2021

Cost of Banking Stabilization Measures as at end-2018

Ireland: Comptroller and Auditor General

2 Cost of banking stabilisation measures as at end-2018

2.1 Following the onset of the financial crisis in 2008, the State undertook a series of measures to stabilise the banking system. This included the provision by the Central Bank of exceptional liquidity assistance to domestic banks, Government guarantees of deposits and certain other liabilities, significant recapitalisation of domestic banks and the establishment of the National Asset Management Agency (NAMA) to acquire impaired assets from banks.

2.2 Previous *Reports on the Accounts of the Public Service* provided estimates of the net cost of the banking stabilisation measures as at the end of 2014 and the end of 2016.[1] The net overall cost continues to evolve as the interventions end or wind down. The purpose of this report is to provide an updated estimate, as at the end of 2018.

2.3 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. The same methodology was applied to estimate the net cost of the stabilisation measures as at the end of 2014 and the end of 2016.

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

Overview of net costs

2.4 The examination analysis has estimated that the net cost to the State from banking stabilisation measures up to the end of 2018 was around €41.7 billion (see Figure 2.1). This estimate is after taking account of the estimated value at 31 December 2018 of the State's investments in banks (€8.4 billion), and NAMA's retained earnings at the end of 2018 (€4.2 billion).

2.5 The estimate of the net cost of banking stabilisation has remained relatively consistent since the initial estimate was produced in respect of the end of 2014. Using a consistent methodology for each period,[1] the net cost has been in the range of €40 billion to €42.4 billion.

Figure 2.1 Estimated net outturn from banking stabilisation measures as at end-2018

Net investments	**€bn**	**€bn**
Investments in banks	€66.8	
Disposals of equity/shares	(€12.4)	
Estimated residual value of investments at end-2018	(€8.4)	**€46.0**
Add net cost of debt servicing		
Cost of debt servicing (estimated)[a]	€22.0	
Central Bank additional income (estimated)[b]	(€12.7)	**€9.3**
Less income from investments/other measures		
Dividends/interest	(€5.1)	
Net income from liability guarantee schemes	(€4.3)	**(€9.4)**
Net cost to the State		**€45.9**
NAMA's retained earnings		**(€4.2)**
Estimated net outturn to the State from banking stabilisation measures as at end-2018		**€41.7**
Estimated long-term recurring annual cost of servicing the debt €1.1 billion to €1.3 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 ISIF, and premiums paid by the NTMA when it redeemed Government bonds that had been 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 interest rates of 2.5% to 3.0% per year; actual cost will be determined by the amount realised from remaining investments and by State's cost of borrowing.

1 The 2014 estimated net outturn was previously reported as €43.1 billion. This did not take account of the Central Bank reserves of around €800 million arising from income related to banking stabilisation measures nor of NAMA's accumulated deficit at the end of 2014 of €75 million. The estimated net outturn has been adjusted to be consistent with the end of 2016 and end of 2018 estimates.

Capitalisation of banks

2.6 The investments of €66.8 billion in banks were funded through

- The Exchequer — €44.4 billion, including €30.85 billion in the form of promissory notes. In February 2013, following the appointment of special liquidators to Irish Bank Resolution Corporation (IBRC), promissory notes to the value of €25.034 billion which were held by the Central Bank as collateral for lending to IBRC were replaced by Government bonds. Between 2014 and 2018, the NTMA redeemed €13.5 billion of these replacement bonds.
- 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.[1]

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

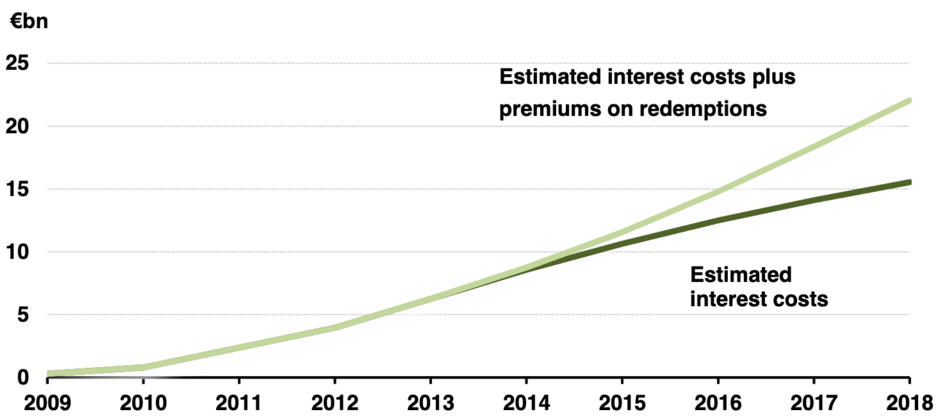
Debt-related costs

2.8 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 €22 billion over the period 2009 to 2018. The cost comprises (see Figure 2.2)

- estimated interest costs (totalling €15.5 billion), including the imputed interest costs of investments made by the ISIF[2]
- premiums (totalling €6.5 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.

2.9 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.

Figure 2.2 Cumulative estimated debt-related costs associated with the State's investments in banks, 2009 to 2018



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

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

2 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.

Central Bank income relating to banking stabilisation

2.10 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.

2.11 For the years 2009 to 2018, the examination has estimated that around €12.7 billion of the Central Bank's surplus income (total €18 billion) was attributable to financial instruments held as a result of banking stabilisation measures taken by the State (see Figure 2.3).[1] All of the Central Bank's surplus income accrues to the State — the Central Bank retained 20% of surplus income relating to banking stabilisation measures (around €2.5 billion), thereby increasing its reserves, and paid the balance to the Exchequer (€10.2 billion) in the form of additional annual dividends.

Figure 2.3 Estimate of Central Bank surplus income attributable to transactions in respect of banking stabilisation measures, 2009 to 2018

	Net interest income	Gains on bond disposal	Total
	€bn	€bn	€bn
Exceptional liquidity assistance[a]	1.89	—	1.89
Government bonds, or Government-guaranteed bonds, held by the Central Bank[b,c]	3.43	7.38	10.81
Total	**5.32**	**7.38**	**12.70**

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

Notes: a Between 2009 and 2013, exceptional liquidity assistance 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 €6.5 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.

2.12 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 €12.5 billion (98%) of the Central Bank's surplus income for the years 2009 to 2018 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).

2.13 The interest on the bonds held by the Central Bank, and the €6.5 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.

1 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.

Ongoing debt servicing costs and income from 2019

2.14 At the end of 2018, the Exchequer continues to incur the cost of servicing the debt associated with the net €54.3 billion cost of the investments in the banks.[1] The examination estimated that this cost is likely to be around €1.2 billion for 2019.[2] The bulk of this is in respect of IBRC (around €0.8 billion) and AIB (just under €0.4 billion). The State has recouped its investment in Bank of Ireland (including associated debt servicing costs), and, therefore, incurs no ongoing debt servicing costs. The ongoing annual cost of servicing the debt associated with Permanent TSB is estimated at around €50 million per annum.

2.15 The long-term cost of servicing the debt associated with the investments will depend on a number of factors including

- The amount the State realises from its remaining investments i.e. the amount the State realises from disposal of bank shareholdings and any NAMA surplus.
- The period for which the Central Bank continues to hold Government bonds. While the Central Bank continues to hold some of these bonds, the interest expense for the State will be offset by income from the Central Bank.
- The cost of funding for the State as it refinances existing debt when it matures.

2.16 In the long-term, the cost of servicing the debt associated with the investments is projected to be around €420 million annually for each percentage point that the State pays on its debt.[3] For example, at an average cost of debt of 2.5%, the cost of servicing the debt would be around €1.1 billion 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 Schemes income

2.17 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.[4] No fees are payable to the State under 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.[5] 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. At that time, liabilities of around €74.6 billion were guaranteed under the scheme. The scheme ended in March 2018. The four institutions that participated in the scheme[6] were required to pay fees for the cover they received.

2.18 By the end of 2018, the State had received net income of around €4.3 billion under the schemes. €4.5 billion had been received in fees (see Figure 2.4). In addition, almost €1.1 billion had been paid in claims, and €900 million had been received from the IBRC special liquidators.[7]

1 The net cost of the investments before estimated residual values (€8.4bn) and NAMA's retained earnings (€4.2bn). This funded amount, which incurs interest costs, will reduce as disposals of residual shareholdings take place, and when 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.

3 Based on estimated values at end-2018. 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.

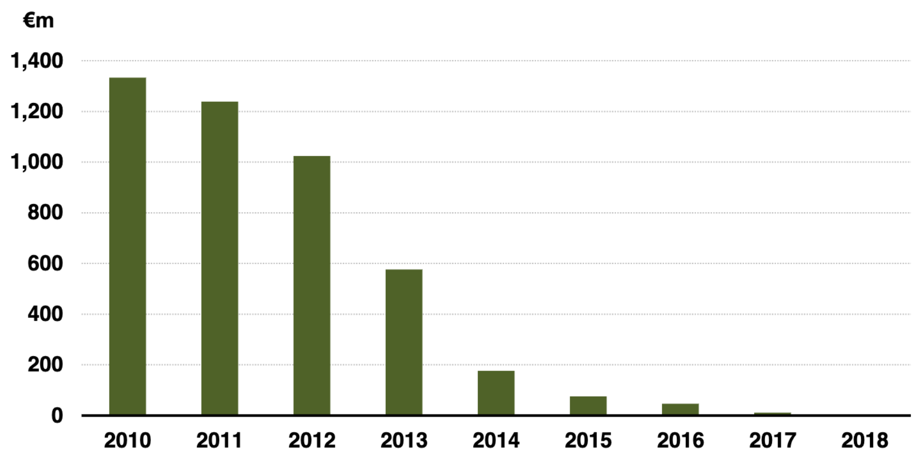
4 Only institutions that are licensed to receive deposits in Ireland and are authorised by the Central Bank are covered.

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

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

7 In February 2019 a further €225 million was received from the special liquidators.

Figure 2.4 Fee income from liability guarantee schemes, 2010 to 2018



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

National Asset Management Agency

2.19 NAMA's purpose was 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.[1,2]

2.20 NAMA paid €31.8 billion to banks to purchase property-related loans in respect of which the borrowers owed just over €74.4 billion. The losses incurred by the banks on the loans was of the order of €42.6 billion, or 57% of the loans' carrying value.

2.21 At the end of 2018, NAMA's financial statements reported accumulated retained earnings of just over €4.2 billion. This is reflected in NAMA's projections at the end of 2018 that it will have an end-of-life yield to the Exchequer of €4 billion. NAMA has stated that this yield is subject to prevailing market conditions.

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

2 In addition, in 2013 following a direction from the Minister for Finance, NAMA acquired from the Central Bank a loan facility deed and floating charge over certain IBRC assets for €12.9 billion in Government guaranteed bonds. The special liquidators repaid the loan facility deed in full and the bonds were redeemed in full in October 2014.

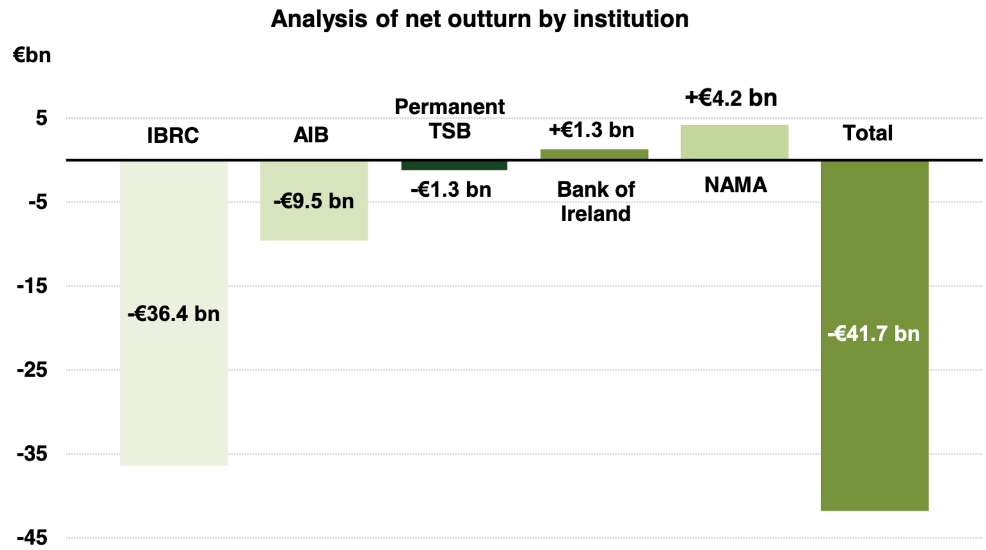
Outturn for individual banks

2.22 After taking account of the estimated residual value of the State's investments, the estimated net outturn, as at 31 December 2018, in respect of the State's level of support for each institution was (see Figure 2.5)

- IBRC — estimated net cost of €36.4 billion
- AIB — estimated net cost of €9.5 billion
- Permanent TSB — estimated net cost of €1.3 billion
- Bank of Ireland — estimated net surplus of €1.3 billion.

2.23 NAMA's retained earnings of around €4.2 billion cannot readily be attributed to loans acquired from specific banks.

Figure 2.5 Estimated net outturn from banking stabilisation measures as at end-2018



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

Conclusions

2.24 By the end of 2018, the estimated cost to the State of measures taken to stabilise the banking system was a net €41.7 billion, after taking account of the value of the State's remaining shareholdings in AIB, Bank of Ireland and Permanent TSB (a combined €8.4 billion), and NAMA's retained earnings at the end of 2018 (€4.2 billion).

2.25 The net costs will continue to rise due to the ongoing cost of servicing the associated long-term debt. In the long term, when all of the State's remaining shareholdings have been sold, NAMA has realised 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 €420 million for each percentage point incurred. For borrowing rates between 2.5% and 3%, it is estimated the interest cost will be between €1.1 billion and €1.3 billion a year for the foreseeable future.

2.26 The eventual net outturn will also be impacted by the extent to which the NAMA surplus and the amounts the State realises for its remaining shareholdings differ from the end of 2018 values.

2.27 The State is not expected to recover further significant funds from its investment in IBRC, which had a net estimated cost of €36.4 billion at the end of 2018.

2.28 It is unlikely that the State will generate a surplus on its investment of €22.2 billion in AIB. At the end of 2018, this investment has cost the State an estimated €9.5 billion, after taking account of the €7.1 billion value of the State's remaining shareholding in AIB. Projected outcomes that the State might recover the full investment do not appear to take account of the estimated cost of servicing the debt associated with the investment (€6.2 billion by the end of 2018).

Annex 2A Outturn as at end-2018

Figure 2A.1 shows the components of the net outturn from banking stabilisation measures as at 31 December 2018 for each bank.

Figure 2A.1 Estimated net outturn, by bank, from banking stabilisation measures as at 31 December 2018

	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	3.9	1.8	12.4	—	12.4
Estimated cost of servicing debt associated with the investments	(6.2)	(0.7)	(0.6)	(7.5)	(14.5)	(22.0)
Related income from the Central Bank [b]	0.1	0.1	—	0.2	12.5	12.7
Income from investments	3.2	1.7	0.2	5.1	—	5.1
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)
Dividend from IBRC special liquidators	—	—	—	—	0.9	0.9
Estimated net cost as at 31 December 2018	**(16.6)**	**0.6**	**(1.9)**	**(17.9)**	**(36.4)**	**(54.3)**
Estimated residual value as at 31 December 2018[c]	7.1	0.7	0.6	8.4	—	8.4
NAMA retained earnings as at 31 December 2018[d]	—	—	—	—	—	4.2
Estimated net outturn as at 31 December 2018	**(9.5)**	**1.3**	**(1.3)**	**(9.5)**	**(36.4)**	**(41.7)**

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

Notes:

a 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).

b 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.

c See Annex 2B for further details.

d NAMA's retained earnings cannot be attributed to individual banks.

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 2018, made disposals to the value of €12.4 billion (see Figure 2B.1).

Figure 2B.1 Capitalisation of banks — investments and disposals, December 2018

	AIB	Bank of Ireland	Permanent TSB	Trading banks total	IBRC	Total
Investments	**€bn**	**€bn**	**€bn**	**€bn**	**€bn**	**€bn**
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	1.0	0.1	4.5	—	**4.5**
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**	**3.9**	**1.8**	**12.4**	**—**	**12.4**
Net investment	**(15.5)**	**(2.0)**	**(2.2)**	**(19.7)**	**(34.7)**	**(54.4)**

Sources: Ireland Strategic Investment Fund and Department of Finance

Notes:

a 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).

b 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).

c 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%.

d 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.

e 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 2018 amounted to €5.1 billion and the estimated residual value of the State's investments in banks as at 31 December 2018 was €8.4 billion (see Figure 2B.2).

Figure 2B.2 Income from and estimated residual value of State's investments in banks, December 2018

Income from investments	AIB	Bank of Ireland	Permanent TSB	Total
	€bn	€bn	€bn	€bn
ISIF				
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	0.50	0.02	—	0.52
Dividends on preference shares	0.45	0.74	—	1.19
Cancellation of preference share warrants	0.05	0.49	—	0.54
Exchequer				
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	**3.24**	**1.68**	**0.19**	**5.11**

Estimated residual value of investments	Valuation
Bank	**€bn**
IBRC[a]	—
AIB[b]	7.1
Bank of Ireland[b]	0.7
Permanent TSB[b]	0.6
Total	**8.4**

Sources: Ireland Strategic Investment Fund and Department of Finance

Notes:
a The Department of Finance considers that the outstanding investment in IBRC is irrecoverable.
b 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-2018 as around €22.0 billion (see Figure 2C.1).

Figure 2C.1 Estimated cost of servicing debt associated with the investments, 2009 to 2018 (including the imputed debt service costs of ISIF investments)

Classified by Year	2009 to 2016	2017	2018	Total
	€bn	€bn	€bn	€bn
Source of funding				
Exchequer[a]	9.8	3.0	3.3	16.1
ISIF	5.0	0.5	0.4	5.9
Total	**14.8**	**3.5**	**3.7**	**22.0**

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	0.6	1.6	14.5	16.1
ISIF	5.2	0.7	—	5.9	—	5.9
Total	**6.2**	**0.7**	**0.6**	**7.5**	**14.5**	**22.0**

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

Note: 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-2018

Source of funding	Method
Exchequer funding	▪ 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 2018, the rate used was the weighted average cost of borrowing by the NTMA at the end of each year. ▪ 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. ▪ The cost of funding Government bonds (including floating rate notes) was calculated using the rates applying to the bonds. ▪ 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	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. ▪ 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 four years 2015 to 2018 the ISIF reported an annualised average return of 1.9% on its discretionary investments. ▪ 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 has been available to the State for purposes other than investing in banks. The second approach (which gave a significantly lower cost of funding than the first approach) was used by the examination (including from 2015 on).

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 2018, the Central Bank realised gains of €7.4 billion from the disposal of some of these bonds.

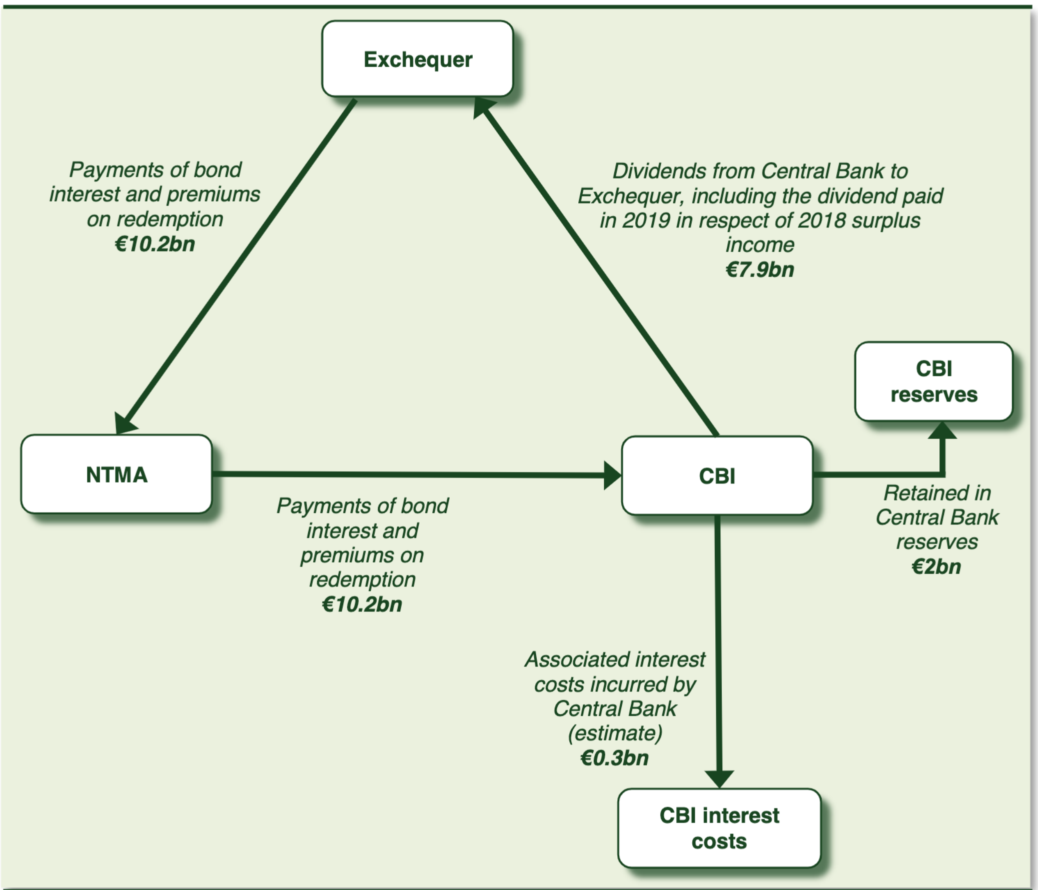
- €6.5 billion of the gains arose from a disposal back to the NTMA of floating rate bonds with a nominal value of €13.5 billion.
- €0.9 billion of the gains arose from disposals to the open market of a 5.4% Government bond.

NTMA payments to the Central Bank

The interest on the bonds held by the Central Bank, and the €6.5 billion premiums paid when the NTMA bought back some of the bonds, is paid by the NTMA from Exchequer funds.

A significant proportion (just over 77%) 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 — flow of funds from/to Exchequer, 2013 to 2018[a]

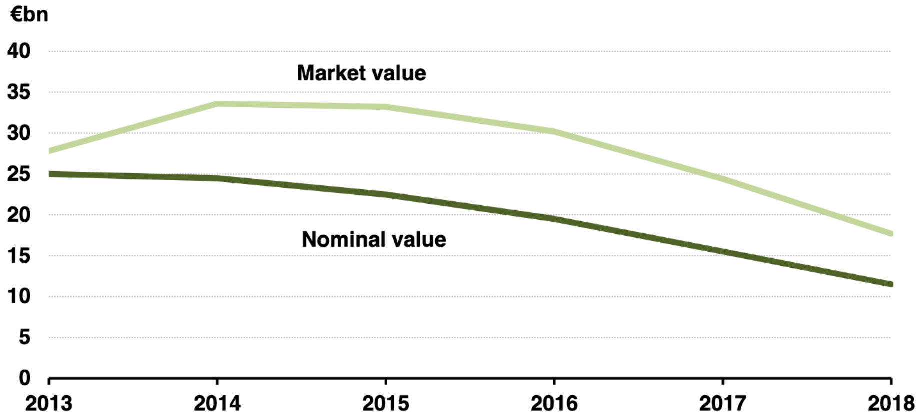


Source: Analysis by the Office of the Comptroller and Auditor General

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 2018, the Central Bank held floating rate bonds with a nominal value of €11.5 billion and a market value of €17.7 billion (see Figure 2D.2). If the Central Bank continues to dispose of these bonds at the same rate as in the period 2014 to 2018, it will have disposed of all the bonds by the end of 2021.

Figure 2D.2 Floating rate notes held by Central Bank of Ireland, nominal and market values 2013 to 2018



Source: Central Bank of Ireland Annual Reports 2013 to 2018. 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 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.