



Dún Laoghaire Constituency



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Ms Catherine Day
Secretary General
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By post & email

18th August 2010

Dear Ms. Day,

**RE: *National Asset Management Agency
Asset Relief Scheme for Banks in Ireland***

The European Commission on the 26th of February 2010 approved the Asset Relief Scheme for banks in Ireland to be administered by the National Asset Management Agency (NAMA), subject to a number of conditions. (State Aid N725/2009-Ireland)

Prior to such approval, I made representations to the Commission in respect of the scale and scope of NAMA and highlighted the potential for distortion of competition in the market.

In order to minimise the distortion of competition, I suggested among other things that *“The European Commission should exclude borrowers from NAMA who have performing loans unconnected to distressed loans that are being acquired by NAMA. This alone would significantly reduce the scale of NAMA, and allow for some continued diversity in the property development and financing markets.”*¹

The Commission in its decision addressed this issue when it stated that *“the Commission views the inclusion of the associated commercial loans as necessary to capture the entire exposure to the impaired borrower relationship as well as to help with aligning the measure with public policy objectives.”*² The underlining premise of

¹ Submission of 12th February 2010.

² Paragraph 138 of Commission’s Decision of 26th February 2010. The footnote to this statement states in the Commission’s Decision that the inclusion of associated commercial loans will help NAMA maximise the recovery obtained on the entire impaired borrower relationship.





the Commission's decision therefore is that there is an *impaired borrower*, who by definition must be the holder of *impaired loans*.

Accordingly, it is fully understandable that where there are commercial loans associated with an *impaired borrower*, that those loans, whether impaired or not, for the reasons outlined by the Commission, be included in the assets which a bank may transfer to NAMA in respect of that impaired borrower. Of course if there is no impaired borrower the issue of transferring associated loans would not arise.

The Commission in its decision clearly sets out the concept of the *impaired borrower*. It states in its decision that "*It is anticipated that the assets will be transferred by 'impaired borrower' exposures across all participating institutions as opposed to transferring portfolio of loans per institution.*"³ Understandably this is designed to ensure that while a borrower may have no impaired loans with one financial institution it may have impaired loans with another such that overall is deemed a *impaired borrower*.

The Commission at paragraph 18 of its decision explains the concept of *impaired borrower*. It states:

"According to the Irish authorities, eligible assets are expected to be concentrated on a small number of very large real estate developers, involved across the whole cycle of property development. Loans to such developers are closely interconnected and interlinked (through cross default and cross guarantee clauses for example as described in footnote 6) which is viewed as significantly contributing to the impairment problems currently threatening credit institutions in Ireland. Therefore, the approach to determining asset eligibility under the scheme is based on the concept of impairment at the borrower relationship level as opposed to impairment at the asset level only (impaired borrower relationship)."

Bearing in mind the extraordinary potential for distortion of competition in the Irish market, given the scale and scope of NAMA, and the efforts made by the European Commission to prevent such distortion of competition by attaching a series of conditions in its approval of the NAMA Asset Relief Scheme for the banks in Ireland, it is of fundamental importance that NAMA, which has been granted unprecedented powers, does not assume even greater powers than that intended and begin to operate outside the scope of the Commission's decision.

In this context, I have had sight of media reports and received representations which suggest that NAMA in its implantation of the Asset Relief Scheme is stepping outside the NAMA framework approved by the European Commission by attempting to include the assets of borrowers who have no impaired loans with any Irish financial institutions and is therefore failing to adhere to the criteria laid down by the Commission that it is only the assets of an "*impaired borrower*", as defined at paragraph 10, 18 of the Commission's decision, which can be taken into NAMA.

³ Paragraph 10 of the Decision.



Furthermore, there seems to be an attempt by NAMA to suggest that by reason simply of the size of the loans of a borrower, even though all unimpaired, can on its own justify such loans being transferred to NAMA.

It is acknowledged that the question of whether a loan is an impaired loan or a borrower an impaired borrower is largely a factual question to be decided at national level. However, at this stage clarity is required from the Commission on some of the fundamental principles of the NAMA Asset Relief Scheme it approved in February 2010, in order to:

- (i) Ensure the proper implementation of the asset relief scheme in Ireland, as approved;
- (ii) Prevent unnecessary distortions of competition in the Irish and EU property and banking sector;
- (iii) Avoid complaints to the European Commission and protracted legal disputes in Ireland; and
- (iv) Ensure there are no undue delays in the full implementation of Nama.

Accordingly, I would ask that the Commission would confirm the following:

1. That for the NAMA scheme to apply there must be *impaired loans*⁴ and an *impaired borrower*⁵;
2. That a borrower to be an *impaired borrower* must have *impaired loans*;
3. That, where a borrower has no impaired loans or associated impaired loans, that borrower cannot be considered an *impaired borrower*⁶, and in such circumstances there is no basis for his or her loans/assets with participating Irish banks to be transferred to NAMA.

I ask for this clarification in the light of the Commission's decision, in particular where it sets out what qualifies as Eligible Assets, which no doubt reflects the representations of the Irish Government on the how the Scheme would be operated in this regard:

*The Irish authorities intend to concentrate on assets from the riskiest parts of the portfolios of the participating institutions, namely land and development loans and associated loans. The assets targeted by the measure are (i) all loans issued for the purchase, exploitation or development of land as well as loans either secured or guaranteed by land, and (ii) some of their associated commercial loans.*⁷

⁴ Impaired loans are loans where a borrower fails to meet his payment and/or other loan obligations to Irish participating banks.

⁵ Impaired borrower is one who has impaired loans to the extent that given his entire exposure to Irish banks he is unable to meet is repayment and other loan obligations.

⁶ Within the meaning of paragraph 10 and 18 of the Decision of the Commission of the 26th February 2010.

⁷ Paragraph 15 of Commission Decision of 26th February 2010.



*The associated commercial loans are loans made to a small number of large developers who constitute the largest borrowers in respect of land and development loans. It is anticipated that, given their interconnected nature with land and development loans, these associated commercial loans are likely to become impaired, if not impaired already.*⁸

*These interconnections and inter-linkages between land and development loans and associated commercial loans can take many forms, including the following*⁷:

- *lending whereby the collateral of an associated loan is cross-collateralised or crossdefaulted with land and development loans;*
- *lending whereby the borrower has land and development loan exposure to one credit institution and an associated loan exposure to another credit institution;*
- *lending whereby the security for land and development loan exposure is also security for an associated loan; and*
- *lending whereby the total indebtedness of borrowers and associated obligors (e.g. connected companies, joint venture partners, guarantors) is of an amount that would adversely affect the stability of any of the participating credit institutions or of the financial system in Ireland.*⁹

*According to the Irish authorities, eligible assets are expected to be concentrated on a small number of very large real estate developers, involved across the whole cycle of property development. Loans to such developers are closely interconnected and interlinked (through cross default and cross guarantee clauses for example as described in footnote 6) which is viewed as significantly contributing to the impairment problems currently threatening credit institutions in Ireland. Therefore, the approach to determining asset eligibility under the scheme is based on the concept of impairment at the borrower relationship level as opposed to impairment at the asset level only (impaired borrower relationship).*¹⁰

It may be seen from the Commission's own decision that for assets to qualify as *eligible assets* for the purpose of being transferred to NAMA there must be *impairment, impairment problems and impairment at the borrower relationship level*. Furthermore, a borrower who is not an impaired borrower and has no impaired loans or associated loans cannot by definition adversely affect the stability of a participating credit institution.

It is my view that were NAMA to oblige a bank or banks to transfer the assets/loans of an *unimpaired borrower* as distinct from an *impaired borrower* to it, this would be totally inconsistent with the representations of the Irish Government as referred to above, would be entirely incompatible with the basic objective of the NAMA Asset Relief Scheme and the Commission's own guidelines on the treatment of impaired

⁸ Paragraph 16 of Commission Decision of 26th February 2010.

⁷ The actual definition of associated commercial assets in the Act is quite broad to allow NAMA to capture the entire borrower relationship and root out most of all potential impairments to come from a relationship.

⁹ Paragraph 17 of Commission Decision.

¹⁰ Paragraph 18 of Commission Decision.



assets in the Community's banking sector¹¹ and would constitute an abuse of the Asset Relief Scheme as approved by the Commission on the 26th of February 2010.

I believe it is in the public interest to have these matters clarified by the European Commission in the light of its decision of the 26th of February 2010 and in particular the conditions contained therein, which were designed to avoid serious distortions of competition in the banking and property market.

I would very much appreciate if you could provide the clarifications sought at your earliest convenience.

I look forward to hearing from you.

Yours sincerely,



Eugene Regan

¹¹ Communication from the Commission on the treatment of impaired assets in the Community Banking Sector. 26/3/2009, C72/1.



EUROPEAN COMMISSION

Competition DG

Markets and cases III: Financial services

Brussels, 08/09/2010*D/9004
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Subject: National Asset Management Agency Asset Relief Scheme for Banks in Ireland

Dear Senator Regan,

I refer to your letters dated 18 August 2010 in which you request confirmation on the following issues:

- (1) *That for the NAMA scheme to apply there must be impaired loans¹ and an impaired borrower².*
- (2) *That a borrower to be an impaired borrower must have impaired loans;*
- (3) *That, where a borrower has no impaired loans or associated impaired loans, that borrower cannot be considered an impaired borrower, and in such circumstances there is no basis for his or her loans/assets with participating banks to be transferred to NAMA*

In the decision³ on the case N725/2009 'Establishment of a National Asset Management Agency (NAMA): Asset relief scheme for banks in Ireland', adopted on 26 February 2010 (hereinafter, 'the Decision'), the Commission assessed the information provided by the Irish authorities on the NAMA scheme, and deemed it compatible with the internal market.

¹ Impaired loans are loans where a borrower fails to meet his payment and/or other loan obligations to Irish participating banks.

² Impaired borrower is one who has impaired loans to the extent that given his entire exposure to Irish banks he is unable to meet his repayment and other loan obligations.

³ JOCE C/94/2010 of 14.04.2010

A public version of the decision is available in the following link:

http://ec.europa.eu/community_law/state_aids/comp-2009/n725-09.pdf

The relevant concepts to determine the scope of NAMA's activities are defined in section II of the Decision. In particular, paragraph 10 of the decision states:

'It is anticipated that assets will be transferred by "impaired borrower" exposures across all participating institutions as opposed to transferring portfolio of loans per institution. [...]'

A more detailed definition of the concept of impaired borrower can be found in paragraph 18:

'According to the Irish authorities, eligible assets are expected to be concentrated on a small number of very large real estate developers, involved across the whole cycle of property development. Loans to such developers are closely interconnected and inter-linked (through cross default and cross guarantee clauses for example as described in footnote) which is viewed as significantly contributing to the impairment problems currently threatening credit institutions in Ireland. Therefore, the approach to determining asset eligibility under the scheme is based on the concept of impairment at the borrower relationship level as opposed to impairment at the asset level only (impaired borrower relationship).'

And footnote 6 states:

'The majority of loans include loan-to-value covenants which if breached and not waived will trigger a "technical event of default" on the loan. With the sharp fall in real estate prices, a significant number of these covenants have been breached. The existence of cross default clauses between land and development loans and commercial loans to the same borrower then means that the commercial loan is also in technical default.'

I would like to remark that 'impairment at the asset level' is not a relevant concept to qualify an asset as eligible, as in paragraph 18 of the Decision.

According to the definitions above, the relevant concept to determine whether an asset is eligible or not to be transferred to NAMA is that the debtor on the loan in question is regarded as an 'impaired borrower'. Impaired borrowers, as considered by the Irish authorities *'are expected to be concentrated on a small number of very large real estate developers, involved across the whole cycle of property development'*. Furthermore, it stems from paragraph 18 and footnote 6 that it is the concept 'impaired borrower' which is relevant, instead of 'impairment at the asset level' due to the existence of contractual links among loans, which may trigger a 'technical events of default'.

The Commission's view on the approach adopted by the Irish authorities to determine which assets are eligible is expressed in paragraph 138 of the Decision:

'In particular, the Commission views the inclusion of the associated commercial loans as necessary to capture the entire exposure to the impaired borrower relationship as well as to help with aligning the measure with public policy objectives⁴.

⁴ The inclusion of associated commercial loans will help NAMA maximise the recovery obtained on the entire impaired borrower relationship.

It should be noted that the Commission has considered the criteria included in the National Asset Management Act 2009 (hereinafter, the Act), to assess the compatibility of the State aid measure. In particular, regarding eligibility of assets, the Commission has considered in its assessment articles 69 through 71, together with articles 2 and 10 of the Act.

I hope the references above are helpful to clarify the issues that you mentioned in your letter.

Yours faithfully,

Signed

Dr Irmfried SCHWIMANN
Director

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