

2 Net cost of banking stabilisation measures

- 2.1** Following the onset of the financial crisis in 2008, the State undertook a series of measures to stabilise the banking system, including
- substantial recapitalisation of domestic banks
 - the provision by the Central Bank of exceptional liquidity assistance to domestic banks
 - Government guarantees of deposits and certain other liabilities and
 - the establishment of the National Asset Management Agency (NAMA) to acquire impaired assets from banks.
- 2.2** The exceptional measures undertaken were complex and interrelated, and have a long term impact on the Exchequer. While the amounts invested in recapitalising banks, proceeds from disposals, income accruing from the investments, and estimated residual values can be readily identified, estimation procedures are required to identify the costs incurred by the State in funding the investments.
- 2.3** In previous reports, I have provided estimates of the net cost of the stabilisation measures based on the best information available at the time (at the end of each of the years 2014, 2016 and 2018). Those estimates were generally in the range of €40 billion to €42 billion.¹ Given the elapse of time and the substantial outworking of many of the stabilisation measures, this report was undertaken to review the estimate of net cost to take account of relevant developments since 2018, and of information available up to the end of 2021.

Overview of net cost

- 2.4** Based on the information available up to the end of 2021, this examination has estimated that the net cost to the State from banking stabilisation measures was around €45.7 billion (see Figure 2.1). This estimate takes account of the estimated value at 31 December 2021 of the State's residual investments in banks (€4.9 billion), and of NAMA's retained earnings (€1.8 billion).
- 2.5** The net outturn in respect of the State's level of support for each institution has also been estimated, taking account of the estimated residual value of the State's investments at 31 December 2021 (see Figure 2.2). This is estimated at
- Irish Bank Resolution Corporation (IBRC) — net cost of €37.3 billion
 - Allied Irish Banks plc (AIB) — net cost of €13.1 billion
 - Permanent TSB — net cost of €1.5 billion
 - Bank of Ireland — net surplus of €1.4 billion.
- 2.6** Across the four banks, the outturn indicated is a net cost of €50.5 billion. This does not take account of NAMA's accumulated earnings of €4.8 billion, because these cannot be readily attributed to loans acquired from specific banks (see Figure 2.2).

¹ Report on the Accounts of the Public Services 2014; Report on the Accounts of the Public Services 2016; Report on the Accounts of the Public Service 2018.

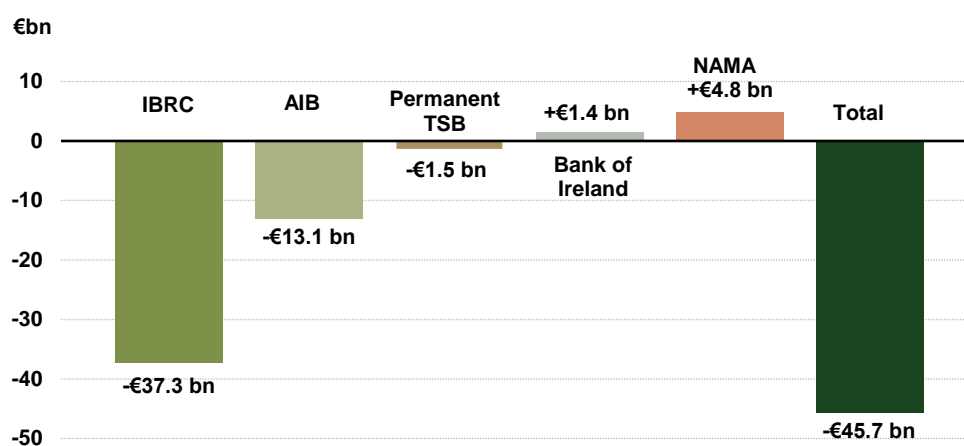
Figure 2.1 Estimated net outturn from banking stabilisation measures as at end-2021

	€bn	€bn
Net investments		
Investments in banks	€66.8	
Disposals of equity/shares	(€12.8)	
Estimated residual value of investments at end-2021	(€4.9)	€49.1
<i>Add net cost of debt servicing</i>		
Cost of debt servicing (estimated) ^a	€28.8	
Central Bank additional income (estimated) ^b	(€16.9)	€11.9
<i>Less income from investments/other measures</i>		
Dividends/interest	(€5.5)	
Net income from liability guarantee schemes and dividend from IBRC special liquidator	(€5.0)	
NAMA surplus paid to Exchequer	(€3.0)	(13.5)
Net cost to the State		€47.5
NAMA's retained earnings		(€1.8)
Estimated net outturn to the State from banking stabilisation measures as at end-2021		€45.7

Estimated long-term recurring annual cost of servicing the debt €0.7 billion to €0.9 billion a year^c

Source: Analysis by the Office of the Comptroller and Auditor General. See Annex 2A 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 Ireland Strategic Investment Fund (ISIF), and premiums paid by the National Treasury Management Agency (NTMA) when it redeemed Government bonds issued to the Central Bank to replace promissory notes.
 - b Estimated portion of the Central Bank's surplus income that is attributable to banking stabilisation measures.
 - c Range assuming rates of 1.5% to 2% per year; actual cost will be determined by the amount realised from the remaining investments and by the State's cost of borrowing.

Figure 2.2 Estimated net outturn for individual banks as at end-2021

Source: Analysis by the Office of the Comptroller and Auditor General. Further detail is set out in Annex 2A.

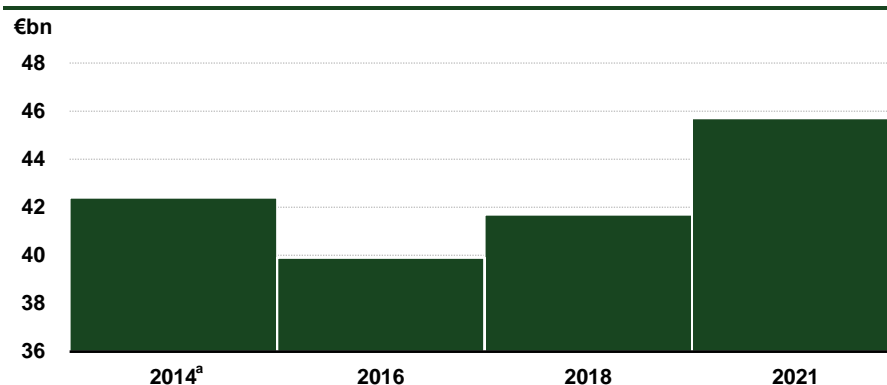
Evolution of estimates of net cost

2.7 The estimate of net cost of the stabilisation measures based on end 2021 information (€45.7 billion) is 8%–15% higher than the previous estimates (see Figure 2.3). This is mainly because

- the estimated net cost of servicing the debt associated with the State's investments includes borrowing costs incurred for three extra years (2019 to 2021)
- the estimated residual value of the State's shareholdings in the banks (adjusted for disposals) is significantly lower.

These adverse impacts are partially offset by dividend receipts from the bank investments and from the IBRC special liquidators, and an increase in NAMA's projected accumulated earnings.

Figure 2.3 Estimates of net cost of banking stabilisation measures using information available at the end of each year 2014, 2016, 2018 and 2021



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

Note a The net cost estimate reported in respect of end 2014 data was €43.1 billion. This has been adjusted here to €42.4 billion, to be consistent with the methodology used in all the later estimates. The adjustment takes account of Central Bank reserves of €800 million and a NAMA accumulated deficit of €75 million, as at end 2014.

Capitalisation of the banks

2.8 Between March 2009 and the end of 2010, the State invested a total of €46.8 billion in the banks. Following a Central Bank review in 2011,¹ the State invested a further €20 billion in the period 2012–2014. The investments — totalling €66.8 billion — were funded as follows

- The Exchequer — €44.4 billion, including €30.85 billion in the form of promissory notes. The promissory notes were eligible collateral for the banks for Exceptional Liquidity Assistance from the Central Bank.
- The Ireland Strategic Investment Fund (ISIF) — €22.4 billion, including ordinary shares received in lieu of dividends on preference shares to the value of €1.7 billion.²

¹ Prudential capital assessment review (PCAR 2011) which identified further capital requirements in three banks — AIB, Bank of Ireland and PTSB. IBRC was not subject to PCAR 2011.

² The investments were originally made by the National Pensions Reserve Fund (NPRF). In 2014, the assets of the NPRF transferred to the ISIF.

2.9 In February 2013, following the appointment of special liquidators to IBRC, promissory notes to the value of €25.034 billion were replaced by Government bonds. Between 2014 and 2021, the NTMA redeemed €19.5 billion of these replacement bonds.

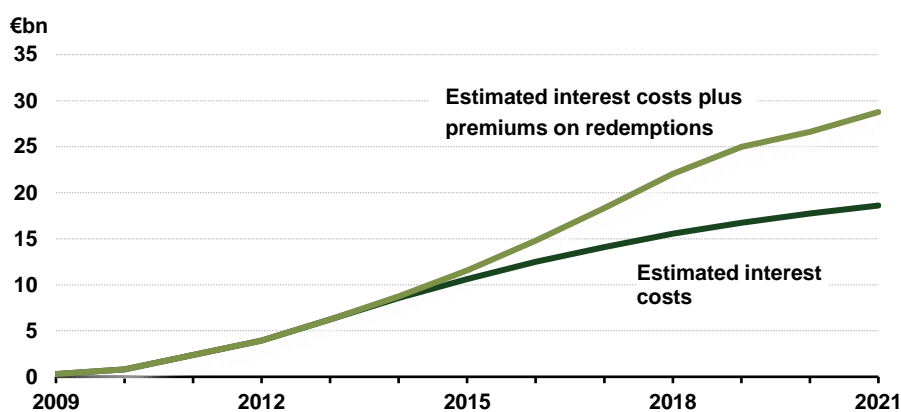
- 2.10** Further detail on the investments, disposals and the income from them is set out in Annex 2B.

Debt-related costs

- 2.11** Because the investments in the banks were funded substantially by increased borrowing, the State bears additional annual debt service and other related costs. In total, the debt-related cost to the State associated with the investments was around €28.8 billion over the period 2009 to 2021 (see Figure 2.4). The cost comprises

- Estimated interest costs (totalling €18.6 billion), including the imputed interest costs of investments made by the ISIF.¹
- Premiums (totalling €10.2 billion) paid by the NTMA when it redeemed Government bonds that had been issued to the Central Bank to replace promissory notes. The premiums arose because the yield on Government bonds was lower at the time of disposal than when the Central Bank acquired the bonds.

Figure 2.4 Cumulative estimated debt-related costs associated with the State's investments in banks, 2009 to 2021^a



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

Note: a Further detail of the estimated debt service costs and the methodology used are set out in Annex 2C. NTMA payments to the Central Bank are described in greater detail in Annex 2D.

¹ Because the ISIF funded its investments from its own resources, there was no direct interest charge. However, 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 ISIF funds had been available to the State for purposes other than investing in banks.

² Surplus income of €22.9 billion before net actuarial losses on the Central Bank's pension scheme of €400 million over the period 2009 to 2021.

³ The other sources of Central Bank income include interest earned on lending conducted by the bank as part of the Eurosystem's monetary policy operations and income earned on securities held under the Eurosystem bond purchase programmes.

Central Bank surplus income related to banking stabilisation

- 2.12** The cost to the State of servicing the debt associated with banking stabilisation measures has been partially offset by related income of the Central Bank of Ireland.
- 2.13** For the years 2009 to 2021, the examination has estimated that around €16.9 billion of the Central Bank's surplus income (total €22.9 billion)² was attributable to financial instruments held as a result of banking stabilisation measures taken by the State (see Figure 2.5).³ All of the Central Bank's surplus income accrues to the State — the Central Bank increased its reserves by retaining 20% of its surplus income (around €3.4 billion relating to banking stabilisation measures); and paid the balance (80%) to the Exchequer (€13.5 billion relating to banking stabilisation measures) in the form of additional annual dividends.

Figure 2.5 Estimate of Central Bank surplus income attributable to transactions in respect of banking stabilisation measures, 2009 to 2021

	Net interest income	Gains on bond disposal	Total
	€bn	€bn	€bn
Exceptional liquidity assistance (ELA) ^a	1.89	—	1.89
Government bonds, or Government-guaranteed bonds, held by the Central Bank ^{b,c}	3.99	11.05	15.04
Total	5.88	11.05	16.93

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

- Notes:
- a Between 2009 and 2013, ELA 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.
 - c €10.2 billion of the gains was paid by the NTMA when it redeemed Government bonds held by the Central Bank; the remaining €0.9 billion was realised from a sale on the open market.

- 2.14** Exceptional liquidity assistance was provided mainly to IBRC, and all of the income and gains in respect of Government bonds was related to IBRC. In total, an estimated €16.7 billion (99%) of the Central Bank's surplus income for the years 2009 to 2021 that arises from banking stabilisation measures is attributable to transactions between the Central Bank and IBRC. The balance is attributable to Bank of Ireland (€99 million), AIB (€66 million) and Permanent TSB (€44 million).
- 2.15** The interest on the bonds held by the Central Bank, and the €10.2 billion premiums paid when the NTMA bought back some of the bonds, is paid by the NTMA from Exchequer funds. Annex 2D provides further detail on Government bonds held by the Central Bank and payments by the NTMA to the Central Bank.

Ongoing debt servicing costs and income from 2021

- 2.16** At the end of 2021, the Exchequer continues to incur the cost of servicing the debt associated with the net €52.4 billion cost of the investments in the banks.¹ The examination estimated that the net debt servicing cost is likely to be around €0.8 billion for 2022.² The bulk of this will be in respect of IBRC (around €0.5 billion) and AIB (around €0.25 billion). The ongoing cost of servicing the debt associated with Permanent TSB is estimated at around €30 million for 2022.
- 2.17** The State has recouped its investment in Bank of Ireland (including associated debt servicing costs), and therefore incurs no ongoing debt servicing costs in respect of that institution.
- 2.18** The estimated annual cost of servicing the debt associated with the investments has fallen in recent years, due to a reduction in the weighted average cost of servicing the national debt which is used to estimate these funding costs (see Figure 2C.2). At the end of 2021 this stood at 1.54%.

1 The net cost of the investments before estimated residual values and NAMA's retained earnings. This funded amount, which incurs interest costs, will reduce as disposals of residual shareholdings take place, and when the balance of NAMA's surplus is paid to the Exchequer.

2 This represents interest costs only. Any premiums paid in respect of bond redemptions will be an additional cost.

- 2.19** The long-term cost of servicing the debt associated with the investments in the banks will depend on a number of factors including
- The amount the State realises from disposal of its residual bank shareholdings, and from any further transfer of NAMA surplus.
 - The period for which the Central Bank continues to hold some Government bonds. (However, this interest expense for the State will be offset by the related surplus income earned by the Central Bank — see above).
 - The cost of funding for the State as it refinances existing debt when it matures.
- 2.20** In the long-term, the cost of servicing the debt associated with the investments is projected to be around €450 million annually for each percentage point that the State pays on its debt.¹ For example, at the average cost of debt of 1.54% at the end of 2021, the cost of servicing the bank stabilisation debt would be around €700 million annually. This estimate does not take account of the additional interest costs that will arise in the future from funding the annual debt servicing costs.

Liability guarantee scheme income

- 2.21** The State guaranteed certain bank liabilities under three main schemes.
- The Deposit Guarantee Scheme (DGS) under which deposits by individuals in covered credit institutions are guaranteed to a limit of €100,000 per eligible depositor per institution.² No fees are payable to the State by the credit institutions covered by 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.³ The credit institutions were required to make payments for the protection provided under the scheme.
 - The Eligible Liabilities Guarantee Scheme (ELG) came into effect in December 2009 and closed to new liabilities in March 2013. The scheme ended in March 2018. The four institutions that participated in the scheme⁴ were required to pay fees for the cover they received.
- 2.22** By the end of 2021, the State had received net income of around €5 billion under the schemes. €4.5 billion had been received in fees. In addition, just over €1.1 billion had been paid in claims, and €1.24 billion, including interest, in respect of guarantee schemes had been received from the IBRC special liquidators.
- 2.23** In addition, the State had received €0.35 billion from the IBRC special liquidators in respect of preference shares held by the State in the former Anglo Irish Bank upon the date of its nationalisation.

¹ Based on estimated net outturn at end-2021. The amount to be funded will increase each year by the amount required to pay ongoing debt servicing costs, and will also incur interest costs.

² Only institutions that are licensed to receive deposits in Ireland and are authorised by the Central Bank are covered.

³ The institutions that availed of the scheme were AIB, Anglo Irish Bank, Bank of Ireland, EBS, Irish Life and Permanent, Irish Nationwide Building Society (INBS) and Postbank Limited (the 'covered banks').

⁴ AIB (including EBS), IBRC, Bank of Ireland and Permanent TSB.

National Asset Management Agency

- 2.24** NAMA was established to acquire certain property-related bank assets (largely loans to debtors who had invested in property) 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 NAMA paid €31.8 billion to banks to purchase loans in respect of which the borrowers owed just over €74.4 billion. The banks incurred losses on the loans of €42.6 billion (57% of the loans' carrying value), precipitating their requirement for recapitalisation.
- 2.25** In 2020 and 2021, NAMA paid a total of €3 billion to the Exchequer, out of its accumulated retained earnings. NAMA's financial statements at end-2021 reported additional accumulated retained earnings of just over €1.8 billion.
- 2.26** At the end of 2021, NAMA was forecasting that it would deliver a total lifetime surplus of €4.5 billion to the Exchequer. NAMA has pointed out that the achievement of the projected lifetime surplus is dependent on realising remaining assets at end-2021 fair value. It also takes into account the projected costs associated with the continued operation of the Agency over the period 2022–2025.
- 2.27** This examination has included NAMA's accumulated earnings of €4.8 billion at end-2021 in its calculation of the estimated net outturn as at end-2021 (€3 billion already paid to the Exchequer by NAMA and a further €1.8 billion of retained earnings at end-2021), and not NAMA's projected lifetime surplus of €4.5 billion.
- 2.28** NAMA managed its loan assets by 'debtor connection', resulting in many portfolios involving borrowing from a number of credit institutions. It is not practical, therefore, to attribute NAMA's contribution to the Exchequer directly to individual banks.

Conclusions

- 2.29** By the end of 2021, the estimated cost to the State of measures taken to stabilise the banking system was a net €45.7 billion, after taking account of the value of the State's remaining shareholdings in AIB, Bank of Ireland and Permanent TSB (a combined €4.9 billion), and NAMA's retained earnings at the end of 2021 (€1.8 billion).
- 2.30** The most significant net costs to the State at the end of 2021 were in respect of
- IBRC, which had a net estimated cost of €37.3 billion.
 - AIB, which had an estimated net cost of €13.1 billion, after taking account of the value of the State's residual shareholding at end-2021 (€4.0 billion).
- 2.31** The eventual net outturn will be impacted by a number of factors
- the extent to which the amounts realised by the State for its remaining shareholdings differs from the end-2021 values
 - whether the final surplus from NAMA differs significantly from its end-2021 accumulated earnings of €4.8 billion — there may be limited scope for NAMA to achieve any significant increase from this figure, as its assets (excluding cash) at end-2021 amounted to only around €1 billion
 - the ongoing cost of servicing the associated long-term debt.

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

- 2.32** In the long-term, when all of the State's remaining shareholdings have been sold, NAMA has realised the balance of its surplus and the Central Bank has disposed of the government bonds it holds, the cost of servicing the debt will be determined by the prevailing borrowing costs for the State — around €450 million for each percentage point incurred. For borrowing rates between 1.5% and 2.5%, it is estimated the interest cost will be between €0.7 billion and €1.1 billion a year for the foreseeable future. This estimate does not take account of additional interest costs that will arise in the future from funding the annual debt servicing costs.
- 2.33** Overall, unless the State realises significantly more than end-2021 values for its residual shareholdings, the overall net cost of the banking stabilisation measures will be around €46 billion. This net cost will increase by upwards of €0.7 billion annually (from end-2021) due to the cost of servicing this level of debt, with the extent of the increase determined by the State's average cost of borrowing.

Annex 2A Outturn as at end-2021

Figure 2A.1 shows the components of the net outturn from banking stabilisation measures as at 31 December 2021 for each bank.

Figure 2A.1 Estimated net outturn, by bank, from banking stabilisation measures as at 31 December 2021

	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)
Disposals of investments	6.7	4.3	1.8	12.8	—	12.8
Estimated cost of servicing debt associated with the investments	(7.1)	(0.7)	(0.7)	(8.5)	(20.3)	(28.8)
Related income from the Central Bank ^b	0.1	0.1	—	0.2	16.7	16.9
Income from investments	3.6	1.7	0.2	5.5	—	5.5
Fees received under liability guarantee schemes	1.8	1.5	0.7	4.0	0.5	4.5
Claims made under liability guarantee scheme	—	—	—	—	(1.1)	(1.1)
Receipts from IBRC special liquidators ^c	—	—	—	—	1.6	1.6
NAMA surplus paid to Exchequer ^d	—	—	—	—	—	3.0
Estimated net cost as at 31 December 2021	(17.1)	1.0	(2.0)	(18.1)	(37.3)	(52.4)
Estimated residual value as at 31 December 2021 ^e	4.0	0.4	0.5	4.9	—	4.9
NAMA retained earnings as at 31 December 2021 ^d	—	—	—	—	—	1.8
Estimated net outturn as at 31 December 2021	(13.1)	1.4	(1.5)	(13.2)	(37.3)	(45.7)

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

- Notes:
- 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).
 - 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 2A.1.
 - €1.6 billion received from the IBRC special liquidators comprised €1.24 billion, including interest, in respect of guarantee schemes and €0.35 billion dividend in respect of preference shares.
 - NAMA's accumulated earnings cannot be attributed to individual banks.
 - See Annex 2B for further details.

Annex 2B 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 2021, made disposals to the value of €12.7 billion (see Figure 2B.1).

Figure 2B.1 Capitalisation of banks — investments and disposals, December 2021

	AIB	Bank of Ireland	Permanent TSB	Trading banks total	IBRC	Total
	€bn	€bn	€bn	€bn	€bn	€bn
Investments						
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	3.4	1.4	0.1	4.9	—	4.9
Preference shares	1.7	1.9	—	3.6	—	3.6
Contingent capital notes	1.6	1.0	0.4	3.0	—	3.0
Irish Life	—	—	1.3	1.3	—	1.3
Disposals of investments	6.7	4.3	1.8	12.8	—	12.8
Net investment	(15.5)	(1.6)	(2.2)	(19.3)	(34.7)	(54.0)

Source: Ireland Strategic Investment Fund and Department of Finance

- Notes:
- 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).
 - In March 2009, the ISIF invested €3.5 billion in preference shares in Bank of Ireland. In quarter one 2010, a total of €1.66 billion of these shares were converted to ordinary shares (included in ordinary shares above).
 - 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%.
 - 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.
 - 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 2021 amounted to €5.44 billion and the estimated residual value of the State's investments in banks as at 31 December 2021 was €4.9 billion (see Figure 2B.2).

Figure 2B.2 Income from and estimated residual value of State's investments in banks, December 2021

Income from investments	AIB	Bank of Ireland	Permanent TSB	Total
	€bn	€bn	€bn	€bn
<i>ISIF</i>				
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 ordinary shares	0.81	0.04	—	0.85
Dividends on preference shares	0.45	0.74	—	1.19
Cancellation of preference share warrants	0.05	0.49	—	0.54
<i>Exchequer</i>				
Coupon interest on contingent capital notes	0.80	0.15	0.15	1.10
Accrued dividend on sale of Irish Life	—	—	0.04	0.04
Total	3.55	1.70	0.19	5.44
Estimated residual value of investments				Valuation
Bank				€bn
IBRC				—
AIB ^a				4.0
Bank of Ireland ^a				0.4
Permanent TSB ^a				0.5
Total				4.9

Source: Ireland Strategic Investment Fund and Department of Finance

Note: a The equity held in AIB, Bank of Ireland and Permanent TSB was valued at market prices.

Annex 2C 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 ISIF investments, as at end-2021 as around €28.8 billion (see Figure 2C.1).

Figure 2C.1 Estimated cost of servicing debt associated with the investments, 2009 to 2021 (including the imputed debt service costs of ISIF investments)

Classified by Year	2009 to 2018	2019	2020	2021	Total
	€bn	€bn	€bn	€bn	€bn
Source of funding					
Exchequer ^a	16.1	2.6	1.4	1.9	22.0
ISIF	5.9	0.3	0.3	0.3	6.8
Total	22.0	2.9	1.7	2.2	28.8

Classified by Bank	AIB	Bank of Ireland	Permanent TSB	Trading banks total	IBRC	Total
	€bn	€bn	€bn	€bn	€bn	€bn
Source of funding						
Exchequer ^{a,b}	1.0	0.0	0.7	1.7	20.3	22.0
ISIF	6.1	0.7	—	6.8	—	6.8
Total	7.1	0.7	0.7	8.5	20.3	28.8

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

Notes: a Exchequer source of funding includes interest paid on promissory notes issued in 2010, interest paid on floating rate Government bonds that were issued to replace the promissory notes, and premiums paid by the NTMA to repurchase floating rate notes from the Central Bank.

b Around €40 million was incurred in respect of Exchequer funding for Bank of Ireland. Due to rounding, this appears as nil in this table.

The methodology used to calculate the estimated cost of servicing the debt associated with each source of funding is set out in Figure 2C.2.

Figure 2C.2 Methodologies used to estimate cost of funding investments in banks as at end-2021

Source of funding	Method
Exchequer funding	<ul style="list-style-type: none"> <li data-bbox="638 421 1426 577">▪ For the years 2009 to 2014, 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 the years 2015 to 2021, the rate used was the weighted average cost of servicing the national debt at the end of each year as provided by the NTMA. <li data-bbox="638 595 1426 678">▪ 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. <li data-bbox="638 696 1426 757">▪ The cost of funding Government bonds (including floating rate notes) was calculated using the rates applying to the bonds. <li data-bbox="638 775 1426 857">▪ Premiums paid by the NTMA to redeem Government bonds held by the Central Bank are treated as an expense in the year in which they are paid, and the associated income from the Central Bank is treated as income.
ISIF	<p data-bbox="638 887 1426 1070">The ISIF 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.</p> <ul style="list-style-type: none"> <li data-bbox="638 1088 1426 1451">▪ The first was to estimate the opportunity cost — that is, what the ISIF would have earned if it had retained the funds to invest at its discretion. The ISIF 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 ISIF 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 (when the assets were held by the NPRF). For the seven years 2015 to 2021 the ISIF reported an annualised average return of 4.5% on its discretionary investments. <li data-bbox="638 1469 1426 1686">▪ 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 ISIF (€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 ISIF funds had been available to the State for purposes other than investing in banks. <p data-bbox="638 1704 1426 1765">The second approach (which gave a significantly lower cost of funding than the first approach) was used by the examination (including from 2015 on).</p>

Source: Office of the Comptroller and Auditor General

Annex 2D Government bonds held by the Central Bank

In 2013, the Central Bank acquired Government bonds with a nominal value of €28.5 billion issued by the NTMA following the liquidation of IBRC. Between 2013 and 2021, the Central Bank realised gains of €11.1 billion from the disposal of some of these bonds.

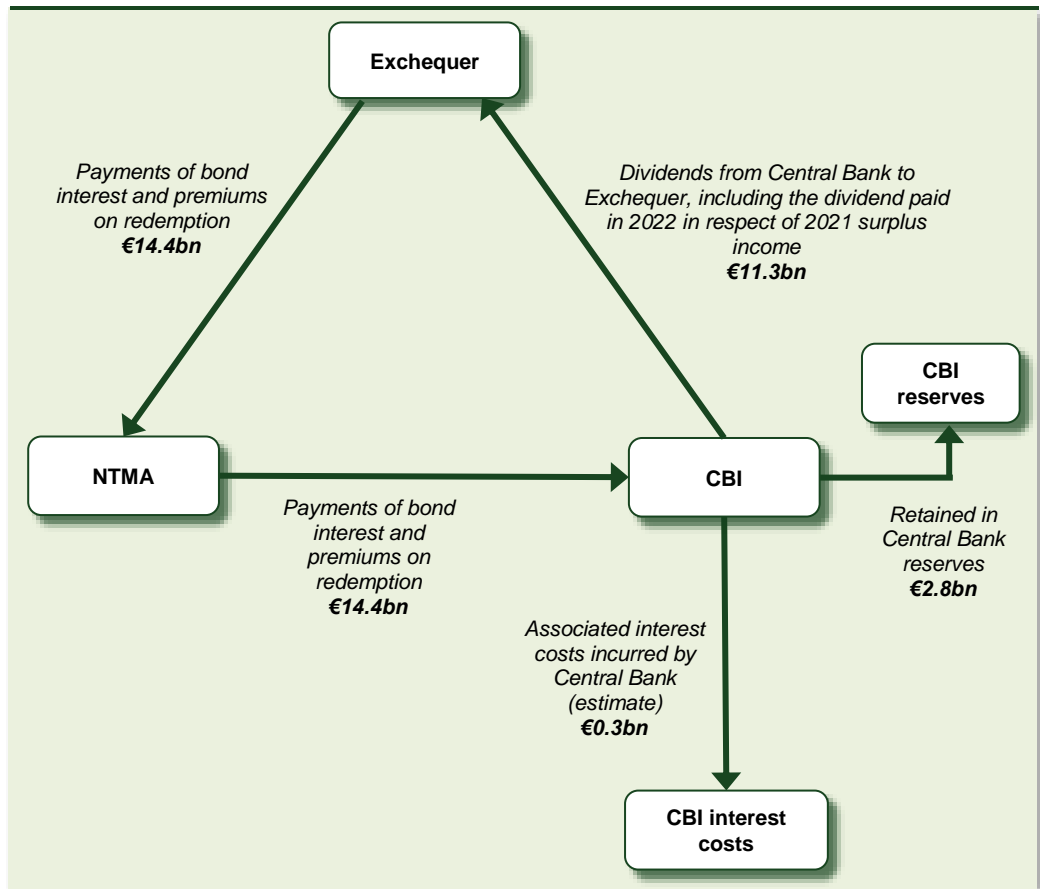
- €10.2 billion of the gains arose from a disposal back to the NTMA of floating rate bonds with a nominal value of €19.5 billion.
- €0.9 billion of the gains arose from disposals to the open market of a 5.4% Government bond.

NTMA payments to the Central Bank

The interest on the bonds held by the Central Bank, and the €10.2 billion premiums paid when the NTMA bought back some of the bonds, is paid by the NTMA from Exchequer funds.

A significant proportion (over 78%) 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 2D.1.

Figure 2D.1 IBRC-related bonds held by Central Bank (CBI) — flow of funds from/to Exchequer, 2013 to 2021^a

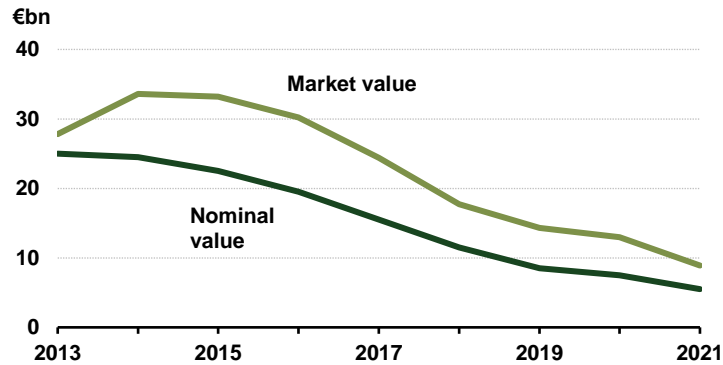


Source: Analysis by the Office of the Comptroller and Auditor General

Note: a In addition, the Central Bank realised a further €0.9 billion from the disposal of IBRC-related bonds on the open market. These funds did not come from the Exchequer.

At the end of 2021, the Central Bank held floating rate bonds with a nominal value of €5.5 billion and a market value of €8.9 billion (see Figure 2D.2). The Central Bank has stated that it intends to sell its remaining floating rate bonds as soon as possible, provided conditions of financial stability permit, and that it will sell a minimum of the bonds in accordance with the following schedule: 2022–2023 (€1.0bn nominal value per annum) and from 2024 on (€2.0bn per annum until all bonds are sold).

Figure 2D.2 Floating rate notes held by Central Bank of Ireland, nominal and market values, 2013 to 2021



Source: Central Bank of Ireland Annual Reports 2013 to 2021. Analysis by the Office of the Comptroller and Auditor General.

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 Central Bank in its reserves.¹ The NTMA will then pay interest, at the lower refinanced rate, to an external party on the funds it has borrowed 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 prior to disposal. This higher interest rate (compared with the lower interest cost if the NTMA redeems the bonds) 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.

