



PROTECTING the TAXPAYER

**Labour's Analysis of the
NAMA Bill, 2009**

September, 2009

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LABOUR'S ANALYSIS OF THE NATIONAL ASSET MANAGEMENT AGENCY BILL 2009

INTRODUCTION

The bill to establish the National Asset Management Agency (NAMA) is one of the most significant pieces of legislation that the Dáil will ever debate. It involves setting up an agency that will acquire some €80 to €90 billion in property-based loans from Irish banks.

The risks to the Irish exchequer are enormous and irreversible. Overpayment by NAMA for these loans will impose a huge financial burden on the State, yet it is clear that this is the inevitable consequence of the current Government's approach

Throughout the banking crisis, Labour has been consistent in our determination to protect the interests of the Irish taxpayer, while advancing proposals to restore a functioning banking system, supplying needed credit to the Irish economy at least cost and risk to the taxpayer. Labour's approach, based on temporary nationalisation of the two biggest banks, minimises the risk to the taxpayer, and provides a potential up-side when the banks are sold back to the private sector.

Labour has also been consistent in our opposition to the underlying culture of greed and recklessness which gave rise to the banking crisis in the first place. During the bubble years, Labour pointed out the dangers and unfairness of soaring house prices, brought forward legislation to control the price of building land, and challenged the tax breaks that were fuelling property prices. Instead of acting to control property prices, Fianna Fáil stoked the property boom, at the same time as they flaunted their relationships with property developers.

As shown in this document, there are serious weaknesses in the proposed governance structures of NAMA. As well as the risks and costs of bad loans being borne by the taxpayer, there is nothing in the NAMA bill to give assurance that a tough commercial approach will be taken with developers.

This document has two parts. The first sets out an analysis of some of the main flaws in the draft NAMA legislation. The second explains the advantages of the alternative approach based on temporary nationalisation.

THE BILL

The Bill sets out the roles of the various players – NAMA, the Minister for Finance, the Governor of the Central Bank the Financial Regulator and the Oireachtas – in the oversight of this portfolio.

Role of The National Asset Management Agency

Under section 10, the main purposes of NAMA are;

- to acquire such eligible bank assets from participating institutions as is appropriate,
- to deal with them expeditiously, and
- to protect or otherwise enhance the long-term economic value of these assets, in the interests of the State.

NAMA is to obtain the best achievable financial return for the State having regard to a number of factors, including;

- the cost to the Exchequer of acquiring bank assets and dealing with acquired bank assets, NAMA's cost of capital and other costs,
- Ministerial guidelines, and
- any factor which NAMA considers relevant.

Role of Minister for Finance

The Bill vests extraordinary powers and discretions in the Minister for Finance. Section 9 does say that, "except where otherwise provided by this Act, NAMA is independent in the performance of its functions". However, on an overall assessment of the Bill's provisions, NAMA in all major respects is not independent but must act at the direction of the Minister.

- The long title and section 55 make it clear that NAMA's function is to acquire "certain assets from certain persons to be designated by the Minister".
- It is also to "perform such other functions, related to the management or realisation of bank assets that it has acquired, as are directed by the Minister": long title and section 11.
- The Minister may confer on NAMA, by order, such additional functions connected with the functions for the times being of NAMA as he or she thinks fit: section 11.
- The designation of "eligible bank assets" to be purchased by NAMA is a power vested by section 56 in the Minister for Finance. He must consult with NAMA, the Governor and the Financial Regulator but the power to designate or not to designate resides with him exclusively.
- Section 13 of the Bill requires NAMA in the performance of its functions to "have regard to any guidelines issued by the Minister".
- In addition, section 14 sets out the Minister's powers of direction. Under this section, "the Minister may give a direction in writing to NAMA concerning the achievement of the purpose of this Act", and NAMA is required to comply with any such direction. Since the "purposes of the Act" are drafted in a wide and general way, this is a very extensive Ministerial power.

Role of the National Treasury Management Agency (NTMA)

The role of the NTMA is a minor one. Although it is at present the temporary home for NAMA, it is to have no control or oversight and has very little by way of an ongoing relationship.

Under sections 38, 39 and 44, the NTMA must provide NAMA with such business and support services and systems as the NAMA Board – not the NTMA Board – determines, acting upon the recommendation of the Chief Executive Officer of NAMA and after consultation with the Chief Executive of the NTMA. It is also obliged to supply staff to NAMA and to provide NAMA with treasury services and advice.

Other than those functions, NAMA appears to be a cuckoo in the NTMA nest.

Role of the Central Bank Governor

Whilst the formula of having a consultation with the Governor of the Central Bank is included in various sections, including section 55 dealing with the designation of “systemically important” banks, clearly the Minister is not bound by, and does not need to have any particular regard to, the views of the Governor.

Role of Oireachtas

The Minister is required under section 45 to furnish an annual statement from NAMA and, under section 49, the audited accounts of NAMA to the Houses of the Oireachtas. But the Bill entitles him to omit “any matter that would disclose confidential information”. “Confidential information” is widely defined, in section 171, as including for example –

- any information relating to the commercial or business interests of a participating institution or of a person who is or has been in a relationship with a participating institution, and
- any information about proposals of a commercial nature and tenders submitted to NAMA or the NTMA by contractors, consultants or any other person.

This could well be construed as justifying withholding any piece of relevant information, as the Minister thinks fit.

Under sections 50 and 51, which deal with Oireachtas Committee hearings, the Chairperson and CEO must appear before the Committee of Public Accounts and deal with general matters that are specified, for example, the economy and efficiency of NAMA, systems and procedures, etc. They may also be required to attend before other Oireachtas Committees but only to provide specified information. Sections 50 (2) and 51 (2) effectively gag both the CEO and Chairperson by precluding them from expressing any opinion on the merits of any policy of the Government or a Minister of the Government, or on the merits of the objectives of such policy.

Section 187 of the Bill appears to leave it in the hands of the Minister for Finance to evaluate after five years whether NAMA “had made progress towards achieving its overall objectives and whether a continuation of NAMA is necessary”. That should be a decision for the Oireachtas, rather than the Minister for Finance.

The Minister and Acquisition Values

The Minister has critical overriding functions in the determination of acquisition values.

- Under section 56, it is the Minister who, by regulations, prescribes the classes of “eligible bank assets”.
- Under section 58 (7), the Minister may make regulations to require NAMA to take into account the report of an expert concerning factors or matters relevant to the determination of the value of any property in question.
- Under section 59 (1), the Minister decides the “adjustment factors” to be taken into account in determining the “long-term economic value” of bank assets.
- Under section 89, the Minister appoints an expert reviewer and, under section 96, the Valuation Panel. The Valuation Panel reviews the total portfolio acquisition value and then proceeds, under section 101, to communicate its position not to NAMA, but to the Minister. The Minister can reject the valuation of a portfolio as given by the Valuation Panel. In other words, if he doesn’t get the valuation he wants from the Valuation Panel they have to reconsider the valuation.

The reality is that the Minister has no professional expertise or capacity to gainsay the collective expertise brought to bear on the evaluation of a portfolio for NAMA, or on the position adopted by his own Valuation Panel.

Powers in relation to re-structuring of banks

Under section 174, the Regulatory Authority may, but only with the approval of the Minister, give a direction to a participating institution in order to achieve the purposes of the Bill. And, by section 176, it is for the Minister to issue directions to participating institutions to draw up or amend restructuring plans.

Given that one of the purposes of the legislation is to facilitate the restructuring of credit institutions of systemic importance to the economy, this section appears to give the Minister sole power to design the future of the Irish banking system and then to impose it on the participating institutions on a unilateral basis.

Such a process undermines the standing and authority of both the Oireachtas and the Regulatory Authority and underscores the manner in which the Bill amounts to a very significant aggrandisement of the powers and functions to the Minister for Finance.

Valuation

The valuation methodology proposed in section 58 is to use “current market value” as the floor and “long term economic value” as the ceiling, when it comes to valuing property. The concept of “long term economic value” included in the Bill is also fraught.

The future value of a property is already reflected in the current market value of an asset. When someone acquires a property, they already make long term economic assumptions in relation to the pros and cons of the purchase in the price that they bid for the property. The concept of ‘long term

economic value' therefore, requires that assumptions be made which depart from this present reality. The structure of NAMA is based on an assumption that property prices will rise again. It is the state, however, that bears the risks if the predictions about 'long-term economic value' are proven to be inaccurate over time.

'Although the measures contemplated by the draft law should restore confidence in the Irish banking system, the ECB considers it important, in line with previous opinions that the pricing of acquired assets is mostly risk-based and determined by market conditions. The preference expressed in the draft law for the long-term economic value of assets, rather than current market values, requires careful consideration in this context. In particular, it should be ensured that the assumptions to determine the long-term economic value of bank assets will not involve undue premium payments to the participating financial institutions to avoid creating inappropriate incentives from their side as regards the use of the scheme.'

European Central Bank, Statement, 31st August 2009

The whole structure of NAMA therefore, is one which places enormous risks on the exchequer. Specific problems include the following.

- 1** Many of the properties to be held by NAMA may never have a purchaser. Just like many of the properties held by IDA and Shannon Development, they may have limited user demand and hence limited market value.
- 2** The State has a wealth of valuation experience and advisors. The Valuation Office/Commissioner of Valuation (property advisors to the Government) has access to all property transactions in the State and would be in a far better position to advise on valuation issues than any other expert. They have a market value section. Was the Commissioner asked for his advice? If not why not? The Valuation Office knows exactly what the market is doing at any time. They have the vital market information. The Valuation Tribunal decides on commercial property valuation disputes for rates and under the Derelict Sites Act they decide on market value. Some of the more recent decisions have been very useful. The Tribunal recently decided on the market value for a development site in Bray Co. Wicklow where the only market evidence was for November 2006. The valuation date under consideration was November 2007. Its decision was that there was a 30% reduction in the market value as between the two dates. (Gillen & Farrell v Bray Town Council, 1st August 2008). If you are considering market value as between 2006 and 2009, the difference would be a lot more than 30% . Why is the Valuation Tribunal being replaced by the Valuation Panel under the NAMA proposal?
- 3** And why is the property information and transactions to be used by NAMA to be kept confidential and away from the public? The decisions of the Valuation Tribunal are published in detail. CPO hearings in front of the Property Arbitrator are open to the public. So why is confidentiality necessary here? Taxpayers should be able to see what is going on.
- 4** The payment to a bank of a "long term economic value" price for loans amounts to a very significant gift by taxpayers. In essence, having regard to the maladministration of the banks and the mismanagement that has led directly to the current economic crisis in the country, it is

difficult to see why taxpayers should have imposed upon them such a burdensome obligation – particularly in circumstances where there isn't even a suggestion that the lending institutions will have to appear before an Oireachtas committee or inquiry to render an account for their mismanagement and misconduct over the past seven years in particular.

- 5 Another critical difficulty about the valuations is that, once the process is in train and one valuation occurs, then a precedent is created which will be referred to in all future valuations: and so it will become impossible to recalculate the valuation process. This contrasts with other sections in the Bill, where changes, amendments and modifications can be brought in. However, once one "acquired portfolio" is given or has fixed for it a "long term economic value" that will become a benchmark for all valuations thereafter.
- 6 The capacity of valuers to give accurate future values of any form of property or security has been discredited and their predictions have been shown to be wrong. Therefore, the "long term economic value" must be based on a mixture of political expediency, having regard to the aims and objectives of the Minister for Finance, and mere prophesy.
- 7 Another problem is that much of the property to be acquired by NAMA is development land. Development land valuations are notoriously difficult, because experts often disagree and figures can prove almost anything. The result is entirely based on expectations, which are almost always incorrect. These "residual valuations" have formed the basis of fraud, scams and economic disasters worldwide.
- 8 It is often forgotten that holding property incurs costs. An empty building incurs significant holding costs including maintenance, security, insurance and local authority rates. Vacant development land is also costly to hold because planning will have to be safeguarded or acquired. Security to prevent trespass and insurances will have to be paid for. All of these properties will need active management. Will NAMA have the capacity to manage these properties?

Legal definition of "long-term economic value"

According to section 58 (1) (c), the concept of "long-term economic value" is defined as the value that the property can reasonably be expected to attain in a stable financial system when current crisis conditions are "ameliorated" and in which a future price or yield of the asset is consistent with reasonable expectations having regard to the long-term historical average.

"Current crisis conditions" is not defined in the Bill. Under the Interpretation Act 2005, an enactment must be construed as always speaking. In other words, an Act, whether passed yesterday, 5 years ago or 10 years ago, must be read by a court in the present tense. Specifically, "an enactment continues to have effect and may be applied from time to time as occasion requires".

So, given that the NAMA legislation is intended to be in place for at least a decade or so, the basic question arises as to whether "current crisis conditions" means the conditions prevailing at the time the Act is passed or whether it means the conditions then prevailing at any future time when the Act has to be construed and interpreted by a court at a future date.

This legislation will give rise to litigation and that its interpretation will be a matter for courts to decide for years to come. The lack of specificity as to the meaning of "current crisis conditions" and the potential difficulty for any court at a future time to work out what the expression means – in particular, the meaning of the word "current" when embodied in a statute that is always speaking in the present tense – seems to undermine any attempt to give legal meaning and effect to the notion of "long-term economic value".

What will a court in 5 years time define as the "conditions" that identify the "current crisis"?

Given that "current crisis conditions" and their amelioration are both concepts that appear central to the definition of "long-term economic value" – which is in turn the basic concept that will govern the price to be paid by the State for impaired loans, it is vital to have more spelled-out thinking about what this phrase actually means.

Overreaching for protection of Purchasers

The Bill deals with the situation where NAMA conveys property. Prior to this happening a process of acquiring possession of the property in question would have to be gone through. In other words, what NAMA initially directly acquires under the Bill are the mortgages/debts and liabilities of developers, together with the benefit of all the securities, charges, solicitors' undertakings and so on which have secured the debts.

Assuming that NAMA proceeds to enforce the security and gets an order for sale and sells the property, section 118 comes into play. It talks about "overreaching" any equitable interest in the land, so that the equitable interest ceases to affect the land, whether or not the purchaser has notice of it.

Many of the securities in question will in reality transpire to be solicitors' undertakings. In many cases undertakings were given in relation to properties which would have included the family home of the developer. It seems likely in many of these cases that formalities in connection with the Family Home Protection Act, including the prior consent in writing of the spouse to the creation of such a mortgage, never occurred.

Such was the frenzy in connection with solicitors' undertakings, particularly between the years 2005 and 2007, that in very many cases indeed, strict formalities were not complied with on the anticipated basis that the security would never be called in.

What information does the Minister have in relation to the validity, robustness and soundness of the securities held by the lending institutions? Is there any possibility that NAMA will be taking unsecured debts or debts where the securities are demonstrably invalid, inoperative or "bogus", as in the "Lynne" cases? Has an audit and evaluation of securities as distinct from debts been undertaken?

If the security instrument is invalid, NAMA will have paid out money which may be irrecoverable, except as an unsecured creditor of the developer personally or the mortgagor/borrower personally. If the mortgagor/borrower is a limited company, then the position is quite hopeless. What remedy does NAMA have if the security turns out to be worthless?

Registration of Title

By section 84 of the Bill, NAMA is exempted from normal statutory obligations relating to public registers of title, interests and charges over land. It is not required to become registered as owner of any security that is part of the bank asset.

In other words, NAMA continues with the same earlier rights as the participating bank. But, if an asset is acquired by NAMA secured on land, there need be no public registered information specifically linked with that asset to determine whether it is controlled by NAMA or not. This drastically limits the information available on public registers to those with an interest in dealing with land and seems designed to restrict knowledge of what NAMA is taking over.

Sanctions

Breaches or non-compliance with provisions in the legislation does not give rise to a single criminal offence. Although participating institutions are obliged to act in utmost good faith, a standard of conduct quite strict and normally associated with insurance contracts and the like, failure to do so carries no criminal consequence and no sanction. That is a shocking omission in all the circumstances. Likewise, although the Bill requires participating institutions to provide information about eligible bank assets, there are no criminal sanctions for any wilful neglect or omission to do so.

Conclusions

NAMA is being established to manage a vast quantity of loans, yet the draft legislation shows the proposed legal structures to be inadequate and dangerous. It is inevitable that political expediency will cause NAMA, the valuers and the Minister to gravitate towards bloated and unrealistic "long term economic valuations" and "upwardly mobile" current market valuations. Ultimately, there is no accountability on the part of the Minister of any substantial nature.

THE ALTERNATIVE TO NAMA

While NAMA as proposed is a high-risk approach to the banking crisis, it is nonetheless vital that the Irish economy have a functioning banking system.

The NAMA proposal has a number of fundamental problems, the most crucial of which is the valuation problem. Given the present state of the property market, it is extremely difficult to estimate the value of the loans, which depends on the value of the underlying properties on which they are secured. The Government is proposing that a discount (haircut) will apply when the loans are transferred to NAMA. If the Government applies a low discount, i.e. estimates a high long-run economic value, then it is taking on the risk that the price of the property might not recover to the long run economic value set for that property, and the state will be liable for the resulting loss.

The higher the discount set, the greater the losses the banks must record and the more their capital is eroded. Since higher losses mean the state having to re-capitalise the banks, and since this will increase the share of the banks owned by the state, the Government's stated preference to avoid nationalisation makes it highly likely that NAMA will over-pay for the loans.

Outline of the Temporary Nationalisation Approach

The alternative to NAMA is temporary public ownership/nationalisation of two key banks i.e. Bank of Ireland and AIB. With this approach, the State acquires the shares in the banks. The bad property loans are written down or transferred to an asset recovery vehicle – an Asset Recovery Trust – and the bank is then recapitalised. In re-capitalising the bank, however, the state is investing in an entity that it owns, and it stands to gain when the bank is re-privatised. A crucial feature of the nationalisation approach is that it dramatically reduces the risks involved in having to value the bad loans.

Since property developers typically have relationships with more than one bank, there would be legal and administrative benefits from combining these loans across the nationalised banks, and dealing with them collectively. Equally, there would be advantages to building a centre of excellence in managing the bad loans and the properties that would be taken into ownership by the state. Loans would be transferred to the proposed Asset Recovery Trust at market value, not at 'long-term economic value'. Again, the risks involved in valuing loans are reduced, since one state-owned entity would be buying a loan from another.

It is this key feature that is highlighted by the former Swedish Minister Mr Bo Lundgren who managed his country's banking crisis in the 1990s. In his visit to Dublin last July and his RTE interview this week he placed great emphasis on this advantage nationalisation has over all other options, that is the transfer of loans from one public agency to another. The International Monetary Fund (IMF) too, has noted this particular advantage that nationalisation offers in situations such as Ireland is presently experiencing;

'Insolvent institutions (with insufficient cash flows) should be closed, merged, or temporarily placed in public ownership until private sector solutions can be developed ... there have been numerous instances (for example, Japan, Sweden and the United States),

where a period of public ownership has been used to cleanse balance sheets and pave the way to sales back to the private sector.

International Monetary Fund, 2009'

Labour believes that the commercial retail banks should ultimately be privately owned, and that nationalisation should be only temporary – for as long as is necessary to sort out the current crisis. Labour has proposed the establishment of a Banking Commission to supervise the appointment of bank boards, to ensure that only suitably qualified people are appointed. The legislation governing nationalisation would specify that the day-to-day running of the banks would not be subject to political control.

Any nationalised bank would be subject to the same accounting, disclosure, and reporting requirements as currently apply to listed financial institutions. This is to ensure transparency as well as to maintain the discipline of market reporting and disclosure.

The State would have to establish an assessment process, to determine what is a fair price to pay for the bank shares. An assessment would have to be made of the value of the bank, based on a number of factors, including the level of impaired debts and the availability of the State guarantee. It would not be responsible for Labour to quote a price for any particular bank, on the information available.

As part of the assessment process, Labour would be open to innovative mechanisms for compensating shareholders. These could include giving shareholders warrants to purchase shares in the de-nationalised banks. Another option would be to give the shareholders a stake in the proposed Asset Recovery Trust.

SOME KEY QUOTES ABOUT NAMA AND NATIONALISATION

20 independent economists, Irish Times, 17 April, 2009

'We see nationalisation as being the inevitable consequence of a required recapitalisation of the banks done on terms that are fair for the taxpayer.'

46 independent economists, Irish Times, 26 August, 2009

'The key difficulty facing the Government is that to pay existing market prices would leave the banks sitting on losses large enough as to effectively bankrupt them. This would then require the State to invest in the banks to such an extent as to effectively nationalise them. Consequently, it is clear that the Government is determined to pay a price for land and speculative developments greatly in excess of the market clearing price.'

European Central Bank, Statement, 31st August 2009

'Although the measures contemplated by the draft law should restore confidence in the Irish banking system, the ECB considers it important, in line with previous opinions that the pricing of acquired assets is mostly risk-based and determined by market conditions. The preference expressed in the draft law for the long-term economic value of assets, rather than current market values, requires careful consideration in this context. In particular, it should be ensured that the assumptions to determine the long-term economic value of bank assets will not involve undue premium payments to the participating financial institutions to avoid creating inappropriate incentives from their side as regards the use of the scheme.'

International Monetary Fund, June 2009

'Insolvent institutions (with insufficient cash flows) should be closed, merged, or temporarily placed in public ownership until private sector solutions can be developed ... there have been numerous instances (for example, Japan, Sweden and the United States), where a period of public ownership has been used to cleanse balance sheets and pave the way to sales back to the private sector.'

Brian Lucey, Associate Professor of Finance, Trinity College Dublin

'This (NAMA), let us recall, is a conscious decision to use taxpayers money to overpay banks for their toxic assets, thereby transferring billions of euro from the taxpayer to the bank shareholders.'

(Irish Times, 7 September, 2009)

Sean Barrett, Department of Economics, Trinity College Dublin

'NAMA is a macroeconomic three-card trick to refinance incompetent bankers and reflate a property bubble without addressing reform in the property market, banks or bank regulation'

(Irish Times, 2 September, 2009)

Ray Donnelly, College of Business and Law, UCC

'The simplest way to ensure the taxpayer receives a fair return from taking over toxic debt is to nationalise the banks.'

(Sunday Independent, 6 September, 2009)

David McWilliams, Irish Independent

'We are being asked to stump up for NAMA based on the reasoning that if we don't do this then investors will flee the country. This is hilarious for anyone who has worked in international finance during a banking crisis; it implies that international investors are prepared to risk their money in a county that is being turned into a large debt-servicing agency for old debts.'

(Irish Independent, 2 September, 2009)