings.

Yours sincerely,

Derek Moran
Secretary General

Appendix 1

A detailed note on the promissory note, how it differentiates from sovereign debt and bonds and a timeline of payments since 2011.

Promissory Note Background

During 2009 it was determined that Anglo and INBS required additional capital. A commitment was provided by the Minister to Anglo and separately to INBS to provide capital of €8.3 billion and €2.7 billion, respectively. This capital was provided on 31 March 2010.

In relation to Anglo, this €8.3 billion of capital was injected by way of a capital contribution. This capital contribution is treated as equity capital for regulatory capital purposes. In relation to INBS, a special investment share was acquired for €100 million in cash and a further €2.6 billion was subsequently injected by way of a capital contribution.

The Government did not pay for these capital contributions in Anglo and INBS with cash. The Government effectively issued an IOU, in the form of promissory notes, to Anglo and INBS for €8.3 billion and €2.6 billion, respectively. As the State had a debt to the institutions, it also had an associated interest charge. This interest charge was set by reference to Government yields at the date of issue on 31 March 2010.

Subsequently, it was determined that Anglo and INBS needed additional capital, which was again provided by increasing the 31 March 2010 promissory notes. The final promissory note increase was on 31 December 2010 bringing the total promissory notes in Anglo and INBS to €30.6 billion. See table below for the increases:

€ billion	**Anglo**	**INBS**	**Total (IBRC)**
31 March 2010	8.30	2.60	10.90
28 May 2010	2.00	-	2.00
23 August 2010	8.58	-	8.58
31 December 2010	6.42	2.70	9.12
	25.30	**5.30**	**30.60**

When the final capital contribution was made on 31 December 2011 an interest holiday was inserted into each of the promissory notes which meant that between 1 January 2011 and 31 December 2012 no interest was payable. 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%.

While there was an interest holiday this did not affect the promissory note repayments of the principal amount. The cash flows on the promissory notes are 10% (€3.06billion) of the original amount per annum until the full amount is repaid. Set out below is a detailed aggregated schedule of capital repayments and interest payments on the promissory notes:

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

As set out above, the total interest cost for the State for all tranches of the Anglo and Irish Nationwide promissory notes would have been €16.8 billion with annual repayments of €3.06 billion per annum until 2023, reducing thereafter until 2031 when the final repayment is made. These annual repayments reduced over time as the various tranches of the promissory notes are repaid. The final payment on the promissory notes of circa €0.1 billion was due to be made on 31 March 2031. The total cost of the promissory notes including the principle amount and interest was estimated at €47.4 billion over the life of the promissory notes.

Scheduled repayments were made on the promissory notes by way of cash payment in 2011 and through the delivery of a long term Irish Government Bond. This reduced the outstanding balance of the Promissory Notes to €25 billion ahead of the restructuring announced in 2013.

Promissory Note Exchange and IBRC Liquidation

In 2013 there was a decision taken to exchange the Promissory Note for a portfolio of low-cost, long-term, non-amortising marketable Irish Government bonds. The interest rate on the Government bonds issued in exchange for the Promissory Notes were set at a floating rate over the 6-month Euribor rate. Importantly, the Government bonds are non-amortising, which means the State only has to pay interest until they mature. This has resulted in a significant cashflow benefit to the State as a result of changing from the current amortising arrangements and moving to an end-of-term repayment.

The result of this transaction was to ease the country's annual borrowing requirement and assisted in an important way for the State to regain the ability to access the international bond markets again and to exit the Troika programme in 2014.

The table below sets out the interest rate on each of the Floating Rate bonds.

Note Type	*Rate*	*Maturity*	*Original Nominal acquired by CBI (€m)*
Floating Rate Note	6 month Euribor+268bps	18/06/53	5,034
Floating Rate Note	6 month Euribor+267bps	18/06/51	5,000
Floating Rate Note	6 month Euribor+265bps	18/06/49	3,000
Floating Rate Note	6 month Euribor+262bps	18/06/47	3,000
Floating Rate Note	6 month Euribor+260bps	18/06/45	3,000
Floating Rate Note	6 month Euribor+257bps	18/06/43	2,000
Floating Rate Note	6 month Euribor+253bps	18/06/41	2,000
Floating Rate Note	6 month Euribor+250bps	18/06/38	2,000
			25,034

At the time of the transaction the weighted average life of the above structure was 34-35 years in comparison to the weighted average life of the Promissory Notes of 7-8 years at that time.

The Central Bank's remaining holdings of these bonds (the FRNs) include an average coupon, or interest rate, (weighted by holding) is 6-month Euribor +266 basis points. For reference, the 6-month Euribor on 15 January 2018 is -0.271%. The 6-month Euribor is reset every 6 months and so is subject to change on those occasions. The last coupons fixed on 14 December for reset on 18 December. 6-month Euribor was -0.271% on 14 December 2017.

The 6-month Euribor is influenced by economic growth and inflation via monetary policy decisions. The setting of the coupon on the basis of Euribor means it is not possible to set out the interest cost of the floating rate notes into the future as the Department would require certainty on future Euribor rates, which it is not possible to acertain. Due to the volatility associated with the disposal of these assets, Budget 2018 contains prudently-based estimates of Central Bank income out to 2021, which factors in interest earned on the floating rate notes.

As indicated, the principal benefits of the promissory note restructuring was to move to non-amortising bonds which resulted in significant cashflow benefits as the redemption of the promissory notes would have been through the issuance of sovereign debt over a much shorter time frame than will occur in terms of redemption of the floating rate notes.

Appendix 2

A note analysing the loans acquired from each bank by NAMA in terms of the number of loans involved, the range in value of those loans and the proportion of the total amount acquired represented by the individual loan values.

The transfer of loans to NAMA from the five participating institutions occurred in a number of phases between March 2010 and October 2011. Consideration of €31.8bn was paid for loans with a par value of €74bn equating to an overall discount of 57%.

A summary of the loan acquisitions, by participation institution, is set out in Table 1 below.

Table 1: Loan acquisitions by PI

	AIB	Anglo	BOI	EBS	INBS	Total
Loan balances transferred (excluding derivatives)	20.4	34.1	9.9	0.9	8.7	74
Consideration paid	9	13.4	5.6	0.4	3.4	31.8
Discount	56%	61%	43%	57%	61%	57%

The discounts that were applied to nominal loan balances to derive an acquisition price were determined for the most part by the current market value of the property securing the loans, and to a lesser extent, by further discounts made to reflect legal difficulties, including, for instance, constraints on enforcement of the security.

Table 2 summarises aggregate data for all acquired loans for which the overall discount was 57%.

Table 2: Aggregate loan valuation data

Data	€bn
A. Aggregate borrower debt (including derivatives)	74.4
B. Current market value of property securing the loans (CMVP)	32.4
C. Long-term economic value of property (Incorporating 8.3% uplift)	35.1
D. Current market value of loans	26.2
E. Long-term economic value of loans (LEVL - acquisition price)	31.8
F. Loan uplift (E minus D)	5.6
G. Discount (A minus E)	42.6
H. Percentage discount (G/A)	57%

Following loan acquisition, NAMA grouped, consolidated and managed the loans by borrower connection, regardless of the financial institution from which the loans originated. Each borrower connection comprised multiple loans, often from more than one financial

institution. Additionally, a single item of security would often secure more than one loan. Thus, NAMA's systems and the management and financial information that it needed were designed to support this operating model.

Table 3 below provides a breakdown of all debtor connections by size of nominal debt exposure. It should be noted that many of the debtors were also indebted to financial institutions which were not part of the NAMA scheme.

Table 3: Distribution of NAMA debtor connections by size of nominal debt *(excluding derivatives)*

Nominal Debt	Number of debtor connections	Average nominal debt per connection €m	Total nominal debt in this category €m
In excess of €2000m	3	2,758	8,275
Between €1000m and €2000m	9	1,549	13,945
Between €500m and €999m	17	674	11,454
Between €250m and €499m	34	347	11,796
Between €100m and €249m	82	152	12,496
Between €50m and €99m	99	68	6,752
Between €20m and €49m	226	32	7,180
Less than €20m	302	7	2,117
Total	772	96	74,015

The consolidated approach to the management of debt at borrower connection level has been one of the cornerstones of NAMA's approach to managing its acquired portfolio. It enabled NAMA to capture surpluses on loans acquired from one institution and to apply them to deficits on a debtor's indebtedness with another institution. It contrasts with the pre-NAMA situation whereby the financial institutions only had limited visibility over a borrower connection's total debt.

It is not possible to provide a breakdown of loans – in terms of volume, range and discount – by financial institution as NAMA's operating systems were not set up to capture information in this format but rather to manage the debts acquired on a borrower connection level.

In order for such information to be provided, NAMA would need to expend significant time, money and resources extracting the required data from its existing systems. Even if such information was readily available, it would not provide an accurate picture due to the fact that many borrowers had loans with more than one institution and also due to the fact that some loans were syndicated.