Chapter 15

National Treasury Management Agency

15.1 National Treasury Management Agency

The National Treasury Management Agency (the Agency) borrows moneys on behalf of the Exchequer and manages Ireland's National Debt. It carries out these functions under the control and general superintendence of the Minister for Finance. In recent years it has also been given a range of other functions, the principal ones being to

- act as the Manager of the National Pensions Reserve Fund
- manage compensation claims on behalf of State agencies
- discharge the functions of the National Development Finance Agency.

In 2007 it took on some additional functions

- It now purchases carbon credits[61] required to meet Ireland's climate change obligations.
- Its central treasury services were expanded to include all non-commercial State bodies and the procurement of foreign currency on behalf of the Department of Foreign Affairs. It also commenced managing moneys[62] in patients' private property accounts on terms agreed with the Health Service Executive.
- In the area of public private partnership schemes its remit was widened[63] to undertake procurement and delivery of projects in all sectors, apart from transport and local government.

Audit of the Agency

Under the provisions of the National Treasury Management Agency Act, 1990, I am required to audit the accounts of the Agency and, when making my statutory Annual Report on the Appropriation Accounts, to also make a report to Dáil Éireann regarding the correctness of the sums brought to account by the Agency in the year.

The Agency's accounts for 2007 have been audited and the accounts, including an administration account and accounts relating to the National Debt, have been presented to the Minister who has laid copies of them before both Houses of the Oireachtas.

I am satisfied that the accounts properly present the transactions of the Agency for 2007 and its balances at year end.

National Debt and Pensions Reserve Fund

At 31 December 2007 Ireland's National Debt stood at €37.6 billion (2006: €35.9 billion). This increase of €1.7 billion on the previous year was a result of an equivalent State budgetary deficit. When account is taken of the effect of derivatives the entire National Debt exposure was in Euro at year end and was made up for the most part of government bonds.

Government bonds are stated at nominal values - these values are the basis for determining dividends and the amounts that will have to be ultimately repaid. In market value terms the value of the overall debt at 31 December 2007 was €39 billion.

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[61] Under the Carbon Fund Act 2007.
[62] Under the Health Act 2007.
[63] Under the National Development Finance Agency (Amendment) Act 2007.

The value of the National Pensions Reserve Fund which, unlike the National Debt, is stated at market values stood at €21.2 billion at 31 December 2007. Its value increased by €2.3 billion in the year of which approximately €1.6 billion was attributable to the State contribution of 1% of gross national product as estimated in the annual budget.

Table 48 National Debt and Value of National Pensions Reserve Fund from 2003 to 2007

Year End	National Debt[a] €m (at nominal value)	National Pensions Reserve Fund €m (at market value)
2003	37,610	9,561
2004	37,846	11,689
2005	38,182	15,418
2006	35,917	18,900
2007	37,560	21,153

[a] The movement in the nominal value of the debt does not equate to the cash proceeds of borrowing due to the effect of tranching and cancellations of existing bonds.

The cost of servicing the National Debt for 2007 was €2.1 billion. However, this includes a transfer of €466m from current funds to a sinking fund to repay debt bringing the current servicing cost to €1.6 billion or around 4.4% of the average debt over the year.

Measuring the Agency's Performance

The Agency's day-to-day responsibility for borrowing and management of the National Debt is exercised in accordance with guidelines given by the Minister for Finance. Detailed benchmark targets and performance measurement rules are subsequently agreed with his Department. The agreed benchmarking system compares the performance of the Agency against a monetary benchmark target in relation to its debt management activities and its portfolio fees[64].

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 in respect of the relevant funding portfolios and are correctly input into the system.
- The calculation of valuations and aggregation of both the benchmark and actual funding portfolios, and the calculation of portfolio fees are correctly performed.

For 2007 these results indicate that the Agency outperformed its benchmark by €31m in relation to its management of the National Debt and other Agency portfolios[65].

[64] Portfolio fees represent a measure of the additional costs that the Exchequer would incur in respect of fees for fund management and other services if those services were not provided by the Agency.
[65] These portfolios consist mainly of Housing Finance Agency borrowings, the Social Insurance Fund and central treasury services.

In addition the Agency generated notional portfolio fees of €15m in accordance with the benchmark rules. These fees were generated mainly in connection with the management of the National Pensions Reserve Fund, the Social Insurance Fund and the National Development Finance Agency.

The National Pensions Reserve Fund (NPRF) is governed by a Commission but is required to perform its functions through the Agency for the period to April 2011[66]. The Agency passively manages a portion of the fund invested in foreign government bonds in line with the Commission's overall investment strategy. It also manages cash assets and currency overlay[67] on behalf of the Commission. Of the €15m in notional portfolio fees recorded by the Agency, €5.2m relate to its activities on behalf of the NPRF.

The equity assets of the NPRF are managed by external investment management firms which are selected by the Agency on behalf of the Commission. The Commission sets the performance benchmark for investments and the managers, and the Agency has processes to regularly review the performance of managers and report the results to the Commission. Each investment manager is subject to a formal annual performance review by the Commission. The Commission determines the appropriate course of action in relation to any performance issues.

Expenses of the Agency

The total administrative income of the Agency was €32.4m of which €31.3m was provided by the Exchequer. This administrative income was applied for the following purposes

Debt management expenses	€9.0m
Expenses of State Claims Agency	€7.2m
National Development Finance Agency expenses	€4.4m
Expenses of National Pensions Reserve Fund	€6.8m
Additional contribution to a defined benefit pension fund approved by the Minister of Finance[68]	€5.0m

The costs associated with discharging the Agency's functions under the Carbon Fund Act, 2007 were not significant in 2007.

Carbon Fund

Ireland can meet its obligations under the 1992 United Nations Framework Convention on Climate Change and the 1997 Kyoto Protocol to that Convention in two ways

- purchasing carbon credits[69] directly from the market or from other Kyoto Protocol parties
- purchasing carbon credits indirectly through investment in managed funds[70] or carbon reducing projects.

The Carbon Fund was established under the Carbon Fund Act, 2007 to facilitate the acquisition of carbon credits. The Agency has been designated as the purchasing agent on behalf of the State and will administer and manage purchases of carbon credits.

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[66] At the end of this period, and at five-yearly intervals thereafter, the Commission may with the agreement of the Minister for Finance reappoint the Agency for a further five-year term or may appoint an alternative Manager.
[67] Currency overlay is the hedging of a proportion of the currency exposure of the National Pensions Reserve Fund.
[68] This contribution is over and above the normal annual contribution made to the scheme.
[69] Termed Kyoto Units under the Carbon Fund Act 2007.
[70] Managed funds encompass a number of carbon reducing projects. There is an element of uncertainty with regard to the extent of carbon credits that are ultimately produced from these investments.

Under the terms of the Kyoto Protocol, Ireland has undertaken to limit its average annual emissions of greenhouse gases in the period 2008 to 2012 to a maximum of 13% more than the level of emissions in 1990. Ireland's strategy to achieve this target is set out in *The National Climate Change Strategy 2007-2012* published by the Department of the Environment, Heritage and Local Government. The strategy includes the purchase of carbon credits in respect of emissions reductions achieved elsewhere as an offset for any emissions by Ireland in excess of its Kyoto limits. It is currently estimated that it will be necessary for the Government to purchase carbon credits for over 3.6m tonnes of excess emissions in respect of each year of the 2008 to 2012 period.

In the *National Development Plan 2007–2013* the Government designated €270m for the purchase of carbon credits in the Kyoto commitment period 2008 to 2012. This is in addition to an initial investment of €20m by the Department in 2006.

To the end of 2007 the Government has entered into commitments of €39m to invest in three funds managed by two international institutions. Payments of €23.7m have been made to these funds of which €3.7m was paid in 2007. These managed funds invest in carbon reducing projects in various countries with the expectation that they will produce carbon credits to offset against excess emissions by Ireland. The number of carbon credits which will ultimately result from these investments will only be quantified by the international institutional fund managers as projects advance and come to completion.

Funding the Agency's Pension Obligations

The Agency operates a defined benefit pension scheme for certain employees[71]. The associated fund is administered by external managers and overseen by scheme trustees. The Agency makes annual contributions to the fund and these amounted to €6.8m in 2007. The annual contribution to the fund in recent years has consisted of

- A proportion of payroll costs made at a rate, currently 25%, determined by the Agency on the advice of an independent actuary.
- An additional contribution over and above the determined funding rate subject to the approval of the Minister for Finance.

The Agency's financial statements disclose the deficit or surplus in the pension fund for accounting purposes in accordance with *Financial Reporting Standard 17 (Retirement Benefits)* at each financial year end.

[71] The Agency also makes contributions to Personal Retirement Savings Accounts (PRSA) for employees who are not members of the Defined Benefit Scheme and €0.5m was paid into these in 2007.

Table 49 sets out the deficit or surplus in accounting terms since 2004 and the associated contributions to the fund.

Table 49 Surplus/Deficit on Pension Fund and Contributions made to Fund in period 2004 to 2007

Year	Surplus/(deficit) in Pension Fund €000	Contributions at 25% of Payroll €000	Additional Contribution €000
2004	(12,888)	1,409	2,000
2005	(12,399)	1,171	3,000
2006	(2,922)	1,593	7,500
2007	2,443	1,772	5,000

Up to the end of 2006 additional contributions of €12.5m had been made for the purpose of reducing the fund deficit. In 2007, an additional contribution of €5m was made to the fund for which the approval of the Minister for Finance was sought and obtained.

The trustees of the pension scheme commission actuarial valuations periodically, as they are required to do by the Pensions Act, 1990. One of the purposes of these valuations is to assess the adequacy of the contributions being made by the Agency and to recommend a future contribution rate, taking account of the funding level of the scheme at the valuation date. When the position was reviewed in 2004 the actuarial valuation suggested that a long-term funding rate of 29.5% of salaries would be appropriate, having regard to the deficit in the scheme at that stage. Taking account of the additional contributions in the form of lump sum payments, which would have the effect of reducing the fund deficit, the Agency decided to continue to fund at its then existing rate of 25% of salaries.

The most recent actuarial valuation of the scheme was carried out in September 2007, using a January 2007 valuation date. It concluded that an appropriate long-term valuation rate would be 20% of salaries. Notwithstanding this, it recommended that the current level of contribution of 25% be maintained.

Different actuarial bases have been used for valuing scheme liabilities for accounting and funding purposes. Thus, the funding valuation calculated the scheme deficit at 1 January 2007 as €200,000 whereas the deficit for accounting purposes was €2,922,000. However, it is the former valuation which forms the basis for deciding on the contributions to the fund.

Audit Concern

The level of funding being provided to the externally managed scheme appeared to exceed its current requirements. The principle of economy should dictate that outflows of exchequer resources should not exceed the demand for funding. I sought the Accounting Officer's views as to why the additional contribution of €5m was made in 2007.

In response the Accounting Officer informed me that on an accounting reporting basis the defined benefit scheme had a deficit of €2.9m at the end of 2006 and would have been in deficit again at the end of 2007 by €2.557m had the additional contribution not been made. The actuarial valuation which forms the basis of a recommended funding level was based on the financial position as of 1 January 2007. Worldwide economic conditions were more stable at that point as it was before the emergence of the credit, liquidity and subprime issues which started in the US and in late 2007 began to affect Europe. These emerging issues were not conducive to stability in the financial markets to which the scheme's

investments were exposed, and in the final quarter of 2007 the Irish Stock Exchange was down 12.04%, Bloomberg European 500 stock index was down 3.14%, and the Dow Jones was down 4.54%. Markets have continued to be dislocated since the end of 2007 and the Accounting Officer expects the scheme to be back in deficit at the end of 2008 if these market conditions prevail. He also informed me that it is important to consider the fact that unlike other State entities or Government Departments who take money out of the Exchequer on a "pay as you go" basis for pensions that the NTMA operates with its own pension scheme where the full contributions to the scheme are charged up annually to its administration budget. Furthermore, he advised that the actuarial report states that the main purpose of the valuation is to review the employer contribution rate taking account of the trustees' funding objectives. As Accounting Officer, and being mindful of this fact, he deemed it important that the scheme should, if possible, be fully funded on both a FRS17 basis and an actuarial basis.

Audit Conclusions

Because pension liabilities are long-term obligations, a longer term view of market performance would be appropriate when deciding on the level of contribution to a funded scheme.

This, together with the desirability of minimising outlays by the State, would suggest that schemes should not be funded in advance of need and that fund deficits should ordinarily be dealt with through an appropriate periodic adjustment to the annual funding rate recommended by the actuary.

An Post - Management Fees

An Post manages a number of Government retail savings products including the Post Office Savings Bank (POSB) on behalf of the Agency. In 2007 these savings amounted to €5.6 billion which represents approximately 15% of the National Debt.

For a number of years the Agency has been in negotiations with An Post on an appropriate long-term fee structure for operating these schemes. Fees had been held at previous year levels or in some cases reduced, pending the finalisation of an agreement with An Post.

In late 2007 the Agency finalised an agreement with An Post for the period 2007 to 2010, inclusive, which encompassed

- Revised management fees for the three saving schemes - Saving Certificates, Savings Bonds and National Instalment Savings - based on amounts saved and transactions in the year.
- A revised management fee for the Post Office Savings Bank based on amounts saved and which is subject to an overall fee limit.
- An additional management fee in respect of the Special Savings Incentive Accounts (SSIAs) based on amounts saved since the inception of the scheme.

A Service Level Agreement (SLA) was concluded which aims to achieve best industry standards in the provision of all services associated with the retail savings products. Under the SLA certain services to be delivered by An Post to the Agency and retail savings customers will be defined and measured in detail and a formal system of objective service level monitoring will be instituted.

Table 50 shows the debt raised and fees paid in respect of the schemes administered by An Post.

Table 50 Amounts Outstanding[(a)] on Retail Savings Products and the Related Management Fees

	2005		2006		2007	
	Debt €m	Fees €m	Debt €m	Fees €m	Debt €m	Fees €m
Savings Certificates	2,208	4	2,215	4	2,223	5
Savings Bonds	1,585	2	1,709	3	1,675	4
National Instalment Savings	385	2	394	3	409	2
Savings Stamps[(b)]	2	1	2	1	2	1
Post Office Savings Bank[(c)]	1,486	28	1,543	25	1,302	35
Total	**5,666**	**37**	**5,863**	**36**	**5,611**	**47**

(a) The balances on the three saving schemes do not include accrued interest. At the end of 2007 an amount of €780m is outstanding in accrued interest on these schemes.
(b) The balance is net of transfers to the POSB.
(c) The drop in deposits with the POSB at the end of 2007 is mainly due to the payments to maturing SSIA account holders.

The total management fees and expenses paid to An Post in 2007 amounted to €47.1m and reflect the agreement reached in the year. The management expenses for the Post Office Savings Bank of €34.6m includes an amount of €5.7m in respect of SSIA management. Except for the SSIAs, in respect of which no management fees had been paid since their beginning in 2001, there was no element of retrospection in the agreement other than that it had effect for all of the year in which it was concluded.

The expected fees payable to An Post in 2008 are estimated to be €42m, of which €30m relates to the POSB.

Savings Scheme for Children

Savings Stamps is a long established scheme, pre-dating the setting up of the Agency. It was designed to encourage children's savings. The stamps are sold to primary school children at post offices and through schools. They are affixed to cards which are then used to open POSB deposit accounts or added to existing POSB accounts. As shown in Table 50 the average balance outstanding on the scheme in recent years amounted to only €2m and the Agency pays an annual management fee to An Post of approximately €1m. Since 2004 the Agency has paid a total of €4m in fees to An Post. Average sales of savings stamps in this period amounted to between €4m and €4.5m per annum, and most of this was eventually passed to the POSB.

Audit Concern

Since no net additional funding had derived from savings stamps since 2004 and the average sales were so low the question arose as to how the outlay on management fees could be justified and whether any action had been taken or is proposed on this matter.

In response the Accounting Officer informed me that the scheme cannot be regarded as a fund raising vehicle, but rather as a means of encouraging children to begin the savings habit. Nevertheless, the Agency has been of the opinion for some time that the costs of the scheme are disproportionate to the benefits. The Agency accordingly proposed its abolition in 1992, 1997 and 1998. These proposals were rejected by successive Ministers for Finance because of the scheme's perceived value in promoting the savings habit in young people and its possible beneficial effect on other Government retail savings

schemes. In 2007, the Agency again sought Ministerial approval to abolish Savings Stamps but on the basis that a replacement savings scheme for children would first be put in place. The details of this new scheme are now being finalised with An Post, and An Post have committed to introduce it with effect from the start of the 2008-2009 school year.

Audit Conclusions

While recognising the argument that the savings habit should be encouraged, a move to a less costly administrative mechanism is desirable.