

## **Chapter 4**

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**Central Government**

**National Pensions Reserve Fund**



## National Pensions Reserve Fund

4.1 The National Pensions Reserve Fund (NPRF) was established in 2001 with the objective of providing a fund of money to meet the future costs of social welfare and public service pensions. An independent Commission (the National Pensions Reserve Fund Commission) was established to control and manage the Fund.

4.2 The Minister for Finance (the Minister) is required<sup>19</sup> to make a contribution each year equivalent to 1% of GNP to the NPRF. This contribution amounted to €1.6 billion for 2009.

4.3 In implementing its investment strategy the Commission seeks to maximise returns within acceptable risk levels with a focus on the long-term, taking account of the fact that the NPRF is expected to contribute to the financing of pension costs from 2025 until 2055.

### Directed Investments

4.4 In 2009, legislation<sup>20</sup> was enacted which permitted the Minister to direct the Commission to invest in listed financial institutions or to underwrite share issues in such institutions where such a direction is in the public interest. The Act also provided that the Minister can direct the Commission with regard to the management and disposal of any such investments.

4.5 In March 2009, the Commission was directed by the Minister to invest €3.5 billion in Preference Shares of Bank of Ireland and in May 2009 to invest €3.5 billion in Preference Shares of Allied Irish Banks. In each case, the investment consisted of

- Perpetual non-cumulative preference shares which pay an annual non-cumulative fixed dividend of 8% at the bank's discretion. If the dividend is not paid in cash, the NPRF receives its value in Ordinary Shares. The Preference Shares can be repurchased by the bank at par value (€1 each) within the first five years and thereafter at €1.25 each.
- Warrants attach to the Preference Shares giving an option to subscribe<sup>21</sup> for ordinary share capital in the bank. The warrants are exercisable any time between the fifth and tenth anniversary of the date of the issue of the preference stock or in the event of an offer for the bank or other change of control, whichever is earlier.

### Rights Attaching to Preference Shares

Preference shares are a type of share capital which confers particular rights, including priority payment of any dividend. The directed investments in Bank of Ireland and Allied Irish Banks Preference Shares rank *pari passu*<sup>22</sup> with Ordinary Shares in any liquidation and the annual dividend ranks *pari passu* with dividend claims of other Preference Shares and ahead of ordinary share dividends. In addition, on foot of the investment, the Minister can appoint 25% of the directors to each bank and the NPRF receives 25% of total ordinary voting rights in respect of change of control and board appointments.

<sup>19</sup> In accordance with the National Pensions Reserve Fund Act 2000.

<sup>20</sup> Investment of the National Pensions Reserve Fund and Miscellaneous Provisions Act 2009.

<sup>21</sup> The exercise price for the Bank of Ireland warrants was set at €0.52 for 177,213,784 shares and €0.20 for 157,523,364 shares. The exercise price of Allied Irish Banks warrants is €0.975 for 155,780,375 shares and €0.375 for 138,471,444 shares.

<sup>22</sup> Generally defined as having equal rights in terms of payment or level of seniority.

## Additional Contributions

4.6 A further €1.4 billion was paid<sup>23</sup> from the Exchequer to the NPRF in 2009 to contribute towards funding the directed investments in the two banks.

4.7 Under the Financial Measures (Miscellaneous Provisions) Act 2009 the assets of the pension funds of eight non-commercial State bodies and universities were transferred to the NPRF on 31 December 2009. The Commission determined in consultation with the Minister that the value of the assets transferred was €993 million. The assets transferred are set out in Figure 19. The pension schemes associated with those funds continue in force for existing members with no impact on benefits or associated provisions for members. All future pension costs will be paid, in the first instance, by the relevant State body or university and, thereafter, will be met by way of Oireachtas grant in lieu of amounts which would have been payable by the pension funds.

4.8 The assets of pension funds of a further six non-commercial State bodies and universities were transferred to the Commission in 2010. The estimated value of post-2009 transfers is of the order of €1 billion.

**Figure 19 Pension Assets Transferred to the NPRF on 31 December 2009**

Responsible State Body / University	Value €m
Arts Council	2.5
Bord Bia	15.7
National Tourism Development Authority	32.9
FÁS	364.6
Forfás	186.3
Shannon Development	52.3
National University of Ireland Maynooth	58.5
Trinity College Dublin	280.5
	<b>993.3</b>

## Value of the NPRF

4.9 The value of the NPRF stood at €22.3 billion at 31 December 2009 (2008: €16.1 billion) composed of discretionary investments with a market value of €15.3 billion and directed investments of €7 billion which were valued at cost under a direction of the Minister. Figure 20 sets out the movement in the NPRF for the year ended 31 December 2009.

<sup>23</sup> In accordance with the Investment of the National Pensions Reserve Fund and Miscellaneous Provisions Act 2009.

**Figure 20 Movement in the NPRF Value for 2009**

	€m		
Value of NPRF at 1 January 2009			16,142
<b>Increase in Value of NPRF (including asset transfers)</b>			
<b>Contributions</b>			
<b><i>Exchequer Contribution</i></b>			
Statutory annual contribution	1,584		
Additional contribution	1,416		
Assets transferred from pension schemes	<u>993</u>	<b>3,993</b>	
<b>Net Income</b>			
Net Discretionary Investment Income (less expenses)	386		
Net Directed Investment Income (less expenses)	56		
Increase in Value of Discretionary Investments	<u>1,758</u>	<b>2,200</b>	<b>6,193</b>
Value of NPRF at 31 December 2009			<b>22,335</b>
<b>The assets of the NPRF are composed of</b>			
Discretionary Investments		15,335	
Directed Investments		7,000	<b>22,335</b>

## Developments Since Year End

### *Payment of Preference Share Dividend*

4.10 On 19 February 2010, Bank of Ireland paid the dividend then due of €250 million. On 13 May 2010, Allied Irish Banks paid the dividend due of €280 million on its Preference Shares. In each case, the payment was made in the form of Ordinary Shares in lieu of a cash payment.

4.11 The reason for the payment by way of Ordinary Shares was because the European Commission had requested that discretionary<sup>24</sup> coupon payments on Tier 1 and Upper Tier 2<sup>25</sup> capital instruments in Bank of Ireland and Allied Irish Banks not be paid while it considered each bank's restructuring plan. The number of shares issued in lieu of cash dividends was calculated by reference to the amount of the Preference Share dividend divided by the average share price in the 30 trading days prior to the date on which the dividend payment was due. Following the issue of these shares the NPRF (including small shareholdings already held in its indexed portfolio within the Discretionary Investment portfolio) held 15.7% of the issued Ordinary Shares of Bank of Ireland and 18.6% of the Ordinary Shares of Allied Irish Banks.

<sup>24</sup> The payment of a cash dividend on preference shares is subject to Board approval. If the dividend is not paid in cash the fund will receive the value of the dividend in ordinary shares.

<sup>25</sup> Tier 1 capital instruments refer to paid up share capital and common stock. Upper Tier 2 capital refers to certain subordinated debts including the preference shares held in the two banks.

### *Conversion of Investment to Ordinary Shares*

4.12 On 30 March 2010 the Minister announced details of the capital determined by the Financial Regulator to be necessary for the banks to meet his requirement of a Tier 1 capital ratio of 8%, of which 7% must be equity. In the case of Bank of Ireland this translated into an additional equity requirement of €2.7 billion and in the case of Allied Irish Banks into an additional equity requirement of at least €7.4 billion. In his statement, the Minister said the State would support both banks in their capital raising to meet these new capital standards.

- In the case of Bank of Ireland this support would be provided through the conversion of part of the NPRF's Preference Shares into Ordinary Shares.
- In the case of Allied Irish Banks it would be provided through commitment to convert part or all of the NPRF's Preference Shares as required into ordinary equity. If additional capital was required it would be provided through investment in Ordinary Shares by the Commission.

4.13 In April 2010, Bank of Ireland announced a plan to raise €3.4 billion equity capital through a share placement and rights issue. The Commission was directed by the Minister in accordance with enabling legislation<sup>26</sup> to participate in the share placement and rights issue in accordance with the terms of a Transaction Agreement with Bank of Ireland. Under the terms of the Agreement

- The Commission agreed to subscribe for 576 million units of Ordinary Stock at a price of €1.80 per unit, through the conversion of the Preference Shares into Ordinary Stock at a price of €1 per unit.
- Bank of Ireland re-purchased, in their entirety, the warrants issued in conjunction with the Preference Stock for €491 million in cash.
- The Commission agreed to participate in the Bank of Ireland rights issue, taking up the full allocation to which it was entitled, based on its holding of Ordinary Stock after the share placement. The consideration for the shares purchased under the rights issue was met through the conversion of 627 million Preference Shares based on a price of €0.55.
- The coupon on the remaining 1,837,041,304 Preference Shares was increased from 8% to 10.25%.

4.14 Following these transactions, the NPRF's holding in Ordinary Shares of Bank of Ireland is 36%. The NPRF received, in addition to the €491 million in respect of the warrants, €52 million in transaction fees under the Transaction Agreement (a €22 million transaction fee, €10 million in share placement fees, a €19 million underwriting fee and €800,000 incentive fee in respect of the rights issue). The market value of its shareholding at 30 June 2010 was €1.3 billion and the par value of its Preference Shares was €1.8 billion.

### *Valuation of the Directed Investments*

4.15 In its 2009 financial statements the Commission has valued the Preference Shares at cost in accordance with the direction received from the Minister and the equity warrants are valued at zero.

4.16 The Commission considered in preparing the 2009 financial statements whether there was any evidence of impairment of the directed investments which might make it appropriate to

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<sup>26</sup> Investment of the National Pensions Reserve Fund and Miscellaneous Provisions Act 2009.

recognise a provision for impairment and concluded that, for the reasons set out below, no such provision was appropriate.

4.17 Bank of Ireland successfully completed a share placement and rights issue in 2010. The conversion of €1.7 billion of the NPRF's Preference Shares into Bank of Ireland Ordinary Shares on the basis of exchanging Preference Shares at par for Ordinary Shares at market price at the time of the transaction was evidence that those Preference Shares had not suffered impairment.

4.18 The additional equity share capital generated in the rights issue, both from the market and from the conversion of Preference Shares, significantly improved the position of the remaining Preference Shares which rank ahead of that equity share capital. The valuation of the remaining Preference Shares would also benefit from an increase in the coupon rate from 8.0% to 10.25%.

4.19 In addition, the bank has been recapitalised sufficiently to meet the requirements of the Financial Regulator.

4.20 Allied Irish Banks was planning to raise capital from private sources and through the disposal of certain overseas assets to meet the capital requirements of the Financial Regulator. To the extent that Allied Irish Banks is unable to raise sufficient external capital, the Minister has indicated that he will convert the Preference Shares as required. While there is still uncertainty about the final outcome, the Commission had no evidence that the directed investment, in that bank, is impaired.

4.21 At 30 June 2010, the value of the directed investments was €6.8 billion made up of the market value of Ordinary Shares (€1.5 billion) and the original acquisition cost of Preference Shares (€5.3 billion). This excludes the €0.5 billion in cash which was received by the NPRF in June 2010 following the conversion of the Bank of Ireland investment to Ordinary Shares.

## Conclusion

The fund was valued at €22.3 billion at the end of 2009. €7 billion of this value was made up of directed investments. These directed investments continued to be stated at cost at the end of 2009 and the Commission did not consider that their value had been impaired.

Since 31 December 2009, the par value of Bank of Ireland Preference Shares held has reduced to €1.8 billion following conversion of the balance of its original €3.5 billion investment into Ordinary Shares.



## **Chapter 5**

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### **Central Government**

### **Financial Commitments under Public Private Partnerships**