Opening Statement to Committee on Public Accounts
Brendan McDonagh, Chief Executive
Thursday, 13th January 2011

Chairman and Deputies,

I understand that I have been invited back here in particular to clarify responses I made to comments and queries raised by certain members of the Committee and particularly, Deputy McGrath at my last appearance here on 18th November 2010.

I have included in an appendix to this statement a transcript of the relevant extracts from that Committee meeting where Deputy McGrath and I discussed the matter of information supplied by the banks about the size of the likely discounts the financial institutions expected on the loans due to transfer to NAMA. Deputy McGrath and the Committee also raised the issue of whether or not further investigation of those matters is warranted. It is important at the outset to remind the Committee that this discussion referred only to information supplied during 2009 - specifically in August and September of that year – and that the NAMA legislation was enacted in November 2009, having been introduced into the Oireachtas in September.

Time does not permit me to re-read those extracts of the Committee's November proceedings into the record today but I would urge that anyone considering this matter or commenting upon it now or in the future should take the time to review these extracts again carefully.

Chairman, in recent weeks, I have read, with some concern, comments to the effect that I had somehow misled this Committee or Deputy McGrath or that I was backtracking on responses I made here on 18 November. As a Public Servant who holds this Committee and all the Committees and Members of the Houses of the Oireachtas in the highest esteem, I am deeply troubled that such claims, which are totally without any basis in fact, should be levelled against me.

I have made no public comment on these matters since 18 November so let me speak very clearly and very plainly now so as to clarify the matter beyond any doubt.

I unequivocally stand over all the replies to questions and queries which I made at the Committee meeting of the 18th November last.

One of the main points which I made, and which Deputy McGrath correctly questioned me on, was that the information put into the public domain by the listed financial institutions in Autumn 2009 **before** the NAMA legislation was enacted, anticipated that the haircut they expected to receive on their loans transferring to NAMA was actually going to be less than the 30% estimate in the Minister's September announcement. As it transpired, the real discount that has been applied across all five institutions, to date is, as we all now know, an average of 58%. The respective discounts applied up to the end of 2010 are: AIB (54%), Bank of Ireland (42)%, Anglo Irish Bank (62%), EBS(60%), and INBS [64]% . My opening statement on 18 November referenced this:

"...the 30% estimate was based on information provided by the financial institutions that their average loan-to-value ratio was 77% and, by implication, that there was on average a residual 23% equity in the portfolio. Property prices did decline substantially in Ireland during 2009 and that certainly would have contributed to the erosion in value but it is not the whole story. Equity releases as

asset values apparently rose certainly contributed to the equity erosion. I can only conclude that, notwithstanding the decline in property prices during 2009, the LTVs were much closer to 100% than the 77% represented."

Therefore, I think it was perfectly reasonable for Deputy McGrath to have suggested at the meeting on 18 November, that he would like to know how the financial institutions formed, around August/September 2009, the clearly incorrect opinion as to their likely discounts and that he considered that matter to be worthy of careful review. For my own part, and this is a point that Deputy McGrath picked up on, I would simply say that the original loan to value ratios of the prospective NAMA loans could not have been as positive as the LTV ratios which the financial institutions advised to me in late Summer and early Autumn 2009: in order to move from a projected discount of under 30% to the real discount of 58%, the real average loan to value could not have been anywhere close to an average of 77%. Certainly, I would accept that the technical detail of the proposed valuation methodology changed between September 2009 as the legislation was introduced and the time it was enacted in November 2009 and was further modified by the EU Commission approval in February 2010. However, the original loan to value ratios would not be affected by this.

Since our meeting with this Committee on 18 November last I and my Chairman have met with the Gardai and have exchanged correspondence with the Financial Regulator's office on this matter. We made it clear that our legal advice is that the loan to value information was provided at a time before the enactment of the NAMA legislation. As the NAMA Act did not exist at that time, any examination of the information provided prior to the Act could **not** be carried out under the NAMA Act or be actionable by NAMA under section 7 or section 203 of the Act.

That of course does not mean that it is not a matter worthy of consideration by other authorities with the relevant powers. The Financial Regulator as far as I am aware is responsible for the conduct of the financial institutions and is also responsible for ensuring that publicly quoted banks provide correct and timely information to the market. Initiation of any such investigation is of course a matter for the Financial Regulator but we have made it absolutely clear that if the Regulator, or any other investigating body, decided to pursue the matter NAMA would of course provide full cooperation insofar as possible and if requested to do so.

Surely it is reasonable Chairman, while acknowledging that NAMA does not have jurisdiction in this matter, for me to have said that I did not disagree with Deputy McGrath when he suggested that those bodies with the necessary powers and jurisdiction have a vital role in investigating this matter. I am disturbed that my replies to Deputy McGrath could have been interpreted in any other way.

Finally it is very important that I reiterate the fact that NAMA did not pay any institution on the basis of their estimated figures supplied in 2009. NAMA only paid on the basis of our own rigorous due diligence of each individual loan. Indeed NAMA received a great deal of criticism from some quarters for the level of due diligence materials we asked for and the steps we took to individually due diligence and value every single loan as is required under the legislation. I believe that our cautious approach has been fully vindicated. The valuation of the loans has been based solely on the Act, the Valuation Regulations and EU Commission approval. We did not accept at face value any of the information provided by the participating institutions but designed a process to enable us to carry out a forensic analysis to determine the correct valuation of the loans. NAMA has protected the taxpayer from the risk of overpaying for the loans and that is the most important fact to emerge. NAMA has done its job diligently and properly in accordance with its statutory mandate and that was acknowledged by Deputy McGrath and the Committee last November.

I trust this clarifies the matter. This concludes my opening statement.

13 January 2011

Appendix 1 – Extracts from PAC meeting 18th November 2010

Brendan McDonagh's opening statement:

"Some commentators have expressed surprise that the discounts that have emerged for each of the institutions and in overall terms may have been much higher than anticipated. However it must be remembered that the initial indications of an aggregate discount of 30% were necessarily based on aggregate information provided last year by the five participating financial institutions. Specifically, the 30% estimate was based on information provided by the financial institutions that their average loan-to-value ratio was 77% and, by implication, that there was on average a residual 23% equity in the portfolio. Property prices did decline substantially in Ireland during 2009 and that certainly would have contributed to the erosion in value but it is not the whole story. Equity releases as asset values apparently rose certainly contributed to the equity erosion. I can only conclude that, notwithstanding the decline in property prices during 2009, the LTVs were much closer to 100% than the 77% represented. My point is that if the LTV disclosed was more accurate this would have resulted in an estimated average NAMA discount of 53% i.e. 30% plus add back on 23% equity.

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

Deputy McGrath in his opening querying stated the following:

"I would like to pick up on the point made by Deputy O'Keeffe on the quality of the information it got from the banks in 2009 and which fed into the draft business plan in October 2009. Some of the information must have come from fantasyland because if one considers the reality NAMA found when it went in and did a loan by loan analysis and a detailed probe, some serious questions need to be answered about the intentions behind.

...We know the reality is entirely different, the level of performing loans is 25% and the loan to value ratio, as Mr. McDonagh mentioned, is closer to 100%, something which is a matter of fact and which did not change because of the deterioration in the economic environment. How could they have gotten it so wrong?

In his response to Deputy O'Keeffe, Mr. McDonagh referred to a lack of systems but I would take a far more cynical view, namely, that the banks were concerned with trying to extract the maximum possible price from the taxpayer for the loans which we were acquiring."

Brendan McDonagh responded as follows:

"In terms of that, I do not disagree with the Deputy. The reality of our detailed loan by loan analysis showed up what it was. People sitting on the boards and senior management in those companies had responsibilities. I recall that when the Minister for Finance went into the Dail on 16 September 2009 and introduced the NAMA Bill there were Stock Exchange statements by the two major banks into the market telling it they expected their discount to be even less than 30%. The reality has turned out to be different. The Deputy is completely right. There are questions to be asked and answered.

We went in, found what the situation was and reported on it. The discounts are much higher than what could have been anticipated. Based on the information provided at the time, and given what we have been dealing with in terms of the banks over the past 10 months and the due diligence which is coming through, they are finding out things about borrowers and loans that they should have had at their fingertips before. They did not have this and there are huge systems failures on the back of that."

Deputy McGrath responded as follows:

"I think it is much more than that. If NAMA had not taken such a rigorous approach in going in and analysing every single loan individually and had taken the information it was given at face value, it would have dramatically overpaid for the loans it was acquiring."

Brendan McDonagh responded as follows: "Absolutely."

Deputy McGrath went on to state:

"That would have been at the net expense of the taxpayer. It seems to me that there was a clear pattern of false and misleading information being fed into NAMA by the main banks in Ireland during 2009. That has to be investigated. I do not know who has the function to refer that information to the Garda, the National Bureau of Fraud Investigation or the Office of the Director of Corporate Enforcement but it needs to be done. Some of the data would have changed with the deteriorating economic environment. I can understand the percentage of performing loans changing, for example and Mr. McDonagh referred to that in his opening remarks. However, getting the loan to value ratio so wrong across the board should have rung alarm bells that there was something more going on. *It needs to be investigated by the Garda and the Director of Corporate Enforcement. I do not know whether NAMA can make information available to them but there is a clear, systematic pattern of false and misleading information being fed into NAMA and that cannot go unaccounted for."*

Brendan McDonagh responded as follows:

"I do not disagree with anything the Deputy said. The first port of call in terms of looking at that must be the Financial Regulator, who has responsibility for supervising and knowing what goes on within the banks. We will provide whatever assistance we can to anybody. I can assure the Deputy that we have established the facts and will make that information available to any regulatory authority, if appropriate. That is where we are now. Other people have questions to answer on what was done in the past."