Chapter 42 National Treasury Management Agency

National Pensions Reserve Fund

National Pensions Reserve Fund

42.1 The National Pensions Reserve Fund was established by legislation in 2001 with the objective of providing a fund of money to meet the future costs of social welfare and public service pensions. An independent Commission (the National Pensions Reserve Fund Commission) was also established under the legislation to control and manage the Fund with the discretionary authority to determine and implement an investment strategy for the Fund.

42.2 In implementing its investment strategy the Commission seeks to maximise returns within acceptable risk levels with a focus on the long-term, given that the Fund is expected to contribute to the financing of pension costs from 2025 until 2055. In accordance with the 2001 legislation, the Minister for Finance is required to pay 1% of GNP into the Fund every year.

Financial Performance of the Fund

42.3 The market value of the Fund stood at €16.1 billion at 31 December 2008 (2007: €21.2 billion). In 2008 the Fund received an Exchequer contribution[142] of €1.69 billion and earned investment income of €695 million. The market value of investments had decreased by €7.34 billion by the year end.

Figure 148 Value of National Pensions Reserve Fund from 2006 to 2008

Period End	National Pensions Reserve Fund €m (at market value)	Fund Value as a percentage of GDP
2006	18,900	10.7%
2007	21,153	11.1%
2008	16,142	8.9%

42.4 The Fund reported a negative investment return in 2008 of 30.4%, mainly due to the fall in the value of equities on international financial markets. The Commission measures the Fund's performance against a benchmark portfolio which is consistent with its strategic asset allocation. Notwithstanding the reduction in the value of its investments the Fund finished 2.4% ahead of its benchmark in 2008. The negative 2008 return has reduced the Fund's annualised return[143] at the end of 2008 to 0.5% (6.1% at the end of 2007).

42.5 The cumulative Exchequer contributions made to the Fund since its inception to the end of 2008 amounted to €16.87 billion thus exceeding the value of the Fund. The positive annualised return reported by the Fund is based on the performance measure applied.

Basis of Calculation of Annualised Return

The performance of the Fund is calculated using a time weighted return which is the industry standard for reporting performance in line with the Global Investment Performance Standards. It is calculated by stopping the clock each time a new cash flow occurs. The return on the funds invested is calculated for the period from one cash flow to the next. These subdivided returns are then accumulated to produce the total time weighted return for a given period.

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142 This contribution equates to 1% of Gross National Product as estimated in the annual budget.

143 The cumulative return reported by the Fund since its inception to 31 December 2008 is 3.5% or 0.5% annualised.

42.6 Figure 149 sets out the transactions and results of the Fund to the end of June 2009.

Figure 149 Movement in NPRF value to June 2009 (unaudited)

	€ m
Value of Fund at 1 January 2009	16,142
Exchequer Contribution to Fund	3,000
Net Investment Income (less expenses)	323
Change in Value of Investments	(59)
Value of Fund at 30 June 2009	**19,406**
The Fund is composed of	
▪ Directed Investments	7,000
▪ Other Investments	12,406

42.7 The value of the Fund, which accounted for 8.9% of GDP at 31 December 2008, is not taken into account in determining the General Government Debt which itself represented 44% of GDP.

Directed Investment under Banking Stabilisation Measures

42.8 A major event subsequent to year end which has impacted on the investment composition of the Fund was the enactment of the Investment of the National Pensions Reserve Fund and Miscellaneous Provisions Act 2009. The Act empowers the Minister for Finance to direct the Commission to invest in listed credit institutions or to underwrite share issues by those institutions, where he decides such a direction is in the public interest. The Minister can also direct the Commission with regard to the management and disposal of those investments.

42.9 On 30 March 2009, the Minister directed the Commission to invest €3.5 billion in preference shares issued by Bank of Ireland and on 12 May 2009 he further directed the Commission to invest €3.5 billion in preference shares issued by Allied Irish Banks plc. The shares are perpetual preference shares with an annual non-cumulative fixed dividend of 8% payable in cash or, in default of payment of the cash dividend, ordinary shares in lieu.

42.10 Warrants issued with, but detachable from, the preference shares give an option to the Fund, in the case of each bank to subscribe for ordinary shares equivalent in number to 25% of the ordinary share capital of each bank[144]. If the options were exercised in full the Fund would then own 25% of the ordinary share capital of each bank. The strike price[145] of the first 15% of the warrants was set at €0.975 for Allied Irish Banks plc and €0.52 for Bank of Ireland. The strike price of the balance of the warrants is €0.375 and €0.20 respectively. The warrants can be exercised between five and ten years from the date of issue of the preference shares or earlier, if another party proposes to acquire control of a bank or ownership of a substantial part of its assets or business.

42.11 Either bank can redeem the preference shares at par value within 5 years from the date of their issue, in whole or part, from profits available for distribution or from the proceeds of any

[144] This is calculated based on the volume of shares as enlarged by the new shares which would be required to be issued on foot of the exercise of the warrants.

[145] The price at which warrants to subscribe for ordinary shares of each bank can be exercised.

issue of stock or securities which would constitute core Tier 1 capital[146]. Thereafter, the redemption price would equal 125% of the issue price. If either bank redeems up to €1.5 billion of the Fund's investment in preference shares from privately sourced Tier 1 capital prior to 31 December 2009, then the warrants will be reduced pro rata to that redemption to an amount representing not less than 15% of the ordinary shares of the bank concerned. Any redemption after this date will have no impact on the warrants.

42.12 In addition to the direction to invest €7 billion in the two banks, the Minister also directed the Commission to undertake a number of functions in relation to the investments in the banks such as monitoring their financial performance, consulting the Minister on senior executive and non-executive directors remuneration issues and reporting to the Minister on matters concerning the investment.

42.13 The two directed investments in the financial institutions taken together represented 36.1% of the value of the Fund at 30 June 2009. The Minister has directed that the preference share investments be held at cost.

42.14 The directed investments were funded by €4 billion out of the Fund's existing resources and prepayments of €3 billion provided to the Fund by way of a frontloading of the Exchequer contributions for 2009 and 2010.

Conclusions

The value of the Fund at 31 December 2008 was marginally less than the State's cumulative contribution since its inception in 2001. The composition of its assets has changed substantially with 36% of the Fund being invested in preference shares of two Irish banks at 30 June 2009. The value of these investments depends upon the outcome of asset restructuring, future trading performance and the funding of the banks.

[146] Tier 1 capital includes ordinary shares, retained earnings and other long-term securities subordinate to all other claims on the bank.