National Treasury Management Agency

# Business Review – July 2010

**Friday, 16 July 2010:** The National Treasury Management Agency (NTMA) today published its Annual Report 2009 and provided an update on activities across the range of its business functions: management of the National Debt, the National Pensions Reserve Fund, the National Asset Management Agency, the National Development Finance Agency, the State Claims Agency and its banking system functions.

Speaking today, NTMA Chief Executive John Corrigan said: "2010 has been an exceptionally busy year so far for the NTMA particularly in the funding and debt management and banking system areas and in bringing NAMA from a start-up to being a fully operational entity. Our experience over the last 18 months has underlined the linkages between many of the activities in which we are involved. Resolution of the banking problem is central to ensuring the sustainability of the Exchequer funding position and to reducing the interest rates we pay on our bonds. This, in turn, will assist both the fiscal position and the banks' ability to raise funding and increase the flow of credit to the real economy."

## ***Funding and Debt Management***

The NTMA raised €15.0 billion in long-term bond funding in the six months to end June 2010 and, as a result, begins the second half of the year in a very strong funding position. When strong sales of the retail State Savings™ products are factored in, more than 80% of the planned €20 billion borrowing in 2010 has already been raised. Taking the maturity profile of the NTMA's short-term borrowing into account, the Exchequer is fully funded through the first quarter of 2011.

The yield premium, or spread, over Germany which Ireland pays on its 10 year bonds declined from peak 2009 levels of nearly 3.0% to around 1.5% at the start of 2010. However, it rose sharply at the end of April 2010 due to a number of factors, including the sovereign funding uncertainties within the EU. The spread over Germany, having widened to 3.0%, has narrowed somewhat in recent weeks and is currently around 2.8%. However, in absolute terms, Irish bond yields have fallen over the last year or so from a peak of 6.1% per annum in March 2009 to 5.5% per annum currently.

Despite these volatile market conditions, the NTMA successfully held its scheduled monthly bond auctions during the first half of the year raising a total of €10 billion in addition to the €5 billion raised through a new 11-year syndicated bond issue in January. Demand for Irish Government bonds has remained strong with the NTMA receiving, on average, bids for 3 times the amount on offer in its monthly auctions.

Ireland is a relatively small issuer and international investors hold some 80% of our long-term debt. The NTMA undertook an extensive marketing campaign during the second quarter of 2010 to brief existing and prospective institutional investors on developments in the Irish economy and the substantial efforts that have been made to address the fiscal, economic and banking issues facing the country. The NTMA conducted a comprehensive round of meetings and presentations to investors in Europe, North America and the Far East.

The NTMA's policy of maintaining large cash balances has underpinned investor confidence and provided valuable flexibility in the timing of its borrowing during 2009 and 2010. Cash balances were around €20 billion at end June 2010.

Retail debt (through State Savings™ products) continues to make a strong contribution to overall funding needs with inflows of €1.4 billion during the first six months of 2010. Investment in the new National Solidarity Bond aimed at individuals and families and allowing them to invest their savings with the State for up to ten years has topped €100 million since it was announced by the Minister for Finance.

At 30 June 2010, Ireland's National Debt stood at €84.0 billion.

The General Government Debt/GDP ratio was 65.6% at end 2009 and is projected to reach 86.9% at end 2010 – close to the euro area average of 84.7%. General Government Debt is a "gross" measure and does not allow for the offsetting of Exchequer cash balances or the assets of the National Pensions Reserve Fund against the gross position. On a net basis, Ireland's debt/GDP ratio was 37.9% at end 2009.

***National Pensions Reserve Fund (NPRF)***

The National Pensions Reserve Fund Discretionary Portfolio (the Fund excluding the holdings in Bank of Ireland and Allied Irish Banks (AIB) held on the direction of the Minister for Finance) earned a return of 2.3% in the six months to 30 June 2010. Since the Fund's inception in 2001, the Discretionary Portfolio has delivered an annualised return of 2.7% per annum compared with an annualised return to the average Irish managed pension fund of 0.7% per annum over the same period. The return on the investments in Bank of Ireland and AIB held at the discretion of the Minister for Finance in the six months to 30 June 2010 was 4.5%. The return to the Total Fund was 3.0%. At 30 June 2010 the Total Fund's value stood at €24.1 billion.

In February and May 2010 the Fund received ordinary shares in Bank of Ireland and AIB respectively in lieu of cash as payment of the first dividend on its preference share investments in these institutions. The payment was made in the form of ordinary shares as the European Commission requested that discretionary coupon payments on Tier 1 and Upper Tier 2 capital instruments in Bank of Ireland and AIB not be paid while it considered each bank's restructuring plan.

In April 2010 the Minister for Finance issued directions to the National Pensions Reserve Fund Commission to convert part of its €3.5 billion holding of Bank of Ireland preference stock into ordinary stock as part of the bank's capital raising exercise, following the negotiation by the NTMA of a deal for participation by the State in the capital raising. Including the proceeds from the cancellation of the warrants issued in conjunction with the preference stock together with transaction fees, the Fund received total cash income of €543 million from Bank of Ireland for participation in the transaction.

Following the above transactions the Fund now holds 36.5% of the ordinary shares of Bank of Ireland in issue and 18.6% of the ordinary shares of AIB in issue.

During the second half of 2009 and early 2010, the Commission completed a scheduled review of the NPRF's long term investment strategy. Circumstances have changed materially over the period since the previous target asset allocation was originally determined some years ago. Principally the Exchequer has moved from surplus to deficit and, therefore, the Commission decided to include a secondary objective within the Fund's investment strategy of seeking to outperform the cost of government debt over rolling five-year periods. The updated strategy is set out in detail in the Commission's Annual Report for 2009 and accompanying press release also published today. Its main points are:

- Equity weightings are reduced, principally reflecting risk considerations attaching to the secondary objective of outperforming the cost of government debt; and

- Diversification is enhanced through the inclusion of some new asset classes and increased weightings to others which are more likely to deliver superior longer term growth and to protect against longer term inflation. These increased allocations include emerging markets and small cap equities, inflation linked bonds, commodities, infrastructure and absolute return investments.

***National Asset Management Agency (NAMA)***

NAMA has made significant progress since the appointment of its Board on 22 December 2009 and EU approval was secured at the end of February 2010. The ten largest systemic exposures with an aggregate value of €15.3 billion (nominal value) have already been acquired by NAMA from the five participating institutions for a consideration of €7.7 billion, a discount of 50%.

The transfer of a second tranche of loans, totalling approximately €13 billion (nominal value) is close to completion and the acquisition of a third tranche totalling some €11 billion (nominal value) is due to begin within weeks. About half of the overall transfer of €81 billion (nominal value) will have been achieved with the completion of the third tranche of loan transfers next month. The full transfer of all relevant loans will be completed by end February 2011.

On 6 July 2010 NAMA published a business plan which details the Agency's financial projections for its lifetime. Under its central scenario, where NAMA recovers the long-term economic value of the assets acquired by it, the plan projects that NAMA will return a profit to the taxpayer of €1.0 billion in Net Present Value terms.

While the National Asset Management Agency is a statutory body in its own right with its own Board and Chief Executive, the NTMA provides it with staff and key support services. The recruitment of personnel who have the necessary skills and who are also able to meet significant prequalifying criteria, including full disclosure of personal assets, interests and liabilities, has been challenging. NAMA has now acquired half of its expected full complement of just over 90 staff, including all of its senior executives, and aims to achieve its full staff complement by the end of the year.

***National Development Finance Agency (NDFA)***

The NDFA has full responsibility for the procurement and delivery of Public Private Partnership (PPP) projects in sectors other than transport and the local authorities. It is also responsible for the provision of advice on the financing of all public investment projects with a capital value of more than €30 million. The NDFA is currently working on some 50 projects with a combined capital value of circa €15 billion.

The NDFA has made progress on a number of areas during 2009 and the first half of 2010. It will reach a significant milestone over the coming months with its first procurement project completion – four primary schools providing 2,700 pupil places in Laois and Offaly which are due to be occupied this coming September for the new school year.

Construction commenced last month on a second bundle of six schools in Cork, Limerick, Kildare, Wicklow and Meath which will provide accommodation for 4,700 students, and are due to be occupied by November 2011. Other projects underway where the NDFA is the procuring authority include a third bundle of 8 schools which will provide accommodation for 4,700 students, third level facilities involving 16 buildings across nine campus locations and facilities for the delivery of radiation oncology services as part of the National Cancer Care Strategy.

A number of projects on which the NDFA has provided financial advice were completed in 2009 and 2010. The Criminal Courts of Justice opened in November 2009 and the Aviva Stadium at Lansdowne Road was officially opened in May 2010. The Convention Centre, Dublin is scheduled to open in August 2010.

The NDFA continues to provide financial advice on a number of high profile infrastructure projects such as Metro North, the DART Underground and the second PPP roads programme including the  N17/N18 (Gort to Tuam) N11/N7 (Arklow, Rathnew, Newlands Cross) and the

M11/M25 (Enniscorthy bypass). It also acts as financial advisor to the Health Service Executive on a number of health projects including the National Paediatric Hospital.

***State Claims Agency (SCA)***

Acting as the State Claims Agency, the NTMA manages personal injury, property damage and clinical negligence claims brought against certain State authorities, including Government Ministers and health enterprises. It also has a risk management role, advising and assisting State authorities in minimising their claims exposures. The SCA's remit was significantly expanded from 1 January 2010 with the delegation of employer liability, public liability and third party property damage claims and associated risks against the Health Service Executive.

There has been a significant decline in employer liability and public liability claim volumes associated with incidents that have occurred since the SCA was established. Since 2002, the number of employer liability claims has fallen by 86% and the number of public liability claims has fallen by 36%.

At end June 2010 the SCA had approximately 4,050 claims under management. The total estimated liability against all active claims was approximately €783 million, of which €693 million related to clinical claims and €90 million to employer liability, public liability & property damage claims.

During the first six months of 2010 the SCA received 500 new claims and resolved 707 claims. The SCA has spent a total of €49 million on the resolution and ongoing management of claims in the six months to end June.

***Banking System Functions***

In March 2010 the Government delegated a number of the banking system functions of the Minister for Finance to the NTMA. The NTMA is required to carry out these functions in accordance with any directions by the Minister. The main functions delegated to the NTMA and the parameters set out in the directions can be summarised as follows:

- to lead discussions with the covered credit institutions to determine their likely capital requirements;

- to negotiate the terms and conditions on which any capital support provided by the State will be invested;
- to manage any Ministerial shareholdings in these institutions.

Initial work in the banking area has focused on the analysis of the financial condition of banks in receipt of State support. The NTMA, in consultation with the Department of Finance, agreed measures with these institutions to meet the revised capital requirements as determined by the Financial Regulator. Subsequently, capital injections in the form of Special Investment Shares in EBS and INBS, promissory notes to Anglo Irish Bank, INBS and EBS and a State supported capital raising by Bank of Ireland have taken place. The NTMA continues to work with the State supported financial institutions to manage the Minister's shareholdings in these institutions.