

Chapter 8

National Pensions Reserve Fund

Central Government

National Pensions Reserve Fund

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

8.2 No Exchequer contribution was made to the NPRF in 2010⁷¹. However an accelerated contribution of €3 billion made in 2009 included an element of pre-funding for 2010.

Directed Investments

8.3 In 2009, legislation⁷² was enacted which permitted the Minister for Finance (the Minister) to direct the Commission to invest in listed financial institutions or to underwrite share issues in those institutions. The Act also provided that the Minister could direct the Commission with regard to the management and disposal of any such investments.

8.4 By the end of 2010, the Commission had effectively assumed the function of an investment vehicle for much of the State's capital injection into the main banks. At that point, the NPRF held 36% of the ordinary share capital in Bank of Ireland (BoI) and 49.9% of the voting ordinary shares in Allied Irish Banks Plc (AIB) together with non-voting shares (which were subsequently converted to ordinary shares in April 2011).

8.5 At 31 December 2010, 34% of the NPRF's resources were devoted to capitalisation of Irish banks and up to a further 44% had been allocated towards the State's contribution to the EU/IMF Programme of Financial Support for Ireland. By April 2011, the NPRF had converted €10 billion of its discretionary investment portfolio into cash and placed it on deposit with Irish commercial banks pending further direction from the Minister as to how this was to be invested.

Investments in Banks

8.6 In March 2009, the Commission was directed by the Minister to invest €3.5 billion in preference shares of BoI and in May 2009 to invest €3.5 billion in preference shares of AIB. In each case, the investment consisted of preference shares which pay an annual non-cumulative fixed dividend of 8% at the bank's discretion. If the dividend is not paid in cash, the NPRF receives its value in ordinary shares. Preference shares which were denominated in units of €1 could be repurchased by the bank at cost within the first five years and thereafter at €1.25 each.

8.7 Warrants attach to the preference shares giving an option to subscribe⁷³ for ordinary share capital in the bank. The warrants are exercisable anytime between the fifth and tenth anniversary of the date of the issue of the preference stock or in the event of an offer for the bank or other change of control, whichever is earlier.

⁷¹ The adjustment to the contribution rate of 1% of Gross Domestic Product was made by the Credit Institutions (Stabilisation) Act 2010.

⁷² Investment of the National Pensions Reserve Fund and Miscellaneous Provisions Act 2009.

⁷³ The exercise price for BoI warrants was set at €0.52 for 177,213,784 shares and €0.20 for 157,523,364 shares. The exercise price of AIB warrants was €0.975 for 155,780,375 shares and €0.375 for 138,471,444 shares.

8.8 Share placement arrangements, in which the NPRF was directed by the Minister to participate, were undertaken by both banks during 2010. In addition, the NPRF acquired further shares as a result of dividends paid by the two banks in the form of ordinary shares.

Directed Investments 2010

Bank of Ireland

8.9 In April 2010, BoI announced a plan to raise €3.4 billion equity capital through a share placement and rights issue. The NPRF converted almost 1.7 billion of its preference shares and used the proceeds to

- subscribe for 576 million ordinary shares at a price of €1.80 per unit (€1.04 billion) and
- participate in the rights issue, taking up its full allocation of almost 1,140 million shares at a price of €0.55 (€627 million).

8.10 The total investment in BoI, shown at cost, is set out in Figure 30.

Figure 30 NPRF Investments in Bank of Ireland at Cost

Date	Investment	Preference shares	Ordinary shares	Total
		Cost €000	Cost €000	Cost €000
March 2009	Preference shares	3,500,000	—	3,500,000
February 2010	Dividend paid in ordinary shares ^a	—	250,444	250,444
April 2010	Conversion of preference shares to ordinary shares	(1,662,959)	1,662,959	—
December 2010	Investment at cost	1,837,041	1,913,403	3,750,444

Note: a In February 2010, the NPRF received a dividend from the BoI of €250 million in the form of ordinary shares.

Allied Irish Banks Plc

8.11 In December 2010, the NPRF participated in a share placement by the bank and subscribed for

- 675 million ordinary shares at a price of €0.3793 per unit (€256 million) and
- 10,489 million cumulative non-voting shares at a price of €0.3396 (€3.562 billion).

8.12 The total investment in AIB, shown at cost, is set out in Figure 31.

Figure 31 NPRF Investments in Allied Irish Banks Plc at Cost

Date	Investment	Preference shares	Ordinary and cumulative non-voting shares	Total
		Cost €000	Cost €000	Cost €000
March 2009	Preference shares	3,500,000	–	3,500,000
May 2010	Dividend paid in ordinary shares ^a	–	280,000	280,000
December 2010	Ordinary shares and cumulative non-voting shares ^b	–	3,818,438	3,818,438
December 2010	Investment at cost	3,500,000	4,098,438	7,598,438

Notes: a In May 2010, AIB paid the NPRF a dividend of €280 million in the form of ordinary shares.

b 675 million ordinary shares and 10,489 million cumulative non-voting shares. The cumulative non-voting shares ranked pari passu with the ordinary shares except for voting rights and were subsequently converted into ordinary shares (in April 2011).

Return on Investments in 2010

8.13 During 2010, the NPRF received income and gains from its investment in the institutions comprising cash and non cash elements as outlined in Figure 32.

Figure 32 Income and Gains on Investments 2010

Income and Gains	Bank of Ireland €m	Allied Irish Banks Plc €m	Total €m
Cash			
Transaction Fees	64.0	65.9	129.9
Cancellation of warrants (which had been issued in conjunction with 2009 preference shares)	479.0	52.5	531.5
Other			
Dividend (paid in the form of ordinary shares)	250.4	280.0	530.4
Total	793.4	398.4	1,191.8

Value of Directed Investments in 2010

8.14 For the year ended 31 December 2009, the NPRF valued the directed investments at cost under a direction of the Minister. At 31 December 2010, following revised directions from the Minister, the directed investments were valued at fair market value. For the ordinary shares and the cumulative non-voting shares, the market price at 31 December 2010 was taken as the fair market value of the shares. For the preference shares, which are not quoted on the market, the National Treasury Management Agency, on behalf of the NPRF, engaged Davy Corporate Finance (Davy) to provide a fair market valuation of the NPRF's holding in the BoI and AIB preference shares as at 31 December 2010.

8.15 The Davy report, concluded that⁷⁴

- the BoI preference shares had dropped in value by around 20.6% from €1.84 billion to €1.46 billion
- the AIB preference shares had declined in value by around 41.5% from €3.5 billion to €2.05 billion.

8.16 The value of the directed investments at the end of December 2010 is set out in Figure 33. Unrealised losses of €3.7 billion have been reported in the accounts of the NPRF for 2010.

Figure 33 NPRF Directed Investments – Fair Market Valuation at 31 December 2010

	Preference shares €000	Ordinary shares and cumulative non-voting shares €000	Total €000
Bank of Ireland			
Cost	1,837,041	1,913,403	3,750,444
Unrealised loss at year end	(378,431)	(1,200,950)	(1,579,381)
Valuation December 2010	1,458,610	712,453	2,171,063
Allied Irish Banks Plc			
Cost	3,500,000	4,098,438	7,598,438
Unrealised loss at year end	(1,452,499)	(689,509)	(2,142,008)
Valuation December 2010	2,047,501	3,408,929	5,456,430
Total Directed Investment	3,506,111	4,121,382	7,627,493

Developments Since Year End

8.17 In April 2011, the NPRF converted its cumulative non-voting shareholding in AIB into ordinary shares on a one-for-one basis. Following this conversion, the NPRF held 92.8% of the ordinary share capital of AIB.

Dividends

8.18 In the first half of 2011, the NPRF received dividends on its preference shares as follows

- On 21 February 2011, BoI paid a dividend due of €14.4 million in cash.
- On 13 May 2011, AIB paid part of a dividend due (€80 million) in the form of ordinary shares. The value of those shares was €12.3 million. The balance of the dividend was settled in July 2011 along with a penalty for late payment of shares to the value of €3.8 million.

⁷⁴ The shares were valued on the basis of publicly available information – the BoI shares were valued using discounted cash flow analysis of the expected dividends from the preference shares. AIB announced in late December 2010 that it was anticipated that the NPRF would convert up to €3.5 billion of its preference shares into ordinary shares. The valuation of the AIB preference shares took account of this announcement.

Decline in Value of Ordinary Shares

8.19 By the end of July 2011, the value of the NPRF's holdings of ordinary shares in the two banks had fallen

- ordinary shares in BoI had fallen in value by 72% from 37.5 cents to 10.5 cents
- AIB's ordinary shares had decreased by 67% from 30 cents to 10 cents.

Further Directed Investments 2011

8.20 In February and April 2011, the Minister issued two directions to the NPRF to hold a total of €10 billion in cash or debt instruments⁷⁵. The Minister stated that the purpose of the directions was to facilitate a proposed contribution of €10 billion from the NPRF to the EU/IMF Programme of Financial Support for Ireland.

8.21 On foot of these directions, the NPRF liquidated assets from its discretionary portfolio to the value of €5.5 billion in February 2011 and €4.5 billion in April 2011. The cash was placed, again by direction of the Minister, on deposit with Irish commercial banks.

8.22 In July 2011, under further directions from the Minister, the €10 billion which was on deposit with Irish commercial banks was invested in AIB and BoI

- €5 billion was invested in ordinary share capital of AIB bringing the NPRF's shareholding to 99.83% and a capital contribution of €3.77 billion was made to AIB
- the NPRF underwrote a rights issue by BoI and took up the rights attaching to its 36% shareholding at a total cost of €1.23 billion.

8.23 On 24 July 2011, the Minister directed the NPRF to sell part of its shareholding in BoI following the rights issue to a group of institutional shareholders. The NPRF stated that this transaction will generate proceeds for the NPRF of €1.05 billion. Following the transaction, the NPRF's shareholding in BoI will be 15%.

Pension Asset Transfers

8.24 Under the Financial Measures (Miscellaneous Provisions) Act 2009 assets of the pension funds of certain non-commercial State bodies and universities were transferred in the course of 2009 and 2010 to the NPRF. By 31 December 2010 assets with a cumulative value of €2.1 billion had been transferred. The source of the assets transferred is set out in Figure 34. The pension schemes associated with the funds transferred continue in force for existing members with no impact on benefits or associated provisions for members. All future pension costs will be paid, in the first instance, by the relevant State body or university and, after current contributions are exhausted, will be met by way of Oireachtas grant.

8.25 The assets of the pension funds transferred to the Commission in 2009 were valued at €1 billion while the assets of six further pension funds transferred in 2010 were valued at €1.1 billion. The value of each fund transferred is set out in Figure 34.

⁷⁵ It was a requirement that such instruments be issued or guaranteed by Eurozone governments and be rated AA or better with a maturity in 2012.

Figure 34 Pension Assets Transferred to the NPRF 2009 and 2010

Responsible State Body/University	Value €m
2009	
Arts Council	2.5
Bord Bia	15.7
National Tourism Development Authority	32.9
FÁS	364.6
Forfás	186.3
National University of Ireland Maynooth	58.5
Shannon Development	52.3
Trinity College Dublin	280.5
2010	
ESRI	17.2
IPA	24.7
National University of Ireland	6.2
National University of Ireland Galway	215.7
University College Dublin	501.6
University College Cork	313.7
Value of Funds Transferred	2,072.4

Value of the NPRF

8.26 The value of the NPRF stood at €2.7 billion at 31 December 2010 (2009: €2.3 billion) composed of discretionary investments with a market value of €5.1 billion and directed investments of €7.6 billion. Figure 35 sets out the movement in the NPRF for the year ended 31 December 2010.

Figure 35 Movement in the NPRF Value for 2010

	€m	€m
Value of the NPRF at 1 January 2010		22,336
Movements		
Assets transferred from pension schemes	1,079	
Income and gains on discretionary investments	1,824	
Income and gains from directed investments	1,192	
Unrealised loss on directed investments	(3,721)	
Taxation and administration costs	(23)	
Change in Value of the NPRF (including asset transfers)		351
Value of the NPRF at 31 December 2010		22,687
The assets of the NPRF are composed of		
Discretionary Investments	15,060	
Directed Investments	7,627	22,687

Conclusion

The National Pension Reserve Fund (NPRF) was valued at €22.7 billion at the end of 2010.

Up to the end of 2010, the NPRF had invested, pursuant to directions from the Minister for Finance, an aggregate of €1.35 billion in Ireland's two main banks, Allied Irish Banks plc and Bank of Ireland. This included reinvestment of €0.53 billion of dividends received in the form of ordinary shares.

At the end of 2010, as a result of an impairment loss of €3.7 billion, the value of these directed investments had fallen to €7.6 billion.

In 2011, the value of the directed investments has been further impaired. By the end of July 2011, the value of ordinary shares held as part of the investments had fallen from the end-December 2010 values by 67% (Allied Irish Banks plc) and 72% (Bank of Ireland).

In 2011, the NPRF has reinvested a €88 million dividend received in the form of ordinary shares from Allied Irish Banks plc and has liquidated €10 billion of assets in its discretionary portfolio. The NPRF deposited this cash in Irish commercial banks pending further direction from the Minister for Finance.

In July 2011, the Minister for Finance directed that the €10 billion be invested in Allied Irish Banks plc and Bank of Ireland and that the NPRF sell shares to the value of €1.05 billion in Bank of Ireland to a group of institutional investors.

