

**Address by Frank Daly, Chairman of the National Asset Management Agency,
to the CPA Annual Conference 2010**

NAMA – the objectives, progress and challenges

Friday, 4th June 2010

Thank you for the invitation to speak at your Annual Conference.

Given that the theme of this conference is the positive-sounding '**Perspectives on Recovery**', perhaps I should get all the negatives out of the way first. NAMA has been established because the Irish banking system lent far too much to one sector of the economy (property), lent far too much to a small number of borrowers within that sector and is now paralysed into inertia as impairments build up and capital is depleted. Some €50 billion was advanced by the five participating institutions to the largest 100 borrowers whose loans are being acquired by NAMA. About €16 billion of this was advanced to the ten largest borrowers. Most of these borrowers had also borrowed substantial amounts from other institutions. The crisis that we must address now developed over a relatively short timescale but will take many years to resolve. My aim today is to look forward and to sketch out how NAMA might contribute to such a resolution.

Objectives

Essentially, NAMA is a workout vehicle which has the capacity and the time to take a longer term perspective on borrowers and assets in so far as it makes commercial sense to do so. It is not a “toxic” or “bad” bank but an asset management agency which will acquire about €81 billion loans from five participating institutions. In exchange, it will pay consideration, at a significant discount, to the institutions in the form of senior and subordinated bonds. The institutions can then use these securities as collateral with the ECB and with the market. With the cash that they receive in return, they will be in a position to revert to their core business of commercial and

personal lending and thereby facilitate the process of economic recovery. As part of the first tranche of loan transfers which has just been completed, in return for acquiring loans totalling €15.3 billion, NAMA issued bonds to a value of €7.7 billion, a discount of 50%. These funds are now available for re-circulation to create much-needed economic activity. In other words these institutions now have €7.7 billion liquidity that they did not have a month ago.

The price paid for a loan by NAMA is based, to a large extent, on the current market value of the underlying property. In the case of many properties, the current market value may be uplifted to reflect NAMA's view of its long-term prospects and, on average, the first tranche uplift was about 11%. Each loan is valued individually and the valuation incorporates not only the value of the underlying property but other factors such as any additional collateral offered by the borrower and whether the loan is performing or non-performing. Where the underlying security on a loan is deficient, NAMA applies a further discount.

NAMA's core commercial objective will be to recover for the taxpayer whatever it has paid for the loans in addition to whatever it has invested to enhance property assets underlying those loans. This objective has not been determined by NAMA; it has, in fact, been set for us by the legislature under Section 10 of the NAMA Act. There has been some comment that the consequence of this objective is that NAMA, having recovered its outlay, will then absolve borrowers of their further obligations. This is absolutely not the case. Borrowers, as both I and NAMA's CEO Brendan McDonagh have already said on a number of occasions, will continue to be liable for the debts that they have incurred. I know from my previous experience in the Revenue Commissioners (and as Accountants you will know from your experience in dealing with Revenue) that tax arrears are never definitively written off – Revenue reserves the right to recover arrears at any stage if it emerges that a taxpayer recovers the capacity to repay his or her debts. It will be the same with NAMA.

Where appropriate, NAMA may agree to debt rescheduling and loan restructuring in the case of borrowers which it believes to be viable within a three-/five-year timeframe but any borrower who expects the taxpayer to assume his or her debt burden clearly misunderstands what NAMA is about. We have been assiduous in

acquiring personal guarantees provided by borrowers to the institutions even if such guarantees are currently worthless and we have, therefore, not paid for them.

The reality that we must deal with is that, based on the discount applied to the first tranche of loans, the property underlying these loans is worth about half of the amount advanced by banks for it. That is the most that we could, notionally, recover today if we foreclosed on all borrowers. The market, however, is in no condition to absorb a large volume of property sales right now and, therefore, NAMA's best interest is served by working with borrowers, where possible, to enable them to recover their capacity to repay their debts. NAMA is expected to have a lifespan of seven to ten years and when, in the view of the Minister for Finance, it has made sufficient progress towards achieving its overall objectives, it will be wound up. If, by the time its work is finished, it has made a surplus, that will accrue to the taxpayer. If, however, it has made a loss over its lifetime, a tax surcharge will be applied to the participating institutions to make up the shortfall.

Progress

As mentioned already, we have made significant progress on the transfer of loans with over €15 billion now acquired. Transfer of the second tranche of loans, totalling about €13 billion, is likely to take place over the coming weeks and with the expected transfer of about €8 billion in the third tranche in July, we aim to have approaching half of the overall transfer completed by then. This is a not inconsiderable achievement in the short few weeks since EU approval was obtained for NAMA. Perhaps the scale of it is better appreciated when one realises that by July we will have transferred approximately 5,000 individual loans, having completed the most rigorous legal due diligence and valuation in respect of every single one of those loans. Our aim is to transfer the remaining loans from the five institutions by the end of the year and certainly no later than end February 2011, the deadline set by the EU Commission.

Much else has been achieved. An elaborate infrastructure has been put in place to conduct a detailed valuation of each loan in the prospective portfolio of €81 billion, not least to ensure that the assets which are being acquired on behalf of the taxpayer are properly secured and fairly valued. NAMA has acquired close to half of its staff

at this stage, including all of its senior executives. Arrangements are being put in place to ensure that participating institutions continue to service borrower loans to a high standard. A credit approval framework has been put in place to enable funding requests from borrowers to be assessed and approved or rejected as appropriate.

NAMA has also begun to engage directly with borrowers. As their loans are acquired by NAMA, borrowers are being asked to produce business plans which will set out detailed and credible targets for reducing their debt. A panel of advisory firms has been set up to advise NAMA in its appraisal of borrower business plans. We are not interested in business plans which envisage borrower debt stabilising or reducing modestly over the medium-term. A borrower must set out how he plans to reduce his debt significantly over a three to five year horizon and, for most borrowers, this means producing a list of assets which can be sold to raise cash which will, in turn, be used to repay debt. Let there be no confusion about this: in NAMA's terms, viability is not a matter of survival on taxpayer life support until the good days come again. Rather it is a matter of setting out a debt reduction target, identifying the assets which will need to be sold in order to achieve that target and convincing NAMA that the borrower has both the will and the managerial capacity to deliver on the target. Where a borrower cannot convince NAMA that he can meet the target, the only option is foreclosure.

Business plans must be grounded in a realistic view of demand, prices and rents and of the future growth prospects of the Irish economy. The outlook for demand will vary significantly by region and by sector: it should be borne in mind that about a third of the loans acquired by NAMA will be backed by property in the UK, much of it in the south of England. There will also be a significant number of loans for prime properties in Dublin and in other cities.

For NAMA, the coming months will be crucial in terms of further developing strategies for managing its portfolio of loan assets and any property assets that it may acquire through foreclosure. As I mentioned above, some key decisions will need to be made about borrowers based on their assets and their prospects of significantly reducing their debt. Strategies will need to be developed for the potential sale of loans or loan portfolios. In order to develop informed strategies, we will need to conduct an

extensive analysis of the supply and demand factors at work for different regions and asset classes.

Role of Auditors

I think it may be appropriate, in the context of this forum, and speaking now in a personal capacity, to comment in passing on the role of auditors, both in the recent past and prospectively. The financial institutions and their largest borrowers have been deservedly lambasted for behaviour which was reckless in the context of the exposures they created, both for themselves and for the country at large. But those who carried out audits of the financial statements of these institutions must at the very least examine their performance before they can absolve themselves of responsibility..

I would question whether it is sufficient anymore for audit practitioners to contend that it is not their function to comment on the business strategies or ethical behaviour of their clients. I am pretty sure that the audit profession is as keen as any other to play its full part in preventing a repeat of the events of the past five or six years. I doubt anybody here takes the view that they have no role to play in this – certainly auditors I speak to are keen to be part of the solution and are open to constructive discussion on the role they can play. That means examining the past and learning from it.

After all that has happened, can the auditing profession continue to suggest that it is not its responsibility to draw attention to significant risks that may become evident in the course of its audits, such as, for instance, the extraordinary concentration of risk that developed at a number of Irish financial institutions during the 2004-2007 period? We cannot go back to a situation whereby an audit firm can complete an audit and then claim either that it did not spot the elephant in the room or that it was not its job to point out that four-legged hunk with the trunk in the corner. Huge reliance is placed on the work of auditors and I would have thought that it is now time for the profession to have a serious review of what its role and responsibilities should be in the context of what shareholders and the wider public expect of it.

A positive note for the future

Taking my lead from the theme of this conference, I want to finish on a positive note. Yes, we are in a deep trough. There is enormous anger that a relatively small group of people, through an abject failure to discharge their responsibilities, could have imposed such a burden on this and on future generations. But, even in the depths of that anger, we know that nobody owes us a living and that only by marshalling our resources and pulling together can we raise ourselves up again.

We have the means to do so.

In particular we have a young, well-educated and gifted workforce and it goes without saying that, to have any hope of early recovery, we must find ways to channel their energy and creativity. We must also appeal to the idealism of the young. We, their elders, dented that idealism by our errors in recent years. We, their elders, can reignite that idealism if we genuinely reform our systems and governance and show our determination to be ethical and principled in our business dealings in future.

We have also done good things with our infrastructure. By and large transport and road networks have improved hugely over the past decade - driving from Dublin to any of the other major cities has now become a pleasure rather a tortuous crawl through a succession of bottlenecks. I marvel at the new bridge across the Suir that makes my regular journey to Waterford not just a driving pleasure but an aesthetic delight as that extraordinary bridge first comes into view in the distance and as its detailed architecture unfolds as I cross it and in my rear view mirror as I leave it behind. The Boyne bridge is similar. Notwithstanding some well-publicised planning calamities, the architectural appearance of our towns and cities has improved significantly. The whole Docklands area (let's leave aside the Glass Bottle site for the moment) is a delight to walk around on a sunny Sunday (and I walked to work there 40 years ago and believe me it was then a dismal depressing place to be!)

So despite the calamities we did some very good things in the tiger years that will stand to us in the future.

But the most positive force in our favour is that we have been realistic enough to face up to our difficulties at an early stage and to apply the necessary remedial action ahead of many of our peers. This has been well recognised and appreciated abroad where the NAMA initiative is viewed with considerable, and largely benign, interest. It is, of course, necessary to conduct a thorough analysis of why we ended up here and there are various reports currently in preparation which, hopefully, will provide us with a more coherent understanding of that. But understanding the causes can only take us so far. Analysis cannot be used as a substitute for action. NAMA is very much part of the action and I hope that I have gone some way towards convincing you of the contribution that NAMA will make towards our recovery.

I thank you again for the opportunity you gave me to address you today.