Possible Questions Arising from Publication of Draft NAMA Legislation

Why NAMA and how will it work?

1. **Why is the Government setting up NAMA?**

   The Government examined all of the potential approaches available to it in dealing with the riskiest loan portfolios on the balance sheets of Irish banks, which were preventing banks from lending into the economy and thereby supporting economic recovery. Following an examination of the options available the consensus amongst the Government's advisors including the Central Bank, the Financial Regulator and the NTMA, was that an asset management agency approach was the best means of ensuring the stability of the financial system, the protection of depositors and ensuring that banks were freed up to lend to the real economy.

2. **How can you justify this further bail-out of the banks for assets and not prevent banks from increasing mortgage rates?**

   The price NAMA will pay for any loan asset will be determined in accordance with the valuation methodology as set out in the draft Bill. It is true that the banks in most instances will not be paid current market value but will be paid a price which is in accordance with the long term economic value of each asset in line with EU guidance. This will allow the price paid for the assets to take account of a number of underlying factors such as demographics, supply and demand projections and macroeconomic projections.

   With regard to mortgage rates, the increase in rates reflects commercial market realities as banks must pay more to access funds in wholesale and retail markets. Interest rates are at historically low rates and are likely to remain very low for the foreseeable future in overall terms and this has provided significant support for households with mortgages in the current challenging economic and financial environment.

The Government has no role in the commercial day-to-day operation of banks here and believes that it is important, where possible, that the banking sector has a market presence and operates within market disciplines and constraints. The Government's objective is to ensure that the lending needs of the real economy are met and a healthy, commercially focused banking system is best equipped to achieve this aim.

3. Why is the Government opposed to the nationalisation of financial institutions?

The Government believes that it is important, where possible, that the banking sector has a market presence and that it operates within market disciplines and constraints. The Government's objective is to ensure that the lending needs of the real economy are met. A commercially focused banking system, which includes banks having a market presence, operating within market disciplines and constraints, is best equipped to achieve this aim. However, should some further recapitalisation of the banks be necessary as a result of NAMA, the Government has made it clear that any further capital injections which it has to make will be by way of equity capital.

The purpose of NAMA is to remove uncertainty about the bank's balance sheets, clean them up, provide them with an ability to access liquidity and to thereby facilitate the availability of credit to the real economy.

4. How will NAMA work in practice?

NAMA will buy loans from the participating banks – these loans will be from the riskiest part of the bank portfolios. This will take these riskier loan classes away from the balance sheets of the banks concerned and make the banks safer and more secure for depositors and investors.

NAMA will pay the banks concerned for these loans on the basis of valuations carried out by experts and in accordance with pre-defined methodology subject to approval of the EU Commission. The bank's book value of the loans will not be a factor and the banks will have to recognise a loss on their books at the time of the transfer.

This payment process will ease pressures on the banks arising from the tighter liquidity conditions that have prevailed for the past year or so, giving them access to cash or near-cash assets in place of the much less liquid property loan assets they had before. Again, this will make for more stable and secure financial institutions, better able to lend and support the domestic economy

NAMA will then manage these loans so as to obtain the best achievable return from them. In the meanwhile, it will collect interest due and pursue debts so as to ensure its own income stream and to recoup the Government investment over time.

NAMA in effect puts itself in the place of the bank that originated the loan, and will have all the same rights to pursue debts, where necessary. Borrowers who continue to meet their contractual obligations, of course, have no reason to worry – their rights are fully protected.

5. **How will NAMA be structured?**

It is intended that NAMA will be a separate body with its own Board appointed by the Minister for Finance, with staffing resources and management services provided by the National Treasury Management Agency (NTMA). It will have all necessary commercial powers of a financial asset management company to establish subsidiaries, to operate through agents, to buy and sell assets, to manage loans and work with borrowers, and to take full and determined action in relation to debts owed.

NAMA itself will maintain a streamlined organisational structure and will outsource work as appropriate. However, it will have complete control of the assets and will make all the major decision in regard to them.

6. **What will be the scale of NAMA?**

A lot of preparatory work has been taking place in regard to NAMA, and the indications are that the level of assets which will have to transfer is in the range indicated in the budget. Until the valuations are actually carried out we will not have final information on the exact costs, but there will be significant discounts on the values at which these assets are carried on the banks' books.

Valuation

7. How will the assets be valued?

Valuations by NAMA will be consistent with EU Commission guidelines and will be based on the current market value of the underlying collateral, adjusted to reflect a longer term economic value which the underlying asset could reasonably be expected to attain.

Detailed regulations on how the long term economic value is to be calculated are been drawn up by the Minister and will be published in September.

There will be an opportunity for institutions to seek a review of the price paid, and any review will be carried out by a valuation panel which will report to the Minister. But NAMA will not be required to take any asset and if appropriate it can refuse to take assets.

8. One of the key issues is the write-down value to be applied to the loans. What is the logic behind the NAMA valuation and how will it differ from the current market value?

NAMA is being established to remove the riskiest identified portfolio of assets, mainly land and development loans, from the books of systemically important financial institutions. The price it will pay for the loans will, in general, be related to the current market value of the property adjusted to the long term economic value in accordance with the EU framework. This will reflect the likely return to NAMA from the assets over time.

The principles of the valuation methodology are set out in the draft legislation and the Minister will be making detailed regulations based on these principles when the legislation is passed. Important points to note are:

- NAMA will not be paying prices for the loans based on "recent bubble property prices", nor will bubble property prices be used in determining the "long term economic value"
- In many cases, the long term economic value will be significantly less than the outstanding loan extended to the borrower.
- Each loan will be valued separately and the actual amount of the haircut or discount applied will depend on the quality of the underlying property and other collateral.
- This means there will not be a uniform haircut across all the loans of the institutions

It is important to note that it is at NAMA's absolute discretion to value the loans on the long term economic value. It can pay the current market value for some loans – it will pay whichever it determines as the appropriate transfer value for that loan depending on the particular circumstance.

9. Will details of the write-downs to be applied to the loans being transferred be made available?

Each loan will be valued separately and the actual amount of the haircut or discount applied will depend on the quality of the underlying property and other collateral. This means there will not be a uniform haircut across all the loans of the institutions but the effective haircut will become apparent once NAMA begins its valuation process.

Participating Institutions and Assets to be transferred

10. Which institutions will be transferring assets to NAMA?

Institutions may apply to the Minister to be designated as participating institutions. The draft text includes objective and non-discriminatory criteria which must be taken account of for designation and these include systemic importance to the State, other State supports available to the institution, maintenance of financial stability and facilitating the flow of credit to the economy. In volunteering for participation, an institution will be required to confirm that it will accept the designation of eligible assets by NAMA and will accept the NAMA valuation of those assets.

11. What type of assets will NAMA be acquiring – will they be acquiring residential mortgages?

Eligible assets for transfer to NAMA will be restricted to land and development books and associated loans. Associated loans will be those loans which are not in the land and development category but which are held by individuals/companies that also have land and development exposures. Associated loans will take account of cross collateralisation and other associated loan exposures of borrowers.

NAMA's Powers

12. What powers will NAMA have?

In addition to a number of general powers NAMA will have all the necessary commercial powers of a financial asset management company to establish subsidiaries, to operate through agents, to buy and sell assets, to manage loans and work with borrowers, and to take full and determined action in relation to debts owed.

NAMA will also have a number of specific and proportionate powers to ensure it can operate on an effective and efficient basis, for example a limited compulsory acquisition power to resolve difficulties which would arise due to the creation or retention of so called "ransom strips".

13. Why will NAMA have the power to obtain a vesting order?

NAMA will be empowered to obtain ownership of the underlying property in respect of which a loan was advanced where there is no prospect of the loan being repaid within a reasonable time or of the land being sold in the short term for a price sufficient to repay the loan. This will enable NAMA to develop the property over the medium term to enhance the return to the taxpayer, rather than requiring a fire-sale of such assets in the immediate short term.

Where property is obtained by way of a vesting order this will not allow the debtor to walk away from the loan, the debt will remain due and owing but will be reduced by an amount appropriate to the market value of the property obtained after other debts secured on it have been repaid.

14. Why will NAMA be permitted to purchase property compulsorily?

This provision is primarily directed at resolving difficulties which would arise due to the creation or retention of so called “ransom strips”. This involves strips of land or rights essential to the development of the property being carved out from the main property. Examples could include essential rights of way or strips of land cutting off access to roads or infrastructure.

In such circumstances NAMA will be entitled to apply to the High Court seeking a compulsory acquisition order, enabling NAMA to purchase such integral and essential land or rights. The court will not permit such a compulsory purchase if it would give rise to a serious risk of injustice.

15. How will it be ensured that participating institutions co-operate with NAMA / ensured that NAMA pays fair value for the loans?

A number of provisions have been included in the draft bill to ensure that NAMA will be in a position to achieve its objectives efficiently and without impediment.

- Participating institutions will be obliged to co-operate with NAMA in respect of the valuation of assets which are to be transferred and to disclose in good faith any defects or problems in respect of such loans or the underlying security.
- The institutions will be required to indemnify NAMA in respect of losses which arise on foot of failure to adequately disclose relevant information or in respect of actions taken by the participating institutions which give rise to liabilities for NAMA after transfer.

- They will also be required to co-operate with NAMA in respect of subsequent litigation and to deal with specific loans in accordance with directions issued by NAMA.

16. Isn't it inevitable that the operations of NAMA will be delayed for years by ongoing litigation and that NAMA will result in a happy hunting ground for lawyers?

It is the right of all citizens in this country to have access to the courts and to justice and it is not possible for legislation to prevent persons from bringing cases to the courts. Nor is it possible or appropriate for the Government to trespass into the discretion of the Courts. However we have taken appropriate steps to ensure that litigation cannot be used to delay or impede the operation of NAMA. We will ensure that litigation will proceed as quickly and efficiently as possible and that where it is possible to adequately deal with a claim by means of damages that NAMA will be able to proceed with its operations despite the existence of ongoing litigation.

17. Why will NAMA have the power to appoint statutory receivers?

It is a standard condition in respect of commercial or land and development loans issued by credit institutions that a receiver can be appointed in the event of default. The provisions relating to a statutory receiver put NAMA in a similar position with regard to loans they have acquired. NAMA would normally also be entitled to appoint a receiver under the terms of the loans they acquire in any case. Where the conditions of the loan enabling appointment of a receiver or the sale of the security are triggered by an appropriate default, NAMA will be able to appoint a receiver by operation of statue in order to realise the security on the loan.

Other Operational Issues

18. **How will NAMA deal with, for example, the recent court action taken against developers by ACC Bank? Do you envisage legal proceedings slowing down the transfer of loans and the work of NAMA?**

    The Minister announced in April the Government's intention to establish the National Asset Management Agency (NAMA) to facilitate the availability of credit to the real economy and to remove uncertainty relating to non performing assets on the balance sheets of systemically important credit institutions. Events in recent weeks has not changed the purpose of NAMA but it has reinforced the need for NAMA to be established as quickly as possible so that there is greater certainty about the financial position of systemically important institutions and their capacity to lend.

    However, NAMA has already had constructive engagement with all the financial institutions and it is envisaged a cooperative business like approach will be adopted to resolving issues arising.

19. **What will be the interest rate paid on the NAMA bonds?**

    NAMA will pay a floating rate of interest on any securities it pays to buy the loans. It is expected that the stream of income from the loan assets transferred to NAMA will be sufficient to meet the interest payments on the NAMA bonds as based on information provided by the financial institutions, the cashflow generating loans pay an average margin of 2% above the floating rate of interest.

20. **Will foreign banks which have loaned to Irish developers and which are not covered by the State guarantee scheme be able to participate in NAMA?**

Institutions will have to apply to become a participating institution. To have loan assets transferred to NAMA, institutions will have to be designated as an eligible participating institution by the Minister for Finance under the draft Bill. In making his decision to designate a bank as a participating institution, the Minister must have regard to a number of factors including the purposes of the Bill, the systemic importance of the bank, the support available to that bank from any other country, any other financial assistance already extended to that institution and the resources available to him.

21. **When do you expect that the first batch of loans will be transferred?**

It is expected that the first batch of loans will transfer to NAMA within a matter of weeks of the Bill being enacted, with NAMA initially focusing on the largest borrowers across the system. This will be facilitated by the preparatory work undertaken with the financial institutions since the announcement of the Government's intention to establish NAMA in April.

22. **What role will Dáil Eireann have in overseeing the operation of NAMA?**

Given the potential number of loans that will be transferred to NAMA and the financial implications of NAMA for the State it is essential that NAMA is accountable to Dáil Éireann and the appropriate Committees for its actions.

To ensure that the Dáil is kept informed of NAMA’s activities, the CEO and the Chairperson of NAMA are accountable to the Committee of Public Accounts and must report to Dáil Éireann on NAMA’s appropriation accounts and reports of the Comptroller and Auditor General who will audit NAMA’s accounts.

The Chairperson and CEO of NAMA will also be directly accountable to the appropriate Committee appointed by either House of the Oireachtas or jointly by both Houses of the Oireachtas.

To ensure that both Houses of the Oireachtas are fully aware of NAMA’s financial and business activities, the Minister will lay copies of NAMA’s annual report and such other reports as appropriate before each House of the Oireachtas.

23. What are the dangers from the proposed outsourcing of the loans to the original institutions that offered them?

NAMA may engage persons or institutions to manage or dispose of assets transferred to NAMA to help ensure that assets are dealt with in the most efficient manner possible to protect the taxpayer’s interest. It is important to note that these staff in the service providers will not be the original staff that provided the loan facility in the first place.

Also NAMA will specify in any contract issued to a service provider that the service provider will operate to the highest standard of honesty and fairness, with prudence and diligence so as to promote the best interests of NAMA. To ensure transparency, NAMA may also engage auditors to audit the books, accounts and other financial statements of the service providers in relation to NAMA activities.

These steps are outlined in the draft NAMA legislation to ensure transparency and that the relationship between NAMA and any service provider operating on NAMA's behalf is of the highest professional standard and that the service provider operates in the best interest of NAMA and in turn the best interest of the State.

24. It was understood that the Government securities issued to pay for the assets transferred to NAMA would add to the level of General Government Debt – however it now appears that this debt may be "off balance sheet". Can you provide further details on this?

Further discussions with the relevant statistical authorities, including Eurostat, are required. However, recent clarifications of treatments in relation to interventions by other Governments in their banking markets may be of some assistance. Basically, NAMA will purchase assets through the issue to the banks of Government securities and/or guaranteed securities. Under Eurostat rules this could result in a very significant increase in gross national debt without the offset represented by the assets purchased being recognised. However, the guidance issued by Eurostat on 15th July requires some further study – it may mean that when NAMA issues securities to pay for bank assets this is essentially an exchange of one form of financial asset for another and Eurostat may treat this as a swap so that by whatever levels your debt may go up because of debt issued it will decrease by the same amount as you have acquired financial assets to an equal value.

The debt issued will be repaid from funds raised through the realisation of those assets over time. The cost of servicing this debt will be offset, as far as practical, from income accruing from the assets of NAMA.

Of course the statistical treatment should not obscure the reality behind the transactions, which is that one asset is being exchanged for another, and that while Government bonds in issue increases, the assets held by the Government, through NAMA, also increase.

25. Have any performing residential mortgage loans been transferred to NAMA?

From the outset, NAMA is tasked with dealing with Land and Development loans in the main and may if necessary acquire loans associated with those which are not of a Land and Development nature.

There is scope for the classes of assets which NAMA deals with to be expanded in future to cover more types of loans should the need arise.

26. How will loans syndicated between Banks that are participating in NAMA and Banks that are not to be treated?

Where related loans are syndicated across one or more institution and not all of those institutions are participating institutions NAMA may only acquire the loans of those institutions which have become participants in the NAMA scheme. However, NAMA has already had constructive engagement with all the financial institutions and it is envisaged a cooperative business like approach will be adopted to resolving issues arising.

Next Steps & Impact of NAMA

27. **When will the legislation be passed?**

The legislation will be brought to the Oireachtas in September with a view to ensuring a proper debate and an expeditious passage of the legislation. In the interim, close collaboration will continue with the European Commission leading to State Aid approval. Consultations will also be undertaken with the European Central Bank.

At a practical level, preparations will continue in relation to preparing the organisational and legal structure of NAMA, and ensuring that all the necessary steps are taken for the commencement of asset transfers later this year. It is intended that assets will transfer in tranches, starting with the loans of the largest borrowers.

28. **Will this have broader implications for the banking sector?**

An intervention of this scale in the banking market is bound to have considerable implications both for the institutions individually and for the broader structure of the banking system. The Minister said that these implications are being considered and may, as indicated earlier, include implications for capital requirements. These matters will form part of the broader context in which the NAMA legislation will be discussed and debated in September.

29. **Do you envisage that the participating banks will require the Government to provide them with further capital following the transfer of loans?**

Loans will be transferred to NAMA at an appropriate written down value which will ensure value for money for the taxpayer and take into account the risk being transferred to the State. It has been previously indicated that, following completion of the transfer of assets to NAMA, the capital position of the institutions involved would be reviewed on a case by case basis.

That said the impact of the difference or write-down on the banks capital ratios will undoubtedly affect individuals bank's capital positions, but so will the reduction in 'Risk Weighted Assets' that will arise for the banks in replacing commercial and other loan assets with Government securities and/or guaranteed securities. Moreover, there may be opportunities for banks to generate core capital through appropriate balance sheet restructuring. Overall, therefore, the capital impacts on individual banks cannot be established in advance of the detailed valuation and pricing process between NAMA and the institutions. The overall process will take some time to complete.

However, should some further recapitalisation of the banks be necessary following NAMA, the Government has made it clear that any further capital injections which it has to make will be by way of equity capital.

30. When can we expect announcements regarding appointments to the Board of NAMA?

The establishment of NAMA involves some complex practical difficulties and it is important that we undertake the detailed preparatory work necessary before finalising the legislative and operational framework. Although we have made good progress on the practical and legal issues to be addressed before NAMA is established our focus remains preparing the enabling legislation and researching the task ahead. In the coming months and of course prior to establishing NAMA and the passing of the

Bill, focus will shift to issues such as the identification of appropriate potential board members. It is envisaged that the make-up of the Board will be finalised before commencement of the Act later this year. In the meantime, NTMA Director Brendan McDonagh has been appointed as interim Managing Director of NAMA to drive the implementation process forward so that NAMA is up and running as soon as possible after it is established on a statutory footing.

31. **How will the draft stand up to Constitutional scrutiny, do you expect it to be referred to the Supreme Court?**

The Bill has been drafted with the input of the Office of the Attorney General and commercial legal advisors appointed to assist the NTMA in preparing for the establishment of NAMA. The Bill sets out a voluntary application process for designation as a participating institution and the powers provided for in the Bill are limited to what is necessary in the public interest.

32. **What will be the final cost to the State of NAMA?**

NAMA will be established on a commercial basis to ensure the best financial return for taxpayers from the management of loans it purchases. In addition, assets will only be transferred to NAMA following the application of the valuation methodology and legal due diligence.

The stream of income from the assets and the proceeds from the eventual sale of the underlying assets will accrue to NAMA. If on the wind up of NAMA, it is profit making this profit will also accrue to the State. In the event that NAMA makes a loss, the Government intends that a levy will be applied to recoup the shortfall.

Availability of Credit

33. What is being done to ensure credit availability to Irish businesses?

A core Government objective is to free up lending on a commercial basis into the economy to support economic growth and a number of actions have been taken to achieve this objective. In the context of the bank guarantee scheme and recapitalisation the banks have made important commitments to support business lending.

A Code of Conduct for Business Lending to Small and Medium Enterprises was published by the Financial Regulator on 13 February and took effect on 13 March. This code will facilitate access to credit, promote fairness and transparency and ensure that banks will assist borrowers in meeting their obligations, or otherwise deal with an arrears situation in an orderly and appropriate manner. This is a statutory code and banks will be required to demonstrate compliance.

In addition, as part of the recapitalisation package announced on 11 February, Allied Irish Bank and Bank of Ireland reconfirmed their December commitment to increase lending capacity to small and medium enterprises (SMEs) by 10% and to provide an additional 30% capacity for lending to first time buyers in 2009. If the mortgage lending is not taken up, then the extra capacity will be available to SMEs. AIB and Bank of Ireland have also committed to public campaigns to actively promote small business lending at competitive rates with increased transparency on the criteria to be met. Compliance with this commitment will be monitored by the Financial Regulator.

An independent review of credit availability, funded by the banks but managed jointly by the banks, Government and business representatives has been completed and is available on my Department's website. Amongst the issues covered by this review are changes in bank lending, repayment terms and a comparison with customer experiences prior to the onset of the financial crisis. The review covered the period June 2008 to February 2009.

34. What are the main conclusions of review on credit availability?

The report is extensive and will require further careful consideration. However, the key conclusions are as follows:

- Total lending to the SME sector by the banks which participated in the review (excluding speculative real estate and construction sectors) remained static in the period at €34.5 billion (but the value of new applications for credit decreased by 42%).

- Demand for credit remains significant with 52% of those surveyed indicating that they had requested credit in the previous year.

- Banks data indicate rates of refusal of credit applications of an average of 14% while the demand side survey indicates an average refusal rate of 24%, rising to 30% for micro enterprises.

- Refusals to businesses with less than 10 employees were highest at 30% with lower refusal rates for larger businesses.

- Requests for new credit were predominantly for working capital/ cashflow reasons to address reductions in revenue and slow downs in debtor collection.

- The review concluded that formal lending policies have not changed but that the application of policies on the ground has resulted in a more cautious approach to lending.

- The cost of new credit to SMEs decreased in the period reflecting reductions in base rates.

- There has been a reduction in the quality of SME loan books with more loans being placed on “watch” or becoming impaired.