Chapter 11

National Treasury Management Agency

Debt Management

Debt Management

11.1 The primary objective of the National Treasury Management Agency (the Agency) as set out in the National Treasury Management Agency Act 1990 (the 1990 Act) is "*to borrow moneys for the Exchequer and to manage the National Debt on behalf of and subject to the control and general superintendence of the Minister for Finance*."

11.2 The 1990 Act enabled the Government to delegate the borrowing and debt management functions of the Minister for Finance (the Minister) to the Agency. Those functions were to be performed subject to such directions or guidelines as the Minister might give. Ultimately, obligations or liabilities undertaken by the Agency in the performance of its functions have the same force and effect as if undertaken by the Minister.

11.3 Borrowing undertaken by the Agency has increased significantly in recent years in order to meet budget deficits and build in an element of pre-funding to manage liquidity risks. In 2009, the net borrowing by the Agency was in excess of €24 billion, following upon over €30 billion borrowed in 2008. Because of the materiality of the borrowing now being effected by the Agency on behalf of the State, the systems, procedures and practices employed by the Agency were reviewed in the course of audit.

Chapter Focus

The chapter reviews the arrangements in place to ensure that

- the Agency's borrowing programmes are based on agreed borrowing requirements and long-term debt costs are minimised consistent with the management of liquidity and other risks
- the Agency's tolerance for risk is identified, monitored and regularly assessed
- an appropriate human resource function is in place that reflects the necessary level of skills in processing, reporting and monitoring activities.

The chapter also reviewed the results of performance monitoring for 2009.

Specification of Borrowing

The level of borrowing to be effected in each year should be formally approved or specified by the Minister.

11.4 In practice, the level of borrowing is not specified in advance by the Minister. The Government has, by order, conferred on the Agency, the function of preparing and submitting to the Minister *as soon as may be in each year a scheme indicating, as respects the moneys proposed to be borrowed by the Agency on behalf of the Minister for the Exchequer in that year, the proportion thereof proposed to be borrowed in the currency of the State, in respect of that year.* With the adoption of the euro, most borrowing is now effected in the currency of the State.

11.5 A borrowing plan is drawn up by the Agency. The primary determinants of the funding proposed are the Exchequer Borrowing Requirement (EBR) which is driven by government decisions and debt refinancing which is monitored and managed by the Agency. More recently, the level of borrowing has also been influenced by the creation of a strategic liquidity buffer. The plan outlines the anticipated sources of the overall borrowing proposed. While it is submitted to the Minister, its content is not subject to formal Ministerial approval.

11.6 Control and general superintendence of borrowing is exercised through Ministerial Guidelines (the debt management guidelines) that set limits to the exercise of the Agency's responsibilities in respect of day-to-day management of the national debt and the operation of the Central Treasury Service[83]. An outline of the debt management guidelines is at Annex A.

11.7 The debt management guidelines remain in force until superceded. In a period of volatility, considerable changes can occur in the borrowing requirement throughout a year. In light of the emerging budgetary position in 2008 the guidelines were amended by removing the limit on the cash balance, which could be held by the Agency. Following correspondence this was formally sanctioned by the Minister in December 2008 and had the effect of giving latitude to the Agency to borrow over €20 billion in excess of that required to meet budget deficits[84].

Conclusion – Borrowing Levels

The statutory provision in relation to borrowing requires the Agency to produce a scheme indicating the proportion of the annual borrowing to be made in the currency of the State. In practice this has been overtaken by events such as the adoption of the euro as the currency of the State, the effecting of virtually all borrowing in that currency and latterly the creation of a strategic liquidity buffer.

While it is accepted that in the execution of its delegated functions the Agency must have commercial freedom to execute borrowings in the market at times and in the amounts it judges most appropriate while taking account of overall market conditions, there would be merit in considering, in the new environment, what might be the most effective means of exercising control and superintendence of the borrowing levels by the Minister for Finance and, in particular, the level of those borrowings.

The Accounting Officer stated that the Minister for Finance had, up to recently, exercised control over the Agency's borrowing levels through guidelines which the Minister issues annually to the Agency under the National Treasury Management Agency Act 1990. These guidelines normally contain an upper limit on the cash balances which the Agency may hold. That limit, combined with the amount of the maturing debt to be refinanced and the Exchequer borrowing requirement as set out in the Minister's annual budgetary statement, represents the approved borrowing level for the year concerned.

However, in the extremely uncertain and volatile conditions prevailing in the capital markets since 2008, the Minister had decided that the Agency should have discretion to determine what level of cash balances is most appropriate and, accordingly, the Minister's guidelines currently do not stipulate a limit on cash balances. The Accounting Officer said that it is envisaged that, as market conditions normalise, the limit on cash balances would be reinstated.

The re-establishment, as part of the Ministerial guidelines, of a cash limit on the size of Exchequer balances would be an effective way of capping the borrowing limit.

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83 Central Treasury Service (CTS) takes deposits from and makes advances to Local Authorities, Vocational Education Committees and non-commercial State bodies. The objective of the CTS is to provide these bodies with a competitive alternative to the banking industry for their treasury business and to make savings for the Exchequer.

84 The average size of the buffer was €24 billion in 2009. A figure of €20 billion is used throughout the report in order to acknowledge the fact that an Exchequer balance up to €4 billion has traditionally been held.

Management of Liquidity

The State must have sufficient cash to meet all liabilities as they arise. The principle of economy of cash balances would dictate that, other things being equal, the amount of debt should be minimised and a balance struck between the amount of any liquidity buffer and its cost to the taxpayer.

11.8 The Agency has procedures[85] in place to ensure that it manages the timing and volume of issuance to guarantee sufficient liquidity. The Agency's Risk Unit produces regularly updated funding plans and liquidity risk profiles in response to the emerging Exchequer deficit and the volatility in the markets in order to ensure that adequate balances are maintained and that the Agency complies with debt management guidelines issued by the Minister for Finance. The annual funding plan breaks down the cash target by product. The Agency liaises with both the Department of Finance and the Revenue Commissioners in managing cash balances as part of the European Central Bank operations with the objective of ensuring that they are maintained within certain limits.

11.9 The Agency stated that the stance of the European Central Bank's monetary policy is the backdrop against which borrowing operations are carried out. Since the Agency has no input into policy in this area and no influence on the result it is simply a given, at any time, which it is conscious of in making decisions.

11.10 In view of the instability in financial markets an additional liquidity buffer was built up late in 2008 mainly through short-term debt raised under the Agency's commercial paper programme. The build up of this liquidity buffer contributed to the increase in the Agency's short-term debt costs of €593 million in 2009 (€215 million: 2008). Interest received on the cash held, which was placed mainly in the Central Bank, amounted to €319 million in 2009 (€368 million: 2008).

11.11 The interest costs on this type of debt varies according to the period to maturity and market conditions. The Agency entered 2009 with a large carry-over from 2008 of servicing obligations. Approximately €11.2 billion had been borrowed under the Commercial Paper Programme in the September and October 2008 period when borrowing costs for this type of debt were high following the collapse of Lehman Brothers and the advent of the financial crisis. The interest paid on this borrowing amounted to €323 million.

11.12 When measured on an accruals basis, the Agency estimates[86] that the net cost of maintaining the elevated cash balances in 2008 and 2009 was approximately €100 million. The Agency stated that it used short-term debt as bridging finance to cover the EBR between bond issues and to build up the liquidity buffer. The Agency also stated that the build up of the buffer not only helped it in the timing of bond issues to avoid the most turbulent conditions in the markets but also gave comfort to investors. It stated that bond issues would have carried significantly higher yields if the buffer had not been in place and that, in its absence, the likely financial impact on the Exchequer position would have far outweighed the cost of the buffer.

[85] These advert to maturity profiles, Department of Finance expenditure profiles and Revenue profiles which are reviewed monthly during the year and more frequently towards year-end.

[86] Based on calculating the spread of the weighted average cost of the short-term borrowing over the deposit rate (EONIA) and applying it to the average level of the buffer.

11.13 At the end of 2009, the liquidity buffer of over €21 billion had been built up mainly from

- Treasury Bills (€8 billion)
- US Commercial Paper Programme (€4 billion)
- Euro Commercial Paper Programme (€3 billion)
- Other short-term debt (€1 billion)
- Irish Government Bond issues (€5 billion).

11.14 A subsequent increase in the level of longer term debt effectively increases the cost of the buffer further.

Conclusion - Liquidity

The Agency has managed its borrowing programmes to ensure that the Exchequer has the liquid resources to meet the cash demands that arose in recent years and has in addition, taking account of the altered situation in financial markets pre-funded the State budget by an amount of the order of €20 billion throughout 2009.

The Accounting Officer stated that, in stressed market conditions, one of the objectives of liquidity management is to be able to issue in the markets on an opportunistic basis when conditions allow. The markets and rating agencies have favourably regarded the cash buffer and the Agency has used it to advantage in demonstrating to investors that Ireland has no liquidity problems such as are perceived in relation to other Euro area countries. The discretion that the Agency has in managing the Exchequer's liquidity buffer in a manner which it judges will best guarantee continued market access should not be compromised, and the cost of the buffer is an 'insurance premium' which is well worth paying.

The net cost of maintaining the elevated cash balances in 2008 and 2008 was approximately €100 million. While accepting the prudence of the pre-funding approach in view of market volatility, the associated cost is material. The Agency would, therefore, need to keep the costs and benefits of the buffer under constant review in the light of emerging market conditions.

In addition, given the substantial cost of the liquidity buffer, it should be the subject of a limit set within the Ministerial guidelines. As for borrowing, generally, the most efficient way of achieving this would be to re-establish an Exchequer cash balance limit within the Ministerial guidelines on the lines that operated up to 2008.

Borrowing Activity

Borrowing activity should be carried out on foot of funding plans and using competitive processes.

11.15 In practice, the Agency draws up a funding plan which is revised in line with movements in the EBR. It takes account of refinancing and liquidity targets. It is drawn up by the Agency once the Department of Finance has sent the Agency its provisional EBR usually in June each year. The plan is adjusted as the EBR is revised by the Department. The EBR forms the main basis for the funding plan. This in conjunction with all maturities in the year, which are calculated by the Agency, make up the funding requirement. The Agency then decides on the source of the funding requirement i.e. retail, short-term and long-term debt.

Debt Management Environment

11.16 The Agency informed me that the primary source of the Agency's information comes from its presence in the markets and its regular and frequent discussions with the primary dealer banks and with investors. It also derives information from its attendance at international fora for debt managers and investors held by international organisations such as the OECD, EU, IMF and World Bank.

11.17 It makes itself aware of what is happening in the markets at all times. This enables it to time its interventions in the markets to maximum effect and avoid situations where several issuers might be in the markets for very substantial deals at the same time to the detriment of all. Within the EU group of issuers an informal procedure exists to minimise this risk.

11.18 The Agency maintains ongoing contact with a primary dealer group that includes virtually all the major international investment banks. It informed me that it discusses its funding options with those banks on a continuous basis and, accordingly, is always aware as it formulates its funding strategy of market conditions and the opportunities for funding in its main Euro area bond market and other markets.

11.19 The Agency also has frequent contact with rating agencies, both proactively, in keeping them fully informed on all new developments in the economy and public finances and through arranging detailed discussions between them and key private and public sector entities during their visits to Ireland. Both the EU and the OECD have fora where sovereign debt managers meet regularly to discuss the latest market developments. The EU Member States publish auction schedules on their own websites and an EU website[87]. In addition, the EU members have an informal agreement to notify the EU Commission and each other when they are about to launch a syndicated bond deal.

Borrowing Strategy

11.20 The Agency's main strategy is to borrow through the issue of Euro denominated debt securities in the Euro area market where Ireland represents about 2% of the total market. Transparency and predictability are key features which investors in those markets seek. Accordingly, the Agency informs the market at the beginning of each year of its calendar of bond auctions for that year giving an indication of the size of each auction.

11.21 All auctions are currently executed using the Bloomberg auction system where bids are accepted and allocated electronically based on a best price bid basis. Results are reviewed by the Agency's Funding and Debt Management Unit prior to acceptance of the bids. In addition, a non-competitive auction takes place immediately after the announcement of the results of the competitive auction. Bids are accepted from primary dealers at the weighted average price in the competitive auction and the three primary dealers who are adjudged by the Agency to have best fulfilled their quoting obligations in the previous calendar month are each entitled to a non-competitive auction allocation of 5% of the amount of each bond sold in the competitive auction. A further 15% of the amount of each bond sold in the competitive auction is made available and the entitlement to this divided among primary dealers in proportion to their allocations in the competitive auction.

[87] Website of Economic and Financial Committee – Sub-Committee on EU Government Bills and Bond Markets http://europa.eu/efc/sub_committee/index_en.htm

11.22 However, in order to raise larger amounts than could be achieved in an auction, especially for the purpose of launching a new bond where initial liquidity (which mainly depends on the size of the bond) is important the Agency from time to time issues bonds through a syndication process when it sees a suitable opportunity in the markets. Issuing bonds through the syndication process involves selecting a lead bank or joint lead banks to seek bids from investors for amounts within a specified yield spread. The Agency ensures that prices remain competitive by approving the yield spread in advance with the lead bank.

11.23 In 2009, €23 billion was raised by way of syndication and almost €11 billion in auctions. Ultimately, the choice of method and the costs are a factor of market conditions at the time. The outturn in 2009 is set out in Figure 46.

Figure 46 Debt Raised in 2009

Method	Nominal Debt €m	Cash Raised €m
Auction	10,763	10,746
Syndication	23,000	22,908

Source: NTMA

11.24 In addition, the Agency issues new products. In 2009, a new long-term bond of 15 years maturity was issued in November, as well as a new Treasury Bill programme begun in March and a new US Dollar Commercial Paper programme introduced in July. These products were designed to attract new investors. In the case of the US Commercial Paper programme, none of the investors would have previously held Irish government debt. The Agency explained that this change was designed to tap additional funding sources identified from market feedback. In these cases, currency risk is minimised through immediate hedging[88].

Conclusion – Borrowing Activity

The Agency draws up funding plans that take account of the EBR, refinancing requirements and latterly the liquidity buffer.

Competitive procurement of long-term funds through the auction and syndication processes helps ensure cost effective borrowing.

Servicing the National Debt

The cost of servicing should be minimised.

11.25 An annual debt service budget is negotiated with the Department of Finance as part of the Multi-Annual Budget process which begins in June and is generally finalised around November each year. There were three debt service budgets for 2009. The first budget was agreed with the Department for the early budget which was announced in October 2008 where the debt service costs were estimated at €3.9 billion. As a result of an increased EBR and higher interest rates, a revised figure of €4.5 billion was subsequently agreed for the budget addendum which was

88 Hedging is the implementation of a set of strategies and processes designed to limit or eliminate, through the use of appropriate instruments, the effects of fluctuations in the price of credit or foreign exchange on the Agency's Debt or investments.

released in January 2009 and the final debt service budget was agreed for the Supplementary Budget which was released in April 2009. This was revised again to €3.9 billion due to savings expected by the Agency.

11.26 At the end of 2009, the actual outturn was €686 million below the agreed budget mainly due to interest rates achieved by the Agency which were lower than those prevailing at the time the Supplementary Budget was agreed and also timing factors relating to the payment of coupons on debt issued in 2009. A rolling forecast is maintained by the Agency's Risk Unit and outturn is reviewed against profile. A monthly analysis of performance against profile with explanation of any differences is provided to the Chief Executive and the Director of Funding and Debt Management.

Conclusion – Servicing the National Debt

The primary indicator of cost minimisation is the extent to which the Agency is successful in raising new debt at rates below the prevailing market rate. In addition, competitive procurement of debt through auctions and syndication should help it to achieve the keenest rates. Budget revisions also help maintain a focus on the outturn target.

The results of benchmarking suggest that the Agency is successful in raising new debt at competitive rates.

Risk Tolerance

There should be a comprehensive framework of goals and risk tolerances for debt and cash management approved by the Minister.

11.27 Apart from the overall imperative to manage liquidity the risks encountered by the Agency can be classified as market risk, counterparty credit risk and operational risk. Risk tolerances are set on the basis of the planned portfolio for the year.

11.28 The overall risk tolerance guidance in the debt management guidelines is

- a net exposure to sterling up to 3%, a net exposure to US Dollar, Swiss Franc and Yen of up to 2% and a net exposure to other currencies of up to 1% but an overall exposure to all foreign currencies of 3%
- a ceiling of 45% on floating interest rate debt
- a limit of 75% of net debt with less than five years to maturity.

11.29 The results achieved for 2009 were

- the Agency had no net exposure to other currencies due to the hedging of all foreign currency borrowings
- the proportion of floating interest rate debt was around 5%
- the proportion of net debt with less than five years to maturity was 44%.

Accordingly, the actual exposures were well within the specified limits in the Guidelines.

Market Risk

11.30 In the case of market risk, the Agency has a set of procedures to gauge the impact of movements in interest rates and foreign exchange rates. These include systems to quantify the sensitivity of budgeted debt service costs, both in the current year and in future years, to movements in market rates.

11.31 Stress tests are used by the Risk Unit to supplement these measures by estimating the possible impact on the debt service budget that may occur under extreme market conditions. A Cost at Risk[89] model is also used to estimate the risk to the debt service budget under different funding strategies and a range of interest rate scenarios.

11.32 Fiscal limits with regard to exposures to potential movements in interest rates and exchange rates are approved by the Chief Executive annually. The Agency's Risk Unit reports monthly on exposures against the preset limits.

11.33 Since the introduction of the Euro, all of the national debt is now either denominated in, or swapped into Euro. Where deals are initiated in non-Euro currency, e.g. under the commercial paper programmes, the relevant product description provides that the exposure should be hedged immediately. The Agency's Risk Unit monitors compliance and ensures that all foreign borrowing deals have a corresponding foreign exchange hedge in place.

Counterparty Risk

11.34 Counterparty credit exposures, arising from the placing of deposits as well as transactions in derivatives, are monitored daily against approved limits. The Agency has in place a comprehensive system for managing its credit risk with other financial institutions. Exposures are measured on an aggregate basis across the various Agency portfolios by a system[90] which provides real-time information on limits and their utilisation. Counterparties are constantly monitored for any events that might affect their creditworthiness and all counterparty limits are subject to a daily review process.

11.35 The debt management guidelines set out the minimum requirements for counterparty quality. The Agency has put in place systems and processes to identify, measure, monitor, control and report its direct counterparty credit risk. The objective of this credit risk management framework is firstly to protect cash and investments and, secondly, to facilitate the maximisation of the rate of return on financial market investments.

11.36 The Agency recently established a Counterparty Credit Risk Committee[91] to assist the Agency's Chief Executive, NPRF Commission and the Board of NAMA in the effective discharge of their responsibilities for managing counterparty risks and exposure. Its main objectives are to ensure that

- an appropriate counterparty credit risk management framework is in place
- investment and treasury operations are conducted within the scope of that framework

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89 Cost at Risk is a measure of the maximum rise in nominal interest costs that can be expected over a nominated time period within a specified level of probability.

90 The SPRINT system is an in-house developed treasury system for the collection and reporting of information for the measurement and management of debt activity. It is linked to internal and external information sources that allow the automation of a variety of debt management tasks from routine calculations to transaction initiation and confirmation.

91 This was implemented in early 2010.

- proper attention is paid to compliance and counterparty risk management issues.

11.37 The management of credit risk is guided by the following general policies

- transactions in financial instruments are conducted and entered into only with approved counterparties after credit limits have been authorised
- all credit limits are now recommended by the Counterparty Credit Committee for approval by the Agency's Chief Executive
- the usage of credit limits is regularly monitored
- all derivative exposures are marked-to-market
- transaction netting takes place in accordance with the terms and conditions of the underlying trading agreements[92]
- concentration of credit risk is managed by setting credit risk limits at a counterparty-specific level.

11.38 The vast bulk of the Agency's deposit activity is transacted with the Central Bank. The average cash held throughout 2009 was €24.2 billion. Cash deposits held with the Central Bank attract a return based on European Central Bank EONIA rate.

Operational Risk

11.39 Operational risk is controlled by policies and procedures that govern payments and by internal organisation processes such as the separation of duties, in line with best practice in the financial sector. Management of operational risk is the responsibility of all business units and is supplemented by the work of the Agency's Control and Compliance units and the internal auditor.

Derivatives

11.40 Under the Agency's operating policies, interest rate swaps should only be entered into for the purpose of managing the interest rate risk associated with the debt and cross-currency swaps transacted in order to manage the exchange risk associated with the foreign debt portfolio. The Agency hedges any foreign currency exposure in short-term borrowings through the immediate use of forward contracts. The performance of derivative contracts is measured under benchmark rules agreed with the Minister. Value at Risk[93] reports are also used to quantify risks under swaps contracts.

11.41 The Debt Service budget includes provisions for payments and receipts under derivatives, itemised by product. The outturn is measured monthly against the budget and any variances are analysed. The market value of interest rate and cross currency swaps is monitored on a monthly basis by the Agency. Overall, reports on compliance with the debt management guidelines are designed to ensure that the derivatives entered into are effective in hedging currency and interest rate risk as required.

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92 In general, master netting agreements are not used. However the Agency is reviewing whether they would be useful in light of additional operations arising from the establishment of NAMA.

93 Value at Risk is expressed as the worst case loss that could be expected to be incurred from a given portfolio as a result of movements in identified risk parameters, over a nominated time period within a specified level of probability.

Other Risks

11.42 The Agency maintains two risk registers. These comprise a general risk register focusing on information technology and people risks and a funding and debt management risk register. Each risk is described, categorised (financial, operational, reputational and regulatory) and assessed using a three-tier level as to its likelihood and impact. Mitigating controls are identified. The work of both the Agency's control function and internal audit is based on the risks to which the Agency is exposed and both report to the audit committee.

11.43 There are several layers of operational contingency planning and event risk management. The Agency ensures that it has a significant number of primary dealer banks for its long-term and short-term issuance programmes so that the unexpected absence of a number of dealers will not endanger the viability of the programmes. It also maintains several separate borrowing programmes – three main short-term paper programmes[94] and two long-term issuance programmes. In addition, the Agency maintains bilateral relationships with a large number of banks so as to facilitate private placements of debt instruments if so desired.

Conclusion – Risk Tolerance

Internally the Agency has a well bedded in risk management system.

While the exposure limits were within the levels specified in the Guidelines there could be merit in setting more stretching limits in order to exert tighter control over the nature of debt liabilities. It would be preferable if they were reviewed and agreed half-yearly to take account of market conditions.

The Accounting Officer stated that the purpose of the debt management guidelines is to set broad parameters for the Agency's delegated borrowing and debt management functions. In his view, the annual guidelines are appropriate in that context.

Operational Capacity and Control

The Agency should have the capability in terms of human resources and standard operating procedures to execute its mandate within a controlled operational environment.

11.44 Detailed job specifications are in place for all Agency roles. The Agency informed me that staff members are recruited from a wide variety of disciplines and at the highest levels of professional expertise and commitment in accordance with those specifications. Candidates complete psychometric assessments including aptitude tests, references are checked and educational qualifications examined.

11.45 Management review staffing regularly and any skill gaps are identified. Succession is considered during the performance review cycle and recently action has been taken to supplement the team to ensure succession options are available. Specific project work is given to staff members as opportunities arise to increase their skill-set and provide development opportunities.

[94] US Commercial Paper, Treasury Bills and Euro Commercial Paper.

11.46 Objectives are in place for all staff with an emphasis on performance feedback, dialogue and development. Training and development programmes are implemented to help staff focus on performance, teamwork and achievement while remaining at the leading edge of their disciplines. Performance is evaluated throughout each year and the evaluation forms part of the annual remuneration review led by the Chairman of the Agency's Advisory Committee.

11.47 The Agency maintains Office Instructions and Product Descriptions that set out the rules for entering, processing and reporting on transactions. Deals are captured in a system which facilitates straight-through processing and the maintenance of a full audit trail. The Agency has in place a comprehensive system of third party confirmations and reconciliations to ensure the integrity of data. The internal control system relies on strict organisational independence of the monitoring and control functions, the segregation of duties and the application of the maker/checker principle to all activities.

11.48 An audit committee operates under a written charter and its main responsibilities include the review and monitoring of risk management arrangements, review and advice on the operation of internal audit and internal controls, assessing the results and implementation of internal audit reviews and reviewing annual financial statements. The committee consists of four members, two of whom are members of the Agency's Advisory Committee, one is a member of the Board of the National Development Finance Agency and one independent external member.

11.49 Compliance with the policies and procedures is monitored by the Agency's Control Unit and by its internal auditor. The audit committee agrees audit plans which are designed to address all material areas of risk.

11.50 Management reports are supplied to senior management daily including funding and liquidity position, cash balances, maturity profile, foreign currency exposures, counterparty credit limits, debt service outturn, EBR versus profile and performance against benchmark. Reports on compliance with debt management guidelines and sensitivity to interest movements are issued to the Chief Executive monthly.

11.51 Three full disaster recovery tests are completed each year at the Agency's business continuity site at Swords Business Campus. Representatives of all Directorates go on-site to test and verify availability of key systems. As part of the testing, the encrypted high-speed link from the Agency's Head Office is shut down to simulate complete loss of the facility. The Control Unit of the Agency is in attendance at all tests to provide a control and audit presence. The Human Resource function also attends. Structured documentation is completed by all testers and retained for audit purposes. The main telephone switchboard is also transferred on one occasion each year to the Swords site as part of the HP/Eircom Suretel service[95] which can be triggered by authorised personnel within minutes should the Agency suffer a catastrophic loss of the Head Office's functionality. The business continuity plan is continually updated with structured quarterly reviews.

11.52 Management information and internal controls are reviewed by the Control Unit and by the internal auditor. The internal audit function operates in accordance with the Framework Code of Best Practice set out in the Code of Practice for the Governance of State Bodies. The work of internal audit is informed by analysis of the risk to which the Agency is exposed, and annual internal audit plans are based on this analysis. The analysis of risk and the internal audit plans are endorsed by the Chief Executive and Directors and approved by the Audit Committee. At least

95 The Eircom Suretel Plan is a facility managed on the Agency's behalf by HP Business Continuity Services which arranges for the transfer of the telephone switchboard to the Agency's business continuity site at HP Swords.

annually, the Internal Auditor provides the management of the Agency and the Audit Committee with a report of internal audit activity including the Internal Auditor's opinion on the adequacy and effectiveness of the system of internal financial control.

11.53 The Accounting Officer, in conjunction with the submission of the Agency's Annual Report and Financial Statements, prepares a Statement on Internal Financial Control which I review in the course of my audit. The Statement outlines the key financial controls in operation which are designed to mitigate risk and confirms that the effectiveness of the system of internal financial control is reviewed annually.

Conclusion – Operational Capacity and Control

The Agency has standardised its operating procedures and its key controls are evaluated in the course of each annual audit. Nothing has come to light in the course of audits that cast doubt on the assertions and assurance provided in the Agency's Statement on Internal Financial Control.

Performance Measurement and Reporting

The Agency's performance in managing debt should be measured and reported against objective standards.

11.54 Under the debt management guidelines, the Agency must provide a quarterly update of its performance as measured by an agreed benchmark to the Minister. The benchmark rules are agreed with the Department of Finance based on debt management parameters set out in the debt management guidelines, the funding requirement as set out in the Budget and prevailing market conditions. The benchmark model is maintained by the Agency's Risk Unit. While reports are run daily, formal reporting to senior management is quarterly. The quarterly update is provided by way of oral briefing to the Minister.

11.55 A firm of accountants is engaged to independently audit the benchmark results. In undertaking their audit they determine that

- the input of actual portfolio transactions during the year is in line with the Agency's records
- the benchmark portfolio transactions are formulated in line with the rules agreed with the Minister for Finance in respect of the relevant funding portfolios and are correctly input into the system
- the valuations of both the benchmark and actual funding portfolios, and the calculation of portfolio fees, are in line with the benchmark rules and appear reasonable.

National Debt Benchmark

The National Debt Benchmark reflects the medium-term debt management objectives of the Exchequer and represents a portfolio with the interest profile, duration and maturity structure which is consistent with guidelines set by the Minister for Finance. The benchmark performance measurement system takes account of both the accumulated cash positions and the net present value of all future cash flows. It calculates the impact of the Agency's actions in the year under review, based on their projected impact over the full life of the debt.

The objective of the performance rules is to measure the value added by the Agency by comparing the cost of funding achieved on a deal-by-deal basis to a market-sourced benchmark price. For example, the cost of funding on government bonds is benchmarked against other Euro sovereigns' government bonds; the cost of commercial paper is compared to Euribor.

I have acceded to the Agency's request not to disclose the details of the performance measurement rules because it might impact on the Agency's bargaining position through disclosure of its pricing targets.

Results of Benchmarking

11.56 Each annual benchmarking round takes account of the economic cost of the Agency's activities, effected in the year, over the full life of those transactions. It then compares the outturn against the cost that would have accrued using the benchmark values. By comparison, the debt service cost reported in the Financial Statements of the Agency measure the cash consequences of transactions in a twelve month period and consequently are subject to variations due to timing factors and the fact that they do not capture the effect of non-cash elements such as discounts. The results of benchmarking are outlined in Figure 47.

Figure 47 Performance against the Benchmark for 2009

Category of Debt	**Performance Outturn**	
	€m	**€m**
Short-Term		
Treasury Bills	28.81	
Exchequer Notes	1.42	
Section 69 and Commercial Paper	31.67	61.90
Cash Management and Exchequer Deposit Placements		4.21
Repos		0.05
		66.16
Long and Medium Term		
Auctions	19.40	
Syndications	50.80	
Other	0.08	**70.28**
Overall		**136.44**

Conclusion – Benchmarking Performance

For 2009, the results of benchmarking indicate that the Agency outperformed the benchmark in relation to its management of the National Debt. In essence, the funding and debt management activity was conducted at a cost that was €136.44 million less than the cost that would have been incurred using the target rates built into the benchmark.

Conclusion

Borrowing plans are drawn up by the Agency in advance of each year and adjusted in respect of emerging funding requirements and market conditions.

The borrowing environment has altered since the establishment of the Agency especially due to the adoption of the euro and the consequent borrowing of most funds in the currency of the State. In addition, the recent financial market turbulence has led to the Agency borrowing in excess of immediate requirements in order to create a strategic liquidity buffer of over €20 billion.

In the circumstances, there may be merit in reviewing the approval mechanisms that underpin the general superintendence and control of the Minister especially around the formal approval of the borrowing levels and, in particular, the level of any strategic buffer. The re-establishment of a cash limit on Exchequer bank balances as part of Ministerial guidelines would be an effective way of achieving that control. In practice, any limit set would need to be sufficiently tight to establish an effective limit, within the current environment, while allowing the Agency, within that limit, sufficient latitude to carry out its borrowing and debt management functions.

From the viewpoint of internal control and management, the Agency has documented standard operating practices, a well bedded in control system and arrangements for reporting on both conformance and performance.

For 2009, the results of benchmarking indicate that the Agency outperformed the benchmark in relation to its management of the National Debt. In essence, the funding and debt management activity was conducted at a cost that was €136.44 million less than the cost that would have been incurred using the target rates built into the benchmark.

Annex A Debt Management Guidelines

The debt management guidelines comprise both specific and general guidelines.

Specific Guidelines

The specific guidelines pertaining in 2009 are designed to ensure that

- the net exposure to foreign currencies is within prescribed limits
- the debt with floating interest rates as a proportion of net debt is within a prescribed ceiling
- the proportion of net debt maturing within a specified time period is under a prescribed ceiling
- bonds are not issued at a discount greater than a specified percentage
- the Post Office Savings Bank reserve will not go below €5 million
- the year-end balance of the Capital Service Redemption Account is less than €1million

In light of prevailing market conditions, no formal limit on total cash balances at year-end was set.

General Operating Guidelines

The following requirements are set out under the general operating guidelines

- With the exception of deposits in the Post Office Savings Bank, any proposal for changes in the remuneration terms or investment limits on national savings schemes is subject to the approval of the Minister, as are proposals for changes in other aspects of the schemes which have clear implications for tax receipts and any proposals for new national savings schemes.
- The Agency is required to report to the Minister quarterly about the main borrowing and debt management transactions carried out during the period, an update of the Agency's performance as measured by an agreed benchmark and details of the actual portfolio of debt at the end of the quarter.
- The Agency is required to ensure that its information and control systems are adequate and appropriate to allow it to monitor the level of risk, taking full account of swaps, futures and other derivative products, to which the Exchequer is exposed as a result of the borrowing and debt management operations carried out by the Agency. The Agency is required to monitor the level of risk with the appropriate frequency for each type of risk and follow best industry practice. Derivatives may be used for the better management of the national debt and, without exception, should be based on the underlying debt.

The Agency must have in place a counterparty risk approval and monitoring system. Apart from a very limited number of cases where the Agency is satisfied as to the risk exposure involved, risk exposures in excess of one year should be confined to counterparties with a long-term rating from Moodys of at least Aa3 (or equivalent from Standard and Poor's or Fitch, i.e. AA), while short-term exposures should be confined to counterparties with either a long-term rating from Moodys of at least A3 (or equivalent from Standard and Poor's or Fitch, i.e., A-) or a short-term rating from Moodys of at least Prime 1 (or equivalent from Standard and Poor's or Fitch, i.e., A1/F1).