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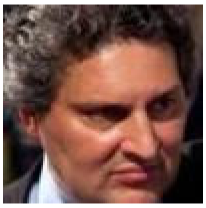
Ireland progressing well through rehab

22 August 2012 | By Keith Mullin, Capital City

I like the idea of amortising debt. In the context of the European debt crisis, it's a great way for governments to exit the interest-only never-pay-off-the debt world they inhabit. I'd suggested in July that a way back into the capital markets for cash-strapped peripheral sovereigns could be offering amortising bonds, if necessary with the sinking fund financed or at least backstopped by the EU rescue apparatus.



IFR Editor-at-large Keith Mullin

But Ireland has gone one better, responding to reverse enquiry and accelerating the plans it had already laid out to issue its own amortisers and linkers to domestic pension funds. The combination of the sovereign's outright bond sales and switches in July and proceeds from the sale of amortising and inflation-linked bonds will pre-fund what had been looking like a worrisome €8.2bn bond redemption in January 2014.

Irish Amortising Bonds (IABs) will be sold to domestic pension funds in the form of sovereign annuities. These are issued by insurance companies and annual income payments are linked directly to payments on underlying reference bonds issued by Ireland or other EU member states. They can only be bought by the trustees of occupational pension schemes (both defined benefit and defined contribution schemes).

IABs will be sold in a range of 15, 20, 25, 30 and 35-year maturities through the sovereign's primary dealer panel (Barclays, BNPP, Citigroup, CA-CIB, Danske Bank, Davy, DB, GS, HSBC, ING, JPM, BofA Merrill, Nomura, RBS, SG and UBS). The initial sale of €500m–€1bn will form part of a programme of between €3bn and €5bn of IABs and linkers sold by the National Treasury Management Agency over the next 18 months.

The NTMA is likely to offer a tonky yield to get paper away, which will be gratefully accepted by pension fund investors battling against deficits and low returns from investing in annuities linked to core European government bonds.

Ireland had marked its post-bailout market debut on July 26 when it received €5.23bn in cash commitments through outright cash sales of €4.19bn (via two new lines of stock) plus €1.04bn in bond swaps (extended to holders of due 2013 and 2014 bonds in return for the new October 2017 or the existing October 2020). That exercise was the sovereign's first foray into the market since 2010. Standing on its own two feet and issuing in its own name is a crucial component of the bailout.

Slightly hedging its bets, agreed payments on sovereign annuities can be written down if there is a non-performance event in relation to the reference bond/bonds (basically non-payment of capital or coupon on the due date). On the upside, investors can also be written up in the event of recovery.

At the end of July, Ireland's national debt still stood at €131.7bn so it has some ways to go before it's out of the maze. But if you take the success of the July exercise; plans for IABs and linkers; and the fact that the yield on Ireland's nine-year bond fell below 6% on Tuesday for the first time in close to two years, you get the impression that the sovereign's capital markets rehabilitation is progressing well.

- Company Profile
- Firm Profile

- Fund Profile
- LP Profile

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