

JOINT COMMITTEE ON FINANCE AND THE PUBLIC SERVICE debate - Tuesday, 26 May 2009

National Asset Management Agency: Discussion.

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Chairman

The purpose of the meeting is to discuss matters relating to the establishment of the National Asset Management Agency. I welcome the Minister for Finance, Deputy Brian Lenihan; Mr. Brendan McDonagh, interim managing director of NAMA, and Dr. Peter Bacon, special adviser to NAMA. I thank them for coming before the joint committee to discuss this important topic. We will hear three presentations which will be followed by questions and answers, commencing with the Minister. Members are reminded of the long-standing parliamentary practice to the effect that they should not comment on, criticise or make charges against a person outside the Houses or an official by name or in such a way as to make him or her identifiable. I draw attention to the fact that members of the committee have absolute privilege but this privilege does not apply to witnesses appearing before the committee.

Minister for Finance (Deputy Brian Lenihan)

I thank the Chairman and members of the joint committee for giving me the opportunity to address them on the proposed National Asset Management Agency. I am joined by Mr. Brendan McDonagh, interim managing director of the agency; his colleague, Mr. Seán Ó Faolán, and Dr. Peter Bacon who prepared the report on the establishment of an asset management agency.

In my Budget Statement of 7 April I announced the Government's decision to set up the agency under the aegis of the NTMA with a view to addressing, in a comprehensive way, the problem of impaired or potentially impaired assets in the banking system. Before the new interim managing director of the agency, Mr. McDonagh, and his colleagues bring members through the operational work under way and to come, I will set out the rationale for the establishment of the agency and explain why it is necessary for our economic recovery.

It is important to be reminded that the reason for the Government's interventions to date, including the establishment of the agency, is to stabilise the banking sector. The banking system is unique and its proper functioning is critical to the smooth running of the economy; therefore, it must be protected by the Government. The recent global financial crisis has given rise to numerous interventions across the developed world. In Ireland, through the bank guarantee, bank recapitalisation and the protection of public ownership, we have provided very substantial support for the banking sector but our overriding objective is clear: to maintain a functioning banking system which will ensure a flow of credit to the economy. Cleansing and repairing the banks' balance sheets is considered fundamental to achieving a sustained recovery of the banking system. That is not a personal view but one subscribed to by the IMF and enjoined on every government in the world.

Following a review of the options available to tackle risky assets, including an assessment by officers in my Department of the options raised by Dr. Bacon,

the Government decided that an asset management agency was the most appropriate solution to address the issue of asset quality in the banking system. The agency will be established on a statutory basis under the aegis of the NTMA. Assets will be transferred from the banks to the agency to strengthen their balance sheets and ensure uncertainty over bad debts is reduced. This will facilitate a sustained flow of credit on a commercial basis to individuals, households and businesses in the real economy.

Because it is clear that the principal uncertainties over asset quality lie in the banks' land and development loans and in the largest aggregate associated exposures, it is these categories of loans which will be transferred to the agency. These assets pose the main systemic risk to the banking sector in Ireland and the most significant obstacle to the recovery and restoration of lending by the banking system. The agency will purchase the assets through the issue to the banks of Government bonds which will result in a very significant increase in gross national debt to be offset by the assets taken in. The cost of servicing this debt will be offset, as far as is practicable, from income accruing from the assets of the new agency. The debt will be repaid from funds raised through the realisation of these assets over time.

The potential maximum book value of loans that will be transferred to the agency is estimated to be in the region of €80 billion to €90 billion, although the amount paid by the agency will be significantly less than this, to reflect the loss in value of the properties. Initial work on the valuation methodology to be applied is under way and will be elaborated on by the interim managing director.

It is important to note that the State will not assume all of the risk in the acquisition of these assets. The assets will be valued on a basis which is sustainable for the taxpayer. This will entail an assumption of losses by the financial institution whose assets are removed. In the longer term, if the agency were to fall short of recouping all of the costs, the Government

intends that a levy should be applied to recoup any shortfall. All borrowers will be required to meet their full legal obligations for repayment. There will be a hardening of the approach to these borrowers as taxpayers' money is at stake and the agency will be expected to protect it in a commercial way and with an independent remit.

This initiative is being developed and implemented within the common EU framework detailed through the European Commission's guidance note on the treatment of impaired assets working closely with the Commission to obtain prior state aid approval. By drawing on the best advice and experience available internationally, we are committed to ensuring this very significant venture will be an example of best practice and meet all of the objectives the Government has set for it.

I would like to comment on what many commentators seem to be suggesting as an alternative to the asset management agency approach, that is, the wholesale nationalisation of the State guaranteed banks. The Government does not accept that the nationalisation of the whole of the Irish banking system would be the short-term panacea that many envisage. The Government believes it is important, where possible, that the banking sector has a market presence and operates within market disciplines and constraints. Our objective is to ensure the lending needs of the real economy are met. A commercially focused banking system which includes banks having a market presence and operating within market disciplines and constraints is best equipped to achieve this aim. Nationalisation would not make the problems faced by the banks go away. I remind members that many of the difficulties relating to managing impaired loans, cleansing the balance sheets of the banks and dealing with legal challenges would also arise in the context of a nationalised banking system and perhaps even to a greater extent. Wholesale nationalisation is something we should avoid, if possible. This is not a position held no matter what the cost but rather a balanced approach to current circumstances. We have nationalised a major

bank which had substantial exposures. I have made it clear that if any further capital injections are required from the State for either of the two main banks, these will be in the form of equity capital, which would have the effect of increasing State ownership of these two banks.

The establishment of NAMA will, no doubt, give rise to complex practical difficulties and it is important that we undertake the detailed preparatory work necessary before finalising the legislative and operational framework. The preparatory process is being overseen at this initial stage by a steering group made up of representatives of the Department of Finance, the Attorney General and the agency. Mr. McDonagh has been appointed as interim managing director to drive the implementation process forward. He will be assisted by an advisory committee to be appointed shortly which will provide him with a range of expert advice.

I have also directed the NTMA to provide the necessary staffing and other facilities, through its existing resourcing arrangements, to support the interim operation of the agency pending its establishment on a statutory basis. The agency is contracting experts to assist the interim managing director and advisory committee and substantive work has commenced on an analysis of eligible assets, valuation methodology and engagements with the financial institutions. My Department is also open to communications with the European Commission with a view to ensuring the establishment of NAMA on a statutory basis is consistent with EU guidelines on the treatment of impaired assets and complies with state aid rules.

I can confirm that it is my intention to publish legislation in July, which allows us sufficient time to get things right. I can also confirm that the Oireachtas will be given adequate time to debate the important issues arising in this legislation and, if necessary, I will seek an early recall to deal with it. Substantial progress has been made since the Government's announcement in April but, clearly, much more needs to be done. We cannot allow ourselves

to rush the process, as the impediments to be overcome are both complex and challenging. Nevertheless, practical arrangements for the operation of the agency are progressing apace. Mr. McDonagh and his colleagues will describe to the committee in more detail the progress which has been made to date and outline what is to come. I think we are agreed that, contrary to much commentary, we have made good progress on the practical legal issues to be addressed before the agency is established.

Mr. Brendan McDonagh

I thank the joint committee for giving me the opportunity to address it on the subject of the proposed National Asset Management Agency. I intend to give an update on our work to date on preparations for the establishment of NAMA, but, first, I wish to give some background information. As the Minister outlined, he appointed me on 5 May to take up the position of interim managing director. He has signalled his intention to appoint an advisory committee shortly with the requisite expertise to assist me with the various issues that will emerge during the planning phase of putting arrangements in place and formulating the framework of the NAMA legislation.

The purpose of the major initiative of establishing NAMA is to transfer key exposures from the financial institutions to NAMA to clean up bank balance sheets and, in return, provide Government bonds for 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 approximately €60 billion. In addition to these, there are loans interconnected or linked with land and development loans estimated to be an additional €20 billion to €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 ECB funding. It is

envisaged that the interest payable on the Government bonds will be offset by interest flows and 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 land and property assets, NAMA will have a commercial mandate and its aim will be to ensure that during the ten to 15 years of its projected lifespan it achieves the optimal outcome in terms of realised value of the assets transferred to it. The Government has stated NAMA will have a clear and strong mandate to ensure the taxpayer does not ultimately pay for the over-exuberant lending practices of the past decade. In the event of there being a shortfall, the Minister and the Government have signalled these will be recouped from financial institutions.

Deputy Joan Burton

Will the speaker slow down as it is very hard to follow?

Mr. Brendan McDonagh

I wish to avail of the opportunity to bring the committee up to date on the work being done in preparation for NAMA. We estimate that approximately €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 to assist in our detailed planning for NAMA and 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 pleased to say they have strongly

signalled 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 the draft heads of the 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 must be addressed from operational, legal and constitutional perspectives. However, as has been emphasised by the Minister for Finance on several occasions, it is important that we make every effort in our preparation stage to identify and address the issues in the draft legislation to get it right.

We will send 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 recruit core staff for NAMA and put 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. This is commonly referred to as being multi-banked. 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 put in place arrangements to ensure 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 for many of the larger borrowers within the NAMA framework. We 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.

The committee 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. I 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 be assessed and valued individually. This is because our current knowledge of the loan books suggests the majority of individual loans are bespoke and have different legal documentation.

In our preliminary discussions with the European Commission it has indicated that it 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 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 the current circumstances the current market value may be well below the book value of assets or indeed in certain cases, there may be no current meaningful market value. In the absence of a market value, the Commission has indicated that it 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 Commission guidance primarily focuses on financial assets such as collateralised debt and loan obligations, asset-backed paper, etc., whereas as the members of this committee will be aware, 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 in many cases pure property plays. The fundamental problem with these loans relates to the steep decline and adjustment in the value of the underlying security in 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 Commission.

The immediate priority of the steering group is to ensure that its proposals in relation not only to valuation methodology but also to 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 Commission to ensure the draft proposals on the valuation methodology which emerge are in conformity with this guidance. The Commission has already signalled that it will be establishing its own panel of international experts to advise it on the proposed methodology and when approved, such methodology will have to be applied uniformly and consistently across institutions. The Commission will insist on this for all member states and Ireland will be treated no differently. It is envisaged that 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 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.

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 adviser within a fortnight, subject to the length of time it will take to evaluate the 60 tenders received by the closing date. 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 covering the areas of asset management, corporate finance and legal issues. These will be supervising panels of external service providers such as valuers, legal firms, planning experts, service-providing financial institutions, etc. The core staff would include property asset managers whose job it is to make recommendations as to disposal or development of any properties that rest with NAMA. 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, supply and demand projections by market segment and by region, assumptions in relation to planning, etc. There will also be senior banking managers who will oversee loan servicing and ongoing management including, and where it makes commercial sense to do so, the restructuring of loans where 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 institutions 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 which at all times will retain control.

This makes sense as there is tremendous knowledge in the institutions at local level on the individual borrowers and loans which NAMA could never replicate. This does not mean that the same people who gave out the loan will deal with the same loan under NAMA. We will insist on staff rotation within the financial institutions to prevent this happening. To ensure NAMA will at all times 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 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 it clear that NAMA's mandate is not to be in the business of liquidation, but to achieve work-out on the loans acquired over time as it can take a longer term perspective than the banks. 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, with a number of major

developers, and made it very clear to them that NAMA fully recognises the difficulties the industry and borrowers face in the current challenging economic environment which is painful for all Irish people, 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 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.

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

That concludes my opening statement. I thank the committee for giving me the opportunity to outline my thoughts.

Dr. Peter Bacon

My PowerPoint presentation has been circulated to the committee, but apologies to the press that it does not seem to be available on screen. It takes us through the task I undertook on behalf of the Minister for Finance in the past three months or so. The objectives of the assignment were to examine the options available for resolving property loan impairments and, in particular, to consider the two broad approaches emerging in the international policy debate, namely, asset management or risk insurance, and in the process to give consideration to aspects of nationalisation that would arise in that context. The overarching goal and clear task given to me was to come forward with a view or recommendation on which approach offered the best prospect of stabilising the economy and supporting future credit growth. That was my job.

The first part of the way I handled that task was to try to get as clear an analysis as possible for the Minister, with respect to the context within which any initiative would be taken. The key features I concluded were relevant to any consideration were the re-emerging of serious constraints on the public finances with which members of the joint committee are familiar and the pace of deterioration; the contingent liabilities of the Exchequer in respect of deposit liabilities which were unavoidably assumed in September 2008; the instability of market liquidity to Irish credit institutions in common with credit institutions across the globe; and arising from this — this is a critical point — the intertwining of sovereign risk with banking risk, leading to the escalating cost of Exchequer debt funding at the time.

Members will know there was a widening in Government debt spreads over German spreads. That intertwining aspect caused the Minister to believe that in resolving the public finance position in April he also wished to deal and make clear what the principled approach would be with respect to the banks. If he did not do that the question would be, "What about the banks?" If one came forward with a proposal about the banks the answer would be, "What about the public finances?" The two had become inextricably

intertwined. The resulting analysis and approach recommended was significantly influenced by those features of the context.

The next major piece in the jigsaw was to get, at a macroeconomic level, an estimate of the extent of the problem. What we did in that regard was to distinguish approximately six categories of property assets, namely, in Dublin, outside Dublin, in and within the UK, in large conurbations and in provincial areas. One looked at categories separately, such as residential land, commercial land and investment property loans, with respect to the commercial sector or mixed-use developments, and evaluated the peak-to-trough declines that were occurring in each category. That was done using the published research of both Irish and international estate agencies and also from a limited consultation process I undertook with some senior figures in the property market in Ireland.

Subsequently, we had the task of estimating the age profile of loans around that peak because the peak was 2006 and the trough is either current or, prospectively, within the next 18 months. Not all loans were taken at the peak so it is necessary to get a profile of those loans. That can be done from published Central Bank data which show that loans to the centre doubled between 2006 to date. That gives a basis for weighting an age profile.

We then determined typical loan-to-value ratios and in this regard I distinguished between development land and investments. I spoke to bankers concerning knowledge of where, typically, loan-to-value ratios lie. One then models all those factors and gets a result. Critically, one conducts a sensitivity analysis on that result. The conclusion of that analysis was that the results are sensitive to variations in the loan-to-value ratio and to changes in peak-to-trough valuations. The message one gets is an overall macroeconomic estimate but individual credit institutions and borrowers' experience will vary significantly depending on the precise characteristics of

the loans. Much of what Mr. McDonagh has said in his detailed account of the current work echoes that.

At that stage we knew the context, the particular features of it that were relevant and the broad order of magnitude of the problem that had to be resolved. I then examined two broad approaches, namely, risk assurance and asset management. I made a recommendation to the Minister in favour of an asset management approach for three principal reasons. First, in the context I outlined, as many members will know, the necessary assumption of the liabilities of the banking system gave rise to extraordinary amounts of speculation in the international media, among investors and among speculators against Irish sovereign risk, that this was an open-ended commitment, a contingent liability. I advised the Minister that one thing that he and his colleagues should avoid was adding to that contingent liability and that whatever approach was to be deliberated and decided upon by the Government should ensure certainty as regards what the liability would be. The asset management approach does this. It has the negative side effect of forcing one to confront the magnitude of the problem up front. In advising the Minister, however, my judgment was that would be a better course than having a further open-ended contingent liability with respect to the assets and liabilities of the banking system.

The second point that influenced me in favour of the asset management approach was that it offered the prospect of putting a disinterested party between the borrower and the lender. A characteristic feature of the Irish situation is the degree of concentration of lending to developers and the relatively high exposure of credit institutions to that sector. The international literature points to the advantages of having a disinterested party. The reality is that Irish banks are uncertain of the claim against the adequacy of their capital. Behind all of this is a question: is the capital base of Irish banks adequate? That is the uncertainty with which we are dealing. In the circumstances, nobody gets medals for saying, "I have got a proposal to

charge up a loan against a limited amount of capital". The disinterested party can take a dispassionate view.

I want to comment on a line in the media that what Bacon proposed to the Government and what the Government is doing on this issue are different in some way. I see no difference in the approach which Mr. McDonagh has outlined and what is contained in the report. The critical point is that NAMA would have strategic control and direction over the loans. Whether the loans are residing in a subsidiary of a bank or in treasury building in the NTMA is neither here nor there; the critical issue is who has strategic control and direction. I see that line of argument as trying to contrive a difference where there is none.

In my own considered opinion, the most important advantage of the asset management approach over the risk assurance approach relates to the continuing provision of capital for the property sector. The gentlemen of the media will know that I have tried to make this point several times, but I seem to fail miserably every time I make it. A characteristic feature of the property sector is that it is privately incorporated and not publicly quoted. A corollary, for example, is the UK system in which one has a number of large property development companies which have had significant recourse to capital markets to bolster their equity, but that channel is not available to Irish developers. As a consequence, the sector is characterised by excessive reliance on bank debt. In fact, the only channel of adjustment has been on the capital base of the banking system. The first call on equity in these loan-to-value ratios has substantially eliminated the equity base of the property development sector.

An asset management agency, particularly one configured as part of the National Treasury Management Agency, which has extensive experience of capital markets and an institutional appeal and reputation can provide a significant opportunity for the economy to provide that equity to work out

complex developments which are semi-complete or in the course of completion and which cannot be completed at this time. In the nature of equity it can take a longer term view than a debt finance agency. In that way it can contribute significantly to the return of an active work-out of these asset properties to the benefit of the economy and the original borrowers of the loans. That in substance was the work undertaken.

In terms of the precise structure upon which I advised, I dealt with the functions and responsibilities such an agency would have, why I believed it should be in the National Treasury Management Agency, the assets to be transferred and eligibility. I have noticed a question frequently asked is why I recommend taking all these loans. This is a point about investors; it is not one about developers and suggesting we take the good as well as the bad loans. The recommendation is that one remove the most infected class of assets. The most infected classes of assets are loans for land and development and the associated cross-collateralised loans which relate in the most part to investment property.

The idea is as follows. If taxpayers' money was used to take, for example, half of the loan, there would be someone in San Diego with a position in an Irish credit institution who would say: "The Irish have taken half of the loan. They have said they have taken the bad half. How do I know there are not more bad loans?" To provide certainty and the incentive for international investors and providers of long-term capital for banks, I recommended removing the infected class of assets. That was the basis for that recommendation.

On the valuation question, the approach I have set out is identical to the one about which Mr. McDonagh spoke. I will not go over it again. It included how NAMA should be capitalised, the kinds of bonds to be used and its business model. The essential business model of NAMA that I envisage is one where we dispose now, sit passively or work actively. I set out a range of projects that would be envisaged in that model.

On staffing, I recommended a staff covering the professions Mr. McDonagh outlined and, perhaps, having client officers, depending on the size of client involved.

Chairman

I thank Dr. Bacon. We will proceed to questions and answers. As the Minister needs to leave at 1 p.m., I propose that he take questions initially.

Deputy Richard Bruton

It is a pity the Minister's time is constrained. I will set aside that I do not believe this is the right choice in order to consider the proposal on its merits. Regarding the evaluation of this choice, why has the Minister not published the comprehensive analysis that we have been told was made? Who is represented on the steering group?

I know Dr. Bacon has a strong reputation, but we also know he was an adviser to developers. We need to have confidence that this advice has been stress-tested by more than one consultant. It is disconcerting that a number of people whose opinion one has to respect are very critical of the plan. They are critical of the potential cost and the downside risks and believe it is not the most appropriate way to proceed. Has sufficient research been carried out to ensure the choice that has been made will get credit flowing, which is what the economy needs, that it is the least costly approach and can be adapted quickly if it goes wrong in order that we will not be sucked into a model that will become a millstone around our necks? I am concerned about the strength of the analysis, the consultation carried out and the huge number of discordant voices whom we must respect.

The risk to the taxpayer of a country which already borrows between 13% and 14% of GDP buying €90 billion in assets is huge. Experts have said that if we

pay commercial prices for the assets in question, the banks will be below water to the tune of €9 billion. Is it the case that the taxpayer must pay at least €9 billion extra for the impaired assets to keep the banks above water? A write-off of 20% would wipe out their value, which is a serious worry. The Minister tells us that he is taking protection against this by a levy to recoup the €9 billion overcharge in the long term. Will that be a statutory provision in the NAMA Bill? If there is a statutory obligation to that effect, the average investor in San Diego will not have any certainty about his or her asset.

The Minister said it was hoped the interest and running costs of NAMA, amounting to €3 billion, would be recovered every year by the money generated by managing the portfolio. How confident is he of this? He gave the impression that the sensitivity analysis showed the costs could be much greater; therefore, can we be confident that we can service that €3 billion or will the taxpayer have to pay for it? Taxpayers will see 60% of their payments swallowed up in interest in the next four years and if one adds the NAMA costs, some 75% to 80% of income tax will be soaked up in interest payments. It is critical that the Minister is correct that the assets can cover the costs.

Professor Bacon said the calculations had been done but that the sensitivity analysis suggested certain things could make it worse. In the Government model, who will take the downside in a bad situation?

Chairman

We agreed that we would ask detailed questions of Dr. Bacon and Mr. McDonagh when the Minister had left.

Deputy Richard Bruton

The Minister will answer as best he can and I am sure we will see—

Deputy Brian Lenihan

There is a large number of questions and I want to give comprehensive answers. Will the joint committee rise for lunch, Chairman?

Chairman

We will keep going.

Deputy Brian Lenihan

In that case, I am prepared to extend the session beyond 1 p.m. I assumed the committee would rise for lunch. That will give members more scope. I will have to refer some questions to officials because they are very technical. Some are more general in character.

Deputy Richard Bruton

I thank the Minister for giving more time. It will be welcome. The joint committee is genuinely trying to grapple with what is the best solution. It is easy to politicise the matter and say Fine Gael stands for a national recovery bank approach, the Government stands for NAMA and the Labour Party stands for nationalisation. We are all groping towards trying to find the best way to protect the taxpayer. I welcome the opportunity to tease out the Minister's proposal.

We have heard from the head of the NTMA that this is a potential legal minefield. That seems to be true. Mr. McDonagh describes individual, or bespoke, loans with different legal documentation. It does not seem to be a simple matter. Will the Minister explain the legal risks? Can shareholders challenge the handing over of good assets? Can individual holders of bespoke loans challenge the fact that terms guaranteed when the loans

were originally set no longer apply when the loans are passed to someone else?

The banks must do everything possible to sort this out before the taxpayer is asked to shoulder it. Is it the Minister's presumption that professional investors in the banks, other than shareholders, should be underwritten? Although that was, apparently, the Government's position initially, it seems the ground is changing rapidly. We see Bank of Ireland buying back bonds at a significant discount. We see Anglo Irish Bank not going ahead with a pay option on the expected date. We hear it may not pay the premium on long-term preferential bonds. Are we beginning to see the emergence of an acceptance by the Government that bond holders — professional investors — will have to share the adjustment? If that is the growing approach, does the Minister believe the NAMA model is the best way of extracting the most out of those professional investors before the taxpayer is resorted to? I fear the NAMA model presents banks and their professional investors with the prospect of getting off the hook, to some degree. We have seen this with bank shares going up. It is important that banks are made to squeeze as much as they can out of the professional investors before the taxpayer is asked to share the burden. I worry that the Napoleonic scale of NAMA will leap into the middle of this situation and lift the burden off their shoulders. They can then sit back in San Diego and say things are looking good for them. That is my worry.

I am sorry for asking so many questions. However, everyone has huge numbers of questions. Perhaps if more documentation on the evaluation side had been published, we might not need to ask so many.

Chairman

If the Minister answered those questions, the replies might cover many others.

Deputy Brian Lenihan

I will cover as much of the ground as I can and refer some of the questions for supplementary replies by Mr. McDonagh and Dr. Bacon.

I thank Deputy Bruton for the constructive way in which he approached the presentations. He made a point about the downside. This is a fundamental issue in the operation of an agency such as NAMA. In respect of such an agency, one must understand it is not about the taxpayer assuming the risk, but about ensuring the banks and developers absorb the pain. The taxpayer only enters the equation after this as the sovereign intervener to protect the entire banking system.

Recently, the ESRI produced a report on the scenarios for economic recovery in Ireland. The report outlined very well the position of the economy in the past year. It went through a domestic contraction through the implosion of a property bubble. The normal working out of this which would have been possible in benign international conditions became very difficult because of stressed world financial markets. There are two major contributory factors to our economic difficulties. This, in turn, required a fiscal adjustment of the order of 4.5% of GDP in the past year. As that fiscal adjustment was worked out in four budgetary adjustments over the year, it became very clear as we approached the final adjustment in April that, as Dr. Bacon pointed out, the risk to the sovereign and the international assessment of the risk to the sovereign was affected by the frail character of the banking system, in addition to the difficulties in the public finances. Therefore, it was essential in the final supplementary budget for this year to make it clear that the Government had a strategy for dealing with the banking crisis and to address the public finances. Both were linked according to the assessment of international and world markets.

We are all politicians and aware of how the political process works. The Government realised there was an argument for bundling the whole NAMA operation in one implementation plan and simply presenting it. However, there was not sufficient time available. Given the magnitude of the issues involved, which everyone accepts, it needed to be worked on over time. At the same time it was important in the final budget, when we were reassuring world markets which we have succeeded in doing, that we made it clear that we had a thought out approach to how we would resolve the banking crisis, in addition to the approach of conforming with our obligations under the Stability and Growth Pact and having a credible three-year pathway to address the difficulties in the public finances. The reason this decision was taken in principle in the budget was to make this clear at home and abroad. Clearly, the downside was one had an interregnum while the proposal was scoped out in greater detail. Nevertheless, the balance of the argument is in favour of having made that initial decision in principle at the outset.

Deputy Bruton fairly asked us to consider the principle at which I had arrived and examine the rationale for it. The first question raised by the Deputy was why I had not published the detailed advice submitted by Dr. Bacon. An excerpted version was published. The reason the full advice was not published was it contained a great range of sensitive information which would affect the market valuations of financial institutions on the Stock Exchange. Dr. Bacon had access at the NTMA to a wealth of information on the work completed on assessing the exposures in the banking system from an accountancy, evaluation and auctioneering point of view. All of this information was at his disposal in drawing up the report. Placing that information in the public domain would have had an immediate impact on the market prices of individual financial institutions.

I refer to the question of whether the search was sufficient and stress-tested. Dr. Bacon was attached to the NTMA. That is where a lot of the analysis work was done with Merrill Lynch with regard to the condition of the financial

institutions. When his report was presented, it was examined by my Department as part of a separate exercise. I understand it was also examined by the Financial Regulator and by the Central Bank. Therefore, it is not a matter of an individual parachuting into the Minister's office with an interesting proposal. Stress-testing has become part of the folklore of the modern banking crisis—

Deputy Richard Bruton

Some of those involved in the stress-testing appear to be less than impressed with what they have seen, if we can judge from what Dr. Somers said.

Deputy Brian Lenihan

On the question of stress-testing—

Deputy Richard Bruton

These are not bodies which are going to tell us the upside and downside.

Deputy Brian Lenihan

The NTMA has been involved in the stress-testing relating to the capitalisation —

Deputy Joan Burton

Even though Dr. Somers knew nothing.

Deputy Kieran O'Donnell

What are we to take from the comments of Dr. Somers?

Deputy Joan Burton

He knew nothing. He said he did not know anything about it.

Deputy Brian Lenihan

I can only go on the information provided for me by my officials and the constant liaison between the NTMA and my Department. Mr. McDonagh has referred to the numerous meetings he has had with my Department about these matters. That is all I can refer to.

Deputy Kieran O'Donnell

How does the Minister regard the comments of Dr. Somers?

Deputy Brian Lenihan

I am not speaking for Dr. Somers. The one point he has made is that he supports the approach taken by the Government. His independent opinion is that it is the correct and only approach available to us but he sees great practical difficulties. That is the reason we are proceeding with care in this matter.

Deputy Richard Bruton

He is the only one who does not observe a vow of silence about everything he sees; that is the difficulty. The one person who might have credibility is raising doubts.

Deputy Brian Lenihan

I do not think the Deputy will see any vow of silence if he will just listen to the answers being given to the questions asked. The question with which I am dealing is whether stress-testing has taken place in respect of this proposal and the answer is yes, stress-testing has taken place, not alone at the NTMA but also at my Department, the Office of the Financial Regulator and the Central Bank. That is the position.

Deputy Seán Barrett

That is not what the Governor of the Central Bank told us about stress-testing.

Deputy Brian Lenihan

I am not going to stand in for other witnesses; I will explain the position as I understand it as a Minister of the Government. If there is some other high official who has misled the Deputy, he had better take up the matter with him or her—

Deputy Seán Barrett

The banks misled us.

Deputy Brian Lenihan

If the Deputy has particular matters he wishes to raise with me in writing, I will consider them but with regard to stress-tests on the Bacon economic analysis which is what we are discussing or is one of the issues we are discussing, such stress-testing took place. There was a very detailed examination of the report at my Department which was separate from Dr. Bacon's preparation of the report.

The question of the statutory levy was raised by Deputy Bruton. Again, the appropriate location for such a statutory levy would be the Finance Act because it would be a revenue raising device. I will examine the matter in that context.

Deputy Richard Bruton

The bank levy will not be an integral part of NAMA.

Deputy Brian Lenihan

It will be an integral part of the NAMA proposal and I will certainly examine any proposals the Deputy wishes to make. However, the appropriate place to impose the levy would be finance legislation rather than the NAMA legislation. Were it to be included in the NAMA legislation, it might have an effect on the valuation of the assets to be transferred but that is a detailed, technical legal issue. The point I am making is that the levy can be—

Deputy Joan Burton

Why?

Deputy Brian Lenihan

The steering group will come to a conclusion, at which we can look in due course. I have not finalised—

Deputy Joan Burton

The Minister needs to explain what he has just said as it is completely inaccurate.

Deputy Brian Lenihan

Mr. McDonagh will explain the position to the Deputy.

Mr. Brendan McDonagh

It is a much more technical accounting issue, as the Deputy will understand. If there was a clawback within the NAMA legislation affecting the balance sheets of the banks, they would not be able to reduce the assets transferred to NAMA because effectively there would be an unpriced option in terms of what the clawback would be in the future. One cannot do this because it would not be possible to take risk weighted assets off the balance sheets of the banks if the levy was imposed in the NAMA legislation.

Deputy Joan Burton

That is another critical valuation issue because the Minister has just said he has a guaranteed fail-safe device — a clawback in the event of the assets not realising whatever the taxpayer takes. Mr. McDonagh is actually saying — I accept what he is saying — that in fact that would be almost legally impossible because of the long-term impact on the balance sheets of the banks, assuming they remained quoted companies but the Minister is directly contradicting this.

Mr. Brendan McDonagh

What I am saying is entirely consistent with what the Minister is saying. I am saying the Government has many mechanisms under which to impose a levy on financial institutions. However, because the extent of the levy will not be determined until NAMA completes its work in, say, ten years time, it will only be then that we will work out the appropriate levy for each individual institution. We will be able to work out what the assets of each individual

institution realised and work out fairly the appropriate levy to be applied to the institution at that stage.

Deputy Joan Burton

Presumably, if they are not nationalised by then, the banks will still be independently quoted or if they had been nationalised, they would have been refloated. Mr. McDonagh is saying there will still be a contingent liability which will remain unpriced for a period of at least ten years and that this contingent liability will relate to the €60 billion to €90 billion discounted on values that we do not yet know. How would any financial analyst decide to exclude this for a period of ten years from the liabilities of such a company?

Mr. Brendan McDonagh

I do not think there is anybody in the room who can determine what the realisation of those assets will be at a future date. The assets will be valued and purchased from the institutions at the appropriate discount. It is indeterminate what those assets will realise. Nobody will know until a future date. At that future date the issue will be how one can claw back any losses. There may be no losses, but if we legislate for this now, it becomes an issue for the institutions and they will not get the assets off the balance sheets.

Deputy Joan Burton

The Minister has said both he and the Government would impose the levy on the banks. A levy constitutes a contingent liability, even if it is ten years hence

Chairman

I ask the Deputy to allow the Minister to continue or we will not get to a point where we can allow the Deputy put her questions.

Deputy Brian Lenihan

I am dealing with Deputy Bruton's question and would like to deal with other questions he raised. First, however, let me be clear. This is a technical legal issue, not one of principle. The point is the levy can be implemented through a Finance Act. That is the sole point I made. Mr. McDonagh has pointed out that it is a technical issue in so far as the NAMA legislation is concerned; that it cannot be included in the NAMA legislation, but that does not mean it cannot be included in legislation at an appropriate time. We can look at the issues constructively or we can decide to make debating points.

The next key question raised by Deputy Bruton was that of the banks. He suggested it should be the banks which should sort this out before the taxpayer.

To return to the issue of legislation raised by Deputy Burton, what will happen in the legislation is that assets will be transferred. It will be made quite clear, contemporaneously with or prior to the introduction of legislation, that the State reserves the right to impose a levy on the banks in the event that the workout results in a loss to the taxpayer. In effect, this states that after ten or 15 years or the designated period of the workout, we reserve the right to recoup any losses, if they materialise. That is what is meant by the statement by the Government that a levy can be applied to ensure there will be no loss to the taxpayer.

On the question raised by Deputy Bruton of whether the banks should sort this out, the problem we are faced with is that the banks have not sorted this out. The problem is that they engaged in serious reckless lending. This has created substantial exposures in the system which mean that some of the

banks are not in a position to lend into the economy or will not be in a position to do so to the extent they should because of the degree of their impairments and exposures. That is the reason the taxpayer must become involved with the banks in the matter because there is a vital issue related to the national economy involved.

We could leave it to the banks to sort this out. That is a policy option of the zombie bank which was taken in Japan. Taking it means, in effect, leaving the banks to sort this out over time, during which time increasing amounts of interest due from the affected parties would be rolled up on loans. The banks would then dry up as sources of credit in the economy because of the continued denial about the reality of the exposures. The key point—

Deputy Richard Bruton

Fine Gael has offered a different view. It would not leave the banks as zombies because there would be a very strict time limit. I asked whether we were creating a situation where the State would leap in to take all of these on its shoulders, effectively allowing Joe in San Diego, or whoever the other professional investors were, to take a very relaxed view, as opposed to—

Deputy Brian Lenihan

I was about to deal with professional investors but do not believe the State can take an indefinitely delayed approach to this issue.

Deputy Richard Bruton

Our approach was not indefinite but had a very strict time limit attached. I do not wish the Minister to distort by creating stray—

Deputy Brian Lenihan

I was not distorting Deputy Bruton's position. I take it he agrees urgent action is needed.

Deputy Richard Bruton

Yes, starting with the banks shouldering the responsibility, as a first phase.

Deputy Brian Lenihan

I will turn to that issue, in the context of the Deputy's remarks about professional investors. However, the only policy options available to the Government in the international literature in which I can find no support for the Fine Gael recovery bank approach concern risk insurance or the bad bank option. I shall deal with Fine Gael's proposal when I turn to the question of professional investors.

On the bad bank option, as opposed to risk insurance, it is clear that if the State had taken the risk assurance approach which was taken in other European countries, this would mean we would have guaranteed loans into the future. Given the history of the banking system, this would have been an indeterminate matter. As I indicated to the committee during a previous hearing on banking, it would be like planting landmines for the State in the future.

Deputy Joan Burton

Nobody in Ireland proposed this. The proposal came from the City of London.

Deputy Brian Lenihan

I beg the Deputy's pardon but it is not just the City of London—

Deputy Joan Burton

Nobody here ever proposed such an approach.

Deputy Brian Lenihan

It is not merely the approach of the City of London but that of the United Kingdom Government. It is also the approach taken by—

Deputy Joan Burton

Nobody in Ireland proposed it. We have a property bust. These are different problems.

Deputy Brian Lenihan

What I said was that we had studied the international models available. Essentially, there were two. The first was the risk insurance model which is accepted in the United Kingdom and partially accepted in the kingdom of the Netherlands. At the time it was also under consideration in Germany. The bad bank model was tried in Sweden and, in one particular instance, the United States. These were the real options we faced; therefore, we had to weigh their competing merits. That is all I am saying.

I shall return to Deputy Bruton's question about professional investors which is fundamental to the debate. The term "professional investor" is very loose and can refer to a wide variety of individuals. First, there is the ordinary person who deposits money in a financial institution. This is an actual person, a living human being, who, in some cases, might be a professional investor, given the scale of the moneys he or she invests. If one moves beyond the ordinary depositor, there are the facilities banks extend to each other, clearly a professional institution lending to another professional institution. Crucially,

moving to bondholders and those who subscribe to bonds in financial institutions, there is a vital distinction the Deputy has not observed to date, namely, that between senior debt and subordinated debt. When bonds are raised on a senior debt basis, this means the bondholders understand they will be repaid. There is no question of their advance or bond being viewed as in some way qualified by risks attaching to the institution. On the other hand, concerning subordinated debt, the advance is made or the bond entered into on the assumption that this category of debt has a risk attaching to it. There is, therefore, a fundamental distinction. I can appreciate that the term "professional investor" is politically popular but it is meaningless because it covers a spectrum of individuals from a mere depositor with a professional interest in depositing money through interbank lending and senior debt to subordinated debt.

The Deputy referred also to bondholders. More narrowly, there is a crucial distinction between a bondholder who holds bonds on the firm undertaking that the money will be repaid and a bondholder with a bond which is subordinated, perhaps perpetually, or dated for a particular period and who has a clear understanding that a risk attaches to the bond. It may be perpetual or may be dated for a particular period of time, but there is a clear understanding that some risk attaches to the bond itself. They are fundamental distinctions as regards investment in financial institutions. If it is proposed by Fine Gael that we should in any way default on our senior debt, that would have serious consequences for our financial system. It would have serious consequences for the banks who would find it difficult to fund their operations worldwide were such a default to be envisaged, suggested, entertained or invited.

Deputy Richard Bruton

The Minister is trying to create a straw man. We said that in the first instance the banks should deal with their problems. That is the essence of our

approach.

Chairman

Please, Deputy.

(Interruptions).

Deputy Richard Bruton

The Minister wants to lecture us about our proposal while he is here to answer questions about his own.

Deputy Brian Lenihan

I do not want to lecture the Deputy. He asked a question, so how does he deal with these bondholders? What is he proposing the banks should do in relation to them?

Deputy Richard Bruton

The Bank of Ireland is already indicating that it will pay less than par. It is talking about 50% of par in relation to bondholders.

Deputy Brian Lenihan

Yes but that is in relation to subordinated debt.

Deputy Richard Bruton

Yes, exactly.

Deputy Brian Lenihan

There is no objection to that.

Deputy Richard Bruton

We are also seeing, contrary to what the Minister signalled before, that Anglo Irish Bank seems to be considering not paying any dividend on its perpetuals. They are not going to turn over so the penny is dropping with the Government that the taxpayers cannot save everyone. That is the essence of the approach we have put forward. The first phase is to get credit going, which is our recovery bank. The second phase is to tell the banks they have the period of the guarantee to come to grips with those parts of their investment underpinning where they can negotiate write-downs and share the pain of this before they go to the taxpayer. I do not want the Minister to try to create a straw version of our proposals to knock down.

Deputy Brian Lenihan

I am not.

Deputy Richard Bruton

We are not here to discuss our proposals.

Deputy Brian Lenihan

No.

Deputy Richard Bruton

I would like to discuss them if we were here to do so.

Deputy Brian Lenihan

If the only professional investors the Deputy is concerned about are the subordinated ones, then there is no difference between us. Subordinated debt is traded in the market at substantial discounts and it is open to financial institutions to offer the purchase of such debt at a discount.

Deputy Richard Bruton

That is a welcome change of position by the Government.

Deputy Brian Lenihan

There is no change of position there.

Deputy Richard Bruton

That is a change of position.

Deputy Brian Lenihan

Perpetual subordinated debt is not even subject—

Deputy Richard Bruton

Up to a couple of days ago, the Minister was saying that the notion that anything would not be paid was catastrophic and that the roof would fall down on our heads.

Deputy Brian Lenihan

I have never suggested that.

Deputy Richard Bruton

That is certainly what the Minister suggested.

Deputy Brian Lenihan

The Deputy has created a considerable ambiguity about whether senior debt bondholders will have their obligations honoured.

Deputy Richard Bruton

There was no ambiguity, our position was quite clear. We were saying that the banks have been given a time limit to sort it or come back to the State and that when they come back to the State the rules of operation would be clear. That was our proposal.

Deputy Frank Fahey

May I comment on this issue, Chairman? It is important that we get clarification on it.

Chairman

Let the Minister reply for a moment.

Deputy Brian Lenihan

I would just like to make this point, and we will refer to Mr. McDonagh. Let us be clear – I have been insistent that what is guaranteed cannot be dishonoured. The debts which Deputy Bruton is now referring to were never guaranteed by the Government.

Deputy Richard Bruton

Exactly.

Deputy Brian Lenihan

They are traded in the marketplace at substantial discounts. It is open to financial institutions to purchase them at a discount if the holder wishes to accept such a purchase. That has been done by the Bank of Ireland recently, which I very much welcome. It is an option which has always been under consideration and I have never suggested otherwise.

Deputy Richard Bruton

It is the core of our option.

Deputy Brian Lenihan

Yes but unfortunately it does not yield the capital base for the recovery bank because the vast amount of bonds held by Irish banks are not subordinated debt, they are debt of a far more fundamental character. They are ordinary senior debt bonds entered into by the banks. There can be no ambiguity about Ireland's capacity or the banks' capacity to honour those at all stages. Any suggestion that those parties should be invited to consider a reduction in the amount repayable to them would have catastrophic effects for the banking system and the funding of the Irish State. That is all I have ever said.

The question of subordinated debt is a very technical one. There is a category of dated subordinate debt, which was included within the guarantee but of course that means the interest payments on foot of such debt have to be paid as they accrue if the reserves are sufficient to meet it. It also means that at the ultimate maturity date such obligations would have to be met. That is

a very technical issue that would not be sufficient to fund the kind of banking operation we are discussing. The fundamental issue here is that our banking system is centrally dependent on funding from overseas and the vast bulk of that funding comes through bonds which are entered into on a term basis. These bonds will be of particular importance to the banks as they recover in the next few years. They will need to be in a position to access that type of funding and there can be no ambiguity about the attitude of the State or the banks towards such obligations. That is all I have ever said. I do not know whether Mr. McDonagh wishes to add to that.

Mr. Brendan McDonagh

In terms of subordinated debt, it is equity-type capital. I agree with the Deputy that there is a risk attached to it. In terms of subordinated debt, it receives a coupon very much as if a dividend is being declared. Banks themselves need to make decisions as to whether they declare the coupon. The Deputy will find that the document is pretty standard in terms of subordinated debt. If the coupon on a subordinated debt is not paid for whatever reason, including not having distributable reserves, which means it cannot be done under company law, there is actually a dividend stopper, which precludes paying coupons on other types of debt.

In terms of senior debt, it is actually an interest payment. In that instance the interest coupon would be paid and that is guaranteed under the guarantee scheme. In Bank of Ireland's recently announced buy-back, it disclosed to the market that this is trading at a discount. Obviously it is trading at a discount because some of the investors, who bought in when it was issued at par at close to 100 and now it is trading at 30 cent to 40 cent, have taken the view that there is a risk attached to that institution and whether it will be repaid. The bank has said it would like to buy back this debt and it would generate an accounting profit, which therefore would increase its core tier 1 capital.

This is a technical point. There is a limiting factor in terms of the amount of subordinate debt that the banks can actually buy back, because they must maintain their total capital ratios – this is a requirement of the Financial Regulator. Institutions operating here in Ireland, or as with most of our institutions operating overseas, need to maintain their total capital ratio. Within their total capital they will have a certain level of subordinated debt. I hope that explains the point.

Dr. Peter Bacon

I will answer the questions that I believe Deputy Bruton addressed to me. Regarding the stress-testing – to use the Deputy's own words – or the evaluation or discipline that was imposed on my own work, it arose at two levels. First, within the NTMA, I do not believe it is an exaggeration to say that between 20 February and 20 March I talked daily to Dr. Michael Somers, Mr. Brendan McDonagh or Mr. John Corrigan about the work that was evolving. I do not believe that is an exaggeration. Those were formal meetings, semi-formal meetings and bilateral discussions between those executives and an interchange of information to me and from me to them.

More formally I made presentations on 6 March to a group chaired by the Minister with participation from the Department of Finance, the National Treasury Management Agency, the regulator and the Central Bank. I submitted draft reports on 14 March and again on 20 March. Following each of those I received comment and feedback via the Department of Finance, specifically channelled through Mr. McDonagh from those four institutions. On the afternoon of 3 April there was a meeting in Government Buildings, chaired by the Taoiseach. Present were the Minister for Finance, the Minister for energy and attended by the secretary of the Government, the Secretary General of the Department of Finance and his senior management team, the chief executive of the National Treasury Management Agency and his management team, the chairman of the regulator and the managing

director of the Central Bank, and I believe some of his officials. There was a formal presentation, not of my report but at that stage a Government memorandum, which was based on the report and the various inputs those various permanent advisory institutions to the Government had made. I can recall the Taoiseach going around each and every one of those institutions, including me, and formally asking about the position with respect to the proposals contained in the Government memorandum and there was a unanimous opinion from each of those institutions at that time as regards what was in the Government memorandum, including from me. In all, in terms of consultancy assignments I have done in the past 15 years, there was a level of reporting and feedback between the client body, to call it that, and me that was equal to or greater than any other assignment I have ever undertaken.

Deputy Bruton made reference to the fact that I had worked for developers. In the past ten years I believe I have carried out consultancy assignments for five of the leading Irish developers and in respect of one of those, I occupied an executive function and sat on the board of the company until December 2007. I believe the experience gained was relevant to being able to advance some practical advice in the context of the strategic approach being pursued. I do not know whether Deputy Bruton believes there is a conflict of interest in the sense that the advice I would be giving would be tainted in favour of developers. If he believes that, I am sorry that he does.

Deputy Richard Bruton

That is not the point. What I think—

Dr. Peter Bacon

May I finish the point? When I read what the Construction Industry Federation has to say about me from time to time in public, I do not believe it

sees me as a friend but that is neither here nor there. For my own part, any relationship I have had with any of the property developers at a commercial level has been professional.

On the substantial point the Deputy made as to whether this is the right way to go, I will deal with a point implicit in what he is talking about, which I believe is a fallacy, namely, that in this somewhere there is a trade-off. There is a view expressed that this asset management approach has an inherent flaw, namely, that if one takes a big haircut there is a capital deficit which the banks have to deal with and if one does not do that and overpays, the taxpayer, if the members will pardon me saying so, gets screwed and the shareholder gets away.

I do not see any trade-off. The reality we face, with which everybody is trying to grapple as a result, as the Minister said, of bad and disastrous lending, is that there are huge losses facing developers and the banking system and there is only person to pick up the bill, namely, the taxpayer.

Regardless of what way the cake is cut, the loss does not change. To use other people's language about the point of the discount, if the discount and gift shareholders are undercut, the taxpayer suffers because the recovery the Deputy spoke about takes place from a higher base. The taxpayer loses in that respect.

If one gets it wrong on the other side and discovers that one has to make up more capital in the banks, who will make it up? In the current environment it is a brute fact that the banks cannot go to capital markets and replenish their equity. I have made the point previously that the loss is the loss. By whom will it be borne? It will be borne by banks and developers, to the extent that there is equity to do so in the case of the banks. One must then replace that equity. Who will replace it? The taxpayer will.

Deputy Richard Bruton

Dr. Bacon is saying, therefore, that the risk to the taxpayer is open-ended.

Dr. Peter Bacon

No, it is not; it is a finite loss. This approach states this is the amount of recapitalisation that will have to take place, that is, this is the discount or loss we will recognise on the transfer of assets. We know the amount of capital, therefore, that we need to put into the banks. We now have a base to work these loans out into the future. We have an amount which leaves the banks clean.

The alternative approach which the Minister has outlined, namely, risk assurance, is that we will insure the loss — it is the same loss; it is not different. It states: "Leave it there; you created it; you sort it out, and whatever the cost is in the next ten, 15 or 20 years we will insure it." Not only does that have the disadvantage of the contingent liability that I mentioned, it also leaves a question about good projects. It is important to point out that there are good property development skills in the country which, unfortunately, have got wrapped up in bad business models. These projects will not be able to progress from further bank debt from banks which are already over-exposed to the sector. The consequence for the wider economy is that these banks cannot get on with the business of lending. No matter what approach one uses, one will apply an approach with respect to a loss. Changing the approach does not change the magnitude of the problem to be dealt with. If one will not be transferring €90 billion to the authority of an asset management agency, one will be insuring it.

The Deputy has also asked how do we know the taxpayer will not be caught at the end of this process. There are two points to be made. There must a reasonable stab at the valuation process, in the context of the current market.

The assets are being transferred at a low figure. The property sector is notorious for cycles and this one has been particularly vicious. The first protection of the taxpayer with respect to the work-out is that the assets are being taken on at the bottom of the cycle, either at a mark to market price or at a normalised valuation.

The second protection being offered to the taxpayer in this approach is the potential that NAMA, as an institutional entity and not having the shortcomings I outlined with respect to the characteristic features of the property development sector, has the possibility of attracting third party equity. That is a fundamental disadvantage if we do not go this way in terms of maximising the work-out. How does one get the capital and finance to work out semi-completed projects which are fundamentally well designed, be they in Ireland, the United Kingdom or elsewhere, without the long-term capital which these entities have not had heretofore?

Chairman

Seven members wish to put questions.

Deputy Brian Lenihan

I did not deal with one or two of the points raised by Deputy Bruton.

Deputy Joan Burton

The Minister and his Department have stated that in extreme stress scenarios Bank of Ireland is well capitalised now that the Government has put €3.5 billion into it. If it is the case that Bank of Ireland is well capitalised — the Minister expressed delight that it was buying back some of its debt — will he explain to the ordinary taxpayer the reason the bank has been included in NAMA? Why is he so confident the fair price NAMA will pay will not wipe out

the core equity capital of the banks? Has the decision been taken on what price will be paid? Given the Minister's confidence that the valuation to be arrived at will not wipe out the bank's core equity, is it the case that the decision has been made in principle?

That brings me to another point. The Minister cited the case of Sweden. An independent valuation board was established there composed of independent economic experts, including individuals from commercial and academic life who were recognised as independent and acting in the public interest. The Minister has proceeded to appoint all the parties in secret. Irrespective of what the merits of these individuals may be, we first learn their names after the Minister has appointed them. We are also told he is ready to appoint another group, a form of steering board, in respect of NAMA, but we have no idea who these individuals will be or what public reporting they may be subject to.

Contradictions have emerged in what has been said. The Minister suggests there will be a degree of toughness shown to developers, while Mr. McDonagh suggests NAMA will work with developers and Dr. Bacon suggests it will be essential and may make good business sense to get other investors to come in and co-fund development projects with the taxpayer, whether these developments are in Ireland, the United Kingdom or elsewhere. Does the Minister agree that substantial State borrowings will be used to meet the requirements of the NAMA proposal? Is he seriously considering having much more of the country's borrowing capacity reserved for the working out of the NAMA proposals rather than being invested in infrastructure such as schools, public transport and roads? I find that prospect extremely worrying.

Conceptually, there is a high degree of conflict between the versions presented by Mr. McDonagh, the Minister and Dr. Bacon. Does the Minister agree with the view repeatedly expressed by the people from Sweden, whose

experience probably most parallels our own in the sense that the difficulties in both countries arose from a property bust, that transparency is essential?

Dr. Bacon has kindly identified that he has worked with various developers. Could the Minister for Finance, in the interests of transparency and the taxpayer understanding the position, set out in full for the public all of the donations, small, medium and large, that he, individually, the Taoiseach and his party have received from developers over the past eight years if he has records going back that far? Dr. Bacon has set out his work experience with developers and is estimable for having done so. It lets us know that he has such experience and that if issues arise with a particular developer, we can ask Dr. Bacon what insights he may have. At the core of what has happened in this country is the relationship of the Minister's party with developers.

Chairman

Hold on for one second.

Deputy Joan Burton

Can I finish my question?

Chairman

The Deputy cannot.

Deputy Joan Burton

The Chairman did not interrupt Deputy Bruton.

Chairman

I want to make one comment. The Deputy asked the Minister a question and is now repeating it. Would she wait until she receives the answer?

Deputy Joan Burton

I am explaining my question.

Chairman

The Minister understands what the Deputy is speaking about.

Deputy Joan Burton

Will the Minister set out, once and for all, the small, medium and large donations received by his party? Did the Minister, or his party organisation in Dublin West, ever receive support from developers at election time, or at other times? This is a core issue, if the Minister is to be transparent—

Chairman

The Deputy is making this political.

Deputy Joan Burton

—in the way the Swedes have been.

Chairman

Please allow the Minister to answer the question. The Deputy has repeated it three times.

Deputy Joan Burton

Can I move on?

Deputy Chris Andrews

As usual, we are hearing insinuation after insinuation. The Minister should be allowed to answer the question.

Deputy Joan Burton

I asked the Minister—

Deputy Chris Andrews

The Deputy has repeated the question approximately five times. It is clear and the Minister should be allowed to answer it.

Deputy Joan Burton

Is Deputy Andrews particularly riled by this because he himself has something to hide?

Deputy Chris Andrews

Does the Deputy think I have something to hide?

Deputy Joan Burton

The Deputy seems upset. He has not interrupted so far.

Deputy Chris Andrews

Does the Deputy think I have something to hide?

Deputy Joan Burton

Does the Deputy have a problem with my question?

Deputy Chris Andrews

Yes. The Deputy has repeated the question four or five times and the Minister should be allowed to answer it.

Deputy Joan Burton

I am just asking the Deputy's party and the Minister to set out what donations have been received.

Deputy Chris Andrews

Does the Deputy think I have something to hide?

Deputy Joan Burton

No. I asked the Deputy if he had.

Deputy Chris Andrews

I thank the Deputy. I am glad she clarified the matter.

Deputy Brian Lenihan

On the constant repetition of the question, I believe I am entitled to answer it.

Deputy Joan Burton

Can I ask the Minister the related question?

Deputy Brian Lenihan

The Deputy is using the time of the committee to make insinuations about me.

Deputy Joan Burton

I am asking about transparency—

Deputy Brian Lenihan

I am entitled to deal with the matter.

Deputy Joan Burton

—as in the Swedish model. Transparency cuts to the heart of the matter. Let me ask the Minister my final question.

I was disturbed by what Mr. McDonagh stated frankly, "We estimate that approximately €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." He then spoke about these loans. Returning to Dr. Bacon's last point and Professor Honohan's important question and comment at the committee and elsewhere, the issue of the under or overvaluation of these loans is critical. A figure of €60 billion of land and development loans has been described. In Sligo recently development land went for a figure of 8% of its value. In Donnybrook, Dublin 4, several buildings in the bank centre, the prime retail commercial location in the country — whether the State owns the banks or the banks remain independent is a moot point — were advertised in the national newspapers at

a 44% discount on what they had been sold for a couple of years previously. The issue of the discount and valuation is vital in this exercise. Because Mr. McDonagh has also stated—

Deputy Frank Fahey

It was fully explained to Deputy Burton how it was worked out.

Deputy Joan Burton

I am sorry if I upset Deputy Fahey, but I have—

Deputy Frank Fahey

The Deputy does not upset me. She is wasting the committee's time.

Deputy Joan Burton

How am I wasting time? I am asking pertinent questions.

Chairman

Deputy Burton should ask her questions. Deputy Fahey should not interrupt her.

Deputy Joan Burton

I am referring to Mr. McDonagh's statement which Deputy Fahey might read.

Deputy Frank Fahey

Deputy Burton does not understand it.

Deputy Joan Burton

Perhaps I do not. As far as the Deputy is concerned, all women are thick—

Deputy Frank Fahey

No.

Deputy Joan Burton

—but we must try.

Chairman

A question, please.

Deputy Joan Burton

I notice that Deputy Fahey does not interrupt men when they ask questions, but he should not worry; I will try to pit my pea brain against his great brain.

Chairman

Deputy Burton should put her question to the Minister.

Deputy Frank Fahey

The zombie bank Deputy Burton wants to set up is all that upsets me.

Deputy Joan Burton

Mr. McDonagh referred to a working out period of ten to 15 years, the complications due to loans being with different banks, some of which were not guaranteed, and bespoke loans. As I do not fully understand what he meant, perhaps he will explain it for me and the taxpayers who may watch a report on this meeting subsequently.

This reverts to the valuation issue. From what Mr. McDonagh is saying, the decreases in value we have seen — 44% in the case of prime Dublin 4 retail property with a guaranteed rent roll — mean that the minimum cost to the taxpayer is as the IMF stated, namely, at least €24 billion. If it should be less, that is, 8% for purely agricultural land in County Sligo and 10% elsewhere, we are facing a higher figure of €50 billion to €60 billion. The taxpayer should not be asked to accept this in the ten to 15 year scenario, the suggested but not yet decided alternative.

The Minister made a suggestion regarding the valuation issue and a fair price. The European Central Bank's valuation mechanism was referred to also. If values have collapsed, why should anything other than market value be used? Does the Minister agree that a phony valuation has been arrived at recently to include fair value, an intrinsic value and a hope value? If we are in that territory, the taxpayer will take the hit at the upper end of the scale. After the Minister's reply, will Mr. McDonagh elaborate at greater length on the statements on valuation he made in his paper?

Deputy Brian Lenihan

I will deal with those questions. Deputy Burton's first question was on extreme stress scenarios as applied to the Bank of Ireland and the fact that it demonstrated that it was well capitalised. She will recall that, at the time of the due diligence, I indicated that it had confirmed PricewaterhouseCoopers' assessment of the institution. There was a consistency between the valuation placed upon it by PricewaterhouseCoopers in its initial reports, the

subsequent auctioneering advice received and the due diligence we had conducted. At all stages, there was a consistency in every examination of the institution, upholding our investment in it. For this reason, Mr. McDonagh was able to reach the conclusion that the bank was well capitalised.

Deputy Burton asked why there should be a NAMA approach to the Bank of Ireland—

Deputy Joan Burton

Why should there be a NAMA?

Deputy Brian Lenihan

—which is a matter that will be discussed with the Bank of Ireland. It is being considered for inclusion in NAMA because it still has impaired assets which are such that resolution is required in order that the loss can be taken upfront to enable it to be a better bank in lending into the economy. The essential choice is whether we insist on the banks taking these losses upfront or postpone them over a long period of time and permit the banks to work out their losses. It is the view of the Government that—

Deputy Joan Burton

Does the Minister have an estimate of that figure?

Deputy Brian Lenihan

May I finish my answer, please?

It is the view of the Government that taking those losses upfront will ensure the banks, such as Bank of Ireland, for example, will be in a position to lend in

an effective way to the economy in a far quicker manner than if it had to work out these loans over an extended period of time. That is the view of the Government and is why the NAMA principle will be applied to Bank of Ireland. However, regarding its capitalisation, it may well be the case that when the NAMA proposal is implemented, it will not require fresh capital. That is the issue.

Deputy Joan Burton

Does the Minister have an estimate of what its NAMA figure will be?

Deputy Brian Lenihan

Again, I made it very clear to Deputy Burton that I am not here to affect Stock Exchange prices and this is something Deputies will have to understand. If I start giving information such as that in this committee, there will be gyrations on the market because people there actually do listen to what I say. If I give such information, that is what happens. I am certainly not getting involved in fuelling Stock Exchange speculation.

On the question of whether I am confident it will not wipe out the core equity of the banks generally, it is worth noting that Anglo Irish Bank has already been nationalised, so it does not have private equity and its shareholders are subject to a compensation process. Allied Irish Banks is the only quoted bank which will be part of this process. I understand Irish Life & Permanent will not be part of it. As far as the four listed institutions are concerned, I have dealt with Bank of Ireland. I have dealt with Anglo Irish Bank and it has been nationalised.

I wish to correct one point. Professor Honohan made an admirable presentation to this committee and I agreed with all of what he said. However, he made one error, namely, saying that these are private

institutions. In fact the institution with some of the largest exposure has been nationalised. That is an important point to remember in the context of the NAMA exercise, because it will apply to Anglo Irish Bank.

I have explained the position regarding Bank of Ireland, Anglo Irish Bank and Irish Life & Permanent. It does not appear they will be within the exercise.

Deputy Joan Burton

The Minister did not explain the situation regarding Allied Irish Bank.

Deputy Brian Lenihan

I am coming to Allied Irish Banks, if I may. When we conducted due diligence on it, we established the pre-NAMA capitalisation requirement was €5 billion. We met its board and what happened then is on the public record, that is, it said it would raise from within its own resources the necessary €1.5 billion over the rest of this year.

The conclusion of the application of the NAMA exercise to Allied Irish Banks will require us to determine whether it requires more capital. Regarding the other institutions—

Deputy Joan Burton

Could I ask the Minister to elaborate? He said he has not reached a conclusion as to whether more capital will be required.

Deputy Brian Lenihan

In Allied Irish Banks.

Deputy Joan Burton

In Allied Irish Banks.

Deputy Brian Lenihan

No, I have not arrived at a conclusion on that issue at this stage and will not go further on the issue. Different considerations arise regarding the building societies, because they do not have private equity involvement. Clearly, NAMA will have application to both of them.

On the question of Sweden and the independent valuation board, it is a matter which will have to be provided for in the legislation on the valuation of the assets which have to be transferred. I agree entirely with Deputy Burton that whoever composes the valuation board has to be above reproach.

The advisory committee is being appointed by me because it is advising the Government on the content of legislation. In our constitutional structure, Governments are of course advised by advisory committees on a confidential basis before decisions are arrived at. The advisory committee will not be organising or assuming executive responsibilities for whatever statutory body or entity is established.

There was a banking crisis at that time throughout Scandinavia. The Deputy referred to the Swedish crisis. In fact, there was a banking crisis in Sweden, Finland and Norway at the same time. The Swedish example is quoted most often. I have read extensively the literature on the Swedish banking crisis. What is most interesting about it is that the first step the Government took to stabilise the banking sector was to guarantee the liabilities of all the banks. The then Swedish Government believed that was the very first step that had to be taken. Deputy Burton extolled the Swedish approach but she must

recognise that was the first step taken by the then Swedish Government, which then nationalised some but not all of the banks, and proceeded to set up a variety of bad bank approaches to resolving its asset resolution difficulties.

In Finland a somewhat different approach was taken where each bank set up its own bad bank. For the sake of completion, Norway tried the outright nationalisation route. I did consider that option. At the time Norway was an extraordinarily prosperous country with ample oil reserves and high GNP, despite its banking crisis, and it could take the risk of nationalising all of the banking sector. In considering the nationalisation option I must bear in mind the experience we had with Anglo Irish Bank both leading up to and since its nationalisation, and also the experience of the other European country that has engaged in a wholesale nationalisation of its banking sector due to the current crisis, namely, Iceland.

On the alleged contradictions between Dr. Bacon and me and Mr. McDonagh on the question of how developers would be approached by NAMA, I assure members that there is no contradiction. If one studies carefully what Mr. McDonagh said in his statement, it was that NAMA would act in a proper commercial way and protect the taxpayer in all the dealings it might have with developers. Dr. Bacon was referring to an entirely different point when he said that NAMA might advantage developers in terms of uncompleted developments. As I understand it, the point he was making is that the Irish banking system, as constituted, is not in a position to fund anything in regard to partially completed developments. He believes the NAMA proposal is attractive in terms of assembling different types of asset under one umbrella, be they uncompleted buildings of a commercial, residential or hotel nature, and that the collective management of the assets through NAMA would be attractive to private equity. Accordingly, money could be attracted to the agency that would ensure that the essential development could take place regarding those assets. That would not be

taxpayers' money. It would be money from private investors. Private investors are unwilling to invest—

Deputy Joan Burton

Taxpayers' money would be in the bonds.

Deputy Brian Lenihan

If I might be allowed to finish—

Deputy Joan Burton

The Minister is implying there is no taxpayers' money involved in NAMA.

Deputy Brian Lenihan

If I might be allowed to finish my point — I will take the question then — private equity money is not even attracted to our banking system. By transferring the assets in this way to a property management company, according to Dr. Bacon's opinion as an economist, there is substantial evidence, which he will have to follow up, that private equity would be attracted to funding such an entity, which would be very attractive from the State's point of view if someone else is willing to assist us in the working out of those loans. That is an attractive feature of the agency which Dr. Bacon is anxious to highlight. That is the essential point. Deputy Burton inquired about the contradictions and I am explaining that there are no contradictions on that issue.

On the question of my ethical obligations as a Deputy and a Minister, I am fortunate that since my election I have always complied with the legislation

that has been in operation. My compliance with the legislation has not been questioned in terms of donations and disclosures.

I wish to mention one additional matter because Deputy Burton asked me to go back a number of years. I had the honour of being appointed a Minister of State in June 2002. Since then, it has been my consistent practice as a Minister not to seek any donations because it is undesirable to do so when acting with the executive authority of the State. Occasionally, at election times individuals have volunteered sums to me and I have always refused to accept any sums. I am not sure that any were tendered but it is my practice to refuse sums from any developer who had an interest in any land in my constituency or elsewhere. I put that on the record. If the Deputy wishes, she can ask a question of the Taoiseach or the Fianna Fáil Party, but since she made an express reference to my local political organisation, the practice is to organise an annual dinner to which residents and voters of Deputy Burton's and mine are free to attend.

Deputy Joan Burton

Are there are any developers?

Deputy Brian Lenihan

I do not actually decide who attends the function, and neither does my organisation.

Deputy Joan Burton

I know that.

Deputy Brian Lenihan

There has not been a very large number. I will not swear on the Bible that there has not been one of them, but they have certainly not provided the bulk of the funding or the bulk of the support for the function, which is designed to ensure that those people who volunteer and work hard in politics get an opportunity to get together once a year and show their support for a local organisation. We need to be careful about this. We have done enough damage to politics in this country without this kind of insinuation being thrown around the place.

There was a question on the frozen market in property. Deputy Burton is seeking to have a market price attached here. The reality is that there is no market at the moment because it is frozen in a wide class of assets. It is impossible for any valuer to make a valuation when the market is frozen, or "illiquid", to use the term used by some of our economic friends. In this illiquid market, evaluation procedure must be devised. Deputy Burton is right to draw attention to the fact that agricultural land — land that has no zoning and was purchased on the speculation or hope of development — has dropped dramatically in value. When I speak of the land in development books of the banks, I speak of the complete construction cycle. I am talking about the complete construction cycle from land which has no zoning but some speculative possibility, through zoned land, to zoned land in which some works are partially completed, to zoned land in which works are completed but the property is undisposed of or the loan is unrealised. I am talking about the complete construction cycle. As has been pointed out already at the committee, each loan requires individual valuation. There cannot be a collective valuation.

The other point which the Deputy overlooked in her question was the issue of the loan to value ratio. She quoted speculative figures about the drop in valuation. The drop in valuation is from the original valuation of the lands or the buildings concerned. The banks' exposure is generally 65% of the original assumed value. In a sense—

Deputy Joan Burton

In many cases was the balance at the height of the market in recent years not the rest of the property being funded personally by the developer? It is quite a convoluted issue.

Deputy Brian Lenihan

That is a very important point, because that is about the equity and that is being wiped out in a sense. The bad bank solution means that the person with the impaired asset takes a very substantial loss, and a substantial loss is also taken by the bank. Looking at it in terms of this particular approach, the first 35% is the equity value of the developer or the owner of the land, and if he or she is not in a position to pay off the loan, then clearly that is wiped out in this exercise. The key question in valuation is not about the wipeout of the initial landowner's equity, but about how much of the banks' equity should in turn be wiped out as well, as we are insisting on the banks taking a loss. Therefore, the taxpayer is third in the queue rather than first. There is a risk and the reason we are focusing so much on valuation is to ensure that this risk is minimised as much as possible. In a frozen or illiquid market, it is not possible to place an exact valuation on the loans, but a long-term commercial valuation can be made. That is what we will have to do.

In relation to the legal difficulties—

Deputy Seán Barrett

What is that kind of valuation?

Deputy Brian Lenihan

It is a long-term economic valuation, rather than—

Deputy Joan Burton

Can the Minister or Mr. McDonagh give us a written definition of that? Is this a new concept in valuation?

Deputy Brian Lenihan

No, it is not a new concept. However, I will refer the matter to Mr. McDonagh.

Deputy Joan Burton

Can I ask a supplementary question on the valuation which might help us all?

Deputy Brian Lenihan

Yes.

Deputy Joan Burton

We all want to see credit flowing again to ordinary businesses. One of the problems with the banks' balance sheets and accounts is the issue of rolled-up interest, something to which Mr. McDonagh referred briefly. I am unclear, as I believe are taxpayers, as to what rolled-up interest means in the context of valuation of the loans and in regard to whether, as has been accounting practice, a rolled-up interest loan can, in some cases, constitute a fresh loan and whether, therefore, much of the apparent lending the banks state is taking place, and which ordinary businesses find difficult to understand, is in fact convoluted by the issue of how our banks deal with rolled up interest. Perhaps the Minister will explain this matter which is critical to the valuation issue. On the one hand, rolled-up interest is added to the value of the loan—

Chairman

I think the Minister and his officials get the message.

Deputy Joan Burton

—while on the other hand rolled-up interest in some cases becomes part of the fresher lending profiles of the banks. Banks say they are lending but business people to whom we have spoken say they are operating a much tighter system. Perhaps the Minister will clarify the position.

Chairman

I would like if Deputy Burton could put her question to the Minister as there are other members wishing to get in.

Deputy Brian Lenihan

I will ask Mr. McDonagh to provide the Deputy with the technical answer to her question. The general answer, looking at this in general economic terms — this was a factor which influenced the Government's decision — is that an impaired loan in respect of which the bank decides to roll up interest can, on the one hand, become an impaired asset, which becomes a bigger portion of the bank's balance sheet, and on the other be presented in the annual accounts as part of the profit of the entity concerned.

Deputy Joan Burton

I know.

Deputy Brian Lenihan

Clearly, that was a very undesirable situation.

Deputy Joan Burton

It also becomes part of the business of the bank.

Deputy Brian Lenihan

I will ask Mr. McDonagh to deal with the more technical aspects on which the Deputy wants information.

Mr. Brendan McDonagh

The Deputy is correct about rolled-up interest. I was a member of the due diligence team that worked on Allied Irish Banks and Bank of Ireland. I have also had access to information in terms of reports compiled by the Financial Regulator in regard to the other institutions. What I have seen in the banks' loan books is that the land and development book generally included a feature that for two years loans had rolled-up interest. Therefore, a loan of €10 million on which the interest was 10% per annum, effectively became a €12 million loan at the end of the two-year period. If at that stage the asset had metamorphosed from land with rezoning to land with planning permission — once a certain element of risk was gone from the loan — it was refinanced or sold on.

Deputy Joan Burton

This makes it sound like the banks are doing business, when they are not.

Mr. Brendan McDonagh

Yes. There are two issues involved. Obviously, they were, where they could, recognising the rolled-up interest, under accounting rules, in the income part of their profit and loss. Whether this formed part of the figures they produced as new additional lending — I am not technically aware of this — I cannot say. It would not, however, surprise me if it formed part of that aspect.

To be complete in terms of answers, I would like now to come back to one other point raised by the Deputy in regard to bespoke loans as referred to in my documentation. Based on my experience, having seen the banks' loan books and having read the various reports and analyses done on them, during the phase of heavy lending from institutions to borrowers, borrowers had a great deal of power.

Deputy Joan Burton

The borrowers or the bankers had power?

Mr. Brendan McDonagh

The borrowers had a lot of power.

Deputy Joan Burton

Had they?

Mr. Brendan McDonagh

Yes, because of competition between the banks to get business. Generally, in terms of extending loans, the banks relied on documentation supplied by the borrower rather than on their own documentation. By nature, these are bespoke loans. The same applies to the loan documentation.

Deputy Joan Burton

What does that mean?

Mr. Brendan McDonagh

Bespoke means something has particular features. Usually a loan document with standard terms and conditions is drawn up by an institution when, to give a simple example, it extends a mortgage.

Deputy Joan Burton

Is this Michael Lynn territory in that one is unsure of the quality of bespoke documentation?

Mr. Brendan McDonagh

It is not a question of quality. It means that if one wants to value these loans which we will be required to do, the terms and conditions of each loan will have to be examined to ensure account is taken of any particular features.

Deputy Joan Burton

It is like Pandora's box and could take years.

Mr. Brendan McDonagh

It will not. I am trying to be frank with the Deputy in noting a feature of the loan documentation drawn up by the banks.

Deputy Brian Lenihan

Most members are familiar with standard banking practice. Banks have standard forms for commercial as well as personal loans but in many cases the competition in making loans to developers was so intense within the banking sector that standard conditions were modified to offer more attractive terms to particular borrowers. We are not suggesting there is additional exposure as a result when we note that the assessment of these loans will take longer because the terms were not standard.

Chairman

I call Senator Quinn who will be followed by Deputy Michael McGrath.

Deputy Brian Lenihan

I want to answer one or two questions which Deputy Burton raised. I had not completed my entire checklist, to which I presume Deputy Barrett was referring.

Deputy Seán Barrett

I want to ask about the valuation. That is the key factor.

Deputy Brian Lenihan

Yes.

Chairman

Please allow Senator Quinn to make his contribution.

Senator Feargal Quinn

It is not easy to keep quiet for two and a half hours without asking questions. I was surprised that Mr. McDonagh spoke about a timeframe of ten to 15 years because I had investigated what had happened in the United States in the establishment of the Resolution Trust Corporation in 1989. This corporation only lasted six years but the figures were considerably different. It took in \$465 billion and the cost to the taxpayer when the assets were sold was \$90 billion. The equivalent cost for us would be €20 billion. Mr. McDonagh spoke about a staff complement of 30 to 40. The aforementioned operation in the United States involved 9,000 people. This scares me because it seems we are not very good at sticking to budgets and timeframes in Ireland.

The IMF has approved Dr. Bacon's NAMA proposals and cited Indonesia as an example of where a similar approach had been taken. Deputy Burton spoke about transparency. Freedom of information provisions will not apply to NAMA, although they were applied in similar contexts in Sweden and Finland. It would be of considerable help if citizens and taxpayers had access to information.

What will it mean for NAMA to be under the aegis of the NTMA? Will the NTMA control NAMA or will the latter have a life of its own?

Deputy Brian Lenihan

I believe Dr. Somers dealt with the question of NAMA being under the aegis of the NTMA when he stated in his testimony that the statute would have to determine the precise relationship between the two bodies. A number of models could be followed such as establishing of NAMA as a stand-alone statutory agency which has grown from the NTMA or creating a defined relationship.

Senator Feargal Quinn

Has that decision been made?

Deputy Brian Lenihan

It has not yet been made, which is why the phrase "under the aegis of" was used. Much of the work has been done within the NTMA which is a reputable organisation. It is important that we build on the strengths of our reputable financial organisation when so many others have been brought into disrepute. International markets and observers would be impressed by our use of the NTMA because they are aware of its reliability as a dealer.

I will have the Senator's question on freedom of information addressed in the context of the statutory provisions that will apply. He referred to the IMF's approval. Clearly, the IMF is telling governments throughout the world that if they want economic recovery, they have to sort out their banks. They have to clean up their balance sheets. There is no other way out of this. The question before the Government was: what is the right way for Ireland?

I presume the Senator is referring to the savings and loans crisis in the context of the American organisation. The five-year work-out is probably what produced the very substantial loss. The reason we have been looking at a longer period is this would be safer from the point of view of the taxpayer in minimising exposure. The savings and loans crisis also generated an organisation of 9,000 persons and I have noticed similar commentary regarding NAMA. We are examining what Mr. McDonagh outlined because we do not want to replicate an organisation which would become an unwieldy monolith. We want a tightly managed organisation with a small, highly professional team at the centre, outsourcing, where necessary, vital professional tasks, thus leading to a firm conclusion.

Clearly, the major exposures will have to be managed centrally within the institution because, as has been pointed out at previous hearings, a number

of developers have substantial cross-exposures across the financial system and it is desirable that they be managed on a centralised basis. It has yet to be determined whether we take a figure of 50, 100 or 150. Clearly, on the other side of the spectrum, the question will be to establish adequate supervisory arrangements within the banks to supervise the working out of these loans. We will be looking at setting standardised criteria for that arrangement.

Every member is looking for the difficulties but one of the most difficult tasks relating to NAMA will be drawing the line as to where the agency must or where it should not enforce. A spectrum of borrowers will be hopelessly insolvent; receivers and liquidators should be installed and NAMA will become the property management company for them. That is one side of the spectrum. Clearly, on the other side, because the agency will take performing loans, there will be a category of borrowers who will pay their debts, trade and discharge their obligations as they fall due. In the middle, the agency will have the most difficult commercial decisions to make in terms of the potential viability of the middle category of borrowers.

Senator Feargal Quinn

What about recruiting the talent to do this? Does the Minister believe the restrictions on the income of bankers who seemed to be able to pay themselves well will remove the incentive for them to join the team?

Deputy Brian Lenihan

The report of the committee which examined this issue has been implemented by the Government. As the Minister responsible for banking, I am paid a lot less than a lot of bankers. The world climate is changing in this regard, not just in Ireland. The Government was very much influenced in arriving at a final decision by the approach taken in Germany. It is difficult to

see how when so much State assistance has been rendered to the financial system — the Germans have a principle that nobody can be paid more than a certain figure — how that figure could not be followed in Ireland.

The Senator's question draws attention to an important matter relating to banking reform. If we want this solution to work — this is based on the best advice I have received both at home and abroad — it is not enough that the agency be managed well; it is also vital that there is a change of culture in the good banks which will emerge from this process. That is why the ongoing work in Bank of Ireland and Allied Irish Banks on capitalisation, management structures and the taking by the State of what is in substance a 25% stake in these institutions is important because the stake must be used to effect a change in management culture in these institutions. It is not sufficient to simply set up an agency and transfer the toxic loans to it to resolve the banking crisis. There must also be a change of culture in the institutions which will be envisaged as being the good institutions which will survive and flourish as banks in the future as a result of this. That is where a great deal of work will also have to be done.

Deputy Michael McGrath

I welcome the Minister, Dr. Bacon, Mr. McDonagh and their colleagues. I have a few key questions about the valuation of impaired business. Dr. Bacon made a comment that the loss is the loss, but whether one overpays or underpays, ultimately the loss will have to be absorbed by the taxpayer or to the extent that it can be recouped. Surely the question of achieving the correct valuation is important, not so much in that the loss will be the same, but because the prospects of recouping that loss will vary significantly. If one overpays for the impaired assets, NAMA will make serious losses and the taxpayer will have paid more. We will then try to recoup it through a levy on the banks, which may or may not have the capacity to pay and payment of which could take years. However, if we underpay, large losses will crystallise in

the banks which will require a greater capital injection, through equity, by the taxpayer in the short term and we will then be at the mercy of the markets as to the performance of that equity because it will be in the form of ordinary shares. The loss may be the same but the prospects of recouping it to the taxpayer will vary, so it is fundamentally important that we get the valuation of the impaired assets right. I know the Minister agrees with this but perhaps he will elaborate on the point.

I have some points on the mechanics of the valuation. I welcome the fact that it will be a loan-by-loan analysis and that there will not be a macro view taken of the loan book. Will performing loans be discounted to any degree? Given the risk of them slipping into non-performance over a period of time, will the value of the underlying asset be of significance and will this be a consideration? I presume NAMA will have a statutory power in the legislation to impose a valuation which has to be accepted where the negotiation with the banks on the value of an impaired asset does not conclude successfully. Will Mr. McDonagh tell the committee whether there is a split between the performing and non-performing loans of the €80 billion to €90 billion book value of loans? Does he have details on how much of that is performing and how much is not?

When will the valuation phase of this process be completed? I presume that once NAMA is operational it will be one of the first objectives that will have to be met. Is the Minister considering achieving the valuation phase of the full loan book in the short term? If so, it will mean that the consequences for the banks will crystallise very quickly. For example, if a figure of €60 billion is put on the €80 billion to €90 billion book value that is an immediate hit to the banks of €20 billion to €30 billion. What is the preliminary assessment of the impact on the banks of such a write-off of losses in terms of their capital base?

I would like clarification on whether all of the property-related loans will be transferred to NAMA or will it be loans above a certain value? It has already been clarified that the current thinking is that the operational day-to-day management of the loans will remain with the banking institutions but NAMA will retain full control over all key decisions. With regard to more vigorous pursuit of developers in default, once the non-performing loans are transferred to NAMA, will it take a more progressive approach towards developers in default and move in quickly to seize the underlying security or will it act on a case-by-case basis?

Deputy Brian Lenihan

Deputy McGrath asked about the position on the statutory basis of the valuation. It will be stated in the legislation and is not a matter of negotiation. There has to be a valuation procedure. I noted that some commentary on NAMA suggests that we are in negotiations with the banking system. We are not in negotiations with the banks and we will state the valuations. Naturally, we hope and believe there will be co-operation and agreement with the institutions but in the absence of agreement the matter will have to be dealt with by legislation. In fairness, I must state that the financial institutions have indicated that they wish to co-operate with us on this matter but we have to have the ultimate reserve legislative power of setting the valuations ourselves.

I will leave the other questions to Mr. McDonagh and Dr. Bacon because they were addressed primarily to them and I am anxious that the question of what is meant by "economic value" should be addressed because Deputy Barrett also raised it earlier.

Dr. Peter Bacon

There is just one question for me and I confirm my agreement that the importance of the valuation process is paramount.

Mr. Brendan McDonagh

The valuation methodology will have to be agreed with the European Commission, which has set down clear guidance on impaired assets in a paper which is on the NAMA website, www.nama.ie. It sets out the methodologies for determining current value and longer-term economic value. We will have to develop proposals for working out the longer-term economic value and have sought advisers to assist us in this regard. The results will have to be presented to the European Commission and the Government for approval and will then form part of the legislation. There will be a loan-by-loan analysis and the question of whether performing loans will be discounted will be based on underlying collateral and whether it is considered the loan could become impaired.

The Deputy asked if I knew which loans were performing as against those which were not. I have some preliminary information in that regard and last week I issued a questionnaire to the banks and institutions to be returned by close of business yesterday evening. I have not yet had an opportunity to analyse the replies in any detail but in the current economic environment I expect a certain percentage to be non-performing.

I was also asked when the valuations would be completed. I have already held discussions with one of the two major financial institutions and it has set up a major project team. The institution has shown me its plans and has indicated that within eight or nine weeks of the NAMA legislation being passed and the agency doing its own preliminary work to carry out the financial and legal due diligence, it will be in a position to transfer its portfolio. I am very encouraged by the effort the institution is putting into the project.

Deputy Michael McGrath

Will the valuation phase be completed before the legislation is published?

Mr. Brendan McDonagh

No. The legislation will set out a valuation basis.

Deputy Michael McGrath

A figure.

Mr. Brendan McDonagh

No, it will set out a valuation methodology, which will be approved by Government and the EU. It will be subject to being passed by the Oireachtas but it will form a working basis for the banks to value their loans. The methodology can be firmed up once the legislation is passed and the final figure can then be worked out. The bank to which I refer told me it would start its work on the basis of the methodology in the legislation once it is published. If the methodology changes as the legislation passes through the Oireachtas, the bank will adapt to take account of it. We will independently verify the value of each individual loan to align both values.

Deputy Frank Fahey

Is there a timescale for that?

Mr. Brendan McDonagh

Yes. On the basis that work can be done in parallel, the institution has said it will value all its loans and will allow us to complete the financial and legal due diligence so that it can transfer its portfolio to NAMA eight or nine weeks after the legislation has been passed. It really wants to get the Government

bonds in return so that it can use them to get liquidity to lend more money into the real economy.

Deputy McGrath also asked if all the loans would be transferred. The Minister's thinking was that the infected portfolio would transfer. Because of the views taken by credit agencies and bank analysts, it is envisaged that the land and development portfolio will transfer, as well as associated exposures.

The final question was whether and how developers would be pursued by NAMA. Each case will be assessed individually, taking account of the particular circumstances and whether it is feasible that the developer will survive. If the developer does not want to co-operate with NAMA and there is no prospect of survival, NAMA will take action against that developer to secure the asset. We must secure assets to protect the interests of the taxpayer. If we have paid an institution for the loan based on the value of an asset, it makes sense that we secure it. As the Minister outlined, certain developers will get through this and others will not. There will be a number in the middle, on whose cases it will be much more difficult to make a decision. That is why it is important that objective criteria apply in order that the correct decisions will be made in the interests of taxpayers. Neither I nor any other individual will make these decisions. A number of people will be involved in making a decision. Advice will be sought to ensure the right one is taken.

Deputy Michael McGrath

If personal guarantees have been given on personal loans, will the borrowers be pursued, if necessary, to achieve the value of the loan?

Mr. Brendan McDonagh

Unfortunately, part of the problem is that people have given personal guarantees. If the banks are placing values on personal guarantees as partial security, that is a consequence of what NAMA will be about. If NAMA has to pursue personal guarantees it will do so. I am sure all members are aware that a number of major borrowers, because of the multi-bank nature of their loans, have offered personal guarantees to five or six banks. A personal guarantee can cover only one loan. It cannot cover six. When valuing a loan from a particular institution, we will have to take account of the collateral offered to each institution. One cannot look at this matter in the context of an individual bank or in a vacuum. One must take account of all the circumstances which can be determined.

Deputy Michael McGrath

In having a debt settled will every avenue be pursued in full?

Mr. Brendan McDonagh

Yes, absolutely.

Deputy Frank Fahey

It is clear from what Mr. McDonagh said that many developers will be starting all over again. That is an important aspect of the work NAMA has to do. I welcome Dr. Bacon's analysis of the model he has proposed. His analysis proves this is the right model. Can Dr. Bacon give us examples of best practice models from other parts of the world which could serve as a comparison for NAMA?

I welcome Mr. McDonagh's detailed description. I am impressed by his outline of the implementation of the model proposed. Much confidence will come from that detailed outline. Mr. McDonagh has said each loan will be

assessed and valued individually. This clarification will deal with much of the misinformation among the public, some of which we have heard today.

It is good to hear NAMA will have a staff of between 30 and 40. We will not see thousands of people involved. It is also important that there will be key staff within the banks. I take it that the banks will be paid little or nothing for their contribution towards the management of the portfolios in which they will have an involvement.

Mr. McDonagh said, "I want to make it clear that NAMA's mandate is not to be in the business of liquidation, but to achieve work-out on the loans acquired over time as it can take a longer term perspective than the banks." The Minister mentioned that drawing the line will be difficult. Surely there will be liquidations. It is important that there are liquidations and that we see them as quickly as possible because that is a critical aspect of what the banks have not faced up to thus far.

My final question is in regard to the foreign assets which are part of the €60 billion portfolio. Will the delegation outline what percentage of the assets are foreign? Is it good that a large percentage of the assets are foreign? Perhaps this is the case. Specifically, in regard to the property portfolio of Anglo Irish Bank in the United States, I am led to believe it can be managed profitably for the taxpayer in the immediate future.

It gives me great confidence to consider the detail of NAMA because Canadian banks have been especially successful and profitable in dealing with the downturn in the property sector in the United States. Some of these banks are managed by young Irish bankers. Will the delegation comment on the view that some very good practice models are to be found in that sector? People are turning around toxic assets and managing them profitably. There is an opportunity for NAMA and the banking sector to begin to make profits much faster than was believed possible up to now, given that we have been

in the downward part of the cycle and it now appears we will begin the upward part. Therefore, there is reason to have much confidence about NAMA.

I especially compliment Deputy Bruton, as he has been very responsible and positive. He has produced an alternative model with which I do not agree but he has been responsible, as can be seen in his line of questioning today. It is critically important for the country that we show a united front as far as possible.

Deputy Brian Lenihan

I am unsure whether the questions were directed at me but I indicated to Deputy Fahey—

Deputy Kieran O'Donnell

They were directed at Deputy Bruton.

Deputy Brian Lenihan

There are two points. I indicated to the committee in respect of the issue of liquidation that it must occur now. However, one of the difficulties the agency will have — I believe it will be its most difficult task — is working this out. There will be individuals in the work-out who will be able to meet their obligations and will, therefore, simply continue to pay their loans. Equally, there will be individuals who will be hopelessly insolvent and receivership, bankruptcy, liquidation, the enforcement of remedies and the realisation of securities must take place in respect of them. There is a middle group which is where the most difficult decisions must be taken. In the case of such persons, a judgment must be made whether the degree of indebtedness is such that they are hopelessly insolvent or whether the indebtedness is

resolvable over time and, therefore, that they are capable of generating projects that will generate a return to NAMA. This middle group will be the most difficult to judge. Implicitly, there is the assertion and the fact that receivers must be appointed and liquidations and bankruptcies, in the case of an individual, must take place, if necessary.

I agree with the comment of Deputy Fahey concerning Deputy Bruton. We all have a duty to work together on these difficult issues. One clear message from the Swedish experience was that when the parties worked together, they made great progress. Equally, Deputy Burton made the point, with which I agree, that maximum provision of information was essential to generate public confidence. One of my great difficulties as Minister is that I am constrained in respect of the information I can place in the public domain because of market sensitivities. However, subject to this, I agree it is important that we provide the maximum amount of information and, in addition, that we work together on these difficulties.

The other questions were directed at the other persons present.

Mr. Brendan McDonagh

I echo what the Minister stated. In my statement I indicated I was not in the business of liquidation. It is not always the first option and every option must be considered. I have heard talk and comments have been made to me personally to the effect that NAMA is going to go out and burn the lands. There is no point in NAMA doing that. NAMA has to weigh up and assess every situation to see which will produce the best outcome.

The Deputy asked a very good question about the fees paid to banks. This formed one of the first questions in my discussions with the European Commission. The Commission came back to me and said, "We will not allow you or any other bank in any other country to receive a fee higher than the

cost of recovery." Effectively NAMA will not be run as a profit centre because the EU is very concerned about state aid implications. If we give the banks the administration and they set up the special purpose vehicles, the cost can be contained within those special purpose vehicles. Some of the costs of head office will not be charged to that special purchase vehicle which NAMA will end up paying for. I assure the committee that I certainly will not allow that.

With regard to the percentage of foreign assets, I asked that very question of the institutions in the preliminary questionnaire I issued to them last week and I have not had a chance to analyse the returns yet as they only came in last night. Based on information which I had before this which was based on the analysis of the loan books of the six institutions which was carried out after the guarantee scheme by PricewaterhouseCoopers for the Financial Regulator, the value of foreign assets of the banks' portfolios was somewhere in the region of about 35% and most of that would be UK assets.

On the specific question of Anglo Irish Bank—

Deputy Frank Fahey

Is that a good thing or a bad thing?

Dr. Peter Bacon

If I might offer a view, I think it is a good thing. There is a difficulty which has been referred to in this room, that with an economy in a depressed state, it is difficult to get a liquid market to the extent that assets are diversified across a number of markets. The UK market is a bigger, deeper and wider market and it is an advantage to NAMA and the taxpayer that there is a diversified set of assets. When it comes to working them out — working out can mean physically working out or it may mean partial sale — one of the attractions of

the NAMA portfolio to an outside investor or to a potential private equity player will be the opportunity to have a look at both the Irish economy and the UK economy. In that respect it is a good thing, in my view.

Deputy Joan Burton

May I ask Mr. McDonagh whether that is 35% of the €90 billion or of the €60 billion?

Mr. Brendan McDonagh

No. That 35% was of the total loan portfolios of the banks, of the six institutions. I do not have the figures analysed yet as I only received the questionnaires last night.

Deputy Joan Burton

Therefore, it is higher than 30% of the €90 billion.

Mr. Brendan McDonagh

I do not know the figure because the information only came in last night. All I can tell the Deputy is about the figure of the loan books of the six institutions. Some institutions have UK operations with residential mortgages and some of those mortgages would be within that 35%. I will be getting those details as part of my assessment.

With regard to Anglo Irish Bank, the Deputy asked about the US portfolio and how good or bad it is. I could not possibly comment at this stage but this will be assessed as part of the process. I have heard comments that it is a very good portfolio but I cannot offer the Deputy any comfort at this stage about how good or bad it is.

Deputy Seán Barrett

Like others, I do not care what system is used once we get out of this mess. I share the views of my party as to one method. Deputy Burton has her own idea of nationalisation and Mr. McDonagh has come forward with this. However, there are two common concerns and one is how can we protect the taxpayer properly and how can we be assured that the future lending policies of the banks — this is the most important consideration — will ensure that money is available for lending in the future. We have no detail of any of this.

People assume that once we remove this mess from the banks, they will behave in a reasonable manner and start lending money in the manner in which we, as elected representatives, want them to do. There is no assurance that will happen. The banks will be very co-operative with NAMA in order to have the mess removed from their books, but what assurance have we received that they will behave rationally and lend to people? What will be incorporated into the proposed legislation to deal with these issues? We sat here and listened to bankers as they told us untruths and led us down an alley. I have no great confidence that when the problem is solved and they get rid of their liabilities and the taxpayer has recapitalised them, suddenly everything will be hunky dory. It will not. Therefore, I want to know where the taxpayers' liability stops.

I have several questions. How will the Government be able to legally impose a charge? Having agreed to buy something and subsequently finding out that it paid too much for it and has to sell at a loss, how will the Government be able to go back to the bank and say it will impose a levy because it paid too much in the first place? I do not think that is legally possible. Has the opposite side an answer to this question? I have yet to find out how it will be able to do this.

The whole basis is the price we will pay. Let me give an example. What is the value of the Ballsbridge sites? Will the Government buy back the Burlington, the Berkeley Court and Jury's sites on the assumption that Dublin City Council, at some time in the future, will rezone them, or will it buy them on the basis that they are hotels and that nobody knows what will happen in the future? How are we to say whether Dublin City Council will amend its development plan or retain these buildings as hotels? How are we to say whether it will allow 15 or 35 storeys in a development? If it allows 35 storeys, the value will be completely different. I am not at all impressed by the answers I have received on the valuations of these buildings. If we get this wrong, we will be in serious trouble. In using the word "we" I mean the taxpayer.

I understand Dr. Bacon's point. If we pay too little, there will be a bigger gap for recapitalisation and if we pay too much, there will be less of a gap. However, one way or the other, it is the taxpayer who will pick up the bill. What protection will be built into the legislation which we have not seen? I strongly recommend that it be brought before the committee. The purpose for which committees were set up originally was to enable the Government to send them the heads of proposed legislation. The committees could then invite in experts to hear what they could add to the legislation and then send it back with recommendations to the Government. What is happening in this case moves us in the opposite direction. We are to be landed with legislation and will in the Dáil on Committee Stage argue for changes, but the debate will only be of value if people with good ideas and fears are allowed to express them and the Government takes them into account. I am sorry, but I do not see any built-in security for taxpayers because certain questions are being left unanswered.

I accept everybody sitting on the other side of the table is acting in good faith. We do not doubt their integrity, but the public needs to be reassured. That has not happened. We are entering unknown territory. I do not have

great confidence in the banks because at this committee we dealt with people in senior positions in the banks and they deliberately misled us. I will not have a great deal of confidence until I see on paper our obligations and what we should be doing. I wish to know what assurance we can have that money will be made available to the small businesses of this country when we take over these liabilities from the banks. What will be our lending policies? We have no guarantee on that. The banks may sit back, build up their assets and be very selective in the type of lending in which they engage. We have no guarantee whatsoever in this area. It is our duty to try to ensure we get back to what one would call a normal banking situation.

Where are all the people who will be in a position to buy all these assets back from NAMA? Where are they and who will give them the money? From where will they borrow it? If one were to put a value on the buildings in Ballsbridge, for example, what bank in its right mind would give the money for that? What bank gave the money in the first place? I pose that big question. Who in their right mind allowed people buy those buildings at the prices they paid? If the banks gave out the money once, it does not mean they will give it out a second time. If I have learned one lesson in life it is that when one makes a mistake one makes sure not to repeat it.

I wish to have assurances on, first, the exact sum of potential liabilities to the taxpayer—

Deputy Frank Fahey

Do not back the same horse twice.

Deputy Seán Barrett

The Deputy is correct. Let us be frank and honest about this. This will be a good debate if we are open and tell the people the liabilities they are likely to

encounter.

Second, what assurances can we have that we will get back to having a normal banking system? Third, when and how will we find a panel of people who will guarantee to us that, as near as is humanly possible, they will not engage in any type of risk-taking in selling off some of these assets? Fear went into my bones when I heard the Minister say we could always go back to the banks and impose a levy. It is an impossibility to go back to somebody and say, "By the way, I gave you too much for that and you really should have paid me this so now I want the balance, thanks very much". The Minister knows the answer he would get. He would be told to get stuffed.

We have one chance here. One should not put another load of debt on the taxpayer. I wish to have some assurances concerning the questions I have posed, which I believe are essential to the entire debate.

Deputy Brian Lenihan

I am happy to say the Finance Act enables us to impose a levy of whatsoever dimension is wished on a financial institution.

Deputy Seán Barrett

That has been challenged.

Deputy Brian Lenihan

That has been done many times over the years. The Deputy mentioned challenges. Dr. Somers made many observations about the legal profession in this country with which I would agree, by and large. We have developed a position in Ireland where everything is legally challenged. It is interesting to note that countries which have had a successful resolution to banking

problems in the past and whose example we are following, did not have anything like the same extent of legal challenge we seem to have. We have a cultural problem in this country in respect of the legal profession and the propensity to interpret Mr. de Valera's Constitution to mean all kinds of things he certainly never intended in the first place. That is why we are taking care with this legislation—

Deputy Richard Bruton

Was there ever a levy before that was not on a deposit base or on a uniform measure? This will be a levy based on the losses experienced over 15 years.

Deputy Seán Barrett

For which the wrong prices were paid.

Deputy Brian Lenihan

The basis for this levy—

Deputy Seán Barrett

One cannot have a levy on this basis.

Deputy Brian Lenihan

—will be made clear as a matter of general principle and will be outlined in the Government's intentions prior to the enactment of any legislation.

Deputy Seán Barrett

The road to hell is based on good intentions. This concerns the law.

Deputy Brian Lenihan

Let me finish my answer. That will lay a sufficient foundation, legally speaking, for any subsequent imposition and that is the position with regard to the levy. Mr. McDonagh explained earlier the technical reasons the levy cannot be combined with the actual legislation but there is nothing to prevent the Government making a statement of its intentions which will lay a solid foundation for any enactment the Oireachtas may wish to adopt in the future.

As regards a site the Deputy mentioned in a particular part of the city, it is fair to say it is a matter of public record that the lending in respect of that site was not drawn from a guaranteed Irish institution. I am taking up the point because the Deputy's reference to it illustrates another aspect of our current banking crisis. The external banking institutions which have banked in Ireland have also been subject to this substantial exposure through property loans in some cases. As a result of this, these institutions are deleveraging. That is a major part of the choke on credit that now exists in the Irish banking and financial system. It illustrates the point of why it is necessary to compel the banking system to take these losses upfront because if we do not do that we will continue to choke credit in the economy. We just have to face up to this.

I do not mean to be critical of Fine Gael but there are not any funny money solutions like the one embodied in the recovery bank proposal. Yes, subordinated debt has been examined but the amount of funding to be derived from that will not solve the Irish banking crisis. The choices available to the Government are either to deal with this matter upfront, acknowledge the losses and work them out over time, or permit the banks to continue to try to work them out over time. That is the choice facing the Government and that is why we went for this particular exercise because it forces the banks to take the losses upfront. It forces those developers who are hopelessly

impaired to write off their losses. It is a policy which is designed to ensure that the banks resume normal lending.

The Deputy made the point — I agree with him — as to what guarantee we have that money will be made available and that lending will take place in future. We have a guarantee that if we do not do this, it will not be made available. That is the important point here. If we continue with an arrangement which allows the financial institutions to try to work things out on the most optimistic view of things for their own shareholders, we have no guarantee that these problems will be addressed or that the real credit problems that we are all suffering in the economy will be addressed.

Deputy Seán Barrett

I am sorry for interrupting but that is why it is important that in all of these deals, as the Minister knows, there should be a brake clause whereby one has a right to say "Listen, we're not happy with your lending". A lot of "subject to's" should go into this sort of thing. We cannot allow a situation where these people may or may not decide. The whole purpose of this is to get money flowing again. That is the kernel of this issue and therefore we must have certain guarantees that it will happen.

Deputy Brian Lenihan

Yes.

Deputy Seán Barrett

We are asking the taxpayer to take a huge risk in order to make this happen and therefore if it is the main purpose of the exercise we need as many guarantees as we can possibly get. I am asking the Minister to ensure that those guarantees are there.

Deputy Brian Lenihan

I agree and that is something that can be examined as part of the arrangement. It raises the Deputy's other point on the need for further consultation before legislation with the Opposition parties. I welcome that suggestion.

I must return to my original point on this, which I said in reply to an earlier speaker. When one is reforming the banking system like this it is not just a matter of setting up an asset recovery vehicle and realising the bad assets. One must also ensure that the institutions which one intends to be the good banks and institutions that lend in future are fundamentally reformed as well. That is why as a shareholder both in Bank of Ireland and Allied Irish Bank, I have indicated that there has to be a structured process of change at board and management level in these institutions. In recent weeks, we have witnessed the beginning of that process of structural change. It is vital because the banks which will emerge from this crisis and will continue to lend to the Irish economy must reorient themselves to the real needs of this economy. Our shareholdings will be used for that purpose but there is a balance here too. We do not want the position that obtains in some wholly-nationalised banks where the State interferes in lending policies to the detriment of correct commercial decisions.

Deputy Arthur Morgan

We were told this afternoon that NAMA would be an honest broker between the Government and the banks — a disinterested party, it was claimed.

Deputy Brian Lenihan

I have a difficulty. I extended a lot of extra time but I am beginning to lose the appointments I have made. I undertook to be here until 1 p.m. I will take the

Deputy's questions. Is he the last speaker?

Deputy Arthur Morgan

I am but if the Minister is under pressure I will—

Deputy Brian Lenihan

No. If the Deputy puts them succinctly I will try to assist him.

Deputy Arthur Morgan

First, we are aware there is any amount of evidence that speculators have manipulated regulation for years. We are aware of the planning tribunals and the costs involved in them. We are aware that local authority members were corrupted by bribes from speculators. Why does the Minister believe this will not happen again? Mr. McDonagh might be best placed to answer that question. The Minister is aware there is a major issue of trust concerning anything that speculators are involved in, and I suggest with good reason because it is well grounded historically.

Second, did Dr. Bacon examine the issue of good bank-bad bank or did the terms of reference permit him to examine that area? The Minister said earlier that he is opposed to nationalising the banks, which is fair enough. However, would it be worth examining, or has he had somebody examine, the option of nationalising the good assets of the existing banks into a good bank while holding the toxic assets in one of the existing banks, on a lifeline basis, until such time as the guarantee expires at the end of September next, at which point they would be allowed to take the course of any insolvent business, and we all know the options in that regard?

Third, will the advisory group report to the National Treasury Management Agency or to the Minister directly? Will there be any public accountability regarding that group in terms of its recommendations, discussions or whatever?

Deputy Brian Lenihan

I appreciate the Deputy's brevity because it has helped me. First, on the question of political or ministerial interference in the operations of the agency, the legislation will have to safeguard or eliminate any possibility of political or ministerial interference with individual decisions at the agency. The Minister is accountable to the Oireachtas for the policies the agency will pursue but in regard to individual decisions, these matters must clearly be reserved to the agency itself. That is one of the challenges in the statute. We cannot have an arrangement where the individual decisions on loans can be in any way interfered with, and guarding against that is one of the challenges of the legislation.

Regarding the NTMA, as I said, its reputation is beyond reproach as a sound financial organisation. That is the reason the Government has established NAMA under the aegis of the NTMA.

On the question of nationalisation and the good bank-bad bank approach, NAMA takes that type of approach in one sense but I take it the Deputy is suggesting combining that with total nationalisation of the banking sector. At least that is what—

Deputy Arthur Morgan

No, I am not. I am talking about nationalising the good parts rather than nationalising all of it.

Deputy Brian Lenihan

There are good parts and bad parts. There will not be anything left if it is all nationalised but on that issue, and another issue I did not refer to this afternoon regarding nationalisation, if we nationalise an Irish bank it can create funding difficulties for the bank. Funding is the crucial issue for the Irish financial system and it is important that we have some banks which have some private involvement because they can then fund themselves abroad as private institutions. Otherwise, if we have a 100% nationalisation of the system, all of the funding of the entire Irish banking system rests on the State and the State exclusively, and I do not believe that would be a sustainable position for the State in the future.

Regarding the advisory group, we are preparing legislation. The advisory group will work through the managing director and also through the steering group. They will report to me and then I will bring proposals to the Government but what I am taking from today's sitting of the committee, and rightly so, is that the Opposition parties are anxious to be consulted at the earliest possible stage about these proposals. I will do that.

Deputy Arthur Morgan

I asked a number of other questions, including the one to Dr. Bacon on the terms of reference.

Dr. Peter Bacon

The terms of reference were quite flexible in terms of looking at the issue — this was a good bank or this was a bad bank. The view I took was that if one removed the bad assets, one was left with a good bank.

Deputy Arthur Morgan

Did Dr. Bacon examine it comprehensively?

Dr. Peter Bacon

Yes.

Deputy Arthur Morgan

That answer took a long time.

Dr. Peter Bacon

I wonder what specifically the Deputy is asking. I hope I have done everything as comprehensively as I can. Is there a specific aspect on which the Deputy wants me to give an opinion?

Deputy Arthur Morgan

Yes. I believe there is significant merit in nationalising the good parts of the bank. I appreciate one must hold the toxic parts on a lifeline because of the guarantee.

Dr. Peter Bacon

I examined that. The baseline conclusion I reached was that it was not necessary to nationalise the good part of a bank. A good part of a bank is able to get the adequate capital resources it needs from the market. To nationalise it would leave it dependent on the Exchequer, which has so many demands on it that cannot be met in the market.

Deputy Arthur Morgan

However, it would have been a vehicle to create a funding stream to SMEs, first-time buyers and so forth.

Deputy Brian Lenihan

A funding stream depends on obtaining funding to fund the bank.

Deputy Arthur Morgan

If one sets up a good bank, it will get it.

Deputy Brian Lenihan

The bank cannot advance money if it does not have funds. The key point for a small country such as Ireland is that many of the funds must be attracted from abroad. If one nationalises the good parts as well as the bad parts, one has then nationalised the banking system. The Irish State must then secure the funds abroad to fund the banking system. In addition to the funds the State must borrow to fund the State this year, it would then be under the obligation of funding an entire banking system. I do not believe, as a matter of public policy for a small country such as Ireland, that to restrict external lending to the State and not to have any private lending overseas would be a desirable economic development. It would not be a sustainable development in terms of providing the funding to which the Deputy refers for small and medium-sized enterprises, house purchasers, car purchasers and for consumer purchases.

There is a balance in this. The argument about nationalisation has lost sight of the fact that in the case of Ireland's three large financial institutions — Bank of Ireland, Allied Irish Bank or Anglo Irish Bank — either of these three institutions is greater than the other three combined in terms of the balance sheet. They are the three crucial institutions among the guaranteed

institutions. The others are important and significant, and engage in an amount of domestic lending. However, with regard to the three larger institutions, one is already nationalised—

Deputy Arthur Morgan

The wrong one.

Deputy Brian Lenihan

—and the State has already acquired a 25% stake in each of the other two. What the Deputy is advocating, essentially, is that the State should take a 100% stake in Bank of Ireland and Allied Irish Bank as well.

Deputy Arthur Morgan

No, I am not.

Deputy Brian Lenihan

Then I am not sure what the Deputy is advocating.

Deputy Arthur Morgan

I am advocating that the Minister nationalise the good parts of those banks. I am aware that he must manage the bad parts.

Deputy Brian Lenihan

Then there is nothing left.

Deputy Arthur Morgan

He does not have to nationalise those.

Deputy Brian Lenihan

Then there is nothing left of the banks. The banks' assets are their loans, and if one nationalises the good loans as well as the bad ones, one owns the entire bank.

Deputy Arthur Morgan

They are toxic assets.

Deputy Brian Lenihan

We are taking ownership of certain good loans on the construction side. What the Deputy is advocating is the wholesale nationalisation of the banking sector. Difficult questions would also arise as to why we should even have two separate banks.

Deputy Arthur Morgan

I am not advocating that.

Deputy Brian Lenihan

Very well.

Deputy Kieran O'Donnell

I will not delay the Minister. I thank our guests for their attendance today. In his Budget Statement in April, the Minister gave the public the impression that if losses were made by NAMA, a levy would be imposed on the banks. He

is now saying the legislation on NAMA will include no reference to a levy but that it will be introduced in a Finance Bill in the future.

I am a former auditor. When auditing the banks, will the auditors include a contingency note about a possible levy down the line? If not, the question is whether this levy can ever be imposed legally. It appears that the Minister has switched the contingent liability from the banks to the taxpayer, but the taxpayer is under the impression that the banks will pay a levy. Will the Minister elaborate on that? The Minister referred to subordinated and senior loans and I am pleased to note he has changed his mind on the former.

Deputy Brian Lenihan

There has been no change of mind. Given that many of these loans were not guaranteed in September, there has not been any change in position.

Deputy Kieran O'Donnell

In terms of the senior debt to which the Minister referred, the Fine Gael Party proposes that a national recovery bank would provide funds to existing banks to enable them to shrink the assets on their balance sheets and repay senior debt at an earlier date. The methodology we propose is not to fully write off senior debt but to negotiate and repay it at an earlier date. Consequently, the senior debt would form part of the overall pain and losses. This is a reasonable proposal.

There is no guarantee under the NAMA proposal that funds will flow to small businesses through the existing banks. The reason we are discussing this issue is that funds are not flowing to small businesses.

Dr. Bacon noted that property is cyclical. We did not have a cycle, we had a bubble. In some cases, the value of development land has been written off to

the tune of 80% and, contrary to what the Minister stated in his budget speech, it appears the taxpayer will pick up the full tab. Once NAMA is in place, will we see a contingency note about the income levy in the audited accounts of the banks?

The Government's decision on NAMA is probably the most monumental financial decision ever taken in the State. The sum involved will probably amount to 40% of gross domestic product and the result will probably be a doubling of the national debt. This is not monopoly money and not only will the taxpayer pick up the tab but there does not appear to be a guarantee that funds will flow to small business.

The Minister used the term "funny money" in connection with the Fine Gael proposal for a national recovery bank. Our proposal is plausible. Mr. McDonagh indicated that existing bank staff would be retained and officials from NAMA will work with them. This can be done under my party's proposal. Why create further bureaucracy by establishing NAMA? Why not allow a national recovery bank to be established and have existing banks deal with their toxic debt until the guarantee scheme runs out? At that point, one could examine the issue.

The Fine Gael Party proposes that a degree of pain would be borne in the area of subordinated and senior debt, rather than imposing all the pain on taxpayers. Subordinated debt probably amounts to €12 billion between the two main banks and €20 billion among all the banks. This is a significant amount.

I ask the Minister to reply first, after which I ask Dr. Bacon and Mr. McDonagh to address the technical questions. The political questions for the Minister relate to the contingency for the banks in terms of the levy and my party's proposals for senior debt. Our proposal would require the banks to deal with

their own mess, whereas the Government is effectively proposing to bail out the banks by sorting out all their toxic debt and related loans.

Deputy Brian Lenihan

As I pointed out — I must repeat this time and again — we own one of the main banks and 25% of the other two. On the levy, the Government will take advice and will be guided by the Attorney General. There will be no question of proceeding with the whole project unless there is absolute legal certainty about the capacity—

Deputy Kieran O'Donnell

Does the Minister have concerns?

Deputy Brian Lenihan

No, the Deputy has raised concerns and these will be addressed before any legislation on the NAMA project proceeds. The Deputy is trying to raise a concern that I maintain is not there.

Deputy Kieran O'Donnell

It is a legitimate concern.

Deputy Brian Lenihan

He has raised a concern which he views as legitimate from the perspective of an auditor. The issue must be examined by the Attorney General because the Government will not proceed with a project of this kind without definitive advice that it is on safe ground in the case of the levy.

Deputy Kieran O'Donnell

Therefore, it has not been reviewed by the Attorney General as yet.

Deputy Brian Lenihan

We are preparing legislation and the Attorney General advises the Government on a constant basis on matters that come before him. There is no question of the Government embarking on this project without absolute certainty on the possibility of a levy in the future as the workout proceeds and comes to a completion.

On the national recovery bank, I will make a few points. I was surprised at Deputy O'Donnell's presentation of it. There are, to my mind, fundamental defects in it. First, he will allow all the existing banks to continue to work out their assets without any supervision by the State.

Deputy Kieran O'Donnell

Over a 16-year period, with supervision by the Financial Regulator.

Deputy Brian Lenihan

Fair enough. Of course they are supposed to be supervised by the regulator. We know that. The point is that in economic terms that means those institutions will become, and continue to be, zombie institutions to a greater or lesser extent in the Irish banking landscape. I outlined earlier—

Deputy Kieran O'Donnell

I would not agree with that.

Deputy Brian Lenihan

I ask Deputy O'Donnell to hear me out. I outlined earlier the difficulties with the externally-owned banks in Ireland which have found themselves substantially exposed to these property exposures. Naturally, their parent banks are none too amused and, therefore, they are not provided with the same element of funds to lend into the economy as they were. Clearly, they are a substantial liability for their external owners who must provide working capital to ensure they can work through their assets over time. Deputy O'Donnell will condemn the Irish-owned banks to exactly the same fate because he states that the banks will try to work out matters over a 16-year period. Whatever period Deputy O'Donnell selects, any extension of time for these institutions inevitably means they will have increasingly less credit to lend to the economy. Therefore, the Deputy is putting all his credit into one bank, namely, the recovery bank. He has not explained from where the funds to establish this bank will come.

Deputy Kieran O'Donnell

The European Investment Bank.

Deputy Brian Lenihan

There is no guarantee that the initial investment by the taxpayer of €2 billion or €3 billion, or whatever sum Deputy O'Donnell wishes to identify, would attract the level of funding, either at the European Investment Bank or at the European Central Bank, that he envisages. There is no assurance of any funding for this institution.

Third, on the question of senior and subordinated debt, great care was taken at the time of the guarantee not to leave the taxpayer exposed on

subordinated debt. The perpetual debt was not guaranteed. The dated debt was guaranteed only at the ultimate maturity dates.

All these types of subordinated debt trade in the markets at substantial discounts and there is an international approach towards redeeming those at present, and we are part of this. As a Minister, I have never seen any difficulty with this or ever had any argument with the Fine Gael Party on subordinated debt.

My argument with Deputy O'Donnell's party — he reopened the issue a few moments ago — is on senior debt because it uses the terms "professional investors" or "bondholders".

Deputy Kieran O'Donnell

I did not use those terms.

Deputy Brian Lenihan

Those terms have been used in debate somewhat casually because senior debt are bonds that have been entered into by Irish financial institutions in which moneys have been advanced on the understanding that the interest would be paid to them. Likewise, the State borrows senior debt because it is a sovereign and people lend money to the Government on foot of bonds which trade at certain rates of interests.

The suggestion that we should invite those bondholders who have senior debt to somehow relinquish their rights is a very dangerous suggestion for the country. As I stated, it would impair our capacity to raise funds to fund the State and it would also have a considerably detrimental impact on the banking system's capacity to raise funds as well. As I understand it, the last place where this was tried was Lehman Brothers, and we all saw what

happened after that. In my view, a policy like this, while it can be looked at and evaluated, is not a policy for this country.

I did not mean to be dismissive. I understand the parties are looking at options, but I just do not think this national recovery bank option has a clear demonstrated funding base that is credible in world markets.

Deputy Seán Barrett

Neither has NAMA.

Deputy Brian Lenihan

I am sorry, it absolutely does.

Chairman

We have gone into a political argument.

Deputy Kieran O'Donnell

We are entitled—

Deputy Brian Lenihan

In his evidence Dr. Somers clearly outlined NAMA's funding base.

Deputy Kieran O'Donnell

There was a potential write-off of up to €75 billion. Depending on reductions, the figure could amount to between €60 billion and €75 billion.

Deputy Brian Lenihan

The Deputy is again ignoring the loan to value issue.

Deputy Kieran O'Donnell

I am not. Whether the Minister wishes to use the figure of €50 billion, it is a significant amount of money that will probably fall to the taxpayer to pay. Our business proposal would not require creditors with senior debt to lose their entitlements. They are business people and, as the old saying goes, a bird in the hand is worth two in the bush. They might be happy to be paid at an earlier date. NAMA may not be established for many months, but Dr. Bacon referred to the need for certainty. The establishment of NAMA has been flagged for the past two months. In that time credit from the banks has dried up. They are not giving credit or renegotiating. These are the practicalities.

Chairman

If the Deputy wants to discuss his party's proposals, he should propose that they be discussed at a specific meeting.

Deputy Kieran O'Donnell

I am just highlighting the point for the Minister.

Chairman

We are discussing NAMA.

Deputy Brian Lenihan

I will conclude by pointing out that the proposed agency has the imprimatur of the European Central Bank in terms of funding. Fine Gael has proposed no institution which would be willing to fund its proposal. I am also drawing attention to the dangers of suggesting the banks should seek a rescheduling of their senior debt in some way.

Deputy Kieran O'Donnell

It should be cancelled.

Deputy Brian Lenihan

That it should be paid up front in capital terms would be to place a considerable obligation on them.

Deputy Kieran O'Donnell

The money would come from the European Investment Bank.

Deputy Brian Lenihan

Given the current shortage of medium-term finance for the banking system, banks are happy to hold onto whatever amount they have and pay interest on it. I am concerned about the reputational damage that would be caused to the country were the Government to enunciate such a policy. I am not prepared to go down that road. There is not a credible funding base, but the Chairman does not want us to argue about these matters.

Deputy Kieran O'Donnell

The Minister should be more concerned.

Deputy Brian Lenihan

I appreciate the constructive spirit in which many of the questions were put.

Senator Marc MacSharry

I will be brief, given the amount of time that has elapsed.

When NAMA was promoted and given the fact that the Government will consider current bank staff in administering loans, was it intended to incentivise the banks to the extent that they would want to recover in excess of the discounted amounts to be paid by NAMA for loans? Will NAMA kick off on one day or will the process be staggered? Will a number of loans be taken on gradually and considered individually or will it all occur instantaneously? As difficulties arise and the Government is satisfied that people will not be able to live up to their loan obligations, will it secure the assets at that stage? Is it intended to liquidate assets as quickly as possible, like the Resolution Trust Corporation in the United States? There were rumours of sweetheart deals and so on, but the net result was \$90 billion in losses because it was done over a six-year period, to which the Minister alluded. Alternatively, will NAMA be allowed to hold assets for an extended period before judging what is the time right to go to the market?

Given the controversy about the potential levy which can be provided for in a Finance Bill, it will be applied well down the road, if necessary. Will we enshrine the principle at the beginning via an agreement with the banks? Has this been done or will it be reflected in an amendment to the forthcoming Finance Bill or NAMA legislation?

Deputy Brian Lenihan

On the Finance Bill issue, we will take advice from the Attorney General on the appropriate course of action. Deputy O'Donnell pointed to the accountancy difficulties, but I am satisfied that there is no constitutional difficulty in that regard. The Government will formulate its proposal in the appropriate way, as advised by the Attorney General.

The other questions are technical and I will leave them to other speakers.

Chairman

Deputy O'Donnell also had a number of technical questions.

Deputy Kieran O'Donnell

In terms of NAMA, the first point was—

Chairman

We will invite another couple of questions. Would that be all right?

Deputy Kieran O'Donnell

I actually had submitted questions. I do not wish to be rude.

Senator Marc MacSharry

Neither do I. We have both been waiting three and a half hours to get the same few answers.

Deputy Kieran O'Donnell

Exactly. When will NAMA be in place? In terms of its cost, what rate of return is expected from the assets in it? We are hearing it will be approximately 4%. What will be the cost of funding for NAMA? The figures do not add up. The cost of funding on international markets for government bonds is approximately 5.2% or 5.5%. The return from NAMA could be 4%. There are also management charges.

Mr. Brendan McDonagh

I will answer the first question on when we expect NAMA to be in place. Based on my discussions with four of the six institutions in the past week, I expect NAMA will take loans from the institutions within eight to ten weeks of the passing of the legislation.

Deputy Kieran O'Donnell

If the Bill is passed in July, NAMA will be in place at the end of August.

Mr. Brendan McDonagh

Yes.

Deputy Kieran O'Donnell

How long will the NAMA process take?

Mr. Brendan McDonagh

It will probably take six to eight weeks after the passing of the legislation.

Deputy Kieran O'Donnell

How will NAMA work in practice? Will there be a block of loans from each bank?

Mr. Brendan McDonagh

It will depend on the size of institution. We will have to make a risk assessment about whether we will take the larger borrowers from each institution at the same time or a smaller institution such as the EBS, for example, which has a small loan book of some €500 million may potentially come across to NAMA with fewer than 100 borrowers may be dealt with first. We will probably work on the principle of a risk assessment, where the greatest risk will probably attach to the top 50 borrowers. We will take them across from each institution at the same time.

Deputy Kieran O'Donnell

Of the top 50 borrowers, what is the highest individual debt? Collectively, what does the amount of debt come to?

Mr. Brendan McDonagh

I received this analysis last night and have not had a chance to scrutinise it in detail, but, in terms of the general commentary, some of the top 50 borrowers have substantial borrowings of hundreds of millions of euro.

Deputy Kieran O'Donnell

Will Mr. McDonagh quantify hundreds of millions of euro?

Mr. Brendan McDonagh

Some borrowers have borrowings in the region of €500 million and a few have more than this.

Deputy Kieran O'Donnell

How many have borrowings of more than €500 million? What is the level above this?

Mr. Brendan McDonagh

I do not have the details in front of me and will have to come back and clarify the matter, but based on the information I can recall, approximately ten borrowers have borrowings of more than €500 million.

Deputy Kieran O'Donnell

Are there any with borrowings above €1 billion?

Mr. Brendan McDonagh

There are a number of borrowers which, if one looked at them collectively across the six institutions, could have borrowings of more than €1 billion.

Deputy Kieran O'Donnell

Individually.

Mr. Brendan McDonagh

Yes.

Deputy Kieran O'Donnell

What are the numbers?

Mr. Brendan McDonagh

I do not have that detail with me. There are a number.

Deputy Kieran O'Donnell

What does Mr. McDonagh expect the total number of borrowers involved with NAMA to be?

Mr. Brendan McDonagh

One analysis I looked at this morning quickly concerned loans greater than €10 million. Some 1,000 to 1,200 borrowers have loans greater than €10 million. Some of these could be the same borrowers across the institutions. Within this, there could be 700 million individual borrowers because the institutions have given the number of borrowers within each category. I will have to come back with the information.

In terms of the scale of NAMA, if one deals with the loans of €10 million and upwards with the greatest risk attached, on average, there are probably 1,000 borrowers.

In terms of the cost of funding, as outlined, a Government bond would be issued by the Government through the NTMA. Our thinking is that it would be a variable rate of interest because many of the loans attached to the property portfolios carry floating rates of interest, with a margin on top. For argument's sake, many of these property loans were provided with a margin of between 1.5% and 2%. Therefore, if one is paying a variable rate of interest, the margin comes into play. In terms of the return—

Deputy Kieran O'Donnell

Many of the loans are non-performing.

Mr. Brendan McDonagh

I do not have that detail with me. It is fair to assume that a certain proportion of them may be non-performing.

Deputy Kieran O'Donnell

Does Mr. McDonagh know the number or the percentage?

Mr. Brendan McDonagh

I do not have the number with me. I am sorry. In terms of the return for NAMA, that will be one of the key metrics of measuring NAMA. It will be a matter for the board of NAMA to set that as a performance indicator when it is appointed by the Minister.

The objective would be to keep any fees incurred by NAMA as low as possible. In terms of fees paid to service providers such as the institutions I outlined previously, the European Commission will not allow the banks to make a profit on any administration so it would be on a cost recovery basis. There will be costs in terms of the staff of NAMA. A total of 30 to 40 people will be involved. A budgetary system will have to be put in place.

Deputy Kieran O'Donnell

Does Mr. McDonagh expect NAMA to make a profit?

Mr. Brendan McDonagh

It is difficult at this stage to estimate whether NAMA will make a profit. As many committee members have outlined, it goes back to the old adage, the day one buys an asset is the day one will sell an asset. The price one pays for an asset is very important. Therefore, it is possible to make a profit if NAMA is able to buy assets at the right price and there is an economic upturn. Certain assets will outperform expectations and others will not. It would be fantastic if we could make a profit but we will do our best to ensure we break even at least.

Chairman

Senator MacSharry had some questions.

Dr. Peter Bacon

It is very difficult to predict where property values will be ten to 15 years hence.

Deputy Kieran O'Donnell

That would be important to the taxpayer.

Dr. Peter Bacon

One can say that the transactions that will take place will be close to the bottom of the market, if not at the bottom of the market. That is point No. 1. Deputy O'Donnell made the point that we have not had a cycle, we have had a bursting of the property bubble. He is absolutely right about that. Only a fool would say that in five years we will go back up to that level again.

NAMA is taking a long-term perspective of ten to 15 years. That is important.

Deputy Kieran O'Donnell

Much of this land will never be built on.

Dr. Peter Bacon

Some of this land will never be built on.

Deputy Kieran O'Donnell

It will end up as agricultural land again.

Dr. Peter Bacon

There is no argument about that.

Deputy Kieran O'Donnell

How will the taxpayer get a return?

Dr. Peter Bacon

The taxpayer will not get a return but neither will the taxpayer be paying above that. It goes back to the point—

Deputy Kieran O'Donnell

Is Dr. Bacon saying that some development land will be acquired from the banks at approximately 80% discount?

Dr. Peter Bacon

At current value, depending on the loan to value ratio. The Minister made the point that the loan to value ratio is the key. If a person has acquired an acre of land that will never be worth more than the value of agricultural land—

Deputy Kieran O'Donnell

Most of the loan to value ratios are currently high. That is the reason we are in this mess.

Dr. Peter Bacon

The Deputy says that. My own assessment is that we need to verify what precisely is the case. Mr. McDonagh and his team are engaged in a due diligence exercise to ascertain that on a loan-by-loan basis. That is the right thing to do. On an aggregate level there is not much disagreement among bankers as to what the loan to value ratio is on development land. Some say 60% or 65%. Others say it is not as high as that, perhaps 55%. It is somewhere in the range of 55% to 65%. When one gets the kind of reduction one is talking about, correctly, on that kind of land, a significant part of it will be absorbed by the fact that the borrower is in there with his equity for the first 35% to 45% of it. The balance will be a hit—

Deputy Kieran O'Donnell

Much of the property that was bought in 2006 and 2007 was highly geared.

Dr. Peter Bacon

I agree.

Deputy Kieran O'Donnell

Some of it was up to 100%.

Dr. Peter Bacon

Nobody is arguing that point. On the point whether there will be a return to the taxpayer or not, the factors that give me encouragement include the point in the cycle at which the assets are being acquired, the method in which they are being acquired, the prospective ten to 15 years we have on the total portfolio, and critically, the value added that NAMA might bring to those good projects at home and abroad — I am not including the agricultural land that was bought at mad prices and that will never be recouped — of a high international standard that can be brought to fruition with the right kind of mix in development skills, institutional capital and the right time horizon to bring those to the market in an optimal way. If that part of this equation can be articulated well, then the outlook that NAMA can deliver to the taxpayer should be favourable.

Mr. Brendan McDonagh

If land has been bought on a speculative basis and is now only going back to agricultural value, then I do not think many people would propose that we would pay more than agricultural value for that land when the loan is being bought off the bank.

Deputy Kieran O'Donnell

Am I correct in saying that the agency will be taking development land at different discounts, depending on the particular parcel?

Mr. Brendan McDonagh

No, that is the reason we are doing each individual loan. It will depend on security, documentation, location, the type of planning and whether it will be viable or not.

Deputy Kieran O'Donnell

That would not be the perception of the public.

Dr. Peter Bacon

Even at the highly aggregated level at which I conducted the exercise in the report for the Minister, I distinguished six categories.

Mr. Brendan McDonagh

Senator MacSharry raised a question about incentivising the banks. I have consulted with people who ran bad banks and who have been advising on running bad banks. Two streams of thought have come from this. The first is that we do not incentivise the banks, but rather we pay them a fee for picking up the loan and that is that. However, the evidence on this is that the recovery rate is somewhat hit and miss. Therefore, the banks move off and as soon as the loans are gone off the balance sheets, they are more interested in doing different activities.

An interesting situation occurred in Indonesia in 1997 with Danaharta, which was the bad bank in that country. That bank effectively set a discount on the actual asset and it applied a further discount of 10% on top of that. The bank could earn that 10% back on the basis that there would be a recovery. If there was no such recovery, then the bank lost that 10%. So if there was a discount of 25%, the bank would only get paid 35% less than the value, as another 10% was added on. That is certainly an option to be examined in incentivising the banks to work in tandem with us.

Senator MacSharry then asked whether NAMA will be created like a big bang or whether it will happen over a period. I think I outlined that in my response to Deputy O'Donnell.

Senator Marc MacSharry

That is correct.

Mr. Brendan McDonagh

If NAMA has to move in and liquidate a difficult borrower, it does not make sense that NAMA would be a forced seller into the market. Sometimes there might be no market there. The objective would be that certain assets will be sold, but if we have the ability to hold these assets until the market recovers, then that might be an option. Obviously, the levy is a policy matter for the Minister.

Senator Marc MacSharry

NAMA will be able to bank matters for a later day.

Mr. Brendan McDonagh

Yes, we must be realistic. We may have no function in the market. Also, as stated, there might be an absence of leverage in the market and as such even though we may have a buyer, we might not have the ability to borrow.

Senator Marc MacSharry

The incentivisation possibilities will be explored.

Mr. Brendan McDonagh

They will be explored by the steering group, which will make recommendations to the Minister.

Senator Marc MacSharry

To be absolutely sure, I accept we have heard this ad nauseam, there is to be a loan-by-loan valuation.

Mr. Brendan McDonagh

Yes. That is a requirement of the European Commission. It is also sensible in this context.

Senator Marc MacSharry

I thank Mr. McDonagh.

Chairman

Mr. McDonagh stated that NAMA will take over the banks' assets over an eight-week period.

Mr. Brendan McDonagh

As I stated, it is hoped this can be done over an eight-week period following the passage of the necessary legislation.

Chairman

How and when will the banks be paid?

Mr. Brendan McDonagh

If the assets are taken over in stages the banks will be paid in stages. Effectively, they will be given Government bonds in consideration of the assets purchased.

Deputy Frank Fahey

I asked about the best practice model. Mr. McDonagh said that he had consulted widely with international experts with a view to drawing up a best practice model. Can he point to any model that he would consider best practice?

Mr. Brendan McDonagh

Bad banks can come about discreetly or in many locations at the same time. The Swedish model has many features which might be appropriate to the Irish circumstance, at least in terms of valuation and transparency, and the manner in which it went about its business. However, some of the models in the US are interesting. An expert who ran a bad bank, Continental Bank in the US, has given us useful advice in terms of how to set up a bad bank. An example of where it has not worked is Mexico. Bad banks can work well in First World countries — Ireland is a First World country — with the right procedures, controls, governance and administration. What it boils down to is the price at which one can purchase assets and what one does with those assets.

As Senator MacSharry said, RTC in the US set about a model of selling off assets as quickly as possible. In my view, that is not the right approach to take. If NAMA is to have a ten-year lifespan — that is a matter for Government — then one should take one's time and try to achieve the best return on the assets purchased.

Deputy Frank Fahey

In terms of the example given, how successful has that been?

Mr. Brendan McDonagh

It has been very successful. They were able to work down a large bank which had many branches in the US. Overall, they were not far off breaking even at the end of the process. This is the information I received from the person who ran the bad bank concerned.

Chairman

I thank the Minister, Dr. Bacon and Mr. McDonagh for attending today and for providing us with a comprehensive briefing on this issue of fundamental national importance. I wish them well in their future deliberations.

The joint committee adjourned at 3.25 p.m. until 11 a.m. on Tuesday, 9 June 2009.

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