

## 3 Cost of Banking Stabilisation Measures as at end-2016

- 3.1 Following the onset of the financial crisis in 2008, the State undertook a number of measures to stabilise the banking system, including the provision by the Central Bank of Ireland (Central Bank) of significant exceptional liquidity assistance to domestic banks, the provision of Government guarantees of deposits and certain other liabilities, recapitalisation of domestic banks and the establishment of the National Asset Management Agency (NAMA) to acquire impaired assets from banks.
- 3.2 The purpose of this report is to provide an estimate of the net outturn of the banking stabilisation measures taken by the State, as at end-2016.

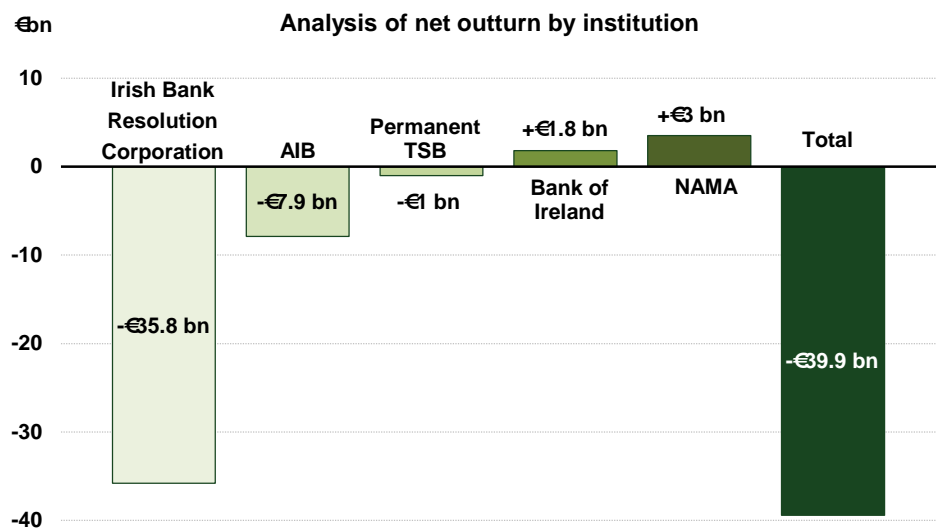
### Overview of net costs

- 3.3 The sums involved in recapitalising banks, including covering their losses, are relatively straightforward to identify. Income accruing from the investments is also generally identifiable. However, estimation procedures are required to identify the costs incurred by the State in funding the investments and in arriving at a valuation of the State's remaining interest in banking assets.
- 3.4 The examination analysis has estimated that the net cost to the State from banking stabilisation measures up to end-2016 was around €56.5 billion. This net cost must be offset by the estimated value at 31 December 2016 of the State's investments in banks (€13.6 billion), and NAMA's projected terminal surplus when it winds up (around €3 billion). This results in a net outflow for the State of just under €40 billion (see Figure 3.1).<sup>1</sup>

<sup>1</sup> At the end of 2016, NAMA's financial statements reported accumulated retained earnings of just over €3 billion. NAMA also reported unrecognised surpluses of €469 million.

**Figure 3.1 Estimated net outturn from banking stabilisation measures as at 31 December 2016**

	€bn	€bn
<b>Cost of capitalising banks (investments)</b>		<b>66.8</b>
<b>Estimated cost of funds invested<sup>a</sup></b>		<b>14.8</b>
<i>Less income</i>		
Disposals of investments	(9.1)	
Income from investments	(4.6)	
Net income from liability guarantee schemes	(3.7)	
Estimated related Central Bank surplus <sup>b</sup>	(7.7)	<b>(25.1)</b>
<b>Estimated net cost to the State from banking stabilisation measures as at 31 December 2016</b>		<b>56.5</b>
<b>Estimated residual value of investments at 31 December 2016</b>	(13.6)	
<b>Estimated surplus from NAMA<sup>c</sup></b>	(3.0)	<b>(16.6)</b>
<b>Estimated net outturn to the State from banking stabilisation measures as at 31 December 2016</b>		<b>39.9</b>
<b>Estimated recurring annual cost of servicing the debt</b>	<b>€1.0 billion to €1.4 billion a year<sup>d</sup></b>	



Source: Analysis by the Office of the Comptroller and Auditor General. See Annex 3A for further detail.

- Notes:
- The estimated cost of servicing the debt associated with the investment in banks includes the imputed debt service costs of investments made by the ISIF, and premiums paid by the NTMA when it redeemed government bonds that had been issued to the Central Bank to replace promissory notes.
  - Estimated portion of the Central Bank's surplus income that is attributable to banking stabilisation measures.
  - The projected NAMA surplus cannot be reliably apportioned to individual institutions.
  - Range assuming interest rates of 2.5% to 3.5% per year. The actual cost will be determined by the amount realised from remaining investments and by the State's cost of borrowing.

## Capitalisation of banks

**3.5** The investments of €66.8 billion were funded through

- The Exchequer — €44.4 billion, including €30.85 billion in the form of promissory notes. In February 2013, following the appointment of special liquidators to Irish Bank Resolution Corporation (IBRC), promissory notes to the value of €25.034 billion which were held by the Central Bank as collateral for lending to IBRC were replaced by government bonds. Between 2014 and 2016, the NTMA redeemed €5.5 billion of these replacement bonds.
- The Ireland Strategic Investment Fund (ISIF) — €22.4 billion, including re-investment of €1.7 billion in ordinary shares received in lieu of dividends on preference shares.<sup>1</sup>

**3.6** Further detail on the investments and the income from them is set out in Annex 3B.

## Disposal of AIB shares in 2017

**3.7** At the end of 2016, the value of the State's share in AIB was €11.6 billion. In May 2017, a dividend of €250 million was paid by AIB to the ISIF. Following this, the value per share was just under €4.19.

**3.8** Subsequently, 29% of the State's shareholding was sold at a price of €4.40 per share — around 5% higher — in an initial public offering (IPO) of AIB to institutional and retail investors. The State realised €3.43 billion in total from the IPO. All fees and expenses incurred by the State in relation to the IPO were paid by AIB directly under the terms of the recapitalisation agreements in place with the bank.

**3.9** Following the sale, the State held 71% of AIB with an estimated value of just under €8.5 billion, at €4.40 per share (the IPO price).

## Banking stabilisation related Central Bank income

**3.10** For the years 2009 to 2016, the examination has estimated that around €7.7 billion of the Central Bank's surplus income (total €12.5 billion) was attributable to financial instruments held as a result of banking stabilisation measures taken by the State (see Figure 3.2). The Central Bank retained 20% of surplus income relating to banking stabilisation measures (around €1.5 billion), thereby increasing its reserves and paid the balance to the Exchequer (€6.2 billion) in the form of annual dividends.<sup>2</sup>

<sup>1</sup> The investments were originally made by the National Pensions Reserve Fund (NPRF). In 2014, the assets of the NPRF transferred to the ISIF.

<sup>2</sup> The Minister for Finance is the sole shareholder of the Central Bank of Ireland.

**Figure 3.2 Estimate of Central Bank surplus income attributable to transactions in respect of banking stabilisation measures, 2009 to 2016**

	Net interest income	Gains on disposal of bonds	Total
	€bn	€bn	€bn
Exceptional liquidity assistance <sup>a</sup>	1.89	—	1.89
Government bonds, and government-guaranteed bonds, held by the Central Bank <sup>b</sup>	2.68	3.17	5.85
<b>Total</b>	<b>4.57</b>	<b>3.17</b>	<b>7.74</b>

Source: Analysis by the Office of the Comptroller and Auditor General.

Notes: a Between 2009 and 2013, exceptional liquidity assistance was advanced to the four banks capitalised by the State.

b These included IBRC-related bonds issued by NAMA, bonds issued to meet a promissory note payment of €3.06 billion, bonds issued to replace promissory notes to the value of €25.034 billion when IBRC was liquidated, and debt issued by the NTMA to redeem some of these bonds.

**3.11** The bulk of the exceptional liquidity assistance (almost 90% based on interest received by the Central Bank) was provided to IBRC and all of the income and gains in respect of government bonds were related to IBRC. In total, an estimated 97% of the €7.7 billion portion of the Central Bank's surplus income for the years 2009 to 2016 that arises from banking stabilisation measures is attributable to transactions between the Central Bank and IBRC (see Figure 3.3).

**Figure 3.3 Central Bank surplus income for the years 2009 to 2016 arising from banking stabilisation measures, by supported bank**

Bank supported by stabilisation measures	Central Bank surplus income attributable to bank support
	€m
AIB	66
Bank of Ireland	99
Permanent TSB	44
IBRC	7,535
<b>Total</b>	<b>7,744</b>

Source: Analysis by the Office of the Comptroller and Auditor General.

### **Government bonds held by the Central Bank**

**3.12** In 2013, the Central Bank acquired government bonds issued by the NTMA following the liquidation of IBRC

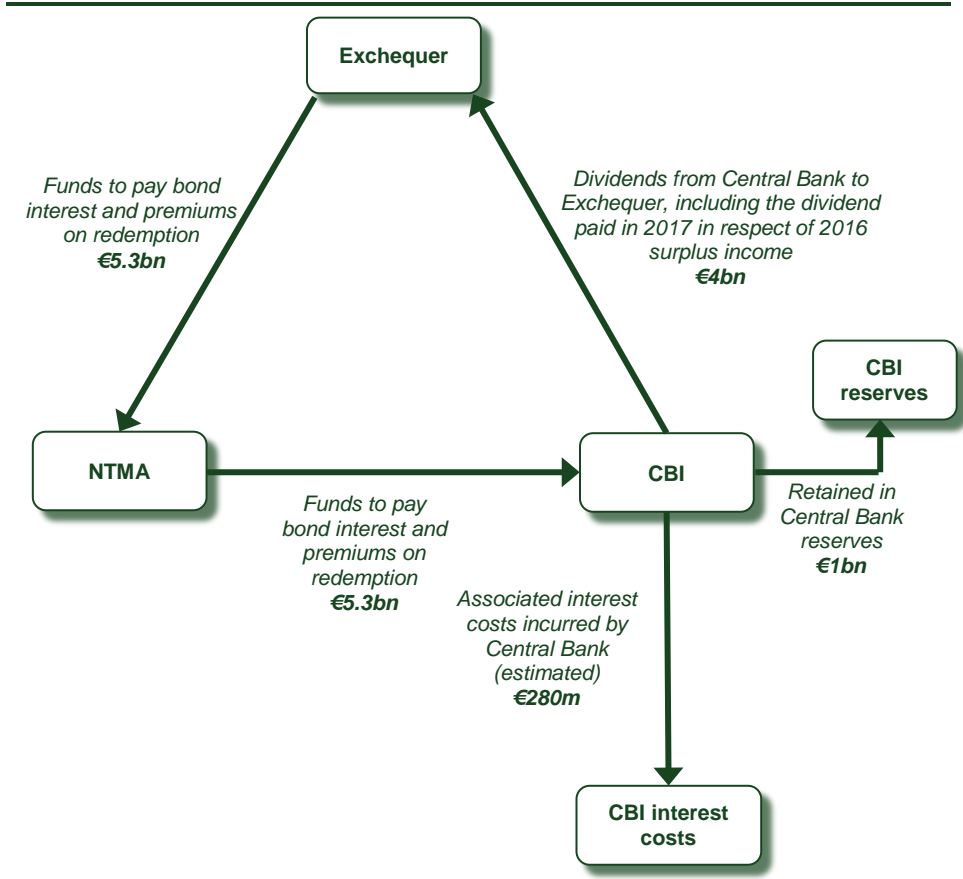
- floating rate Irish government bonds with a nominal value of €25.034 billion with maturities ranging from 25 to 40 years, to replace promissory notes
- a 5.4% yielding Irish 2025 government bond with a nominal value of €3.461 billion.

- 3.13** Between 2013 and 2016, the Central Bank earned net interest of €2.7 billion from the bonds and realised gains of €3.2 billion from the disposal of some of these bonds <sup>1</sup>
- €2.3 billion of the gains arose from a disposal back to the NTMA of floating rate bonds with a nominal value of €5.5 billion
  - €0.9 billion of the gains arose from disposals to the open market of the 5.4% government bond.

*NTMA payments to the Central Bank*

- 3.14** The interest on the bonds and the premiums paid when the NTMA bought back some of the bonds, is paid by the NTMA to the Central Bank from Exchequer funds (including state borrowing).
- 3.15** About three quarters of the interest and premiums paid by the NTMA to the Central Bank has been returned to the Exchequer as part of the dividend paid by the Central Bank from its surplus income, thereby reducing the net cost of servicing this part of the debt. This circular flow of funds is described in Figure 3.4.

**Figure 3.4 IBRC-related bonds held by Central Bank — flow of funds from/to Exchequer, 2013 to 2016<sup>a</sup>**



<sup>1</sup> The Central Bank also acquired other assets, including NAMA bonds, as a result of the liquidation of IBRC. It had sold all but €33 million of these bonds by the end of 2016, realising a gain of less than €1 million.

Source: Analysis by the Office of the Comptroller and Auditor General.

Note: a In addition, the Central Bank realised a further €0.9 billion from the disposal of IBRC-related bonds on the open market. These funds did not come from the Exchequer.

**3.16** The Central Bank stated in its 2016 annual report that it intends to sell the remaining floating rate bonds as soon as possible, provided conditions of financial stability permit. It stated that it will sell minimum amounts of these securities in accordance with the following schedule: 2017-2018 €0.5 billion per annum, 2019-2023 €1 billion per annum and from 2024 €2 billion per annum, until all bonds are sold.

**3.17** The net impact of the disposal by the Central Bank of government bonds on the Exchequer is the same whether the bonds are redeemed by the NTMA using funds borrowed at market rates, or the Bank sells the bonds on the open market. The consequent effective cost of servicing the debt that is related to the disposals is the same.

- If the bonds are redeemed by the NTMA using borrowed funds, any premium paid by the NTMA on redemption returns to the State, either as part of the Central Bank dividend or retained by the Bank in its reserves.<sup>1</sup> The NTMA will then pay interest to an external party on the funds it has used to redeem the bonds.
- If the bonds are sold to a third party, the Central Bank will realise a gain. In these circumstances, the NTMA continues to pay interest on the bonds, to the purchaser, at the same rate that would have been paid to the Central Bank prior to disposal. This higher rate of interest is offset for the State by the Central Bank's gain on disposal.

### Debt-related costs

**3.18** Because the investments in the banks were funded by increased borrowing, the State bears additional annual debt service and other related costs. In total, the debt-related cost to the State associated with the investments was around €14.8 billion over the period 2009 to 2016. The composition of the debt-related cost is indicated in Figure 3.5.

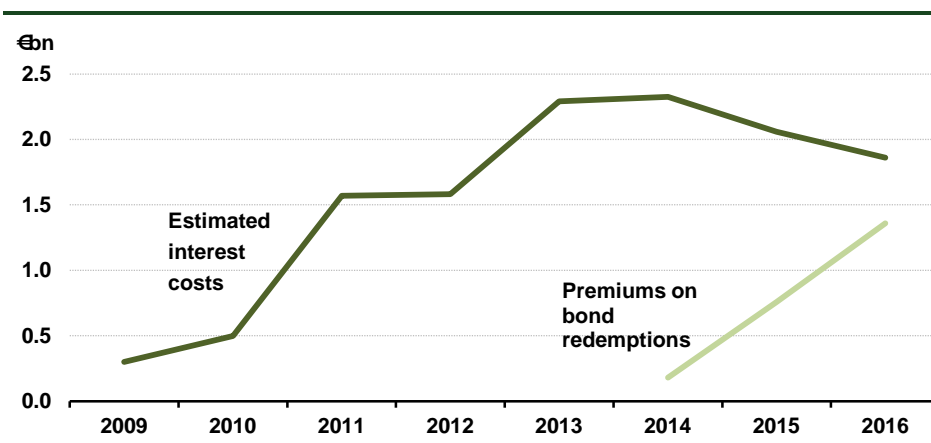
- Estimated interest costs were €12.5 billion, including the imputed interest costs of investments made by the ISIF.<sup>2</sup>
- Premiums totalling €2.3 billion paid by the NTMA when it redeemed government bonds that had been issued to the Central Bank to replace promissory notes. The premiums arose because the yield on government bonds was lower at the time of disposal than when the Central Bank acquired the bonds.<sup>3</sup>

1 It is assumed that the yield on bonds at disposal is lower than the yield when the bonds were issued, giving rise to a gain on disposal for the Central Bank.

2 The ISIF funded its investments from its own resources so there was no direct interest charge to the State for these investments. However, there is an opportunity cost to the State for the investment. For the purposes of this examination, this imputed cost has been calculated as the interest incurred by the Exchequer on the borrowings that could have been avoided if the ISIF funds had been available to the State for purposes other than investing in banks.

3 The cost of premiums would normally be accounted for evenly over the remaining period of a debt. The Central Bank treats the premiums as income in the year it receives them. In order to have consistency of treatment, the premiums have been treated in this report as an expense in the year they were paid by the NTMA.

**Figure 3.5 Estimated debt related costs associated with the State's investments in banks, 2009 to 2016**



Source: Analysis by the Office of the Comptroller and Auditor General.

- 3.19** Further detail of the estimated debt service costs and the methodology used by the examination are set out in Annex 3C.

### ***Ongoing debt servicing costs and income from 2017***

- 3.20** At the end of 2016, the Exchequer continues to incur the cost of servicing the debt associated with the net €56.5 billion cost of the investments in the banks.<sup>1</sup> The examination estimated that this cost is likely to be around €1.7 billion for 2017.<sup>2</sup> The bulk of this is in respect of IBRC (just over €1 billion) and AIB (around €0.6 billion). The State has recouped its investment in Bank of Ireland (including associated debt servicing costs), and, therefore, incurs no ongoing debt servicing costs in relation to Bank of Ireland. The ongoing annual cost of servicing the debt associated with Permanent TSB is estimated at around €50 million per annum.
- 3.21** The long-term cost of servicing the debt associated with the investments will depend on a number of factors including
- The amount the State realises from its remaining investments i.e. the amount the State realises from disposal of bank shareholdings and any NAMA surplus.
  - The period for which the Central Bank continues to hold government bonds. While the Central Bank continues to hold these bonds, the interest expense for the State will be offset by income from the Central Bank.
  - The cost of funding for the State as it refinances existing debt when it matures.
- 3.22** In the long-term, the cost of servicing the debt associated with the investments is projected to be around €400 million annually for each percentage point that the State pays on its debt. For example, at rates of 2.5% and 3.5%, the cost of servicing the debt would be between €1.0 billion and €1.4 billion annually.

### **Liability guarantee schemes income**

- 3.23** The State guaranteed certain bank liabilities under three main schemes
- The Deposit Guarantee Scheme (DGS) under which deposits by individuals in covered credit institutions are guaranteed to a limit of €100,000 per eligible depositor per institution.<sup>3</sup> No guarantee fees are payable to the State under this scheme.
  - The Credit Institutions (Financial Support) Scheme (CIFS), which operated between 2008 and 2010, provided a guarantee for a broad range of bank liabilities for seven institutions that opted to avail of the scheme.<sup>4</sup> The credit institutions were required to make payments for the protection provided under the scheme.
  - The Eligible Liabilities Guarantee Scheme (ELG) came into effect in December 2009 and closed to new liabilities in March 2013. At that time, liabilities of around €74.6 billion were guaranteed under the scheme. The four institutions that participated in the scheme were required to pay fees for the cover they received.<sup>5</sup>

Further detail on each scheme is set out in Annex 3D.

- 3.24** By the end of 2016, the State had received net income of around €3.7 billion under the schemes — €4.5 billion had been received in fees, almost €1.1 billion had been paid in claims, and €280 million had been received from the special liquidators of IBRC (see Figure 3.6). Fees paid in respect of liabilities that are covered under the ELG scheme have fallen significantly since 2012, and in 2016 amounted to just €47 million.

<sup>1</sup> The balance funded, and thereby incurring interest costs, will reduce as disposals of residual shareholdings take place.

<sup>2</sup> This represents interest costs only. Any premiums paid in respect of bond redemptions will be an additional cost.

<sup>3</sup> Only institutions that are licensed to receive deposits in Ireland and are authorised by the Central Bank are covered.

<sup>4</sup> The institutions that availed of the scheme were AIB, Anglo, Bank of Ireland, EBS, Irish Life and Permanent, INBS and Postbank Limited (the 'covered banks').

<sup>5</sup> AIB, IBRC, Bank of Ireland and Irish Life and Permanent.

**Figure 3.6 Net income from liability guarantee schemes, 2010 to 2016**

	DGS	CIFS	ELG	Total
	€bn	€bn	€bn	€bn
Fees paid to the Exchequer <sup>a</sup>	—	0.8	3.7	4.5
Claims paid by the Exchequer	—	—	(1.1)	(1.1)
Dividend from special liquidators of IBRC <sup>b</sup>	—	—	0.3	0.3
<b>Net income</b>	<b>—</b>	<b>0.8</b>	<b>2.9</b>	<b>3.7</b>

Sources: Central Bank and Department of Finance

- Notes:
- a Includes approximately €8 million in interest earned when the fees were on deposit in the Central Bank.
  - b This represents 25% of the €1.1 billion claims paid by the Exchequer. The Department of Finance pointed out that the special liquidators have stated that they expect to ultimately pay 75% to 100% of valid claims when the liquidation of IBRC is completed.

### National Asset Management Agency

- 3.25** NAMA's purpose is to acquire certain property-related bank assets (largely property loans to debtors) from Irish banks, to hold and manage the loans and related collateral and ultimately to dispose of these assets in a manner that protects the State's interests.<sup>1,2</sup>
- 3.26** NAMA paid €31.8 billion to banks to purchase property-related loans in respect of which the borrowers owed just over €74.4 billion. The loss incurred by the banks on the loans was of the order of €42.6 billion, or 57% of the loans' carrying value.
- 3.27** At the end of 2016, NAMA's financial statements reported accumulated retained earnings of just over €3 billion. It also reported an unrecognised surplus of €469 million which, if maintained, will be recognised as further surplus over NAMA's remaining life. NAMA's surplus will, when realised and paid to the Exchequer, reduce the overall cost of banking stabilisation measures.
- 3.28** NAMA has stated that the Board has approved a projected terminal surplus of up to €3 billion, and that this is subject to favourable market conditions being maintained to realise the remaining assets.

1 The banks were Anglo Irish Bank, AIB, Bank of Ireland, INBS and EBS.

2 In addition, in 2013, following a direction from the Minister for Finance, NAMA acquired from the Central Bank a loan facility deed and floating charge over certain IBRC assets for €12.9 billion in Government guaranteed bonds. The special liquidators repaid the loan facility deed in full and the bonds were redeemed, in full, in October 2014.

## Conclusions

- 3.29** By the end of 2016, the estimated net cost to the State of measures taken to stabilise the banking system was €56.5 billion. When the estimated value at that date of the State's remaining shareholdings in AIB, Bank of Ireland and Permanent TSB (a combined €13.6 billion), and NAMA's projected surplus (€3 billion) are taken into account, the estimated net outturn as at end-2016 is a cost of around €39.9 billion.
- 3.30** After taking account of the estimated residual value of the State's investments, the estimated net outturn, as at 31 December 2016, in respect of the State's level of support for each institution was
- IBRC — estimated net cost of €35.8 billion
  - AIB — estimated net cost of €7.9 billion
  - Permanent TSB — estimated net cost of €1 billion
  - Bank of Ireland — estimated net surplus of €1.8 billion.
- The projected NAMA surplus cannot be reliably apportioned to individual institutions.
- 3.31** The price achieved in the 2017 sale of 29% of the State's shareholding in AIB was 5% higher than the estimated end-2016 value, indicating an increase in the value of the total shareholding at the time of the sale of almost €600 million.
- 3.32** Many significant interventions to stabilise the banks are still playing out, and their outcomes will affect the eventual net outturn.
- 3.33** The Central Bank holdings of banking-related government bonds (including government-guaranteed bonds) has resulted in a circular movement of funds between State bodies. When the Central Bank disposes of the bonds, the net annual cost to the Exchequer of servicing the debt associated with the investments in banks will effectively increase because the interest on the bonds will then be paid to external parties, and none of this will be paid to the Central Bank.
- 3.34** In the long term, when all of the State's remaining shareholdings are sold, NAMA has realised its estimated surplus and the Central Bank has disposed of the government bonds it holds, the cost of servicing the associated long-term debt will be determined by the prevailing borrowing costs for the State — around €400 million for each percentage point incurred. For borrowing rates between 2.5% and 3.5%, it is estimated the interest cost will be between €1 billion and €1.4 billion a year for the foreseeable future. Servicing costs associated with the interventions will continue at some level until Ireland's debt level falls by around €40 billion.

### Annex 3A Outturn as at end-2016

Figure 3A.1 shows the components of the net outturn from banking stabilisation measures as at 31 December 2016 for each bank.

**Figure 3A.1 Estimated net outturn, by bank, from banking stabilisation measures as at 31 December 2016**

	AIB <sup>a</sup>	Bank of Ireland	Permanent TSB <sup>a</sup>	Trading banks — total	IBRC <sup>a</sup>	Total
	€bn	€bn	€bn	€bn	€bn	€bn
Cost of capitalising banks, through investments	(22.2)	(5.9)	(4.0)	(32.1)	(34.7)	(66.8)
Estimated cost of servicing debt associated with the investments	(5.2)	(0.7)	(0.6)	(6.5)	(8.3)	(14.8)
Disposals of investments	3.3	4.0	1.8	9.1	—	9.1
Income from investments	2.7	1.7	0.2	4.6	—	4.6
<b>Estimated net cost of capitalisation measures</b>	<b>(21.4)</b>	<b>(0.9)</b>	<b>(2.6)</b>	<b>(24.9)</b>	<b>(43.0)</b>	<b>(67.9)</b>
Fees received under liability guarantee schemes	1.8	1.5	0.7	4.0	0.5	4.5
Claims made under liability guarantee scheme	—	—	—	—	(1.1)	(1.1)
Dividend from special liquidators of IBRC	—	—	—	—	0.3	0.3
Related income from the Central Bank <sup>b</sup>	0.1	0.1	—	0.2	7.5	7.7
<b>Estimated net cost as at 31 December 2016</b>	<b>(19.5)</b>	<b>0.7</b>	<b>(1.9)</b>	<b>(20.7)</b>	<b>(35.8)</b>	<b>(56.5)</b>
Estimated residual value as at 31 December 2016 <sup>c</sup>	11.6	1.1	0.9	13.6	—	13.6
<b>Estimated net outturn as at 31 December 2016</b>	<b>(7.9)</b>	<b>1.8</b>	<b>(1.0)</b>	<b>(7.1)</b>	<b>(35.8)</b>	<b>(42.9)</b>

Source: Analysis by the Office of the Comptroller and Auditor General.

- Notes:
- a Investments in AIB include those in EBS which was acquired by AIB in July 2011. Irish Life and Permanent changed its name to Permanent TSB in May 2012. IBRC was formerly Anglo Irish Bank (Anglo) and Irish Nationwide Building Society (INBS).
  - b Around €40 million of the stabilisation-related income from the Central Bank is attributable to Permanent TSB. Due to rounding, it does not appear in Figure 3A.1.
  - c See Annex 3B for further details.

### Annex 3B Capitalisation of banks through investments

In total, the State made capital injections of €66.8 billion, net of fee income of just over €260 million, into four financial institutions and had, by the end of 2016, it had made disposals to the value of €9.1 billion (see Figure 3B.1).

**Figure 3B.1 Capitalisation of banks — investments and disposals, up to end-December 2016**

	AIB	Bank of Ireland	Permanent TSB	Trading banks — total	IBRC	Total-all Banks
	€bn	€bn	€bn	€bn	€bn	€bn
<b>Investments</b>						
Ordinary shares <sup>a</sup>	(10.8)	(3.1)	(2.3)	(16.2)	(4.1)	(20.3)
Preference shares <sup>b</sup>	(3.5)	(1.8)	—	(5.3)	—	(5.3)
Capital contribution	(6.0)	—	—	(6.0)	—	(6.0)
Contingent capital notes <sup>c</sup>	(1.6)	(1.0)	(0.4)	(3.0)	—	(3.0)
Value of promissory notes issued <sup>d</sup>	(0.3)	—	—	(0.3)	(30.6)	(30.9)
Irish Life	—	—	(1.3)	(1.3)	—	(1.3)
<b>Investments net of fee income <sup>e</sup></b>	<b>(22.2)</b>	<b>(5.9)</b>	<b>(4.0)</b>	<b>(32.1)</b>	<b>(34.7)</b>	<b>(66.8)</b>
<b>Disposals</b>						
Ordinary shares	—	1.1	0.1	1.2	—	1.2
Preference shares	1.7	1.9	—	3.6	—	3.6
Contingent capital notes	1.6	1.0	0.4	3.0	—	3.0
Irish Life	—	—	1.3	1.3	—	1.3
<b>Disposals of investments</b>	<b>3.3</b>	<b>4.0</b>	<b>1.8</b>	<b>9.1</b>	<b>—</b>	<b>9.1</b>
<b>Net investment</b>	<b>(18.9)</b>	<b>(1.9)</b>	<b>(2.2)</b>	<b>(23.0)</b>	<b>(34.7)</b>	<b>(57.7)</b>

Sources: Ireland Strategic Investment Fund and Department of Finance

- Notes:
- a Ordinary shares include dividends on preference shares received in the form of ordinary shares (AIB €1.41 billion and Bank of Ireland €0.25 billion).
  - b In March 2009, the NPRF invested €3.5 billion in preference shares in Bank of Ireland. In Quarter One 2010, a total of €1.66 billion of these shares were converted to ordinary shares (included in ordinary shares above).
  - c Contingent capital notes qualify as tier two capital. They convert to ordinary shares under certain circumstances, including if the core tier one capital ratio falls below 8.25%.
  - d The promissory notes held by IBRC were cancelled in February 2013 and exchanged between the NTMA and the Central Bank for floating rate treasury bonds totalling €25.034 billion.
  - e Fee income deducted from investments totalled around €260 million.

***Income from investments and estimated residual value of the State's investments in banks***

Total income received in respect of the investments to the end of 2016 amounted to €4.6 billion and the estimated residual value of the State's investments in banks as at 31 December 2016 was €13.6 billion (see Figure 3B.2).

**Figure 3B.2 Income from and estimated residual value of State's investments in banks, December 2016**

Income from investments	AIB	Bank of Ireland	Permanent TSB	Total
	€bn	€bn	€bn	€bn
<b><i>ISIF</i></b>				
Fee income on preference shares	0.03	0.03	—	0.06
Ordinary shares in lieu of dividends on preference shares	1.41	0.25	—	1.66
Dividends on preference shares	0.45	0.74	—	1.19
Cancellation of preference share warrants	0.05	0.49	—	0.54
<b><i>Exchequer</i></b>				
Coupon interest on contingent capital notes	0.80	0.15	0.15	1.10
Accrued dividend on sale of Irish Life	—	—	0.04	0.04
<b>Total</b>	<b>2.74</b>	<b>1.66</b>	<b>0.19</b>	<b>4.59</b>
<b>Estimated residual value of investments</b>	<b>11.6<sup>a</sup></b>	<b>1.1<sup>b</sup></b>	<b>0.9<sup>b</sup></b>	<b>13.6</b>

Sources: ISIF and Department of Finance

Notes: a The shareholding was valued, by Ernst and Young, on behalf of the ISIF.

b Valued at market prices.

### Annex 3C Estimated cost of servicing the debt associated with the State's investments

The examination has estimated the cost of servicing the debt associated with the investments, including the imputed debt service costs of NPRF investments, as at end-2016 at around €14.8 billion (see Figure 3C.1).

The methodology used to calculate the estimated cost of servicing the debt associated with each source of funding is set out in Figure 3C.2.

**Figure 3C.1 Estimated cost of servicing debt associated with the investments, 2009 to 2016 (including the imputed debt service costs of NPRF investments)**

Classified by Year						
	2009 to 2014		2015	2016	Total	
	€bn		€bn	€bn	€bn	
<b>Source of funding</b>						
Exchequer <sup>a</sup>	5.0		2.1	2.7	9.8	
NPRF/ISIF	3.7		0.7	0.6	5.0	
<b>Total</b>	<b>8.7</b>		<b>2.8</b>	<b>3.3</b>	<b>14.8</b>	

Classified by Bank						
	AIB	Bank of Ireland	Permanent TSB	Trading banks — total	IBRC	Total
	€bn	€bn	€bn	€bn	€bn	€bn
<b>Source of funding</b>						
Exchequer <sup>a</sup>	0.9	0.0 <sup>b</sup>	0.6	1.5	8.3	9.8
NPRF/ISIF	4.3	0.7	—	5.0	—	5.0
<b>Total</b>	<b>5.2</b>	<b>0.7</b>	<b>0.6</b>	<b>6.5</b>	<b>8.3</b>	<b>14.8</b>

Source: Analysis by the Office of the Comptroller and Auditor General.

- Notes:
- a Exchequer source of funding includes interest paid on promissory notes issued in 2010, interest paid on floating rate government bonds that were issued to replace the promissory notes, and premiums paid by the NTMA to repurchase floating rate notes from the Central Bank.
  - b Around €40 million was incurred in respect of Exchequer funding for Bank of Ireland. Due to rounding, this appears as zero in this table.

**Figure 3C.2 Methodologies used to estimate cost of funding investments in banks as at end-2016**

Source of funding	Method
<b>Exchequer funding</b>	<ul style="list-style-type: none"> <li>▪ For the years 2009 to 2014, the cost of funding investments was estimated using the rate of the most recent borrowing by the NTMA in the quarter in which the transactions occurred, using rates provided by the NTMA. For 2015 and 2016, the rate used was the weighted average cost of borrowing by the NTMA at the end of each year.</li> <li>▪ For disposals or income received in cash, the reductions in the cost of funding when the proceeds were received by the Exchequer were calculated using the same approach.</li> <li>▪ The cost of funding government bonds (including floating rate notes) was calculated using the rates applying to the bonds.</li> <li>▪ Premiums paid by the NTMA to redeem government bonds held by the Central Bank are treated as an expense in the year in which they are paid, and the associated income from the Central Bank is treated as income.</li> </ul>
<b>NPRF/ISIF</b>	<p>The ISIF funded its investments from its own resources. Therefore, there was no direct interest charge to the State for these investments. However, there was an opportunity or imputed cost to the State because, if the funds had not been invested in the banks, they would have been available for other purposes. Two approaches were considered by the examination as a basis for estimating the imputed cost of funding to the State.</p> <ul style="list-style-type: none"> <li>▪ The first was to estimate the opportunity cost — that is, what the ISIF would have earned if it had retained the funds to invest at its discretion. The ISIF pointed out that the assets liquidated to fund the investments in the banks were mainly liquid global assets (including debt and equity instruments), which left the Fund with an increased weighting in illiquid assets (including private equity and property). The ISIF stated that if the withdrawals had not occurred, it is reasonable to assume that the Fund would have remained invested in line with its long-term strategic asset allocation and that the Fund would have earned the same return as its long-term strategic benchmark over the period 2009 to 2014 — around 11% per annum (when the assets were held by the NPRF). In 2015 and 2016, the ISIF earned an average return of just under 3% per annum.</li> <li>▪ The second was to estimate the cost of the funds at the Exchequer's cost of borrowing, on the basis that if the funds had been available to the Exchequer, State borrowing could have been reduced by the cost of the investments made by the NPRF (€20.7 billion). The imputed interest cost has been calculated, by the examination, as the interest incurred by the State on the borrowings that could have been avoided if the NPRF funds has been available to the State for purposes other than investing in banks.</li> </ul> <p>The second approach (which gave a significantly lower cost of funding than the first approach) was used by the examination.</p>

### Annex 3D Liability guarantee schemes

Certain liabilities of banks were guaranteed by the State under three main schemes — a Deposit Guarantee Scheme, the Credit Institutions (Financial Support) Scheme and the Eligible Liabilities Guarantee Scheme.

#### *Deposit Guarantee Scheme*

The Deposit Guarantee Scheme guarantees eligible deposits up to €100,000 per depositor in any bank, building society or credit union licensed to receive deposits in Ireland and authorised by the Central Bank.<sup>1</sup>

Banks, including credit unions with effect from 30 November 2012, subject to the provisions of the scheme were required to deposit funds to the value of 0.2% of their total deposits in a Deposit Protection Account administered by the Central Bank. Any claims of depositors under the scheme would be met in the first instance from the resources of the Deposit Protection Account and any residual shortfall would then be met from the Central Fund of the Exchequer which would be recouped in due course from the banking sector.

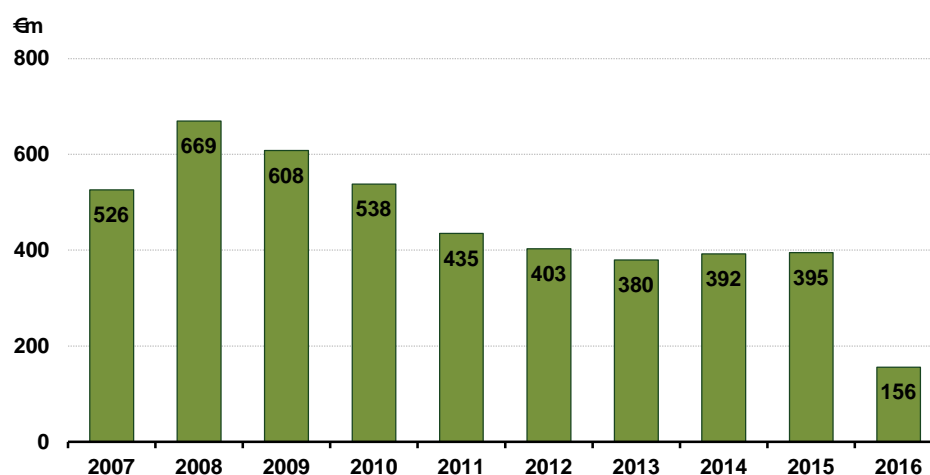
At the end of 2015, regulations introduced new funding requirements for the Deposit Guarantee Scheme resulting in the establishment of the Deposit Guarantee Scheme Contributory Fund (DGS Contributory Fund), to replace the Deposit Protection Account.<sup>2</sup> The DGS Contributory Fund must reach a target level of 0.8% of covered deposits by 2024. The first annual contributions by credit institutions to the DGS Contributory Fund were collected at the end of 2016 totalling €93 million.

In order to assist in the smooth transition from the Deposit Protection Account to the DGS Contributory Fund and to ensure sufficient funding is available for Deposit Guarantee Scheme purposes during this time, legislation provided for the transfer of 0.2% of covered deposits (€179 million) from the Deposit Protection Account to the Deposit Guarantee Scheme Legacy Fund in early 2016. Residual balances in the Deposit Protection Account of €217 million were returned to credit institutions at this time.

At the end of 2016, 25 banks and building societies and 313 credit unions were subject to the provisions of the scheme. The balance in the Deposit Guarantee Accounts at that date was €156 million (see Figure 3D.1).

<sup>1</sup> Financial Services (deposit guarantee scheme) Act 2009.

<sup>2</sup> Directive 2014/49/EU on deposit guarantee schemes was transposed into Irish Law by the European Union (deposit guarantee schemes) Regulations.

**Figure 3D.1 Deposit Guarantee Scheme account balances at year-end 2007 to 2016<sup>a</sup>**

Source: Central Bank Statement of Accounts 2007 to 2016.

Note: a From 2007 to 2015 inclusive, the funds were held in the Deposit Protection Account. At end-2016, the funds were held in the Deposit Guarantee Scheme Contribution Fund (€93 million) and the Deposit Guarantee Scheme Legacy Fund (€63 million).

Payments, totalling €71 million, were made under the schemes to eligible depositors subsequent to the liquidations of IBRC (€37.3 million)<sup>1</sup>, Berehaven Credit Union (€11 million)<sup>2</sup> and Rush Credit Union (€22.7 million)<sup>3</sup>. The payments were met from the Deposit Protection Account and Deposit Guarantee Scheme Funds, and no call was made on Exchequer funds.

1 €25 million paid in 2013, €11 million paid in 2014, €1.2 million paid in 2015 and €0.1 million paid in 2016.

2 Berehaven Credit Union was liquidated in July 2014.

3 Rush Credit Union was liquidated in November 2016.

4 The legal basis for the scheme was provided through the Banks (Financial Support) Act 2008, which was signed into law on 2 October 2008. The institutions that availed of the scheme were AIB, Anglo, Bank of Ireland, EBS, Irish Life and Permanent, INBS and Postbank Ireland Limited (the 'covered banks').

### **CIFS Bank Guarantee Scheme**

The Credit Institutions (Financial Support) Scheme (the CIFS Bank Guarantee Scheme), which operated from September 2008 to September 2010, provided a guarantee for a broad range of bank liabilities for seven covered institutions that opted to avail of the scheme.<sup>4</sup>

The CIFS Bank Guarantee Scheme expired on 29 September 2010 and any liabilities that had not transferred to the Eligible Liabilities Guarantee Scheme by that date no longer benefited from a Government guarantee.

The covered institutions were required to make payments for the protection provided under the scheme. As a result, just over €759 million was received from the banks and almost €4.6 million in interest was earned on the balances held. After the expiry of the scheme, the total amount raised was paid over to the Exchequer as no claims had been made.

### Eligible Liabilities Guarantee Scheme

The Eligible Liabilities Guarantee Scheme (ELG scheme) came into effect in December 2009. It was designed to provide a longer-term guarantee of certain banking liabilities. The scheme is administered by the NTMA on behalf of the Minister.

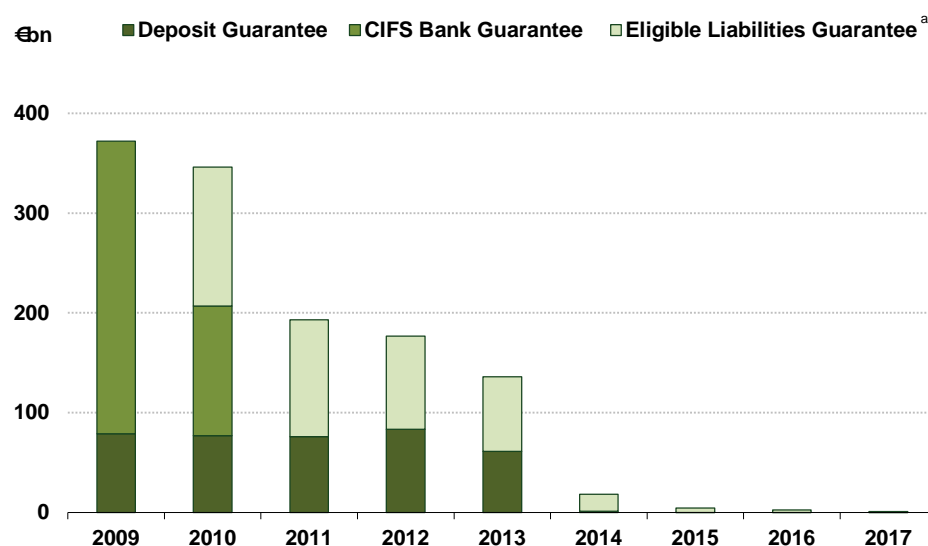
The four institutions participating in the ELG scheme pay a fee for the cover they receive.<sup>1</sup> Fee payments are made into a designated account at the Central Bank and are paid quarterly to the Exchequer in arrears. Fees collected from the institutions to the end of December 2016 amounted to just over €3.7 billion with interest earned on the account totalling €3.28 million. The total has been paid over in full to the Exchequer.

On 26 February 2013, the Minister announced the closure of the scheme to all new liabilities with effect from midnight on 28 March 2013. Amounts covered by the scheme when it closed totalled €74.6 billion, but have reduced to €1.1 billion by March 2017 (see Figure 3D.2).

#### Claims under the scheme

A number of claims under the scheme were made following the liquidation of IBRC in February 2013. Total claim payments at 31 December 2016 were €1,081 million — €934 million in respect of bonds and €147 million for deposits.

**Figure 3D.2 Guaranteed liabilities of four covered institutions<sup>1</sup>, March 2009 to March 2017**



<sup>1</sup> The four institutions participating in the ELG scheme were AIB, IBRC, Bank of Ireland and Irish Life and Permanent.

Source: Department of Finance

Note: a From October 2016, no Bank of Ireland liabilities are covered by the Eligible Liabilities Guarantee.

