

**Address by Frank Daly,  
Chairman of the National Asset Management Agency,  
at the Association of Compliance Officers Annual Dinner**

**Thursday, 27<sup>th</sup> May 2010**

#### Introduction

Thank you for the invitation to be the Guest Speaker at the Association's Annual Dinner. It is perhaps apt that the Chairman of the National Asset Management Agency should be addressing a body devoted to compliance given that NAMA owes its existence to a number of critical and interconnected failures in compliance, regulation, risk management and governance. NAMA was established to deal with the consequences of serious governance failures in a number of Irish financial institutions, failures which were compounded by inadequate regulation.

#### Failures

The results of such failures are all too evident: an excessive concentration of lending to one sector, an excessive concentration of lending to a small number of borrowers within that sector and a banking system which has been paralysed by the scale of its self-inflicted losses. We estimate that some €50 billion was advanced by the five participating institutions to the largest 100 borrowers whose loans are being acquired by NAMA. About €16 billion of this was advanced to the largest ten borrowers. Most of these borrowers had also borrowed from other institutions. The scale of this concentration of risk within institutions and across institutions is hard to understand.

Governance failures were not just a matter of scale.

Due process was also a victim of the rush to lend: it has become increasingly clear during NAMA's loan due diligence process that much of this lending was carried out in haste and inadequately secured and documented. The causes of these failures and the mindset which led to them will, I hope, be better understood some day soon as others compile the story of that time. However I did come across recently, in a different context, a reference by the psychologist Irving Janis which resonated strongly with me, and may with you, in that matter of the mindset of the time.

Janis was fascinated by the ways in which groups that were comprised of otherwise intelligent, well meaning and moral individuals could make decisions that turned out to be unintelligent and have unfortunate consequences. In 1972 he coined the term "groupthink" to describe the conditions under which this happened and noted a range of symptoms of this process. Among these he included;

- the illusion of invulnerability that creates excessive optimism, makes people ignore obvious dangers and encourages excessive risk taking;
- unquestioning belief in the inherent morality of the group that inclines people to ignore the ethical or moral consequences of their decisions;
- collective rationalisation in which people discount warnings that challenge the group consensus;
- self-censorship, by which doubts and deviations from the perceived group consensus are not expressed or tolerated;
- stereotyping those opposed to the group as weak, biased, impotent or stupid;
- direct pressure to conform placed on any member who questions the group couched in terms of disloyalty.

Strike a chord perhaps?

Whatever the causes, whatever the mindset, NAMA's role is to deal, professionally and robustly with the consequences.

#### NAMA now

Before turning specifically to compliance matters, I wish first to outline where the NAMA process currently stands. The Minister announced the decision to establish NAMA in April 2009 and what followed was an intensive drafting effort which culminated in one of the most complex pieces of legislation ever to be enacted by the Oireachtas. The National Asset Management Agency Act, 2009

was passed in November and the Agency was formally established just before Christmas. NAMA is essentially an asset management agency, not a “toxic” or “bad” bank. It will acquire performing and non-performing property-related loans from the five participating institutions. Relieved of these inert exposures and provided with securities which can be used as collateral with the ECB and with the market, the aim is that institutions will revert to their core business of commercial and personal lending and thereby facilitate the process of economic recovery.

NAMA will acquire about €81 billion of loans but, as consideration, will pay significantly less than that. The price paid for a loan by NAMA will be based, to a large extent, on the current market value of the underlying property. In many cases, that current market value of the property may be uplifted to reflect NAMA’s view of its long-term prospects. This is the price that NAMA can realistically expect to realise on the property over a seven to ten year horizon, otherwise known as its long-term economic value. The average uplift in the first tranche of loans recently transferred was 11% relative to current market values. In other words, NAMA is not making any heroic assumptions that price levels in the Irish and UK property markets will revert to the levels seen over much of the past decade.

In essence, NAMA’s core objective will be to recover for the taxpayer whatever it has paid for the loans in addition to whatever it has invested to enhance property assets underlying those loans. It is expected that NAMA will have a lifespan of seven to ten years and when it has achieved its core objective, it will be wound up. After 2012 and every five years thereafter, the Minister will review the extent to which NAMA has made progress towards achieving its objectives and will decide whether its continued existence is warranted. If, by the time its work is finished, NAMA has made a surplus, that surplus will accrue to the taxpayer. If, however, it has made a loss over its lifetime, a tax surcharge will be applied to the participating institutions to make up the shortfall.

NAMA will be acquiring loans, not property. The extent to which it acquires property will depend on the viability of borrowers and the extent to which they are willing to co-operate. If they continue to service their loans, little will change from their perspective. However, we know, of course, that many borrowers are in distress and in no position to service all the debts that they have accumulated. NAMA will be in a position to assess each borrower’s viability more rigorously and impartially than banks have done to date. Moreover, this assessment will be based on the borrower’s aggregate exposure to all institutions, not the limited view that each institution has had to date.

After their loans have been acquired by NAMA, borrowers will be asked to produce business plans which will set out detailed and credible targets for reducing their debt, including any asset disposals which will contribute to that end. A panel has been set up to facilitate NAMA in its appraisal of borrower business plans. There will be an onus on borrowers to prove their medium-term viability and this must be based on a realistic assessment of their prospects given the current over-supply of property, likely trends in demand, in prices and in rents and the future growth prospects of the Irish economy. As regards growth, the core underlying assumption will be that the economy will revert to moderate rates of growth over much of the coming decade. The outlook for demand will vary significantly by region and by sector: in addition to loans for the landbanks and the ‘ghost’ estates that are much discussed, about a third of the loans acquired by NAMA will be backed by property in the UK, much of it in the south of England. There will also be a significant number of loans for prime properties in Dublin and in other cities.

We have made significant progress in relation to the acquisition of loans. Transfer of the first tranche has now been completed and over €15 billion of loans has been acquired from AIB, Bank of Ireland, Irish Nationwide, EBS and Anglo Irish Bank. For these, the consideration paid was €7.7 billion, a discount of about 50%. With the second and third loan tranches amounting to about €21 billion transferring over the coming months, we aim to have about half of the overall transfer completed by the end of July. Our aim is to transfer the remaining loans from the five institutions by the end of the year and certainly no later than end February 2011, the deadline set by the EU Commission.

As Chairman of the Board of NAMA, I am aware that significant milestones have been passed but also that the road ahead is likely to be uneven. The NAMA Board will, over the coming months, dedicate itself to developing strategies for managing its portfolio of loan assets and any property assets that it may acquire. Some key decisions will need to be made about borrowers based on their assets and their prospects of significantly reducing their debt. Strategies will need to be developed for the potential sale of loans or loan portfolios. A key project will be an extensive analysis of supply and demand factors at

work for different regions and asset classes; this will enable NAMA to develop appropriate and informed strategies for regions and asset classes.

Much of the public debate prior to NAMA's establishment was centred on the argument that NAMA was a bailout for banks and borrowers on the assumption that it would overpay for its acquired assets and prop up borrowers who were essentially unviable. I would hope that NAMA has already established clearly that, based on a 50% discount in the first tranche, it is paying no more or less than a fair price to the banks for their loans. I also expect that borrowers will find NAMA equally formidable in the forthcoming detailed discussions about their business plans. The challenges ahead remain daunting but I have great confidence that NAMA can successfully deliver for the taxpayer on the task which that has been set for it.

#### Compliance

Let me turn now to issues which may be of more direct interest to members of this Association. The background to NAMA's establishment meant that there was always going to be a heavy emphasis in the legislation on ensuring that NAMA was perceived to be above reproach in matters of compliance.

The NAMA Act deals with a number of compliance issues such as conflicts of interest, data confidentiality and lobbying. The issue of conflicts of interest has been a regular topic for discussion in sections of the media. The key obligation under the Act is that of disclosure of interests, whether actual, potential or indeed perceived. Section 30 of the Act provides that a member of the NAMA Board must disclose any pecuniary or beneficial interest he or she may have in any matter under consideration by the Board. The Act is clear in setting out how potential conflicts should be managed. A Board member may not influence nor seek to influence a decision to be made in relation to the matter under discussion; he or she may take no part in any consideration of the matter; he or she must absent themselves from the meeting or that part of the meeting during which the matter is discussed and he or she may not vote on a decision relating to the matter. If the Minister is satisfied that a Board member has contravened these requirements, he may remove that member from office. Supplementing this is a requirement under Section 31 of the Act, that Board members and NAMA officers provide, on an annual basis, a statement of their interests to NAMA.

There are other restrictions. A NAMA officer cannot hold a company directorship without the approval of the CEO. Furthermore, he or she is not permitted to accept any hospitality from any person, client, firm, company or other legal entity with which NAMA has dealings. This is an absolute restriction – there are no *de minimus* exceptions. There are also restrictions on personal account transactions in the form of prohibitions on dealing in quoted Irish financial and property shares and associated instruments, in commercial property and in property funds in Ireland and the UK.

You may also be aware of the fact that, under Section 221 of the Act, it is an offence to lobby NAMA. What may be less well known is that an officer or Board member of NAMA, if he or she is the subject of such lobbying, is obliged to report the matter to the Garda Síochána and failure to do so is also an offence. A person who commits either of these offences is liable to a fine or imprisonment or both. There are also, as you would expect, stringent data confidentiality requirements which restrict the circulation of data which NAMA officers acquire in the course of their duties.

The question of potential conflicts of interest among service providers is also one that has received some comment. The guiding principle here has also been one of disclosure. Under Section 45 of the Act, NAMA must seek to ensure that expert advisers and service providers make every effort to avoid or manage conflicts of interest and to declare any potential or actual conflicts to NAMA. In the case of legal firms or property valuers, for instance, they have been required to declare in advance the institutions and borrowers for whom they have carried out work in the past. This information is used by NAMA to allocate workload so that conflicts can be effectively managed. Contrary to what seems to be implied by some public comment, it would not be possible for NAMA to carry out a very thorough due diligence process without recourse to the relevant valuation and legal expertise. Taxpayers are entitled to the assurance that the loan assets being acquired on their behalf are properly secured and fairly valued. In a small country, the pool of professional expertise available to carry out this work is limited so that conflicts, rather than being avoided, must instead be addressed and managed.

As I have said there is a heavy emphasis in the NAMA Act on ensuring that NAMA is, and is perceived to be, above reproach in terms of compliance. This is absolutely as it should be. No matter

how serious the crisis in which we find ourselves, there can be no shortcuts in how we deal with it. Compliance should never be an optional extra, a safe haven to which we retreat when things get rough. It should be at the core of how we do business in this country. The NAMA Board, from the beginning, has been keen to ensure that it adopts best practice in terms of the various compliance issues that arise for it. Hopefully, one of the lessons that may have been learned from the events of recent years is that best practice compliance and commercial success are not in conflict with each other; rather one is the foundation on which the other can be solidly built.

If I may finish on a personal note in regard to compliance.

I spent most of my 40 years in public service in an organisation where difficult encounters with the ordinary citizens of this country could not be avoided – and some of those encounters were very difficult indeed!

Not one of them however approached an encounter in January 2009 which for me was extraordinary in terms of the anger, emotion and distress which I witnessed. I refer to EGM of Anglo Irish Bank in the Mansion House, where, as a newly appointed Public Interest Director I sat on the podium as the nationalisation of Anglo Irish Bank was confirmed to hundreds of shareholders and as it dawned on them that their shareholdings were probably worth next to nothing. I witnessed palpable distress that day. Not the distress of large investment undertakings, corporates or sophisticated market players. The distress was that of ordinary people, who had been assured that investments in banks were safe and who now realised that the reality was quite the opposite. To see those ordinary people realising that their capital and income stream - their nest eggs for the future, their legacies to their children, their chances of a holiday – were all gone, was a scene I would not wish to witness again. Even worse perhaps is the damage it did to their confidence in the system and their own self-confidence.

What's that got to do with compliance? Everything.

We are changing for the better our attitude in this country to compliance and regulation – and I pay tribute this evening to the role that members of the ACOI are playing in that. We are, quite properly, having robust debates about compliance and regulation in terms of policies, macro impact, best practice and the like. We are busy analysing its effect on business and economic growth and what model will serve us best in attracting foreign investment.

All well and good.

But let's not forget that in the end compliance comes down to its personal impact – to the positive impact of good compliance and to the disastrous consequences of non compliance for ordinary people. Compliance is about ensuring that there are no more scenes like that in January 2009 in the Mansion House; no more shattered dreams; no more vulnerable people left in fear for their future.

A certain Ms Helmsley once commented cynically to the effect that tax is for little people – in a completely opposite and positive sense, I like to think that compliance **is** for little people.

I know you will not forget this as you continue your good work.

Thank you for the opportunity to have made these comments.