3 Cost of Banking Stabilisation Measures as at end-2014

3.1 Following the onset of the financial crisis in 2008, the State undertook a number of measures to stabilise the banking system. The initial responses to the crisis, in late 2008 and 2009, focused on liquidity support by the Central Bank of Ireland and State guarantees for bank liabilities. Some of these measures gave rise to significant contingent liabilities for the State.

3.2 Measures taken since 2008 include the provision by the Central Bank of 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.

3.3 The purpose of this report is to provide an estimate, as at end-2014, of the financial cost of the banking stabilisation measures taken by the State. The report also outlines the extent of consultancy costs incurred in respect of banking stabilisation activities and the costs incurred in respect of the shareholding management unit of the Department of Finance (the Department), which has responsibility for managing the State's investments in the banks.

Overview of Costs

3.4 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 interest in banking assets. It should also be noted that the estimates are at a point in time, and will change – the State's shareholdings in banks may rise or fall in value in the future, and the cost of servicing the debt used to fund the investments will continue to accrue for many years to come.

3.5 The examination analysis has estimated that the net cost to the State from banking stabilisation measures up to end-2014 was around €60 billion. The estimated value at 31 December 2014 of the State's investments in banks was around €17 billion, resulting in a net outturn for the State of around €43 billion (see Figure 3.1). The long-term annual recurring cost to the State of servicing the debt associated with these investments will be determined by the level of interest rates, in particular, the State's cost of borrowing.[1]

3.6 In addition, at the end of 2014

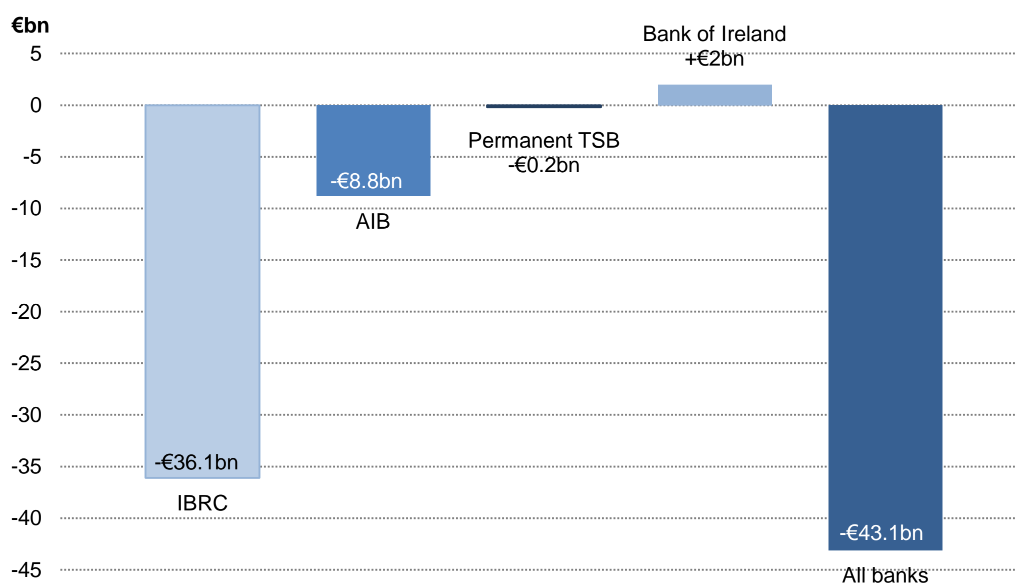
- NAMA had reported accumulated losses of €126 million. NAMA has, however, indicated that it anticipates making a surplus of up to €1 billion when it is wound up.
- Payments of around €152 million in respect of consultancy services had been made by the Central Bank, the National Treasury Management Agency (NTMA), the Department and the National Pensions Reserve Fund (NPRF).
- Since August 2011, approximately €7.6 million had been incurred in operating a dedicated banking and shareholding management unit in the Department.

1 Other factors that will determine the long-term debt servicing cost include the amount the State realises for its remaining investments and the period for which the Central Bank continues to hold government bonds.

Figure 3.1 Estimated net outturn from banking stabilisation measures as at 31 December 2014

	€ billion	€ billion
Cost of capitalising banks (investments)		**66.8**
Estimated cost of servicing debt (to end December 2014) [a]		**8.7**
Less income arising from:		
Disposals of investments	(5.3)	
Income from investments	(3.8)	
Net income from liability guarantee schemes	(3.3)	
Estimated related income from the Central Bank [b]	(3.3)	**(15.7)**
Estimated net cost to the State from banking stabilisation measures as at 31 December 2014		**59.8**
Estimated residual value of investments at 31 December 2014		**(16.7)**
Estimated net outturn to the State from banking stabilisation measures as at 31 December 2014		**43.1**
Estimated annual cost of servicing the debt [c]		***0.85 – 1.7***

Estimated net outturn by bank as at end-2014



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

Notes:
a The estimated cost of servicing the debt associated with the investment in banks includes the imputed debt service costs of investments made by the NPRF.
b The examination has estimated the portion of the Central Bank's surplus income that is attributable to banking stabilisation measures.
c Range assuming interest rates of 2% to 4% per year; actual cost will be determined by State's cost of borrowing.

Capitalisation of Banks

3.7 The investments of €66.8 billion were funded through

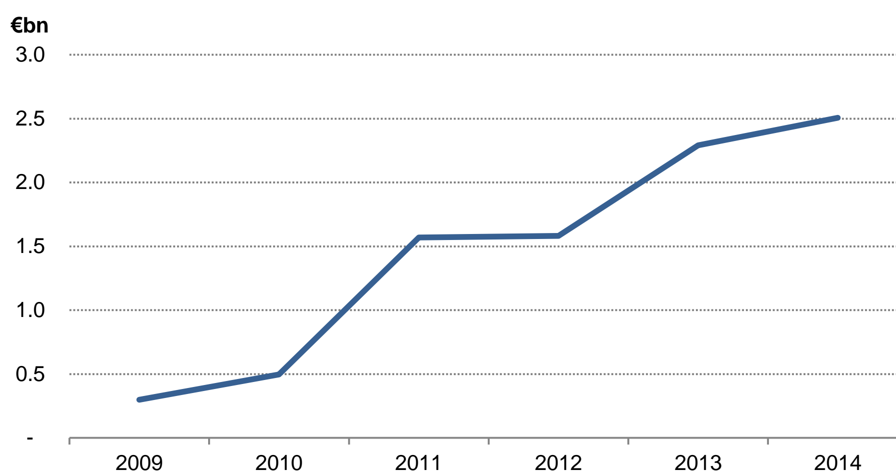
- the Exchequer – €44.4 billion, including €30.85 billion in the form of promissory notes. In February 2013, following the appointment of special liquidators to IBRC, promissory notes to the value of €25.034 billion which were held by the Central Bank as collateral for lending to IBRC were replaced by government bonds
- the NPRF – €22.4 billion, including re-investment of €1.7 billion in ordinary shares received in lieu of dividends on preference shares.

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

Debt Service Costs

3.9 In addition to the capital cost of the investments, the State bears the annual debt service costs associated with them. The examination has estimated the debt service cost to the State associated with the investments (including the imputed debt service costs of investments made by the NPRF) was around €8.7 billion in total for the period 2009 to 2014 (see Figure 3.2).

Figure 3.2 Estimated debt service costs associated with the State's investments in banks, 2009 to 2014



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

3.10 The estimated debt service costs comprise two elements

- the interest costs incurred in respect of borrowings to fund cash investments by the Exchequer, promissory notes issued by the Minister for Finance and government bonds issued by the NTMA, and
- the imputed interest costs of the funding used by the NPRF in its investments (see Figure 3.3).

Figure 3.3 Investments by NPRF – imputed debt service costs

The NPRF funded its investments from its own resources. Therefore, there was no direct interest charge to the State for these investments. However, if the NPRF funds (approximately €20.7 billion cash investment) had not been invested in the banks, either the NPRF would have invested the funds to earn a return or the funds could have been available to the State and used as an alternative to borrowing for other purposes. Thus, 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 NPRF funds had been available to the State for purposes other than investing in banks.

3.11 Interest on the national debt, together with interest payments on promissory notes, for the period 2009 to 2014 was around €31.7 billion. The €8.7 billion estimated cost of servicing the debt associated with investments to end-2014 (including the imputed debt service costs of the NPRF investments) represents almost 28% of this.

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

Banking Stabilisation Related Income from the Central Bank

3.13 The Central Bank may retain up to 20% of its surplus income annually, thereby increasing its reserves.[1] It pays the balance to the Exchequer in the form of an annual dividend, in the year subsequent to the year in which the income was earned.

3.14 For the years 2009 to 2014, the examination has estimated that around €4.1 billion of the Central Bank's surplus income was attributable to financial instruments held as a result of banking stabilisation measures taken by the State, of which €3.3 billion was paid to the State in the form of dividends (see Figure 3.4). This represented 52% of the total dividends (€6.4 billion) paid by the Central Bank over this period.

Figure 3.4 Estimate of Central Bank dividend attributable to transactions in respect of banking stabilisation measures, 2009 to 2014

	Net interest income	Gains on disposal of bonds	Total	80% included in dividends paid to State
	€bn	€bn	€bn	€bn
Exceptional liquidity assistance [a]	1.89	–	1.89	1.51
Government bond, or Government-guaranteed bonds, held by the Central Bank[b]	1.48	0.74	2.22	1.78
Total	**3.37**	**0.74**	**4.11**	**3.29**

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 and bonds issued to replace promissory notes to the value of €25.034 billion when IBRC was liquidated.

1 The Central Bank Commission determines the amount of surplus income to be retained annually. For each year from 2008 to 2014, the Central Bank retained 20% of its surplus income.

3.15 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 was related to IBRC. In total, an estimated 95% of the €3.3 billion portion of the Central Bank's dividends to the State for the years 2009 to 2014 that arises from banking stabilisation measures is attributable to transactions between the Central Bank and IBRC (see Figure 3.5).

Figure 3.5 Amount of Central Bank dividend for the years 2009 to 2014 attributable to banking stabilisation measures, by bank

	AIB	Bank of Ireland	Permanent TSB	IBRC	Total
	€bn	€bn	€bn	€bn	€bn
Dividend attributable to banking stabilisation measures	0.05	0.08	0.04	3.12	**3.29**

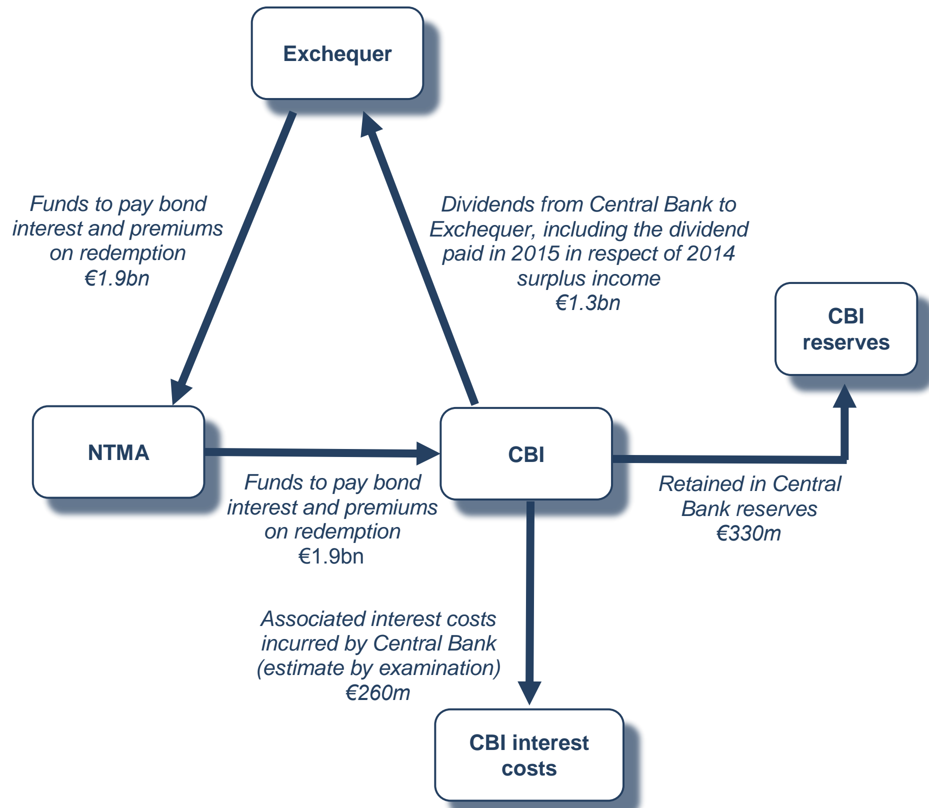
Source: Analysis by the Office of the Comptroller and Auditor General.

3.16 For the years 2009 to 2014, the Central Bank's reserves increased by €1.36 billion from €1.32 billion to €2.68 billion. The examination estimated that around €820 million of this is due to net income that the Central Bank has retained from transactions in respect of banking stabilisation measures (€380 million in respect of interest earned on exceptional liquidity assistance and €440 million in respect of interest and gains on government bonds).

3.17 The interest on the bonds held by the Central Bank is paid by the NTMA, from Exchequer funds. In addition, in 2014, the NTMA repurchased some of the bonds from the Central Bank at a premium, generating a gain of €180 million for the Central Bank.

3.18 A significant proportion (estimated by the examination at almost 70%) 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 3.6.

Figure 3.6 IBRC-related bonds held by Central Bank – flow of funds from/to Exchequer, 2013 and 2014[a]



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

Note: a In addition, the Central Bank realised a further €562 million from the disposal of IBRC-related bonds on the open market. These funds did not come from the Exchequer.

Government Bonds held by the Central Bank

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

- Floating rate bonds with a nominal value of €25.034 billion with maturities ranging from 25 to 40 years, issued to replace promissory notes.
- A 5.4% Irish 2025 government bond with a nominal value of €3.5 billion.

3.20 During 2013 and 2014, the Central Bank realised gains of almost €743 million from the disposal of some of these bonds.

- €180 million of the gains arose from a disposal back to the NTMA of floating rate bonds with a nominal value of €500 million.
- €562 million of the gains arose from disposals to the open market of €2.65 billion nominal value of the 5.4% government bonds.

3.21 In addition, the Central Bank acquired other assets, including NAMA bonds, as a result of the liquidation of IBRC.

3.22 At the end of 2014, the Central Bank reported unrealised gains of €9.4 billion on the remaining bonds that it held at that date – €9.1 billion in respect of the floating rate notes and almost €300 million in respect of the 5.4% Irish 2025 government bond. The gains arose because the yield on government bonds was lower at the time of disposal (realised gains), and at the end of the year for the remaining bonds (unrealised gains), than when the Central Bank acquired the bonds.

3.23 The Central Bank stated in its 2014 annual report that it intends to sell the combined portfolio of the floating rate bonds and the 5.4% bond 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: 2015-2018 (€0.5 billion per annum), 2019-2023 (€1 billion per annum), and 2024 on (€2 billon per annum until all bonds are sold).

3.24 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 increase because the interest on the bonds will then be paid to external parties and none of this will be repaid to the Exchequer in the form of surplus income generated by the Central Bank.

3.25 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 bonds are sold 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.[1] 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. This higher rate of interest is offset for the State by the Central Bank's gain on disposal.

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.

3.26 The disposal by the Central Bank of the bonds will result in an increase in the net cost to the Exchequer because interest that had been previously paid to the Central Bank (and either returned to the Exchequer or retained by the Central Bank in its reserves) will become payable to a third party.

3.27 The Central Bank pointed out that the State would not necessarily benefit from a delay in disposal of the bonds. It has indicated that it will not hold the bonds to maturity so they will have to be refinanced at some point, and delayed sales or refinancing may involve larger net servicing costs in the long run, depending on future interest rate movements.

Liability Guarantee Schemes Income

3.28 The State guaranteed certain bank liabilities under three main schemes

- the Deposit Guarantee Scheme (DGS) under which deposits by individuals in covered credit institutions[1] are guaranteed to a limit of €100,000 per eligible depositor per institution. 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. The credit institutions were required to make payments for the protection provided under the scheme.[2]
- 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.[3]

3.29 By the end of 2014, the State had received net income of around €3.3 billion under the schemes – €4.4 billion had been received in fees and almost €1.1 billion had been paid in claims (see Figure 3.7). Further detail on each scheme is set out in Annex D.

Figure 3.7 Net income from liability guarantee schemes, 2010 to 2014

	DGS €bn	CIFS €bn	ELG €bn	Total €bn
Fees paid to the Exchequer [a]	–	0.8	3.6	4.4
Claims paid by the Exchequer	–	–	(1.1)[b]	(1.1)
Net income	**–**	**0.8**	**2.5**	**3.3**

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 The Department stated that the €1.1 billion paid under the ELG scheme is expected to be recovered when the liquidation of IBRC is completed.

Ongoing Debt Servicing Costs and Income from 2015

3.30 At the end of 2014, the Exchequer continues to incur the cost of servicing the debt associated with the €60 billion cost of the investments in the banks. The examination estimated that this cost is likely to be around €2.3 billion for 2015. The bulk of this is in respect of IBRC (around €1.2 billion) and AIB (around €0.9 billion).[4]

1 Only institutions that are licensed to receive deposits in Ireland and are authorised by the Central Bank are covered.

2 The institutions that availed of the scheme were AIB, Anglo, Bank of Ireland, EBS, Irish Life and Permanent, INBS and Postbank Limited (the ’covered institutions’).

3 AIB, IBRC, Bank of Ireland and Irish Life and Permanent.

4 The ongoing annual costs of funding for the other two banks are estimated at around €60 million for Bank of Ireland and €100 million for Permanent TSB.

3.31 Around a third of the estimated annual debt servicing costs for 2015 are in respect of the government bonds held by the Central Bank, which currently holds most of the bonds that were issued by the State following the liquidation of IBRC. The cost of servicing the debt associated with the investments will be partially offset by surplus income paid to the Exchequer by the Central Bank from the interest it earns from these bonds, and from any gains on disposals.

3.32 In addition, the State continues to receive some fees in respect of liabilities that are covered under the ELG scheme – these have fallen significantly in 2013 and 2014.

3.33 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 for its remaining investments. As further disposals of the investments are made by the State, the debt associated with the investments will fall. If the State realises the estimated value of the remaining investments as at end-2014 (€16.7 billion), it will thereafter incur the cost of servicing around €43 billion of debt in the long-term. The amount to be funded may vary from this, if the disposal value of the remaining investments is greater or less than the end-2014 valuations
- 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.

3.34 In the long-term, the cost of servicing the debt associated with the investments is projected to be around €430 million annually (if €17 billion is realised for the remaining investments) for each percentage point that the State pays on its debt. For example, at rates of 2% and 4%, the cost of servicing the debt would be between around €850 million and €1.7 billion annually.

National Asset Management Agency

3.35 NAMA's purpose was 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.[1]

3.36 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.

3.37 NAMA's financial statements from 2010 to 2014 report accumulated losses of €126 million. NAMA has, however, indicated that it anticipates making a surplus of approximately €1 billion when it is wound up.

Cost of Consultancy Services

3.38 The State, through the Central Bank, the NTMA, the Department and the NPRF has used the services of advisors extensively in the course of developing and implementing the measures aimed at stabilising the banking sector.

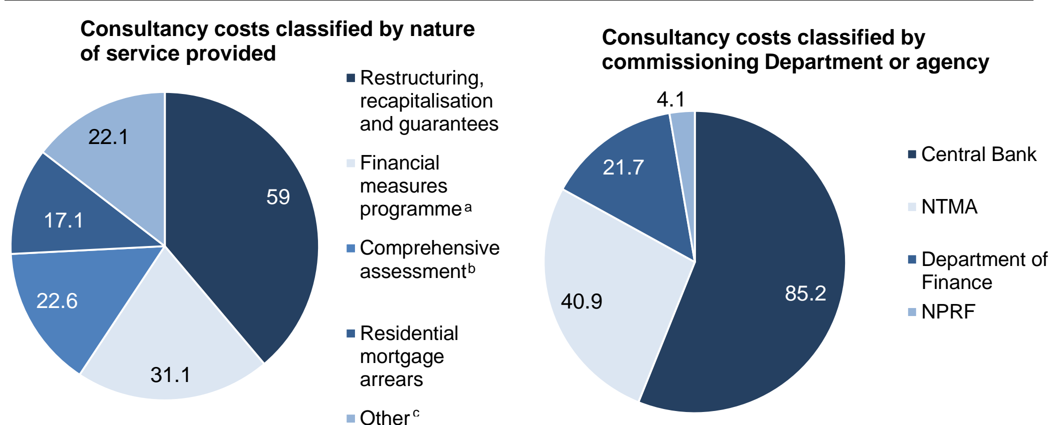
1 The banks were Anglo, AIB, Bank of Ireland, INBS and EBS.

3.39 By the end of 2014, these services had cost almost €152 million. The Department also pointed out that, where appropriate, it receives advice from firms on a pro bono basis.

3.40 Figure 3.8 sets out the consultancy costs incurred, classified by the nature of the service provided and by the commissioning Department or agency. Four firms accounted for 60% of this expenditure – Arthur Cox (€33.1 million), Blackrock Financial Management (€23.5 million), Ernst and Young (€20.9 million) and KPMG (€13.2 million).

3.41 Details of payments made classified by the year in which they were incurred and of the payments made to consultants are set out in Annex E.

Figure 3.8 Payments for consultancy services classified by nature of service and by commissioning body, 2008 to 2014 (€ millions)



Sources: Central Bank, NTMA, Department of Finance and the NPRF.

Notes:

a The Central Bank financial measures programme was a review of the capital and funding assessments of the domestic Irish banks.

b The European Central Bank's comprehensive assessment, incorporating asset quality reviews and stress tests, assessed the financial position of banks in advance of the introduction of the Single Supervisory Mechanism in November 2014.

c Other includes advice of a general nature (€10.0 million) and advice in respect of credit unions (€4.2 million), NAMA (€2.9 million), crisis management (€2.5 million), bank nationalisation (€2.0 million), the banking crisis inquiry (Nyberg) (€0.4 million) and liquidity assistance (€0.1 million).

3.42 The Department stated that it has concluded processes to appoint panels of both financial and legal advisors to assist in matters such as the future sale of the State's bank investments and other assignments that may arise from time to time. The list of the firms on each panel is set out in Annex E.

3.43 The Central Bank and the NTMA pointed out that they recover a large proportion of the consultancy costs from the banks, while the Department states that it also recovers some of the costs.

Shareholding Management Unit

3.44 The NTMA banking unit was seconded to the Department on 5 August 2011 resulting in the creation of a new stand alone shareholding management unit.

3.45 The shareholding management unit is responsible for managing the Minister for Finance's shareholdings in the banking sector and in NAMA, and represents the Minister's interests in relation to the oversight of NAMA, the credit unions and the liquidation of IBRC.

3.46 The cost of operating the unit from inception to the end of 2014 was €7.6 million. At present, there are approximately 20 Department and NTMA staff employed in the unit. The Department pointed out that staff employed in the unit have a wide range of banking, capital markets, corporate finance and legal expertise.

Conclusions

3.47 By the end of 2014, the estimated net cost to the State of measures taken to stabilise the banking system was just under €60 billion. Net investments (after disposals) of just over €61 billion and estimated debt servicing costs associated with the investments of almost €9 billion were offset by net income totalling just over €10 billion from the investments, liability guarantee schemes and associated dividends from the Central Bank.

3.48 At the end of 2014, the estimated value of the State's remaining shareholdings in AIB, Bank of Ireland and Permanent TSB was €16.7 billion. When these shareholdings are taken into account, the estimated net outturn as at end-2014 was a cost of just over €43 billion.

3.49 The total net cost will continue to grow each year because the State will incur the cost of servicing the associated debt – estimated at around €2.3 billion for 2015. This will be offset by income earned by the Central Bank on IBRC-related government bonds while the Central Bank continues to hold those bonds.

3.50 In the long term, when all of the State's remaining shareholdings are sold 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 €430 million for each percentage point incurred. For borrowing rates between 2% and 4%, it is estimated the annual interest cost will be between €850 million and €1.7 billion.

3.51 The estimated net outturn does not take account of any return that the State might obtain from NAMA or of any residual value in IBRC that may accrue to the State. NAMA has indicated that it expects to achieve a surplus of around €1 billion by the time it is wound up.

Exchequer Income from the Central Bank

3.52 It is estimated that around €3.3 billion of the total annual dividends paid to the Exchequer by the Central Bank for the years 2009 to 2014 is attributable to banking stabilisation measures – €1.5 billion in respect of exceptional liquidity assistance provided to banks and €1.8 billion in income and gains from government bonds held by the Central Bank.

3.53 The Central Bank holdings of banking-related government bonds (including Government-guaranteed bonds) has resulted in a circular movement of funds between State bodies. The NTMA paid around €1.9 billion to the Central Bank in 2013 and 2014, of which around €1.3 billion was returned to the Exchequer as part of the Central Bank's annual dividend. The Central Bank retained a further €330 million as reserves.

Outturn for Individual Banks

3.54 There are significant differences between the individual banks in the level of State support provided. After taking account of the estimated residual value of the State's investments and allocation of income and costs, the estimated State outturn, as at 31 December 2014, in respect of each institution was

- IBRC – estimated net cost of €36.1 billion
- AIB – estimated net cost of €8.8 billion
- Permanent TSB – estimated net cost of €0.2 billion
- Bank of Ireland – estimated net surplus of €2 billion.

3.55 The ongoing costs of servicing the debt associated with the investments are largely attributable to the measures taken to recapitalise IBRC and AIB.

- An estimated €1.2 billion will be incurred in respect of IBRC in 2015, although this will be offset by income from the Central Bank as it holds most of the IBRC-related government bonds.
- Approximately €0.9 billion will be incurred in respect of AIB.
- Less than €0.2 billion, in total, will be incurred in respect of Bank of Ireland and Permanent TSB.

Annex A Outturn as at end-2014

Figure 3.9 shows the components of the net outturn from banking stabilisation measures as at 31 December 2014 for each bank.

Figure 3.9 Estimated net outturn, by bank, from banking stabilisation measures as at 31 December 2014

	AIB[a]	**Bank of Ireland**	**Permanent TSB**[a]	***Trading banks – total***	**IBRC**[a]	**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	*(3.7)*	*(0.7)*	*(0.4)*	*(4.8)*	*(3.9)*	*(8.7)*
Disposals of investments	–	*4.0*	*1.3*	*5.3*	–	*5.3*
Income from investments	*2.0*	*1.6*	*0.2*	*3.8*	–	*3.8*
Estimated net cost of capitalisation measures	(23.9)	(1.0)	(2.9)	*(27.8)*	(38.6)	(66.4)
Fees received under liability guarantee schemes	1.7	1.5	0.7	*3.9*	0.5	4.4
Claims made under liability guarantee scheme	–	–	–	–	(1.1)	(1.1)
Related income from the Central Bank [b]	0.1	0.1	–	*0.2*	3.1	3.3
Estimated net cost as at 31 December 2014	***(22.1)***	***0.6***	***(2.2)***	***(23.7)***	***(36.1)***	***(59.8)***
Estimated residual value as at 31 December 2014[c]	13.3	1.4	2.0	*16.7*	–	16.7
Estimated net outturn as at 31 December 2014	**(8.8)**	**2.0**	**(0.2)**	***(7.0)***	**(36.1)**	**(43.1)**

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

Notes: a Investments in Allied Irish Banks plc (AIB) include those in the Educational Building Society (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 related income from the Central Bank is attributable to Permanent TSB. Due to rounding, it does not appear in Figure 3.9.

c See Annex B for further details.

Annex B 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 2014, made disposals to the value of €5.3 billion (see Figure 3.10).

Figure 3.10 Capitalisation of banks – investments and disposals, December 2014

	AIB	Bank of Ireland	Permanent TSB	*Trading banks - total*	IBRC	Total
Investments	**€bn**	**€bn**	**€bn**	***€bn***	**€bn**	**€bn**
Ordinary shares [a]	(10.8)	(3.1)	(2.3)	(16.2)	(4.1)	(20.3)
Preference shares [b]	(3.5)	(1.8)	–	(5.3)	–	(5.3)
Capital contribution	(6.0)	–	–	(6.0)	–	(6.0)
Contingent capital notes [c]	(1.6)	(1.0)	(0.4)	(3.0)	–	(3.0)
Value of promissory notes issued [d]	(0.3)	–	–	(0.3)	(30.6)	(30.9)
Irish Life	–	–	(1.3)	(1.3)	–	(1.3)
Investments net of fee income [e]	**(22.2)**	**(5.9)**	**(4.0)**	**(32.1)**	**(34.7)**	**(66.8)**
Disposals						
Ordinary shares	–	1.1	–	1.1	–	1.1
Preference shares	–	1.9	–	1.9	–	1.9
Contingent capital notes	–	1.0	–	1.0	–	1.0
Irish Life	–	–	1.3	1.3	–	1.3
Disposals of investments	**–**	**4.0**	**1.3**	**5.3**	**–**	**5.3**
Net investment	**(22.2)**	**(1.9)**	**(2.7)**	**(26.8)**	**(34.7)**	**(61.5)**

Sources: NPRF 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 two 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 State's Investments in Banks

Total income received in respect of the investments to the end of 2014 amounted to €3.8 billion and the estimated residual value of the State's investments in banks as at 31 December 2014 was €16.7 billion (see Figure 3.11).

Figure 3.11 Income from and estimated residual value of State's investments in banks, December 2014

Income from investments	AIB	Bank of Ireland	Permanent TSB	Total
	€bn	€bn	€bn	€bn
NPRF				
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	–	0.74	–	0.74
Cancellation of preference share warrants	0.05	0.49	–	0.54
Exchequer				
Coupon interest on contingent capital notes	0.48	0.15	0.12	0.75
Accrued dividend on sale of Irish Life	–	–	0.04	0.04
Total	**1.97**	**1.66**	**0.16**	**3.79**

Estimated residual value of investments	Valuation
Bank	**€bn**
IBRC [a]	–
AIB [b]	13.3
Bank of Ireland [c]	1.4
Permanent TSB [d]	2.0
Total	**16.7**

Sources: NPRF and Department of Finance.

Notes:
a The Department stated that it considers the outstanding investment in IBRC to be irrecoverable.

b Equity (€7.2 billion), preference shares (€4.6 billion) and contingent capital notes (€1.6 billion), The figures do not tot to €13.3 billion due to rounding. The equity and preference shares were valued, by Ernst and Young, on behalf of the Ireland Strategic Investment Fund (ISIF). The assets of the NPRF transferred to the ISIF in December 2014. The contingent capital notes were valued at cost.

c The equity held in Bank of Ireland (€1.4 billion) was valued at market prices.

d Equity (€1.6 billion) and contingent capital notes (€0.4 billion). The State made an equity investment of €2.3 billion in Permanent TSB. This investment has not been valued since then. No such valuation was required for Government accounting purposes. In 2015, Permanent TSB conducted a capital raising exercise in which the State did not participate. Following this exercise, Permanent TSB requested the Minister for Finance to sell part of its shareholding in order to reduce the State's share of the enlarged share capital to 75% to facilitate a main market listing on the Irish and London stock exchanges. The State received €97 million for the disposal. The Department estimated that the value of the State's remaining equity investment is €1.5 billion based on market prices in August 2015. On the basis of the disposal in May and this estimated valuation, the residual value of the equity as at end-2014 is €1.6 billion. The contingent capital notes were valued at cost.

Annex C 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-2014 as around €8.7 billion (see Figure 3.12).

Figure 3.12 Estimated cost of servicing debt associated with the investments, 2009 to 2014 (including the imputed debt service costs of NPRF investments)

Classified by Year

	2009	2010	2011	2012	2013	2014	Total
Source of funding	**€bn**	**€bn**	**€bn**	**€bn**	**€bn**	**€bn**	**€bn**
Exchequer	0.08	0.17	0.35	0.72	0.75	0.74	2.81
Promissory notes	–	–	0.57	0.01	0.01	0.01	0.60
Floating rate notes [a]	–	–	–	–	0.67	0.95	1.62
NPRF	0.22	0.33	0.65	0.84	0.86	0.81	3.71
Total	**0.30**	**0.50**	**1.57**	**1.57**	**2.29**	**2.51**	**8.74**

Classified by Bank

	AIB	Bank of Ireland	Permanent TSB	*Trading banks – total*	IBRC	Total
Source of funding	**€bn**	**€bn**	**€bn**	***€bn***	**€bn**	**€bn**
Exchequer	0.61	0.04	0.39	*1.04*	1.77	2.81
Promissory notes	0.05	–	–	*0.05*	0.55	0.60
Floating rate notes	–	–	–	–	1.62	1.62
NPRF	3.02	0.69	–	*3.71*	–	3.71
Total	**3.68**	**0.73**	**0.39**	***4.80***	**3.94**	**8.74**

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

Note: a The cost of funding the floating rate notes includes premiums paid by the NTMA to repurchase some of these notes from the Central Bank.

Promissory Notes

Promissory notes were issued to EBS (€250 million) and IBRC (€30.6 billion) in 2010. By the end of 2014, the State had made capital repayments of €49 million in respect of the promissory notes issued to EBS, in addition to interest of €51 million, leaving a balance of €201 million. A further payment in 2015 reduced the balance to €187 million.

In respect of the promissory notes issued to IBRC

- the interest charge in respect of 2010 was €554 million. Under the terms of the notes, no interest was charged for 2011 or 2012
- by the end of 2012, the State had made promissory note payments of €6.12 billion, in the form of government bonds to the value of €3.06 billion and cash of €3.06 billion, leaving a net balance of just over €25 billion
- when joint special liquidators were appointed to IBRC in February 2013, the remaining promissory notes, which were held by the Central Bank as collateral for lending to IBRC at that time, were replaced with government bonds to the value of €25 billion. These bonds were issued by the NTMA to the Central Bank.

Bonds Issued to Replace Promissory Notes

Floating rate bonds with a nominal value of €25 billion were issued by the NTMA to the Central Bank with maturities ranging from 25 to 40 years. The rate of interest on the bonds is based on the 6-month Euribor interest rate plus a fixed margin averaging 2.62% across the eight issues.

In 2014, the Central Bank sold €500 million of these bonds back to the NTMA. Due to the drop in the cost of borrowing, the value of the bonds had increased and the Central Bank made a gain of €180 million on the disposal.

The methodology used to calculate the estimated cost of servicing the debt associated with each source of funding is set out in Figure 3.13.

Figure 3.13 Methodologies used to estimate cost of funding investments in banks as at end-2014

Source of funding	Method
Exchequer funding	▪ 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 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.
Promissory notes	▪ The cost of funding the promissory notes is the amount of interest paid by the State.
Government bonds	▪ The cost of funding government bonds (including floating rate notes) was calculated using the rates applying to the bonds.
NPRF	The NPRF 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. ▪ The first was to estimate the opportunity cost – that is, what the NPRF would have earned if it had retained the funds to invest at its discretion. The NPRF 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 NPRF 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. ▪ 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 had been available to the State for purposes other than investing in banks. For disposals or income received in cash, the reductions in the cost of funding when the proceeds were received by the NPRF were calculated using the same approach. The second approach (which gave a significantly lower cost of funding than the first approach) was used by the examination.

Annex D 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.

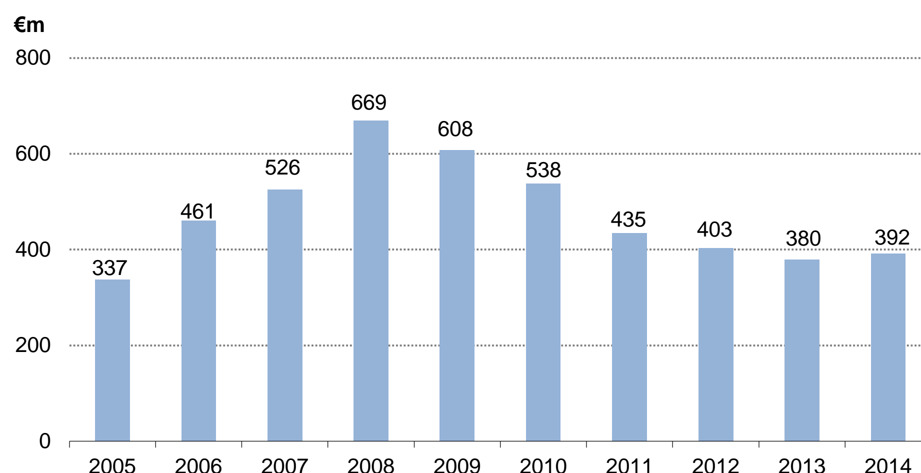
Deposit Guarantee Scheme

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.[1]

Banks, including credit unions with effect from 30 November 2012, subject to the provisions of the scheme are 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 2014, 32 banks and building societies and 377 credit unions were subject to the provisions of the scheme. The balance in the Deposit Protection Account at that date was €392 million (see Figure 3.14).

Figure 3.14 Deposit protection account balance at year-end 2005 to 2014



Source: Central Bank Statement of Accounts 2005 to 2014

Payments, totalling €47 million, were made under the scheme to eligible depositors subsequent to the liquidations of IBRC (€36 million)[2] and Berehaven Credit Union (€11 million).[3] The payments were met from the Deposit Protection Account and no call was made on Exchequer funds.

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.[4]

1 Financial Services (Deposit Guarantee Scheme) Act 2009.

2 €25 million paid in 2013 and €11 million paid in 2014.

3 Berehaven Credit Union was liquidated in July 2014.

4 The legal basis for the scheme was provided through the Credit Institutions (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 institutions’).

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.

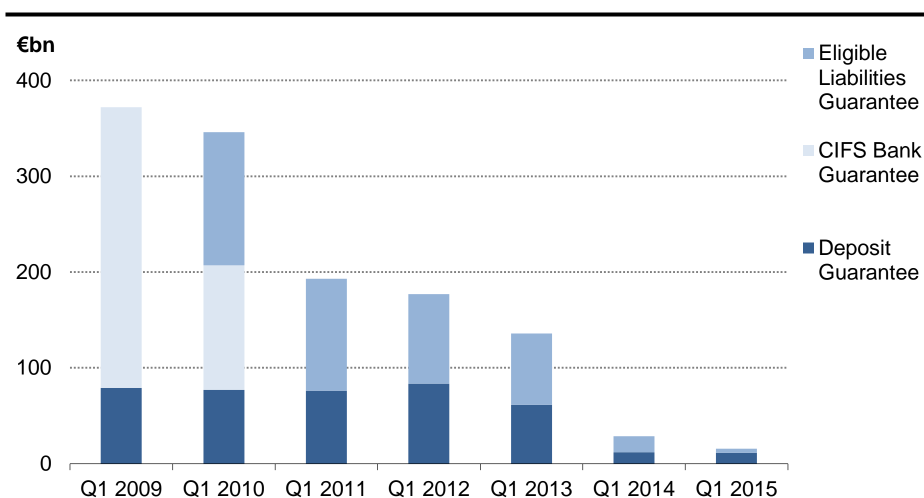
The four institutions participating in the ELG scheme pay a fee for the cover they receive.[1] Fee payments are made into a designated account at the Central Bank and are paid quarterly to the Exchequer in arrears. Fees collected from the institutions to the end of December 2014 amounted to just over €3.58 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 had reduced to €4.2 billion by March 2015 (see Figure 3.15).

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 2014 were €1,072 million – €934 million in respect of bonds and €138 million for deposits. A further €2 million has been paid in claims in 2015 in respect of IBRC deposits.

Figure 3.15 Guaranteed liabilities of covered institutions, March 2009 to March 2015



Source: Department of Finance

1 AIB, IBRC, Bank of Ireland and Irish Life and Permanent.

Annex E Payments for Consultancy Services

The State, through the Central Bank, the NTMA, the Department and the NPRF, has used the services of advisors in the course of developing and implementing the measures aimed at stabilising the banking sector.

By the end of 2014 almost €152 million had been paid by these bodies in respect of consultancy services – Figure 3.16 sets out the payments, classified by the measure for which the related service was provided.

Figure 3.16 Payments for consultancy services for banking stabilisation measures, classified by nature of service provided, 2008 to 2014

	2008	2009	2010	2011	2012	2013	2014	Total
Phase of stabilisation	**€m**	**€m**	**€m**	**€m**	**€m**	**€m**	**€m**	**€m**
Restructuring, recapitalisation and guarantees	6.48	14.24	12.02	18.23	3.36	3.49	1.16	58.98
Financial measures programme	–	–	–	28.13	1.57	1.14	0.30	31.14
Comprehensive assessment	–	–	–	–	–	–	22.62	22.62
Residential mortgage arrears	–	–	–	0.02	7.01	8.67	1.41	17.11
Other[a]	0.06	6.49	2.73	8.39	1.55	1.75	1.10	22.07
Total	**6.54**	**20.73**	**14.75**	**54.77**	**13.49**	**15.05**	**26.59**	**151.92**

Sources: Central Bank, NTMA, Department of Finance and the NPRF.

Notes: a Other includes advice of a general nature (€10.0 million) and advice in respect of credit unions (€4.2 million), NAMA (€2.9 million), crisis management (€2.5 million), bank nationalisation (€2.0 million), the banking crisis inquiry (€0.4 million) and liquidity assistance (€0.1 million).

19 firms received payments totalling €149 million – payments range from €664,000 to €33 million – while a further 53 received a total of €2.9 million – payments ranged from less than €10,000 to just under €350,000 (see Figure 3.17).

Four firms received almost 60% of the total

- payments made to Arthur Cox included €26.9 million in respect of restructuring, recapitalisation and guarantees, €2 million in respect of NAMA and €2 million in respect of bank nationalisation
- payments to Blackrock Financial Management included around €12.5 million in respect of the financial measures programme and €11 million in respect of residential mortgage arrears
- payments to Ernst and Young included €5.9 million in respect of residential mortgage arrears, €10.2 million in respect of the comprehensive assessment and €4.5 million in respect of the financial measures programme
- payments to KPMG included €11.2 million in respect of the comprehensive assessment and €2.0 million in respect of crisis management.

Figure 3.17 Payments for consultancy services for banking stabilisation measures, classified by service provider, 2008 to 2014

Service provider	Central Bank €m	NTMA €m	Department of Finance €m	NPRF €m	Total €m
Arthur Cox	1.86	9.92	19.12	2.16	33.06
Blackrock Financial Management	23.48	–	–	–	23.48
Ernst and Young	20.90	–	–	–	20.90
KPMG	13.19	–	–	–	13.19
Goldman Sachs	–	9.39	–	–	9.39
PricewaterhouseCoopers	6.06	0.45	0.37	1.58	8.46
Merrill Lynch	–	7.33	–	–	7.33
NM Rothschild & Sons	–	6.96	–	–	6.96
Boston Consulting Group UK LLP	5.08	–	–	–	5.08
McKinsey & Company	–	4.41	–	–	4.41
Deloitte and Touche	4.11	–	0.10	–	4.21
Barclays Bank plc	3.51	–	–	–	3.51
Grant Thornton	2.16	–	–	–	2.16
Mazars	1.76	–	0.11	–	1.87
Matheson Ormsby Prentice	0.38	0.07	1.09	–	1.54
McEvoy Partners	–	0.99	–	–	0.99
MKO Partners	0.93	–	–	–	0.93
McCann Fitzgerald	0.86	–	–	–	0.86
AIB Corporate Finance Ltd	–	0.66	–	–	0.66
Other [a]	0.89	0.69	0.94	0.41	2.93
Total	**85.17**	**40.87**	**21.73**	**4.15**	**151.92**

Sources: Central Bank, NTMA, Department of Finance and the NPRF.

Note: a 53 individuals or firms received payments totalling €2.93 million. These payments ranged from less than €10,000 to just under €350,000.

Figure 3.18 Firms qualified to provide specialist financial services to the Department of Finance, 2015

1 – Capital markets, strategic, mergers and acquisitions and restructuring advice	2 – General financial advice	3 – Capital markets distribution services
Bank of America Merrill Lynch	Alvarez and Marsal	Bank of America Merrill Lynch
Barclays	Aon Hewitt	Barclays
Citi	BlackRock Solutions	Citi
Credit Suisse	Boston Consulting Group	Credit Suisse
Deutsche Bank	Citi	Deutsche Bank
Goldman Sachs	Ernst and Young	Goldman Sachs
JP Morgan	Goldman Sachs	Goodbody
Lazard	Goodbody	Investec
Nomura	Grant Thornton	J&E Davy
Rothschild	IBI	JP Morgan
UBS	KPMG	Nomura
	MKO – EisnerAmper	UBS
	Oliver Wyman	
	Promontory	
	UBS	

Source: Department of Finance

Figure 3.19 Firms qualified to provide specialist legal services to the Department of Finance, 2015

William Fry

Arthur Cox

A&L Goodbody

Matheson

McCann Fitzgerald

Mason Hayes & Curran

Byrne Wallace

Source: Department of Finance

Voted Expenditure