



**Opening Statement to Committee on Public Accounts
Brendan McDonagh, Chief Executive
Thursday, 18th November 2010**

Chairman and Deputies,

Thank you for the opportunity to address you on the setting up and operation of the National Asset Management Agency and on the Special Report of the Comptroller and Auditor General.

I very much welcome the first report of the Comptroller & Auditor General which was published on 2 November. It shows the huge amount of work on the part of the NAMA Board and NAMA staff to make NAMA operational within a short period of time. There is this misconception that NAMA has been around for a very long time but the reality is that it only really came into full operation at the start of 2010 after the Board was appointed. Therefore, NAMA today has only been in existence for 11 months and by the time it is a year old, it will have acquired €73 billion of eligible assets from the five participating institutions. This is a remarkable speed of execution especially since EU Commission approval was only granted at the end of February 2010. The C&AG's report highlights the huge amount of work that has gone in to the operational setup, due diligence, the oversight by the EU Commission and the strong corporate governance put in place by the Board. I would like to express my personal gratitude to the Board and the officers of NAMA and of the NTMA for the tremendous effort they have applied to make NAMA operational.

It is important to remember that the eligible loan assets to be managed by NAMA were created by the financial institutions and that NAMA's role is to deal with the aftermath of this injudicious lending. The Irish banks are not alone here and the majority of banks in the developed world were also aboard this high-octane credit bubble. NAMA is, first and foremost, an asset management agency, established with the aim of transferring certain higher risk property-related exposures from the balance sheets of the participating financial institutions in return for Government-guaranteed securities. We will manage these loans with the aim of achieving the best possible return for the taxpayer over a 7 - 10 year timeframe. Replacing these property-related loans with Government Guaranteed Securities will help remove uncertainty about the soundness of banks' balance sheets, provide the institutions with much needed liquidity and should make it easier for the institutions over time to access capital (for some) and liquidity (for all) in the international capital markets.

The loan transfers to NAMA will see about 11, 000 individual loans with a nominal value of €73 billion acquired for a consideration which is expected to be of the order of €31 billion, representing an average discount of about 58%.

Our sole focus at NAMA is to bring proper and disciplined management to these acquired loans and borrowers with the aim of achieving the best possible return and to protect the interests of the taxpayer. We have to date held many face-to-face meetings with the borrowers whose loans have been acquired in Tranches 1 and 2.

Each borrower was directed to submit a comprehensive business plan in accordance with NAMA's template. Each individual borrower's viability has and will be rigorously assessed as part of the business plan review process. We are willing to engage with an open mind with our acquired clients but I must reiterate that we require full disclosure of all material information and we will not waste time with borrowers who do not wish to cooperate or who have not yet accommodated

themselves to the current realities of the property market or their own perilous financial situation.

The Business Plans of the Tranche 1 and Tranche 2 borrowers with exposures of €27 billion are complex in nature but we will have completed our analysis of all 30 debtors by mid December. These, in consideration terms, represent over 40% of all those Debtors who will transfer to NAMA. The issues emerging from the Debtor Business Plan reviews are by and large common: debtors who have over borrowed against assets, overheads still at unsustainable levels, proposed build-out of green field sites and debtors still wanting to hoard assets and not sell anything to pay down their debt until some unknown time in the future when asset prices recover.

The Board is very clear, as I am, about what NAMA needs to do and what we expect from our acquired debtors. Just as any borrower from a bank must expect to have to repay his or her debts, the same will apply to anyone whose debts are transferred to NAMA. NAMA has a clear commercial mandate to recover debt and therefore its purpose is certainly not to let developers or any other borrowers walk away from their responsibilities. Borrowers who continue to meet their contractual obligations have nothing to fear from us but those who do not can expect NAMA to take whatever actions it considers necessary to protect the interests of the taxpayer.

Some commentators have expressed surprise that the discounts that have emerged for each of the institutions and in overall terms may have been much higher than anticipated. However it must be remembered that the initial indications of an aggregate discount of 30% were necessarily based on aggregate information provided last year by the five participating financial institutions. Specifically, the 30% estimate was based on information provided by the financial institutions that their average loan-to-value ratio was 77% and, by implication, that there was on average a residual 23% equity in the portfolio. Property prices did decline substantially in Ireland during 2009 and that certainly would have contributed to the erosion in value but it is not the whole story. Equity releases as asset values

apparently rose certainly contributed to the equity erosion. I can only conclude that, notwithstanding the decline in property prices during 2009, the LTVs were much closer to 100% than the 77% represented. The financial institutions may well have known this or perhaps they were in denial but that is not for me to adjudicate. My point is that if the LTV disclosed was more accurate this would have resulted in an estimated average NAMA discount of 53% i.e. 30% plus add back on 23% equity.

Furthermore, NAMA's own detailed due diligence on a loan by loan examination has revealed a picture of poor loan documentation, of assets not being properly legally secured and of inadequate stress-testing of borrowers and loans by the financial institutions. The legal documentation is capable of remedy and in fact the majority of the €1 billion of loans we did not acquire in tranche 1 have now been acquired by NAMA after we forced the institutions to remedy the legal issues with the borrower by advising we would apply 100% discount if they did not. I would acknowledge that the participating institutions have worked hard in tranches 2 and 3 to deal with these legal issues as they compiled their NAMA due diligence, this is the right course of action but it is frustratingly slow. It is much harder to fix a problem than to do it correctly in the first instance. We estimate that the final overall NAMA discount will be about 58% for the total acquired portfolio of €73 billion.

Another area where there has been comment relates to the percentage of performing loans. This was estimated at 40% in mid 2009. There are valid reasons why the 40% figure would not hold in 2010 given the scale and pace of the economic downturn; business failures along with a fall in rents on new leases would have impaired a borrower's ability to pay his loans. That is a fact of life and we will have to deal with that aspect as we manage the portfolio. There are other factors such as debtor management, the charging of rents etc which can improve the performing nature of loans. The NAMA Board has set a realistic target of 25% in its Business Plan and we believe that that this will be achievable once we have acquired all the loans and have set about and applied a disciplined debtor management process.

NAMA's accounts for the second quarter of 2010 were also released on 2 November and they show that we are making good progress on financial performance with a profit of €6 million being achieved. In terms of cash performance, NAMA generated €130 million net cash from operating activities in the second quarter. Cash was primarily generated from receipts from borrowers (interest paid on loans) of €117 million and NAMA derivative net cash inflows of €73 million. The significant cash outflow for quarter two comprised €47 million advanced to borrowers to complete projects and fund working capital. NAMA was also cash-generative in the third quarter from its operating activities and this permitted us to repay at the end of October the €250m advanced by the Minister for Finance to NAMA in May for its working capital.

There has been much comment about service providers to NAMA. I wish to emphasise firstly that we will only use external service providers where it is absolutely necessary. There are certain services which would not make sense for NAMA to undertake such as primary servicing or master servicing. Furthermore where we do have to engage service providers we have a strong focus on getting the best value for money that we can. We estimate that we will have achieved substantial savings of about €40m in due diligence costs when all the eligible assets are acquired.

NAMA, by its nature, will require the services of insolvency practitioners but I am very concerned at the levels of fees the insolvency industry charges. I welcome the recent moves by the Commercial Court to highlight this issue and it was resulted in substantial fee reductions. The market in Ireland is much undeveloped and, in our view, the widespread use of corporate receivers for property assets is unnecessary and inappropriate. I am determined that NAMA is going to change the market by using Statutory Receivers and property receivers as is the practice in the UK rather than traditional receivers who in most property-related cases may not add very much value.

As I mentioned, the concept of property receivers is well established in the UK market where they are commonly known as LPA (Law of Property Act) or fixed charge receivers. Property receivers have been active in the UK market for over 20 years and a specialist sector has developed there to provide property receivership services.

The property receiver is appointed to take control of and ultimately sell assets over which the lender has a fixed charge. The appointment does not include the borrower entity (typically the company that granted the lender a fixed and floating charge). As such the property receiver has no role or involvement in running the borrower company.

The main perceived advantages with property receivership are the focus on the property, the direct reporting relationship between the property manager and the lender and the avoidance of liabilities associated with the borrower company. This means that the property receiver can concentrate on optimising the value of the property and deliver results at lower cost to the lender than the comparative corporate receivership.

The property receivership is focused on taking control of the property, insuring and managing it and ultimately preparing the property for sale.

The property focus, direct reporting and low-cost are very attractive to NAMA as the required skills for the receivership and property management are provided by one firm and there is less chance of duplication of roles or unnecessary charges in the process.

I do accept that where the borrower is either a trading entity or where the corporate structure is complex, there will be a need to retain corporate receivers to

take control of all aspects of the borrower company secured by fixed or floating charges.

Irish lenders have traditionally appointed insolvency practitioners as receivers even though property receivers would have been more appropriate. Where an insolvency practitioner is appointed to a property company, he will immediately have to appoint a property manager as the insolvency firm is unlikely to have the required property skills. The property manager will either be from the borrower's own team or from a firm of property managers who report to the receiver. This immediately creates a double layer of fees and often the borrower ends up working for the receiver. NAMA does not intend to follow this practice and intends to promote the concept of property receiverships in the Irish market.

Earlier this year NAMA conducted a tender competition to appoint panels of firms to act as receivers and carry out other enforcement work in Ireland and the UK (the two markets where the vast bulk of the secured properties are located).

The competition attracted significant interest and the evaluation of fees disclosed a significant variation in proposed fees between insolvency practitioners and property managers (the latter would be acting in the capacity of property receivers).

Typically NAMA will put together an enforcement strategy before it enforces which will only be put into operation if a consensual agreement cannot be reached with a borrower. However, NAMA has to be realistic and understands that not every borrower will be prepared to either agree a workout/asset disposal plan or implement such a plan in good faith. In these circumstances, NAMA will have carried out full contingency planning and will be in a position to enforce against the borrower at any time if there is a lack of co-operation or bad faith.

I said it before and I repeat that NAMA is not the problem; it is merely cleaning up a difficult situation created by others. One of the ironies of recent months has been

the shift in some of the public commentary from the claim that NAMA would overpay for assets to the newer claim that, by underpaying for them, NAMA is decimating the banks capital. Neither proposition is accurate and is ill informed. We have no wish to pay any more or any less for assets than what they are worth. We endeavour to pay fair value at all times. We work to the valuation guidelines laid down in legislation and approved by the EU Commission and we apply the methodology consistently – it would be totally inappropriate for us to adopt any other approach. NAMA is subject to intensive scrutiny from the EU Commission and the Financial Regulator which audits the acquisition and valuation process. The Commission has already completed its oversight of Tranche 1 transfers and given us a clean and unqualified bill of health in this regard. We expect their Tranche 2 opinion shortly. There is also provision under the NAMA Act for the participating institutions to appeal the valuations to an independent Valuation Panel who will make the final determination in due course as to what constitutes fair value for appealed cases.

NAMA has to look to the future and deal with the realities as to where we stand today. We have to be smart and we have to be innovative. We have to preserve and enhance value and we cannot allow the market to take advantage of us. I can assure the Committee that my colleagues and I in NAMA and the NTMA will remain resolutely focussed on the interests of the taxpayer as our work continues in the months and years ahead.

I thank the Committee for the opportunity to have made these comments. We are happy to take any questions you may have.

NAMA

18th November 2010