Promissory Note Transaction

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Summary:

- The Irish Government and the European Central Bank have agreed to replace the Promissory Notes provided to the State-owned Irish Bank Resolution Corporation (IBRC) with long-term Government bonds. The maturities of the bonds span from 25 to 40 years. As part of this arrangement, IBRC (the former Anglo Irish Bank and Irish Nationwide merged) was liquidated. The CBI took charge over the Government bond issued last year to meet the then Promissory Note payment and the new long-term Irish Government bonds in order to replace ELA, the instrument which was formerly an asset of the CBI. All other assets will be transferred to NAMA. In turn, NAMA will pay for these loan assets with (Government-guaranteed) NAMA bonds. See simplified sequence below:

Figure 1: Simplified balance sheets before and after Promissory Note transaction

Before...

Central Bank of Ireland

Assets	Liabilities
•ELA	•"Other Liabilities" *(intra-Eurosystem)*

IBRC

Assets	Liabilities
•Promissory Notes •Loan Assets	•ELA

After...

Central Bank of Ireland

Assets	Liabilities
•Long-Term Irish Government Bonds •NAMA Bonds	•"Other Liabilities" *(intra-Eurosystem)*

NAMA

Assets	Liabilities
•Loan Assets	•NAMA Bonds

Benefits of Transaction:

- The three salient benefits of the transaction for the Irish State are as follows:
  - **Funding Requirement:** The near-term funding requirement (cash flow) for the State will be significantly improved. In the initial years, instead of funding a set payment of €3.06bn related to the workout of IBRC, the Government will have to borrow less than €1bn per annum. (In practice, the net refinancing requirement is actually lower than the amounts stated above - ex-ante and ex-post - because annual surplus

income from the Central Bank of Ireland to General Government can be subtracted from the State's funding needs). Over the next decade, it is estimated that the funding requirement falls by c. €20bn as result of this agreement.

- **General Government Balance:** Ireland's General Government deficit will improve as a result of the new arrangement. In 2013, it is unlikely to benefit thanks to up-front costs of the liquidation of IBRC all other things equal. But in each of 2014 and 2015, the General Government deficit may narrow by about 0.6 percentage points of GDP: see Table 1. Official forecasts currently stretch out to 2015 only. The revised workout of IBRC may continue to ameliorate the deficit in the period 2015-2020. Please see: *Department of Finance 'Presentation on Transaction Overview' (pp.11-12) for further details.*[1]

- **General Government debt:** General Government debt is likely fall over time compared with the status quo. However, the extent of the benefit to Ireland will depend on a wide range of outcomes in this case. Among other things, it depends on the holding period of the new Government bonds, the workout of the loan assets destined for NAMA and the path of future interest rates.

- The holding period of the new Irish Government bonds has been announced. The CBI will sell a minimum of:
  - €0.5bn before end-2014
  - €0.5bn a year in 2015-2018
  - €1bn a year in 2019-2023
  - €2bn a year after 2024 until all bonds are sold

  The Central Bank of Ireland may pay an annual dividend to General Government amounting to the majority of the difference between the coupon on the bonds and the main refinancing rate (the rate it pays on its own liabilities to the Eurosystem) on the balance of its Government bonds outstanding. This helps to keep Ireland's ultimate funding cost low. The stated profile of sales also provides certainty from a debt management perspective.

  Note that the debt build-up over time will also be limited by the NAMA bonds used to pay for the leftover loan assets in IBRC. These bonds are expected to price in line with the original ones issued by NAMA to purchase the loan assets of the "pillar" banks i.e. referencing six-month Euribor and to be rolled over until cash is generated to pay them off.

[1] Available at: http://www.finance.gov.ie/documents/publications/presentation/2013/newjmpres.pdf

Table 1: General Government Balance (GGB) estimated impact

GGB Impact (€m)	2013	2014	2015
Underlying GGB per Budget 2013 Document	**(12,645)**	**(8,905)**	**(5,325)**
Adjustments:			
1. Promissory Notes - interest savings	1,875	1,775	1,675
2. Government Bonds - interest costs	(800)	(875)	(950)
3. ELG claim costs*	(1,000)	0	0
4. Interest cost of payments under ELG	(50)	(50)	(50)
5. Change in CBI surplus income dividend	0	50	125
6. Interest cost savings (incl. interest on interest)	0	100	225
7. NAMA true-up**	n.a.	n.a.	n.a.
Change in Underlying GGB Due to Transaction	25	1,000	1,025
Underlying GGB Post-Transaction	**(12,620)**	**(7,905)**	**(4,300)**
Pre-Transaction Underlying GGB/Nominal GDP	**(7.5%)**	**(5.1%)**	**(2.9%)**
Post-Transaction Underlying GGB/Nominal GDP	**(7.5%)**	**(4.5%)**	**(2.4%)**
Change (pp)	**0.0**	**0.6**	**0.6**

* *Estimated ELG claim costs range: €0.9 - €1.1 billion*

** *Unknown until end of valuation process*

Note: Budget 2013 forecasts assume no dividend paid by IBRC to the State

Source: Department of Finance

Table 2: General Government Debt (GGD) estimated impact

GGD Impact (€m)	2013	2014	2015
GGD per Budget 2013 Document	**203,500**	**209,200**	**211,900**
Adjustments:			
1. Promissory Notes - interest savings	(500)	(1,825)	(1,750)
2. Government Bonds - interest payments	800	875	950
3. ELG claim payments*	1,000	0	0
4. Interest cost of payments under ELG	50	50	50
5. Change in CBI surplus income dividend	0	(50)	(125)
6. Interest cost savings (incl. interest on interest)	0	(100)	(225)
7. NAMA true-up**	n.a.	n.a.	n.a.
Change in GGD in Year	1,350	(1,050)	(1,100)
Cumulative Change in GGD	**1,350**	**300**	**(800)**
GGD post-transaction	**204,850**	**209,500**	**211,100**
Pre-Transaction GGD/Nominal GDP	**121.3%**	**120.2%**	**116.8%**
Post-Transaction GGD/Nominal GDP	**122.1%**	**120.3%**	**116.4%**
Change (pp)	**0.8**	**0.2**	**(0.4)**

* *Estimated ELG claim costs range: €0.9 - €1.1 billion*

** *Unknown until end of valuation process*

Note: Budget 2013 forecasts assume no dividend paid by IBRC to the State

Source: Department of Finance