



National Asset  
Management Agency

# **Different Models for Supporting Banking Institutions**

Richard Cantillon School  
Friday 10<sup>th</sup> September  
2010

“Ireland is paying for its decision to set up a toxic-loan repository that forces banks to clean up their balance sheets vigorously, rather than put off dealing with problems (as Germany has done) or insure dodgy loans and just hope they improve (as Britain has). In the long run Ireland’s response is the better one, but in the short term it puts pressure on the borrowing because the government has to keep injecting capital into broken banks”

- *Source:* The Economist “Ireland’s Banking Mess; Austerity is not enough to avoid the scrutiny by the markets”. August 19<sup>th</sup> 2010 .

# Facts – Irish Financial Institutions

The losses already exist in the loan books of financial institutions due to poor lending practices and declines in asset values – what NAMA does is that it forces the upfront recognition of those losses by the banks.

## **CLARITY**

The banks would have to be recapitalised in any event to deal with these losses.

## **INEVITABILITY**

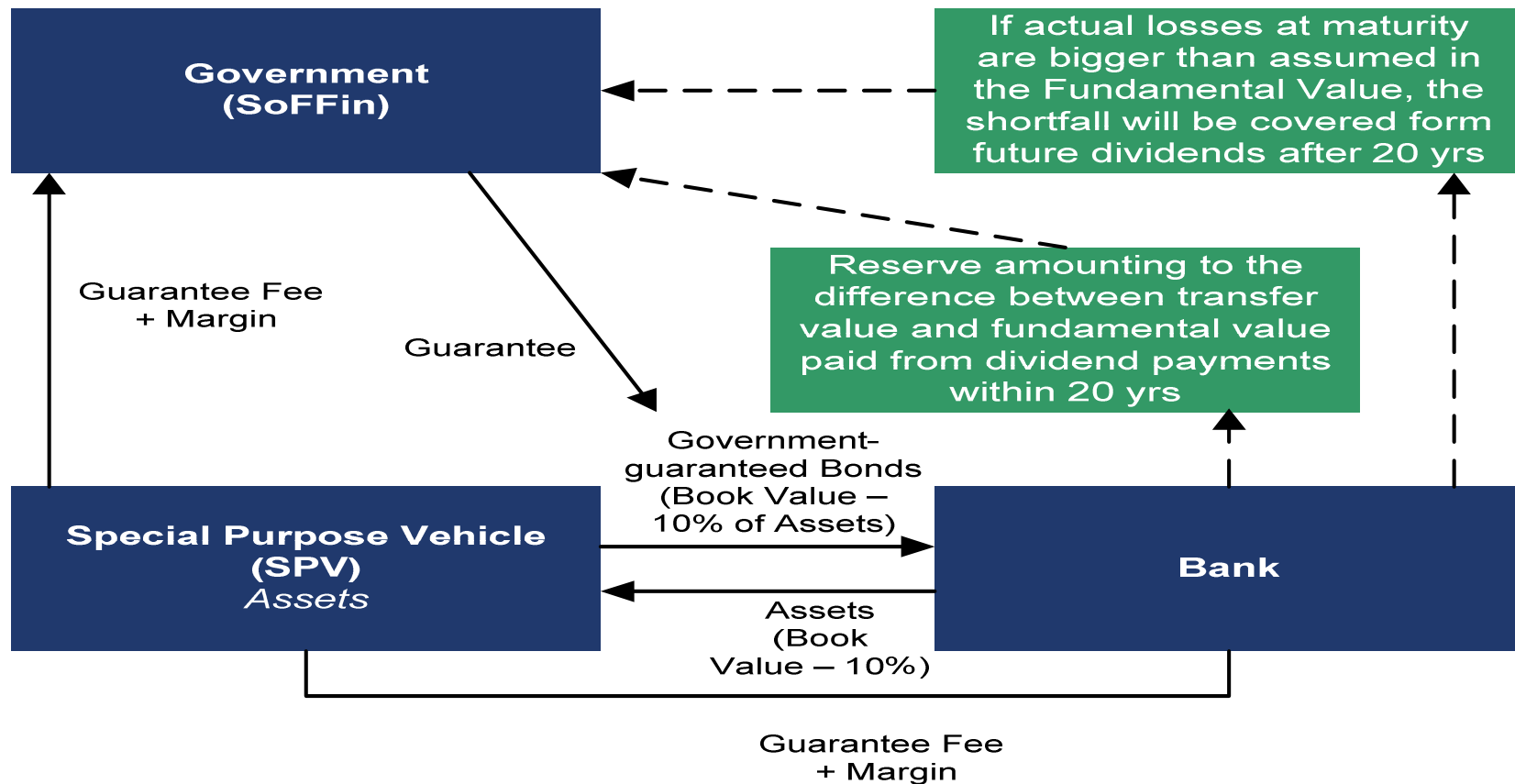
NAMA does provide liquidity to the banking system.

## **ACCESSIBILITY**

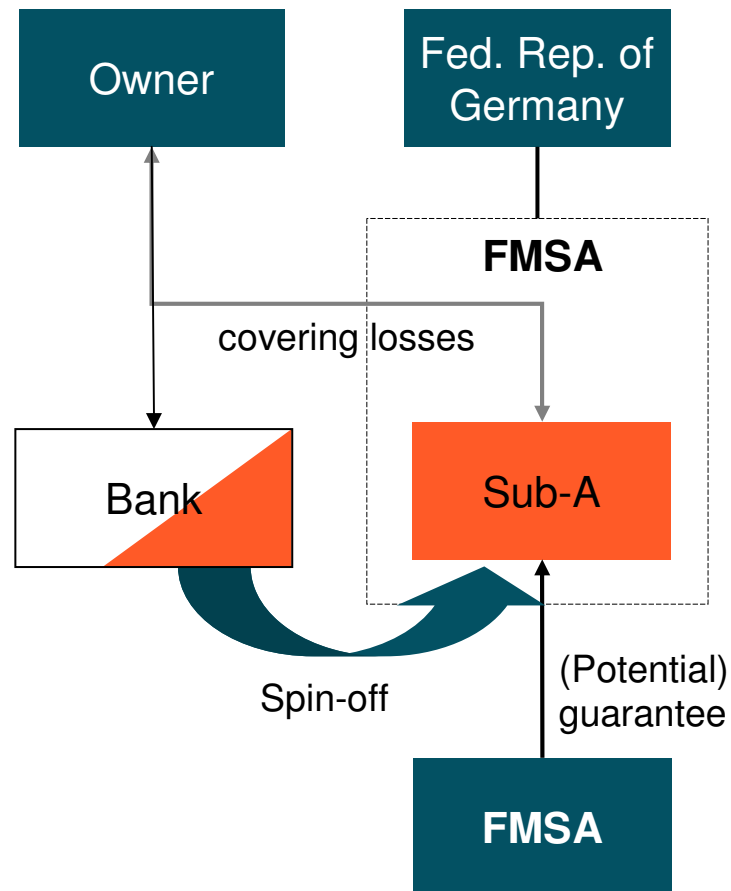
It is up to the banking system to use that liquidity provided by NAMA to lend to the real economy on a risk adjusted basis.

## **CONSEQUENCE**

# German Bad Bank Private Sector Model closed 22 January 2010 – asset transfers from German Banks into Bad Bank SPV at only 10% discount from Book Value



## German Bad Bank Model 2010 – Nationalised Banks or Landesbanks - €800 bn potentially – application to join closes 31 December 2010.



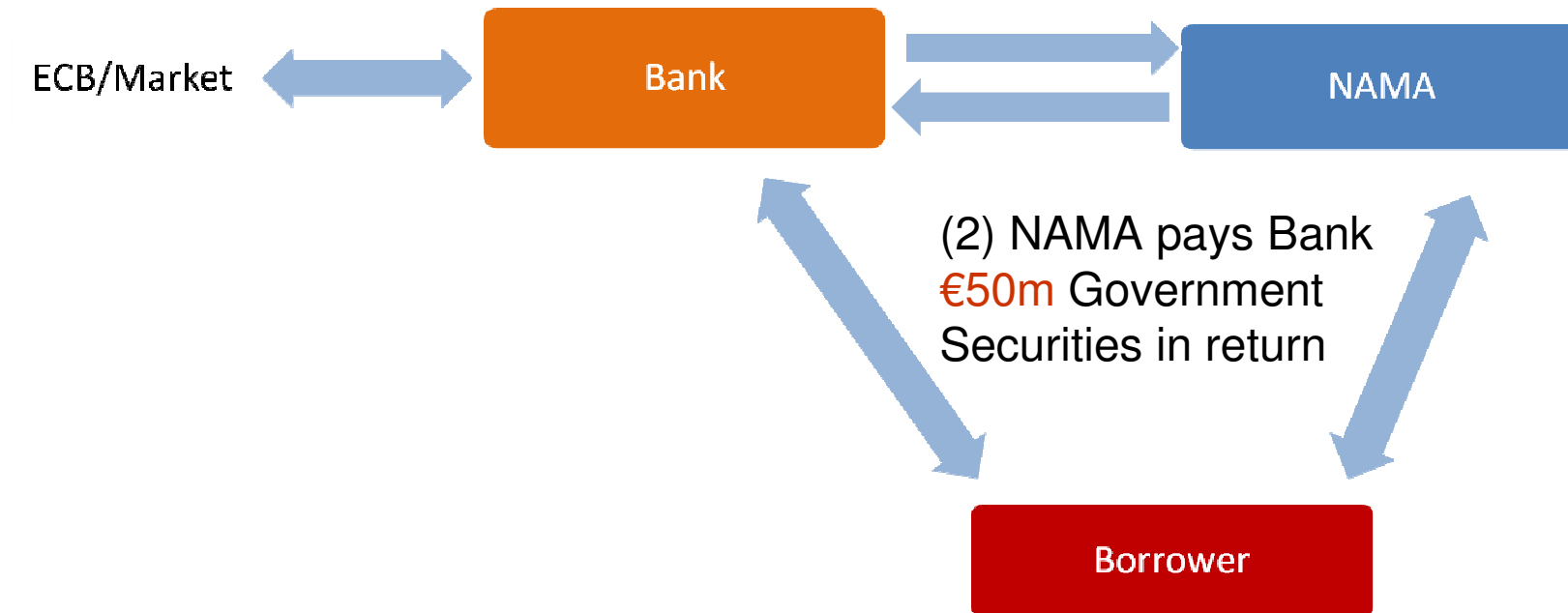
- Eligible for structured securities, as well as other risk assets (property loans) and non-strategic business units
- Sub-agency ("Sub-Aida") is a public law entity established by FMSA (Financial Management Stabilisation Agency owned by German Government) and subject to continuing legal oversight by FMSA
- Owners of bank spin off assets to Sub-Aida , which allows for **transfer at book value**; no write downs for the transferring bank
- **Banks or Sub-Aida neither subject to national regulatory capital requirements nor to international accounting standards**
- Transferring bank reduces Risk Weighted Assets (RWA) and frees up capital
- Owners of the bank remain responsible for the transferred assets: they cover any losses and liquidity shortfalls of the Sub-Aida
- There are currently two AidA cases:
  - Erste Abwicklungsanstalt ([WestLB](#); c.€85bn)
  - FMS Wertmanagement ([Hypo Real Estate](#); €210bn)
- When OWNERS (Regional Govts) no longer can cover the losses, **the excess losses are covered by FMSA (German Govt.)**

# UK Asset Protection Scheme (APA) - £231 bn at end 2009

- Its an insurance scheme – Assets **stay on** Balance Sheet of Royal Bank of Scotland (RBS)
- **£60BN** of the initial loss is borne by RBS – **First Loss**
- RBS Core Tier 1 Capital is only **£50 bn** at 30 June 2010
- Any **FURTHER losses** **above** **£60BN First Loss** are borne **90%** by Asset Protection Agency (UK Treasury), **10%** by RBS = **CONTINGENT LIABILITY OF UK Government**
- RBS pays an insurance premium of £700m pa for 2009-2011 and £500m pa until **2099** to UK Treasury
- Expected Loss per APA is £57bn – and only 15% is their expected loss on **Commercial Real Estate** – IPD UK Commercial values down over 34% since end 2006
- APA Business Plan forecasting **£5bn** profit over its life.

# NAMA Business Model - €81 bn Loans

(1) Bank Sells €100m Loan to NAMA



(3) Borrower continues to owe €100m to NAMA despite NAMA only having paid €50m to the Bank for the Loan.

# NAMA Business Model

## Bank Perspective – Sale of loans to NAMA for Government Bonds

- Reduces risk weighted assets (RWA) which will have a high weighting for capital ratio purposes
- Removes Loans from Bank's Balance Sheet that Generally cannot be used for collateral purposes to access liquidity with Central Banks or market counterparties
- Receives Government Securities which can be used as collateral with Central Banks and market counterparties for liquidity (zero weighting RWA)

## NAMA Perspective

- NAMA controls the relationship with the borrower and makes all the decisions.
- NAMA receives income on the acquired loan portfolios (using floating interest rate plus a profit margin)
- NAMA pays an interest coupon on Government bonds (floating interest rate)



## Background - NAMA

Massive growth in property-related lending 2004-2007.

Insufficient attention within banks or within overall banking sector to basic risk management principles such as stress-testing.

Insufficient attention to key issue of supply /demand.

No rigorous analysis of whether scale of the rise in property prices could be justified by economic fundamentals.

## Background - NAMA

Enormous scale of lending to individuals who had little or no supporting corporate infrastructure or access to capital markets.

Poor quality of credit appraisal.

Over reliance on wholesale money markets.

Failures of governance on the part of lending institutions' Boards.

Regulatory failures.

# NAMA – why?

1

- Irish Government became deeply involved in the banking system when it provided a wide-ranging guarantee for banks liabilities (€440 billion) on 30<sup>th</sup> September 2008.

2

- Examination of loan books of all institutions which partook in the guarantee scheme in October/November 2008.

3

- Government decided that certain institutions required to be recapitalised to deal with potential loan losses – late December 2008.

4

- Government nationalised Anglo Irish Bank in January 2009

# NAMA - why?

5

- After nationalisation of Anglo Irish Bank, the Government re-assessed the amount of recapitalisation required and decided in February 2009 to invest €3.5 billion preference shares in AIB and BOI – this was completed on 31<sup>st</sup> March (BOI) and on 13<sup>th</sup> May (AIB).

6

- The Government also decided in February 2009 to assess whether some asset relief mechanism should be introduced – Minister for Finance asked Dr. Peter Bacon to prepare a report on options.

7

- The Government decided that an asset management option as recommended by Dr. Bacon was the best option and the proposed establishment of NAMA was announced on 7th April as part of the Supplementary Budget 2009.

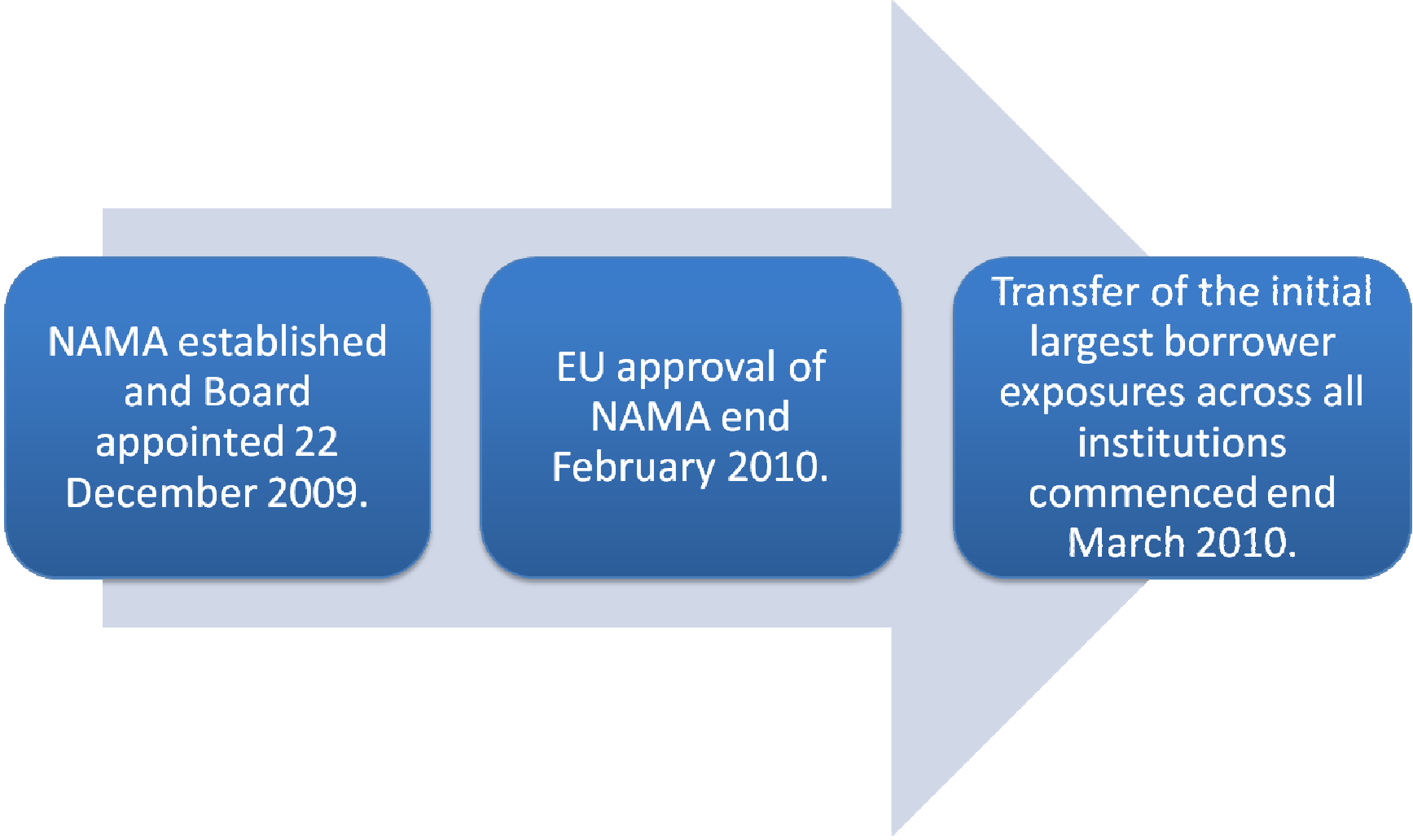
# The NAMA Timetable since April 2009

Bill was published  
in the form of a  
consultation paper  
– Thursday, 30th  
July 2009

Bill was introduced  
in the Dáil –  
Wednesday 16<sup>th</sup>  
September 2009

Committee and  
Final Stages –  
October/November  
2009

# The NAMA Timetable since April 2009



NAMA established  
and Board  
appointed 22  
December 2009.

EU approval of  
NAMA end  
February 2010.

Transfer of the initial  
largest borrower  
exposures across all  
institutions  
commenced end  
March 2010.

# NAMA – who are we?

The National Asset Management Agency is a State agency with a commercial remit to implement Government policy and legislation passed into law by the Oireachtas.

Set up to acquire both performing and non-performing loans from participating institutions. Key criterion is that the liabilities of impaired or potentially impaired borrowers and assets in the property sector are removed from bank balance sheets.

To manage (hold, dispose, develop or enhance) assets.

To achieve the best possible return for the State on the acquired loans and on any underlying assets that may be realised over a 7 - 10 year timeframe.

**Objective:** At a minimum, the target is to breakeven, at least, over a projected lifespan of ten years.  
NAMA Business Plan of 30 June 2010 Central Scenario projects a NPV profit of €1 billion.

# NAMA Governance

NAMA Board – seven members appointed by Minister plus CEO of NAMA and Chief Executive of NTMA.

CEO of NAMA is accountable officer for PAC.

4 Board Committees

2 Advisory Committees

NTMA provides staff and support services to NAMA.



# NAMA - Accountability

Annual Statement to Minister and Oireachtas

Annual Report & Accounts

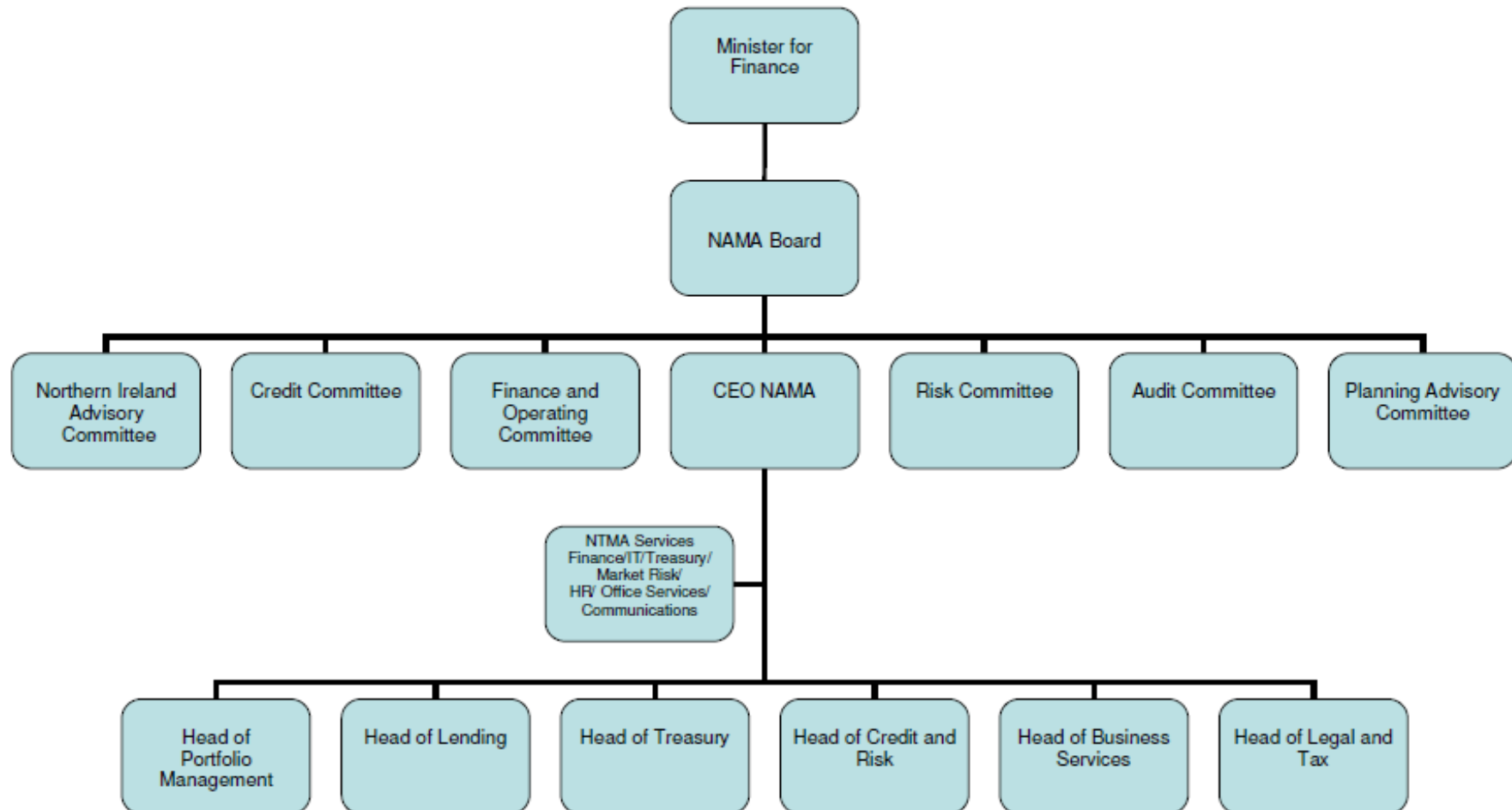
Quarterly Reports to Minister and Oireachtas

Oireachtas committees – Chairman and CEO will give evidence whenever requested to do so.

Comptroller & Auditor General

EU Commission (through Financial Regulator and otherwise) to audit and ratify loan valuations

# NAMA Organisation Structure



# EU Issues

## ➤ EU State Aid

EU Commission have approved NAMA – end February 2010.

- ❖ Eligibility criteria re institutions and assets

- ❖ Valuation Methodology

EU must approve:

- ❖ Each Tranche of loan transfers as it is completed – Tranche 1 of €15.3bn approved in August 2010, tranche 2 of €12 bn being audited currently by EU.

- ❖ Bank Viability/Restructuring post-NAMA.

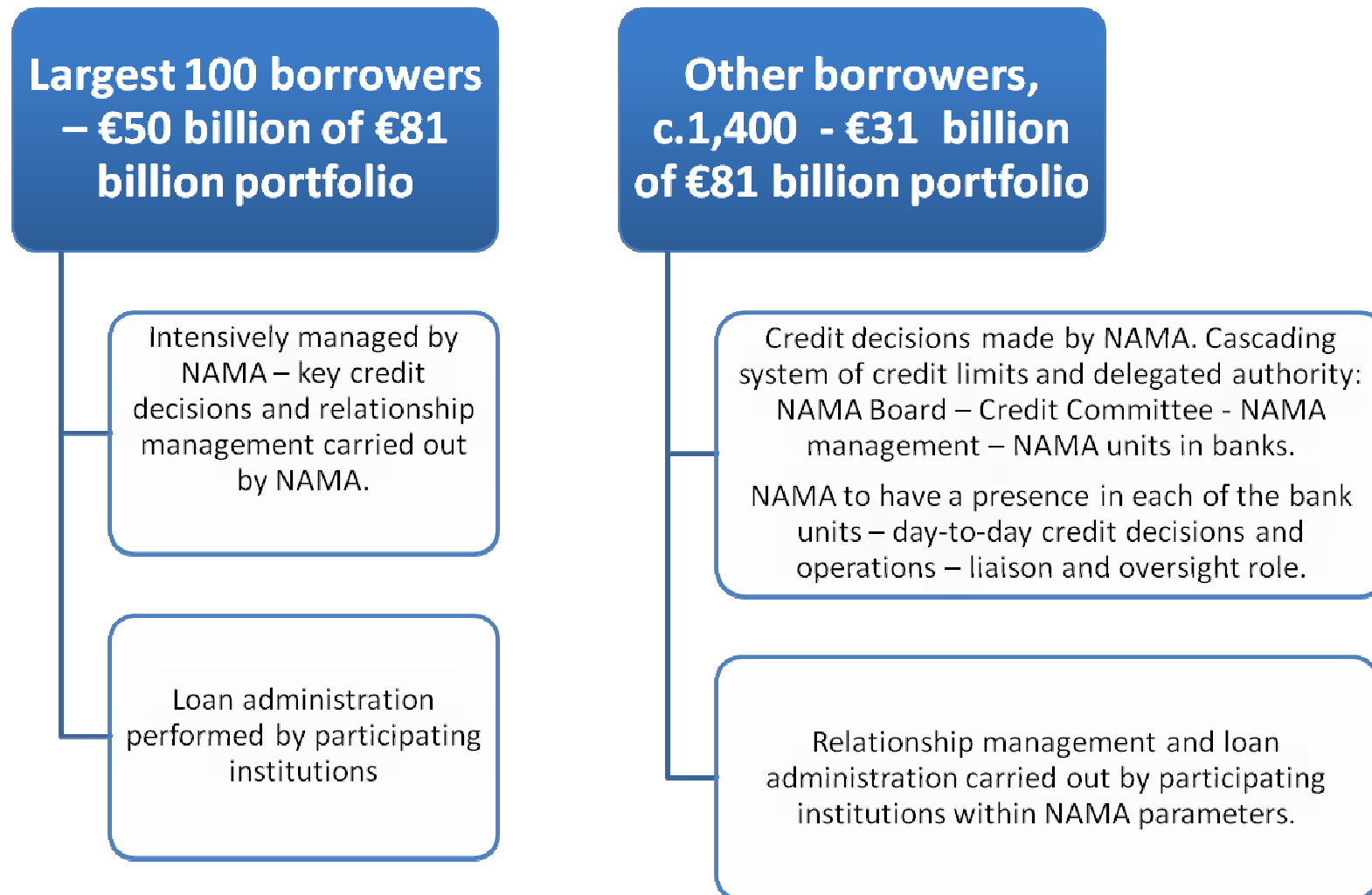
# EU Issues

## Eurostat

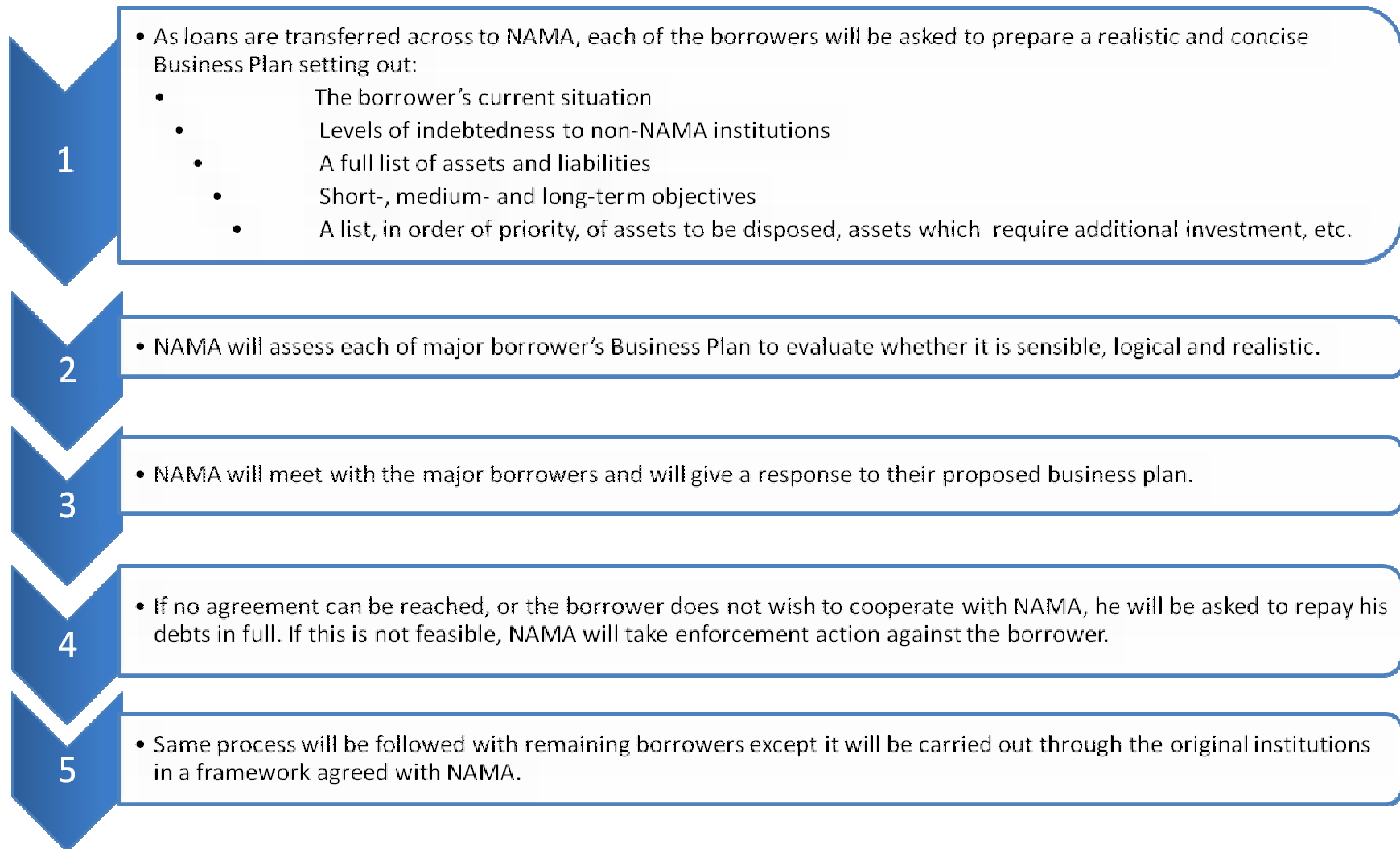
Eurostat agreed in late October 2009 that NAMA would be off- Balance Sheet if it operated through a majority privately owned Master SPV.

NAMA to maintain veto on SPV.

# Borrower Engagement



# Business Plan Process



# NAMA – Can it succeed?

NAMA, with 67% of its prospective assets based in the Republic of Ireland and an additional 6% in Northern Ireland, is dependent on a sustained economic recovery on the whole island. This, in turn, will be dependent on the respective Governments' management of the economy and the restoration of competitiveness. As an open economy, Ireland should also benefit from growth among our large trading partners if economic fundamentals are restored.

27% of assets that will be based overseas, mainly the UK (21%), will recover more quickly and we would envisage that this part of the NAMA portfolio would be realised earlier.

NAMA does not require anything other than modest growth over its expected 7/10 year life to break even on its portfolio.

# Common misconceptions about NAMA

Borrower bailout? **No**

- Borrowers will continue to owe 100% of liability. NAMA will assess each borrower's viability more rigorously and impartially than banks have done to date. Some borrowers are unlikely to survive this process.

Bank bailout? **No**

- Current value of property will be stringently assessed – banks valuers will have a duty of care to NAMA – assumptions will be scrutinised closely by NAMA's own valuer panel. Cross-checking for consistency.
- Subordinated debt - 5% - first loss
- Provision for tax surcharge on bank profits after NAMA wind-up if it has any accumulated losses.



# Common misconceptions about NAMA

Scale of property  
market recovery  
**not impossible**

- Some commentary has suggested that property market will need to recover to 2004-2007 levels for NAMA to break even. The scale of recovery required is, in fact, a more modest 10% over the lifetime of NAMA taking into account the 5% of subordinated debt (€2bn).

NAMA – a goldmine for  
advisers? **No**

- Costs on advisory services have been low to date.
- Very competitive and thorough public procurement process for valuation and legal due diligence services will drive costs down.
- 100% of the cost of the due diligence services will be recouped from the banks.
- Taxpayer acquiring c14,000 loans – we all need assurance that taxpayer is getting a fair deal and that assets are being rigorously valued and due diligenced.

# NAMA – Asset transfer

Our target of completing the loan transfers by end-February 2011 is entirely dependent on the readiness of each financial institution in having the information prepared on each individual loan for the NAMA due diligence process.

Commentators have made the incorrect assumption that NAMA will not take enforcement proceedings against any defaulting borrower in 2010. NAMA will do so if necessary but each individual borrower must first be given a fair opportunity to present an updated business case within a reasonable timeframe to make a pitch for survival.

NAMA is a workout vehicle, not a liquidation vehicle, and can take the longer view on borrowers and assets if it makes commercial sense to do so.