Opening Statement by NTMA Chief Executive John Corrigan

to the

Joint Committee on Finance, Public Expenditure and Reform

24 January 2013

Chairman, Members

Introduction

I am pleased to have the opportunity to meet with the Committee today. While the NTMA manages a wide range of assets and liabilities on behalf of Government, in my opening remarks I propose to focus mainly on the area of debt management, and on the steps we are taking to regain full access to the markets. I will also update the Committee on the measures being taken by the National Pensions Reserve Fund to invest in the domestic economy.

Before getting into these areas in detail I would like to refer briefly to some of the current priorities in the NTMA's other areas of activity. The National Development Finance Agency's PPP expertise is being utilised to assist with the delivery of the Government's infrastructure stimulus package; NewERA is leading and managing the Bord Gáis Éireann transaction on behalf of the Government and the State Claims Agency's remit has been extended to deal with third-party costs arising from certain Tribunals of Enquiry as well as providing ongoing claims and risk management services to Government. Of course the NTMA is also providing staff and business and support services and systems to NAMA with almost half of its staff resources deployed in this area.

As Committee members will no doubt be aware, from March 2010 to August 2011 the NTMA's remit included certain banking system functions of the Minister for Finance. The delegation of banking system functions to the NTMA was ceased with effect from August 2011 and the NTMA banking team was seconded to the Department of Finance. As a result, the NTMA no longer has any statutory responsibilities in the banking area. Of course, the ongoing restructuring of the banking sector remains a crucial factor in driving down yields on our bonds and regaining full market access.

Re-engagement with the Markets

We have made very considerable progress in our re-engagement with the markets since my last appearance before the Committee in September 2011.

The NTMA's working plan has been to return to the markets on a phased basis, both through shorter-term issuance and by taking advantage of opportunities to issue long-term debt, as and when they arise. During 2012 and earlier this month we conducted a number of successful long-term debt market operations as well as making a return to a regular schedule of short-term Treasury Bill auctions.

In 2012 the NTMA's engagements with the debt markets included bond switches (€4.5 billion); the issuing of conventional bonds (€4.2 billion) and the issuing of a completely new debt instrument, Irish Amortising Bonds, tailored to meet the needs of the domestic pensions industry (€1.0 billion). Earlier this month we raised €2.5 billion from the sale of five-year bonds at a yield of 3.32 per cent. It was encouraging to see that more than 200 institutional investors – including fund managers, pension funds, bank treasuries and insurance companies - placed orders totalling more than €7 billion, almost three times the amount sold with strong demand from the UK, mainland Europe and the US.

The combined effect of these debt market operations has been to eliminate the challenging "funding cliff" presented by a bond repayment of almost €12 billion due in mid January 2014 – a priority for the NTMA. This substantial redemption, coming so soon after the end of the EU/IMF programme, was seen by investors as a major obstacle to our smooth exit from the programme. The gradual sourcing of funding in the market to meet that January 2014 repayment has been viewed positively by the investment community and has been a contributory factor to the continued fall in Irish bond yields.

As I mentioned, our 2012 funding included the introduction of a completely new debt instrument, Irish Amortising Bonds, tailored to meet the needs of the domestic pensions industry. Unlike standard bonds where the annual interest payment is followed by the repayment of principal at maturity, the new amortising bonds will pay an equal amount each year over their lifetime. This reflects the preference of pension schemes and annuity providers for a steady stream of income.

The NTMA's objective is to diversify its investor base and part of that includes the provision of products that meet the needs of domestic investors. An active and stable domestic investor base is not only important in its own right, but is also an important signal of confidence to overseas investors considering investment in Irish bonds.

I would like to comment briefly on our Treasury Bill programme which we recommenced last July when we issued €500 million of 3 month Bills at an annual equivalent yield of 1.8 per cent. Last week we held our fifth such auction: again €500 million of 3 month Bills but at an annual equivalent yield of 0.2 per cent. We believe that with the success of the auctions we have regained normal market access at this short end of the curve.

Developments in Yields

Ireland has seen a significant decline in bond yields through 2012, most markedly in shorter maturities, restoring the yield curve to a more normal upward slope compared to the inversion that marked much of 2011. For example the yield on the 2014 bond has declined from 7.58 per cent at end 2011 to 1.05 per cent currently while the yield on the October 2020 bond has declined from 8.26 per cent at end 2011 to 4.11 per cent currently.

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

- Ireland's consistent delivery on its EU/IMF programme commitments;
- the progressive elimination 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; and
- the Outright Monetary Transactions "OMT" policy initiative by the ECB.

In absolute terms the yields on our bonds are at low levels but the spreads against Germany remain high – currently 2.98 percentage points for the October 2020 bond. Some of this of course reflects differences in credit rating – Ireland being a BBB credit whereas Germany is a AAA credit but another factor is that extremely low German yields are driven by Germany's status as a safe haven investment.

Investor Relations and Issues

Following Ireland's entry into the EU/IMF programme at the end of 2010, our credibility among institutional investors had greatly diminished. Uncertainty remained throughout the first quarter of 2011, as investors awaited the results of Ireland's severe stress tests and restructuring plan for the "pillar" banks. Following the publication of the PCAR results, the NTMA began the process of re-engaging with investors to rebuild damaged relationships, develop new ones and ultimately pave the way for eventual return to bond issuance.

This involved a structured programme of face-to-face meetings putting the investment case for Ireland to investors in Europe, the US, the Middle East, Asia and to the domestic market. These presentations are based on three simple principles: tell investors the facts, do not over-promise, and return regularly with a progress update. It is a slow and deliberate process, but one which I believe has already paid dividends and is being reflected through the rebuilding of Ireland's international reputation and, critically, investor buying of new debt issuance and falling yields on our bonds.

The following are seen as key issues from the perspective of investors and potential investors in Irish Government bonds:

- Ireland's ability and willingness to continue to meet the fiscal consolidation targets and the quarterly undertakings set out in the EU/IMF programme;
- Ireland continuing to achieve economic growth despite the ongoing requirement for fiscal consolidation;
- the risk of further recapitalisation requirement for the banks;
- continued progress in reducing contingent liabilities, of which NAMA's programme of asset disposals is the most important element;
- the regaining of trade competiveness, highlighted by the return of large surpluses on the current account of the Balance of International Payments;
- improvement in Ireland's sovereign credit ratings; and
- the eventual resolution of the wider eurozone sovereign debt and banking crisis.

There have been a number of positive developments in these areas over the last year. Investors see the economy stabilising and are giving Ireland credit for being well ahead of other troubled European countries in implementing its adjustment process.

Of course it is likely that a lot of this "good news" is priced into Ireland's reduced bond yields. In particular, the market has priced in, to a greater or lesser extent, relief on the promissory notes and other bank related debt. Indeed, notwithstanding all the steps that Ireland has taken and continues to take to address its domestic issues, wider eurozone uncertainty remains a risk to achieving sustainable market re-entry.

Credit Ratings

Ireland retains investment grade status with Standard & Poor's and Fitch, which have both set a rating of BBB+, three notches above sub-investment grade. Moody's downgraded Ireland to sub-investment grade in July 2011 which was the last downgrade by any of the major rating agencies.

As Ireland's average rating across the three main agencies is still investment grade, Irish Government bonds remain in the main bond indices.

In early 2012 each of the three main rating agencies downgraded a number of eurozone countries in response to the sovereign debt and banking crisis. Ireland avoided a downgrade during that round of rating actions and has maintained its current rating, thanks to progress made in restoring creditworthiness. Indeed the announcement by Fitch Ratings last November that it was revising Ireland's outlook from negative to stable was the first positive action by a ratings agency on Ireland since the start of the financial crisis.

On a very general level I would note that the ratings agencies are satisfied with the progress made by Ireland as reflected in the positive quarterly reports from the troika. But the scope for ratings upgrades is constrained by the agencies' concerns about global economic growth on which Ireland is seen to be dependent, the wider eurozone issues and the need to make progress towards a banking union in order to secure a delinking of sovereigns from banks. It is instructive to note that NAMA is not a headline issue for the ratings agencies.

The reason why our sovereign credit ratings are so important, apart from somewhat limiting the market for buyers of Ireland's sovereign debt, is the fact they represent a ceiling for the rating of other Irish entities, and are a key driver of the funding costs of the banking sector.

Debt Sustainability

As I noted to the Committee in 2011, in order to stabilise our debt/GDP ratio Ireland needs to get back to running a primary budget surplus (the budget balance excluding interest payments) as soon as possible. Indeed in the context of debt sustainability, this metric is far more important than the absolute level of debt per se. I would note that the projections published by the Department of Finance in Budget 2013 are for the General Government Debt/GDP ratio to peak at 121 per cent in 2013 and to start to decline thereafter when the Government will, once again, be running primary budget surpluses.

2013 Funding

The NTMA's focus in 2013 will be on stepping up its re-engagement with the markets so that Ireland is positioned to successfully exit the EU/IMF programme.

To achieve this, we plan to raise in the region of €10 billion during the year, subject to market conditions: with the €2.5 billion issue earlier this month we are already a quarter way towards achieving this target.

Raising €10 billion this year would give the NTMA – and investors – the comfort of having a full year's advance funding in place. Such funding "visibility" is vital if Ireland is to successfully exit the programme at the end of this year.

Continuing access to the markets remains critically dependent on a number of external factors – particularly developments at a wider eurozone level. Indeed, we are in something of an investment "sweet spot" at the moment benefiting not only from more positive sentiment toward Ireland, as I have already alluded to, but also from greater risk appetite among investors generally. I am encouraged by the positive start to the year, but it would be unwise to be complacent. Markets do not necessarily move in a straight line and investor sentiment can be fickle.

We are likely to proceed with a syndicated issue of a longer-term bond prior to resuming regular scheduled bond auctions, although we will remain adaptable in light of circumstances.

NPRF

Before concluding I would like to turn briefly to the National Pensions Reserve Fund and the work being done in refocusing its investments towards commercial investment in Ireland. As Committee members may be aware, earlier this month the NPRF announced investment commitments to three new long-term funds that will provide €850 million of equity, credit and restructuring / recovery investment for Irish small and medium-sized businesses and mid-sized corporates. The NPRF played a significant role in the development of the funds and will be a cornerstone investor in each, alongside additional investment from third-party investors.

I have attached the press release issued by the National Pensions Reserve Fund Commission announcing these investments to this Statement for the Committee's information.

I look forward to the Committee's questions.

National Pensions Reserve Fund announces new funds - €850m available for investment in Irish SME sector

- 3 new SME funds to provide equity, credit and restructuring/ recovery investment
- NPRF will invest up to €500 million across new funds as cornerstone investor
- Further step in refocusing of NPRF towards commercial investment in Irish economy

Wednesday 9 January 2013 – The National Pensions Reserve Fund (NPRF) has today announced investment commitments to a suite of three new long-term funds which will provide equity, credit and restructuring / recovery investment for Irish small and medium-sized businesses (SMEs) and mid-sized corporates. These funds were referenced by the Minister for Finance in his Budget 2013 speech.

The NPRF has played a significant role in the development of the three funds and will be a cornerstone investor in each alongside additional investment from third-party investors. The three funds combined will involve a commitment by the NPRF of up to €500 million.

The details of the funds announced today are as follows:

- The **SME Equity Fund** (total fund size €300 million - €350 million / NPRF commitment €125 million) will focus on investing in healthy businesses seeking to grow, including those with overleveraged balance sheets. The fund, which has received commitments from other-third party investors, is operational and is managed by Carlyle Cardinal Ireland in Dublin.

- The **SME Turnaround Fund** (total effective fund size €100 million / NPRF commitment €50 million) will invest in underperforming businesses which are at or close to the point of insolvency but have the potential for financial and operational restructuring. Typically 40 per cent of the capital invested by the fund will be used to buy the business and 60 per cent will be used to finance the turnaround in order to place it on a sustainable long-term footing. The fund is operational immediately and is managed by Better Capital. The London Stock Exchange-listed investment fund, BECAP12 Fund, which is managed by Better Capital, will co-invest not less than 51% of the investment into each transaction with the NPRF providing the remainder. Better Capital will establish a Dublin office from which to source deal flow.

- The **SME Credit Fund** (initial fund size €450 million / NPRF commitment €175 million - €325 million depending on the amount of third-party investment raised) will lend to larger SMEs and mid-size corporates and will be managed by BlueBay Asset Management. The SME Credit Fund may also acquire and refinance loans close to maturity where existing lenders are not willing to provide new lines of credit. Lending by the fund will be at competitive market rates with loan sizes ranging from €5 million to €50 million with an estimated average size of €15 million. Returns to investors in the fund will vary according to their position in the fund's capital structure. The NPRF has agreed a Letter of Intent with BlueBay regarding the NPRF's investment in the SME Credit Fund and the objective is for the fund to be operational by early in the second quarter of 2013.

The NPRF is also currently reviewing additional SME fund opportunities that would complement those announced today, with the objective that the eventual suite of funds would have the capacity to invest across the full spectrum of SME financing needs.

The SME funds represent a further step in the redeployment of the NPRF towards commercial investment in the Irish economy. By committing its resources as a cornerstone minority investor, the NPRF's assets can act as catalyst for attracting additional investment from third-party investors into funds targeted at areas of strategic importance to the economy. The commitments to the SME funds have been made under the existing NPRF mandate which is due to be amended by legislation to facilitate further investment in Ireland.

Speaking today, **National Pensions Reserve Fund Chairman Paul Carty** said: "This substantial commitment by the NPRF represents a significant step towards its future objective of focusing on investment opportunities in the Irish economy while at the same time earning commercial returns. SMEs are the backbone of the domestic economy and we believe that the development of these new financing options will enhance their ability to contribute to economic recovery."