EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 31 August 2009

on the establishment of the National Asset Management Agency

(CON/2009/68)

Introduction and legal basis

On 30 July 2009 the European Central Bank (ECB) received a request from the Irish Minister for Finance (hereinafter the 'Minister') for an opinion on the National Asset Management Agency Bill 2009 (hereinafter the 'draft law').

The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community and the third and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions[1], as the draft law relates to the Central Bank and Financial Services Authority of Ireland (CBFSAI) and rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft law

1.1 The purposes of the draft law are, *inter alia*, to remove uncertainty about the valuation and location of certain assets of credit institutions of systemic importance to the Irish economy, to facilitate their restructuring, to restore confidence in the banking sector, to facilitate the availability of credit in the Irish financial markets, and to address the serious threat to the Irish economy and the stability of credit institutions in Ireland generally[2]. To this end, the draft law provides for the establishment of a corporate body, the National Asset Management Agency (NAMA), to acquire eligible bank assets from participating institutions, expeditiously deal with the assets acquired by it and protect or otherwise enhance the long-term economic value of those assets, in the interests of the Irish State[3]. According to the Minister, the potential maximum book value of loans that will be transferred to the NAMA is estimated to be in the region of EUR 80 to EUR 90 billion, although the amount paid by NAMA will be significantly less than this to reflect the loss in value of the

1 OJ L 189, 3.7.1998, p. 42.

2 Section 2 of the draft law.

3 Sections 9 and 10 of the draft law.

assets[4]. Regarding the payment for bank assets, NAMA or the NAMA group entity which acquires the bank asset concerned will transfer or issue to the participating institution debt securities issued by the Minister, NAMA or the relevant NAMA group entity equal to the acquisition value of the bank asset[5]. As noted by the Minister, replacing property related loans with Irish Government bonds will strengthen the balance sheets of the banks and this will increase their capacity to access liquidity in the financial markets and, if necessary, through Eurosystem liquidity operations, making them better able to lend and support the Irish economy[6].

1.2 Under the draft law, a credit institution may apply to the Minister, within 28 days (or such longer period that the Minister prescribes) after the establishment date for the scheme, for it and its subsidiaries to be designated as participating institutions[7]. The Minister, after consultation with the Governor of the CBFSAI and the Irish Financial Services Regulatory Authority (hereinafter the 'Regulatory Authority'), may designate a credit institution as a participating institution if satisfied that: (a) the credit institution is systemically important to the financial system in Ireland; and (b) the acquisition of eligible bank assets from the credit institution is necessary to achieve the purposes of the draft law, having regard to (i) support available to, or received by, the credit institution from the State, any other Member State or a member of the group of the credit institution, (ii) the financial situation of the credit institution, and (iii) the resources available to the Minister[8].

1.3 Under the draft law, the Minister may, after consultation with NAMA, the Governor of the CBFSAI and the Regulatory Authority, prescribe classes of bank asset as eligible bank assets, including: (a) credit facilities provided by a participating institution for the purpose of purchasing, exploiting or developing development land, or where the security connected with the credit facility is development land or an interest in a company engaged in purchasing, exploiting or developing development land; (b) other credit facilities whose total indebtedness is such that, in the Minister's opinion, acquisition by NAMA is necessary for the purposes of the draft law; and (c) any other class of bank asset the acquisition of which, in the Minister's opinion, is necessary for the purposes of the draft law[9]. A class of bank asset so prescribed by the Minister will not include any bank asset entered on a participating institution's balance sheet after 31 December 2008 (although bank assets that are renegotiated, restructured or refinanced after that date may be included provided they were entered on the balance sheet on or before 31 December 2008)[10]. Eligible assets may include foreign assets, meaning bank assets governed in whole or in part by the law of a State or territory other than Ireland[11].

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4 Financial Statement of the Minister for Finance, 7 April 2009, available on the Department of Finance's website at: www.budget.gov.ie.

5 Section 68(2) and (3) of the draft law.

6 Statement by Minister for Finance on NAMA legislation draft paper, 30 July 2009, available on the Department of Finance's website at www.finance.gov.ie.

7 Section 53(1) of the draft law.

8 Section 55(1) of the draft law.

9 Section 56(1) of the draft law.

10 Section 56(4) and (5) of the draft law.

11 Section 67 of the draft law.

1.4 Under the draft law, the acquisition value of a bank asset is its long-term economic value as determined by NAMA, meaning the value that it can reasonably be expected to attain in a stable financial system when current crisis conditions are ameliorated[12]. NAMA will determine the long-term economic value of a bank asset by reference to: (a) the current market value of the property comprised in the security for the credit facility; (b) the current market value of the bank asset by reference to market rates and accepted market methodology; and (c) the long-term economic value of the property, meaning 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[13].

1.5 In determining the acquisition value of a bank asset, NAMA will have regard to: (a) any value that the participating institution concerned submits as being, in its opinion, the current market value of the property comprised in the security for the credit facility; (b) the acquisition value already determined in accordance with the valuation methodology of another similar bank asset; (c) the credit worthiness of the debtor or obligor concerned; (d) the performance history of the debtor or obligor in respect of that asset; and (e) any reports of an expert furnished to NAMA concerning factors relevant to the determination of the value of property or property of a particular type or in specific locations or with specific features[14].

1.6 The Minister may make regulations providing for adjustment factors to be taken into account in determining the long-term economic value of a bank asset and the property comprised in the security for a credit facility, having regard to: (a) Community State aid rules and any relevant Commission guidance; (b) in relation to determining the long-term economic value of the property, the extent to which the price or yield of the asset has deviated from the long-term historical average, supply and demand projections by reference to the type of asset and its location, macroeconomic projections for growth in GDP and inflation, demographic projections, land and zoning considerations, and future transport planning; (c) in relation to the long-term economic value of bank assets, the net present value of the anticipated income stream associated with the loan asset, current and projected vacancy rates for rental property, loan margins, an appropriate discount to reflect NAMA's cost of funds plus a margin that represents an adequate remuneration to the State that takes account of the risk in relation to the bank assets acquired by NAMA, the mark-to-market value of any derivative contracts associated with the bank asset, any ancillary security (e.g., personal guarantees, corporate assets), fees reflecting the costs of loan operation, maintenance and enforcement; and (d) any other matter that the Minister considers relevant[15].

12 Sections 58(1)(d) and 58(2) of the draft law.

13 Sections 58(1)(c) and 58(3) of the draft law.

14 Section 58(6) of the draft law.

15 Section 59 of the draft law.

1.7 Under the draft law, NAMA will be required to determine the long-term economic value of a bank asset in accordance with, *inter alia*, Community State aid rules[16]. In this respect, NAMA may, if it considers it appropriate after consultation with the Minister, and subject to any regulations made by the Minister for this purpose, having regard to, *inter alia*, Community State aid rules, determine that the acquisition value to be assigned to particular bank assets or class of bank assets will be their current market value or a greater value (not exceeding their long-term economic value) that NAMA considers appropriate in the circumstances[17].

1.8 The draft law contains detailed provisions on adjudication by a valuation panel having relevant expertise on disputes referred to it by NAMA relating to the eligibility of assets for acquisition by NAMA and the total portfolio acquisition value determined by NAMA[18]. Regarding disputes over total portfolio acquisition values, the valuation panel advises the Minister as to the correctness of NAMA's valuation having regard to current market values; on this basis the Minister may either confirm the advice of the valuation panel or remit the matter to the valuation panel for reconsideration[19]. Where the current market value of the portfolio concerned is not greater than the acquisition value of the portfolio, no adjustment will be made to the total portfolio acquisition value regardless of the basis on which that value was determined[20]. Subject to this, where the Minister's determination is that the total portfolio acquisition value of the acquired portfolio as determined by NAMA should be increased, the Minister may direct NAMA to compensate the participating institution[21].

1.9 The draft law provides that the Regulatory Authority may, with the Minister's approval, give directions to participating institutions in order to achieve the purposes of the draft law, to restrict balance sheet growth, restrict the institution's ability to take over other credit institutions, require balance sheet reduction or restrict or require consolidation and merger of participating institutions[22]. The Minister, after consultation with the Governor of the CBFSAI and the Regulatory Authority, may direct a participating institution to draw up, submit or amend, within a specified period, a restructuring plan or a business plan[23].

1.10 Regarding NAMA's administrative functioning, under the draft law there will be a Board of NAMA[24]. The Minister may advance to NAMA (or a NAMA group entity) such sums of money as are necessary for performance of its functions, and NAMA (or a NAMA group entity) may, with

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16 Section 58(3) of the draft law.

17 Section 58(4), (5) and (6) of the draft law.

18 Sections 72, 76 and 96 to 104 of the draft law.

19 Sections 101 and 102 of the draft law.

20 Section 102(3) of the draft law.

21 Section 102(4) of the draft law.

22 Section 174 of the draft law.

23 Section 176 of the draft law.

24 The NAMA Board will comprise seven members appointed by the Minister, the Chief Executive Officer (CEO) of the Irish Government's debt management agency, the National Treasury Management Agency (NTMA), which will provide resources and staff to NAMA, and the CEO of NAMA, who will be appointed by the Minister after consultation with the NAMA Chairperson and the NTMA CEO. Sections 17 to 41 of the draft law.

the Minister's approval, borrow, with or without the Minister's guarantee, such sums as it determines to be necessary for the performance of its functions (including debt securities borrowed from the Minister or NTMA and debt securities issued by NAMA or a NAMA group entity to provide consideration for the acquisition of bank assets)[25]. The Minister, after consultation with the Governor of the CBFSAI, may issue written guidelines to NAMA in connection with any of its functions under the draft law, and may give binding written directions to NAMA concerning the achievement of the draft law's purposes[26]. NAMA is otherwise stated to be independent in the performance of its functions[27]. In general, neither NAMA nor any NAMA group entity will be taken to be providing a service or carrying out an activity which would require it to be authorised or regulated by the CBFSAI[28].

2. General observations

2.1 In line with its previous opinions, the ECB emphasises that, when adopting measures to deal with the financial crisis, Member States should act in a coordinated manner in order to avoid significant differences in national implementation having a counter-productive effect, which may involve distortions in global banking markets. Moreover, it is crucial to ensure consistency with the management of liquidity and with the operational framework of the Eurosystem[29]. Against this background, any measure implemented in an individual Member State should ensure a sufficiently level playing field within the euro area, which is of key importance to maintain the integrity of the euro area banking system.

2.2 It is understood that NAMA will not purchase any assets eligible as collateral in Eurosystem operations. NAMA may of course purchase assets that could alternatively be used as underlying assets for Eurosystem eligible asset-backed securities. However, as NAMA will finance asset acquisitions by transferring newly-issued bonds issued or guaranteed by the Irish State to participating institutions, it may be expected that NAMA's activities will increase the amount of Eurosystem eligible collateral available to Eurosystem counterparties. Irish Eurosystem counterparties may therefore find it easier to raise liquidity in central bank operations. Moreover, as government bonds are generally accepted as collateral in interbank repo markets, Irish banks may be in a better position to borrow in the market. Accordingly, the NAMA scheme may contribute to improve the funding situation of Irish banks.

2.3 Regarding the features and implementation modalities of asset support schemes, the Eurosystem has developed a number of guiding principles aimed at attaining the following objectives: (i) safeguarding financial stability and restoring the provision of credit to the private sector while

25 Section 44 of the draft law.

26 Sections 13 and 14 of the draft law.

27 Section 9(3) of the draft law.

28 Section 183 of the draft law.

29 See, for example, Opinion CON/2009/54. All ECB Opinions are published on the ECB's website at www.ecb.europa.eu.

limiting moral hazard; (ii) ensuring that a level playing field within the single market is maintained to the maximum extent possible; and (iii) containing the impact of possible asset support measures on public finances.

2.4 The Eurosystem has identified seven guiding principles which can be seen as sufficiently broad to apply to all schemes falling under the wide category of asset support measures[30]. The NAMA asset removal scheme is broadly consistent with these principles.

2.4.1 First, participation in the NAMA scheme is voluntary, and the eligibility criteria have been carefully crafted so as to ensure that institutions with the largest concentration of impaired assets will be given priority, having due regard to the systemic relevance of the institutions concerned, as well as the support available to these institutions from other sources and the financial situation of individual institutions.

2.4.2 Second, while eligible assets are largely focused on development loans arising out of projects both within and outside Ireland, the draft law contains the necessary degree of flexibility to allow the classes of assets eligible for acquisition by NAMA to be expanded, thereby ensuring that the definition of eligible assets is, in legal terms, kept relatively broad. Also, by excluding assets entering institutions' balance sheets after 31 December 2008, the NAMA asset removal scheme does not provide banks with wrong incentives, encouraging them to originate assets following the announcement of the scheme.

2.4.3 Third, regarding the valuation of eligible assets, asset-specific haircuts on the eligible assets' book values appear to be contemplated, and independent third-party expert opinions play a role in the valuation process for the NAMA scheme. The detailed provisions of the draft law regarding valuation issues reflect the fact that the pricing of eligible assets is a crucial and complex issue that is likely to determine the overall success of the NAMA scheme. 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[31]. 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.

2.4.4 Fourth, regarding risk-sharing between NAMA and the participating institutions, the ECB understands that in the longer-term, if NAMA were to fall short of recouping all of the costs of the

30 Guiding Principles for Bank Asset Support Schemes, 25 February 2009, available on the ECB's website at www.ecb.europa.eu.

31 See, for example, Opinion CON/2008/52 and Opinion CON2008/60.

scheme, the Irish government intends that a levy should be applied to recoup any shortfall[32]. The ECB considers that a guiding principle for the scheme should be that there is an adequate degree of risk sharing in order to limit the cost to the government, to provide the right incentives and to maintain a level playing field across the participating institutions.

2.4.5 Fifth, the NAMA asset removal scheme appears to be constructed so as to have a sufficiently long duration to address the significant challenges presented by such a scheme. This is counter-balanced by the imposition of a 28-day extendible deadline within which credit institutions must apply to participate in the scheme, which should support the need for the scheme to be temporary in nature, and the need for harmonisation across the EU, and in particular within the euro area, which is of crucial importance.

2.4.6 Sixth, the ECB notes that the Irish Government shares the guiding principle that the preservation of private ownership is preferable to nationalisation[33]. If the NAMA scheme will be successful in this respect, this strategy should help to avoid, in the short-term, the high costs involved in nationalisations and, in the medium-term, the risk of banks' objectives being diverted from profit maximisation to alternative goals that might distort the market structure and jeopardise the level playing field.

2.4.7 Seventh, given that an ultimate aim of any asset removal scheme is to help banks restore an adequate flow of lending into the economy and, to the extent possible, avoid large scale and expensive direct government ownership, it will be necessary to carefully monitor the institutions participating in the NAMA scheme to ensure that their self-interest does not cause them to focus on preserving and rebuilding their own equity, instead of lending into the economy.

2.5 The ECB welcomes that the NAMA scheme has been designed to comply with Community State aid rules.

3. Specific comments

3.1 *Role of the CBFSAI*

The ECB understands that the role of the Governor of the CBFSAI will be exclusively limited to providing advice and opinions through consultations on the activation and operation of the scheme and the restructuring and business plans of participating institutions. The provisions of the draft law requiring the Governor of the CBFSAI to be consulted with respect to various matters should reinforce the Governor's financial stability responsibilities under Irish law. While the ECB appreciates that the provisions of the draft law recognise the CBFSAI's expertise in this field, the ECB emphasises that functions to be performed by the CBFSAI for the benefit of the scheme must

32 Opening Statement to Joint Committee on Finance and the Public Sector by the Minister for Finance, 26 May 2009, available on the Department of Finance's website at www.finance.gov.ie.

33 Opening Statement to Joint Committee on Finance and the Public Sector by the Minister for Finance, 26 May 2009, available on the Department of Finance's website at www.finance.gov.ie.

be conducted in a manner that is fully compatible with the CBFSAI's institutional and financial independence, in order to safeguard the proper performance of its existing tasks under the Treaty and the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the 'Statute of the ESCB'). In this regard, the ECB welcomes that the provision of the draft law authorising the Governor to disclose to the Minister and the Regulatory Authority any information that the Governor receives concerning a participating institution or any of its subsidiaries is subject to the requirements of the Treaties governing the European Communities and the Statute of the ESCB[34]. The ECB also welcomes the clarification that nothing in the draft law prevents the Governor or the Regulatory Authority from performing their functions in relation to any credit institution or other person authorised or regulated in the State, or affects any obligation arising under the Treaties governing the European Communities[35]. The specific manner in which this latter provision is formulated could be helpfully aligned with similar provisions of Irish legislation adopted during the current financial crisis which are designed to protect the independent performance by the CBFSAI of the tasks and duties conferred upon the CBFSAI by the Treaty, and which also make explicit reference to the obligations arising under the provisions of the ESCB Statute annexed to the Treaty[36].

3.2 *Prohibition of monetary financing*

It is understood that the draft law will comply fully with the prohibition of monetary financing laid down in Article 101(1) of the Treaty, read in conjunction with Council Regulation (EC) No 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 [now 101] and 104b(1) [now 103(1)] of the Treaty ('Council Regulation (EC) No 3603/93')[37]. In this respect, NAMA will qualify as a 'public undertaking' within the meaning of Article 101(1) of the Treaty and Article 8 of Council Regulation (EC) No 3603/93 as NAMA is to be established under the draft law as a 'public undertaking' over which the Irish State may exercise a dominant influence by virtue of its ownership of it, its financial participation therein and the rules which govern it. In particular, the Minister advances to NAMA the funds that are necessary for performance of its functions, and appoints all the members of the NAMA Board. Moreover, the Minister (after consultation with the CBFSAI Governor, acting independently) will have the power to issue written guidelines to NAMA in connection with its functions, and may give binding written directions to NAMA concerning the achievement of NAMA's purposes. NAMA's assets will thus be under the effective control of the Irish State. Therefore, overdraft facilities or any other type of credit facility with the CBFSAI in favour of NAMA, as well as the direct purchase from NAMA by ESCB central banks of debt instruments, will not be possible, in view of the prohibition of monetary financing under Article 101 of the Treaty.

34 Section 173 of the draft law.

35 Section 3 of the draft law.

36 See, for example, section 2(3) of the Anglo Irish Bank Corporation Act 2009.

37 OJ L 332, 31.12.1993, p. 1.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 31 August 2009.

[signed]

The President of the ECB

Jean-Claude TRICHET