NATIONAL ASSET MANAGEMENT AGENCY

Opening Statement to Joint Committee
on Finance and the Public Sector
by Brendan McDonagh, interim Managing Director
Tuesday, 26th May 2009

Chairman, Deputies and Senators,

Thank you for the opportunity you have given me to address you on the subject of the proposed National Asset Management Agency (NAMA). I do intend to give you an update on our work to date on preparations for the establishment of NAMA.

The Minister appointed me on the 5th May to take up the position of interim Managing Director of NAMA and he has signalled his intention to appoint an advisory committee with the requisite expertise shortly to assist me with the various issues that are emerging during this planning phase of putting arrangements in place and in formulating the framework for the NAMA legislation.

The purpose of this major initiative of establishing NAMA is to transfer key exposures from the financial institutions to NAMA so as to clean up bank balance sheets and in return provide Government Bonds to the banks thus enabling the flow of credit to the real economy to resume. Key exposures identified by the market and the credit rating agencies include all the land and development loans of the eligible institutions of c €60 billion in addition to those commercial loans which are interconnected with, or linked to, land and development loans, this is estimated to be an additional €20 – 30 billion. NAMA will, therefore, acquire both performing and non-performing loans. In return, the institutions will receive Government Bonds issued by the NTMA and they may use these bonds as collateral to avail of European Central Bank funding. It is envisaged that the interest payable on the Government Bonds would be offset by interest flows on performing loans acquired by NAMA.

While NAMA will deal initially with the management of transferred loans, there is little doubt that, ultimately, a large part of its work may well be the management of a portfolio of underlying property assets. In managing these loan and property assets, NAMA will have a commercial mandate and its aim will be to ensure that, over the ten to fifteen years of its projected lifespan, it achieves the optimal outcome in terms of the realised value of the assets that are transferred to it. The Government has stated that NAMA will have a clear and strong mandate to ensure that Irish taxpayers do not ultimately end up paying for the over-exuberant lending practices of the last decade. In the event of there being a shortfall the Minister and the Government has signalled that this will be recouped from the financial institutions.

I want to avail of this opportunity to bring the Committee up to date with the work currently being done in preparation for NAMA. We estimate that about €60 billion of land and development loans and some €20 billion to €30 billion of the larger associated commercial loans of the eligible institutions will be transferred to the Agency. Essentially, these loans constitute the main systemic risk to the banking system in Ireland. Last week, I asked the guaranteed institutions to provide me with a breakdown of these loans so as to assist us in our detailed planning for NAMA and to enable the full implications, in terms of the capital adequacy of the institutions, to be initially assessed. I received their responses yesterday and I am glad to say that the institutions have signalled strongly to me their intention to co-operate fully with us both before and after the establishment of NAMA.

Since the announcement of the decision to establish NAMA, a Steering Group comprising the NTMA, the Department of Finance and the Attorney General's

Office has been meeting up to twice-weekly to consider a range of issues which will need to be addressed as part of the draft NAMA Bill. It is expected that draft Heads of Bill will be ready within two to three weeks and that the Bill subject to Government approval will be published in July. The Bill will necessarily be complex, not least because of the potential difficulties that will need to be addressed from operational, legal and constitutional perspectives, but as has been emphasised by the Minister for Finance on a number of occasions, it is important that we make every effort in our preparation stage to identify the issues and address these in the draft legislation so as to get it right.

We will be sending teams of experts, hired on short-term contracts, into the institutions to perform legal and financial due diligence on eligible loans as soon as possible. At the same time, we will be recruiting core staff for NAMA and putting in place the requisite management information systems to enable us to monitor and control the loans and any resultant property assets. It should be borne in mind that many of the larger borrowers will have loans outstanding with a number of institutions (commonly referred to as being multi banked) and, for the first time, it will be possible to get an overview of their total exposure across the financial institutions covered by NAMA. We will also be putting in place arrangements to ensure that there is ongoing communication between NAMA and the covered financial institutions. We are realistic enough to recognise that there are institutions which will be outside of NAMA but which may also have provided loans to many of the larger borrowers within the NAMA framework. We would envisage that NAMA and these institutions will have to work together in many instances to protect our common interests but this will be done at all times in a commercial way to protect the interests of Irish citizens.

You will be aware also that there has been much comment about the valuation of property assets underlying bank loans and the discount to be applied to the book value of such loans when they are transferred to NAMA. There is considerable speculation on the level of discount or haircut that will be applied by NAMA. I wish to advise the Committee that it is not possible at this stage to determine what that discount will be as it is dependent on such a wide range of factors and also the fact that each loan will have to assessed and valued individually. This is because based on our current knowledge of the loan books suggests that the majority of individual loans are bespoke and has different legal documentation. Furthermore, in our preliminary discussions with the EU Commission they have indicated that they will require individual loan assessment and valuation. We are all aware that there has been a substantial readjustment in the property market and that may continue for some time yet. However, in its Guidance on the treatment of impaired assets published in February, the EU Commission suggested that, in the first place, assets should be valued on the basis of their current market value, where possible. It acknowledged, however, that, in current circumstances, the current market value may be well below the book value of the assets or, indeed in certain cases, there may be no current meaningful market value. In the absence of a market value, the EU Commission has indicated that they would consider a transfer value reflecting the underlying longer-term economic value of the assets to be an acceptable benchmark as a basis of valuation methodology. The EU Commission guidance primarily seems to focus on financial assets (collateralised debt and loan obligations, Asset Backed paper etc) whereas as the members of this committee will be aware that while property loans are in themselves financial assets, the designated assets on the Balance Sheets of the Irish institutions that will transfer to NAMA are indeed pure property plays. The fundamental problem with these loans relates to the steep decline and adjustment in the value of the underlying security i.e. the property market both domestically and internationally; - this is commonly referred to as an old fashioned property bust. How this EU Guidance paper on valuation methodology is defined for the purposes of property assets in the Irish context is one of the core and central issues currently being discussed by the Steering Group and has already formed part of initial discussions with the EU Commission.

The immediate priority of the Steering Group is to ensure that its proposals, in relation not only to valuation methodology but also eligibility criteria for institutions and asset classes, are consistent with EU rules on State Aid. The Department of Finance continues to maintain a close dialogue with the EU Commission to ensure the draft proposals on the valuation methodology which emerges are in conformity with the EU Guidance on the Treatment of Impaired Assets. The EU Commission has already signalled that they will be establishing their own panel of international experts to advise them on the proposed methodology and that when approved such methodology will have to be applied uniformly and consistently across institutions. The EU Commission will insist on this for all member states and Ireland will be treated no differently. It is envisaged that EU Commission approval will be received prior to the publication of draft legislation.

In addition to the legal and valuation questions, other issues being assessed in detail by the Steering Group which will report on an ongoing basis to the Minister and ultimately will have to obtain Government approval include NAMA's corporate governance structure and reporting arrangements and the question of NAMA's potential powers including, potentially, Compulsory Purchase Orders (CPO) and powers in relation to borrowing and the investment of equity and working capital in joint ventures. NAMA will have three options in relation to the assets it acquires: it can dispose of them at an early stage; it can hold them with a view to disposing of them when market conditions have improved or it can develop them to enhance the return. To do so, it is envisaged that NAMA will have the option of entering into joint ventures, partnerships or form special purpose vehicles with other interested parties to enhance the value of some of the acquired assets. The overall objective and foremost in the mind of NAMA will be what will achieve the optimal return and will be in the best interests of the taxpayer.

I should mention also that much work is being done in terms of operational plans for NAMA, including its organisational structure, business model, identifying key staff and a detailed implementation plan. My colleagues in the NTMA and I have been consulting as widely as possible with international experts in this area with a view to drawing up a best-practice model for how NAMA will operate. To ensure that we have available to us the best advice on the key issues facing us, we have issued a tender seeking banking and financial advisory services during the pre-establishment phase which is envisaged to be for the period between now and the passing of the NAMA legislation. There has been a huge level of interest in this RfP with over 600 expressions of interest and, following a detailed evaluation of all the proposals received by yesterday's deadline of 25 May, we would hope to be in a position to appoint an advisor within a fortnight subject to the amount of time that it will take to evaluate the number of tenders received. We will also be issuing separate tenders seeking other discrete specialist advice over the coming weeks to assist the Steering Group on specific technical aspects of the legislation. A list of all NAMA related tenders will be published on the website www.nama.ie

On the organisation front, our thinking at the moment is that NAMA should be a division within the NTMA of about 30 to 40 staff, possibly based around a core of senior managers (asset managers, corporate finance, legal, etc.) supervising panels of external service providers (valuers, legal firms, planning experts, service providing financial institutions etc.). The core staff would include property asset managers whose job it would be to make recommendations as to disposal or development of any properties that NAMA ends up with. Their advice on how to achieve the optimal return on NAMA loan and property assets would be based on well-informed knowledge of the markets and analysis of factors such as historical property prices, economic growth projections, market recovery assumptions (by region and by asset type), supply/demand projections by market segment and by region, assumptions in relation to planning, etc.

There will also be senior loan\banking managers who will oversee loan servicing and ongoing management including, and where it makes commercial sense to do so, the restructuring of loans if necessary. In terms of getting NAMA operational as soon as the legislation is enacted our developing thinking is that we expect to come to some arrangement with the banks which would mean that they would continue to administer and service transferred loans within specially created companies but that all key business decisions in relation to those loans would be made centrally by NAMA who at all times will retain control. This makes sense as there is tremendous knowledge in the institutions at local level about the individual borrowers and loans, which NAMA could never replicate. This does not mean that the same people who gave out the loan will be dealing with the same loan under NAMA, and we will insist that there will be staff rotation within the financial institutions to prevent this. To ensure that NAMA at all times will have control of the process we have taken advice from experts who have done this in other countries or have advised on such NAMA type solutions and they recommend that NAMA should also have a number of senior people on the ground in each institution overseeing the process of administration by the financial institutions. We have met and outlined this business model proposition with senior members of the Irish Congress of Trade Unions who represent bank staff.

As regards borrowers, I want to make clear that NAMA's mandate is not to be in the business of liquidation but to achieve workout on the loans acquired over time as it can take a longer term perspective than the banks can. Borrowers will still owe NAMA the full amount they originally borrowed from the banks and there is no question of a bailout for any borrower. We have met the Construction Industry Federation along with a number of major developers and we have made it very clear to them that NAMA fully recognises the difficulties the industry and borrowers are facing in the current challenging economic environment which is painful for all Irish people and not just the construction industry. We have outlined that NAMA will work constructively and professionally with those parties and stakeholders willing to co-operate with us to achieve its objective of ensuring the optimal return for the exchequer;

however, those unwilling to do so for whatever reason will face the full legal consequences available to NAMA to protect its interests. We also have made it clear that the transaction is between NAMA and the financial institutions and that while the developers are an interested party, NAMA will pursue its own objectives.

We have also had discussions with the Central Statistics Office and Eurostat on the accounting aspects of NAMA and the implications for the General Government Debt and general Government Balance.

In conclusion, none of us would wish to be in the situation in which we now find ourselves. It is unprecedented. The task ahead is indeed challenging but, if all those involved – borrowers, lenders, Government and NAMA - approach it in a spirit of co-operation and in a committed, commercial and professional manner, it is a task which is surmountable and achievable and we believe based on our preliminary discussions with the various stakeholders that it can be done relatively quickly after the legislation is enacted. I wish to assure the Committee that my colleagues and I at the NTMA will work assiduously, professionally and without fear or favour to make NAMA work in the interests of our country. Failure to face up, recognise and deal with the problems in our banking system is simply too costly to contemplate for this and future generations of Irish people.

Chairman, this concludes my opening statement and I thank the Committee for the opportunity to outline my thoughts.