Joaquín ALMUNIA
Vice-President of the Commission
Competition Commissioner
European Commission
B-1049
Brussels
Belgium

[redacted]

Friday, 17th September 2010

Dear Commissioner Almunia

I previously wrote to your predecessor, Commissioner Nellie Kroes, about the Irish National Asset Management Agency (Nama) on 17th December 2009 regarding its original business dated 13th October 2009. At that time, my concerns were related to the manner in which the plan treated rolled-up interest and its failure to provide fully-integrated financial projections (i.e. annual profit and loss accounts and balance sheets) to accompany the published 11-year cashflow projections. For convenience, I attach a copy of my original letter and the Commission's response.

I am now writing to the Commission, as a concerned citizen of Ireland and Irish tax payer, to express serious concerns about further aspects of Nama's business plans, specifically, its revised plan dated 30th June 2010.

Issues

This plan indicated that Nama had adapted the Amortised Cost (Effective Interest Rate) method which considers expected cash flows, not contracted cash flows, on loans. Page 18 explained that:

> "This means that the Profit & Loss account will reflect what is happening in reality in cashflow terms, rather than taking income to the Profit & Loss account that is not cashflow-based e.g. NAMA will not accrue interest rollup to its Profit & Loss account. It reflects an accounting approach which values the loans by taking the "actual" initial value plus future expected cashflows less potential impairments."

Aside from facilitating the "disappearance" of rolled up interest from Nama's projections, this method enables Nama to write down the value of loans acquired from the covered institutions from the very outset. The effect of this can be seen in the maiden quarterly accounts of the National Asset Management Limited Master SPV dated 30th June 1010. I would refer you to the entry of 371,016 (€000) for loans and receivables in the consolidated balance sheet (page 17) and Note 8 (page 23) which shows that the original value of these loans were 814,357 (€000). The accompanying income statement (page 18) makes no reference to this loan write down which amounted to €443 million (54%).

Against this background, I would argue that Nama's updated business plan is misleading and diverges very significantly from its original plan, used to help secure material approvals from the Commission and Eurostat, in the following respects:

1. It excludes rolled-up interest accruing after it acquires loans from the covered institutions[1]. In my initial letter to the Commission, I estimated that this could amount to €10.9 billion over the eleven years commencing 2010. As evidence of this, please observe that Nama's original business plan provided for interest income of €9.46 billion in the budget projections (Table 7 on page 12) for the three years commencing 2010 as compared with cash interest income of only €4.5 billion for the same period (Table 6 on page 10). The difference of €4.96 billion is rolled up interest which disappears, thanks to the accounting methodology, in the updated business plan.
2. The original business plan indicated in a bullet point accompanying the 11-year cash flow projections that "of the €77 billion nominal value of loans acquired, €62 billion will be repaid by borrowers and that loan defaults or debt restructuring will occur on €15 billion (a rate of 20%)". This implied that Nama would be accounting for these transactions via Profit and Loss accounts. Clearly, this is not happening thanks to the use of the Amortised Cost (Effective Interest Rate) method.

   I don't wish to comment in any detail here on the divergences between the projections in Nama's original business plan (which informed its establishment) and its actual experience to date. Clearly, it is paying well above market rates for loans; the proportion of performing loans is much lower than projected; banks are transferring fewer good loans; and discounts are far higher than expected due to poor security and documentation. Most of these performance shortfalls are being disguised by the use of the Amortised Cost (Effective Interest Rate) method.

Concerns

Based on this assessment, I am concerned that (a) the updated business plan diverges in several critical areas from the original plan used by the Commission as a guide when approving Nama's establishment and modus operandi and (b) Nama's use of creative accounting effectively buries about €50 billion of losses comprising €40 billion of loan write offs and €10 billion of uncollected rolled up interest.

These concerns have two significant implications as follows:

1. It becomes much easier for Nama to report an illusionary "profit" when wound up. It also made it possible for the Irish authorities to secure Eurostat approval for the use of a "for-profit" public-private SPV to help exclude Nama's borrowing from Exchequer debt calculations and to claim that Nama was the best solution to Ireland's banking crisis.
2. With the stroke of the pen, Nama is effectively forgiving about €50 billion of debts. Where is the "moral hazard" and justice in this when, based on Nama's creative accounting, every billion euro of discount on the loans being acquired is immediately written off to the benefit of borrowers? Repeated suggestions by the Minister for Finance and Nama that it will pursue debts to the "greatest possible extent" must be

[1] Interest accruing before this event is included in the nominal value of loans being transferred.

taken with a pinch of salt as they don't even appear in Nama's balance sheet or form part of Nama's core objective[2].

Proposals

My suggestions to address the foregoing concerns are as follows:

1. Nama should be obliged to show the full value of the loans being acquired in its balance sheets and to properly account for debt and interest write offs only when all methods of recovery have been exhausted.

   I have raised my concerns about this directly with Nama via an open letter (copy attached) to its board. I received no response from Nama but did secure a response (copy attached) from the office of the Minister for Finance which failed to alleviate my concerns that Nama could end up costing taxpayers tens of billions without disclosing this in its principal financial statements.

2. Section 10 of the Nama Act deals with the purpose of Nama and refers back to Section 2 which states that the Act's purposes include protection of the taxpayer and contributing to social and economic development.

   For the avoidance of doubt and to make matters crystal clear, the Government should be requested to amend the Nama legislation to indicate that maximising the recovery of original debts, over and above the actual cost of acquiring loans and recovering expenses, is an explicit objective under Section 10 Subsection (2) (c). This change together with my first suggestion would eliminate any possible misunderstandings amongst taxpayers or Nama's borrowers. It would also ensure that Nama is not wound up by the Minister for Finance as soon as it reaches break even in cash flow terms. As matters stand, the Minister and Nama have both indicated that Nama could be wound up in as few as 7-10 years in contrast with the much more realistic horizon (given Ireland's very unfavourable and uncertain economic prospects) of 10+ years as originally envisaged.

Conclusion

Let me make a final point which may become relevant. As you will know, the Minister for Finance is proposing to split Anglo Irish Bank into a funding bank and an asset recovery bank which will take over the €38 billion of Anglo's loans that are not being transferred to Nama. According to a Government statement, the recovery bank's "dedicated focus will be on the work-out over a period of time of the assets not being transferred to Nama in a manner that maximises the return to the taxpayer". So, we could have a situation where about €36 billion

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[2] The Chairman of Nama, when speaking at the CPA's Annual Conference on 4th June 2010, sought to clarify Nama's objective in the following terms:

"NAMA's core commercial 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. This objective has not been determined by NAMA; it has, in fact, been set for us by the legislature under Section 10 of the NAMA Act. There has been some comment that the consequence of this objective is that NAMA, having recovered its outlay, will then absolve borrowers of their further obligations. This is absolutely not the case. Borrowers, as both I and NAMA's CEO Brendan McDonagh have already said on a number of occasions, will continue to be liable for the debts that they have incurred."

of Anglo's loans (minimum loan threshold of €5 million) are going into Nama at a discount of about 60% while €38 billion of smaller loans are transferred to the proposed asset recovery bank at no discount. These divergent approaches, by two very similar bodies, point to discriminatory practices with larger borrowers effectively benefiting from up-front write-downs which would not be applied to smaller borrowers.

I believe that my concerns merit consideration by the Commission and I would welcome any investigation that the Commission would undertake into them.

Finally, could I ask your office to email me at brian@planware.org to confirm receipt of this letter?

Yours sincerely

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Brian Flanagan

Enclosures (4)