Ireland's Banking Problems: Three Questions

Presentation to Oireachtas Committee on Finance and the Public Service

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May 6, 2009

Three Questions

1. What is the scale of the problem with our banks?
2. How do we fix the problem while minimising the cost to the taxpayer?
3. What is the role of NAMA?

The Scale of the Problem: Losses Set To Wipe Out Shareholder Equity

	AIB	BOI
Core Tier 1 Capital	€7.7 billion	€7.3 billion
Estimates of Property-Related Loan Losses:		
Goodbody Stockbrokers	€10.1 billion	€8.6 billion
JP Morgan	€10.8 billion	€8.1 billion
Davy's	€7.5 billion	€4.0 billion
Market Capitalisation	€0.85 billion	€0.77 billion

Facing up to the Scale of the Problem

- Following an analysis by PWC, the Department of Finance has stated that "under extreme stress scenarios" Bank of Ireland only needed the additional €3.5 billion in capital that the government has provided them and that AIB need €5 billion (of which, at least €3.5 billion will come from the state).
- Few believe these figures accurately reflect the scale of loan losses. (PWC do not have a good track record on this issue. Late last year, they stated that none of the banks covered by the guarantee would need additional capital through 2011.)
- Does the government believe these figures?
- If so, why do we need a NAMA?

How Do We Fix the Problem?

- The problem is that property-related losses are wiping out the capital bases of the Irish banks. (This is before factoring in upcoming losses on mortgages, business loans and credit cards.)
- The solution is recapitalisation.
- Until the banks are well-capitalised, international investors will not lend to them unless the state liability guarantee stays in place, with all the risks to the Irish taxpayer that this entails.
- International investors are far more wary now about lending to banks: Capital ratios will need to go to higher levels than prevailed prior to the financial crisis.

Protecting the Taxpayer

- The Irish government is currently the only source of equity capital for our banks.
- Once fully re-capitalised, our leading banks will be profitable institutions with a substantial market value and, as the only provider of equity capital, the taxpayer should receive a corresponding ownership stake.
- The terms of these deals should be fair: €7 billion for a right to purchase one-quarter of banks worth €1 billion on the stock market was not a good deal for the Irish taxpayer.
- Any public ownership stake acquired can then be sold off later.
- This process may require temporary nationalisation.
- The government is rightfully wary of this route. The banks would need to be run as independent commercial operations and readied for privatisation as quickly as possible.

NAMA

- Asset Management Companies to take bad assets off the books of insolvent banks have been used around the world.
- By cleaning up the balance sheet, they remove uncertainty about future losses and allow bank management to focus on the rest of the business.
- But a transfer of assets from a bank to an AMC does not boost equity capital.
- NAMA should not be used as a vehicle for opaque re-capitalisation, in which the government overpays for bad assets.
- I am greatly concerned that (a) Claims that relatively small amounts of capital are required and (b) Government arguments that nationalisation is not the path to go down, are setting us up for this scenario.