(Almost) nobody could read the accounts properly

How Bank of Ireland opened the gateway to private equity and morphed Ireland into a fertile habitat for cuckoos and vultures


Bank of Ireland was vulturised by funds that understood its confusing accounts

By Vanessa Foran

ON 7 April 2009, the Minister for Finance, the late Fianna Fáil TD Brian Lenihan, introduced the National Assets Management Agency, a "bad bank".

In response to the Ministerial announcement, Bank of Ireland assembled an internal 'Specialist Property Group' with the task of identifying what they could sell to Nama.By that September, this Group collated loans styled as 'Financial Assets Held for sale' (AFS). In their announcement, Bank of Ireland stated this AFS was worth €16 billion. This was a valuation already based on better days. This €16 billion toxic loan bundle was responsible for 12% of their total loan book.

Brian Lenihan always made it very clear that Nama would not be stumping up on the valuations the participating banks were citing.

In total, these banks quoted roughly €77.4 billion for these toxic AFS lots.

When all the dust settled; Nama would pay €31.7 billion. So the banks took a 59% price reduction on their 'high hopes' valuations to sell to NAMA.

The Financial Statements for the year ending 31.03.2008 contained within the Annual Report presented at the Bank of Ireland AGM earlier that year (July) reported that they had doubled the rate of impairment charges against their loan book; 14% of total loan book value (LBV) at year-end 2007 as against 28% LBV by 2008. So an avid reader of the Bank of Ireland Annual Report and accompanying Financial Statements would already have know their loan assets were heavily impaired by the time NAMA was instigated.

> Nothing points you to receipts, only to impairments and losses

So the 12% of customer lending assets now being treated as a toxic AFS on the same balance sheet, had already thrashed the bank and its shareholders with impairments.

Providing for estimated bad debts is a standard practice usually based on specific events assessed on industry standards: on payment history and on external factors, like market and regulatory conditions such as taxation and legislation.

What the originating drawdown value of these loans, plus the loss of their expected interest income was before their send-off to Nama, is anyone's guess, but we do at least know, because PWC confirmed it in their Audit Report, that within domestic lending operations alone, standard debt provisions went from €63 million in 2007 or 14% of total LBV, to 0 28% LBV (or €146 million) by year end 2008. You might now also recognise that Bank of Ireland was still aggressively growing its loan book throughout 2008.

Then there are additional Impairment Charges. In the Annual Report for the nine months of the year to 31.12.2009, "impairment charges" are mentioned 73 times. Of the total Impairment Charges subtracted from the Loan Books, 55% of them or € 2.778 billion had to be taken from that AFS, leaving it worth €12.235 billion within months of its €16 billion promise, before getting further treatment in the small print of notes.

What the drawdown worth of the individual loans

> Between 2007 and 2010, if mentioning massive write-downs within the audit report and the published Financial Statements was not technically a statutory and regulatory requirement, then you might still have expected the CEO's report and the Chair's report to have been blunter and more upfront

within that AFS might have been when contracts were signed between the creditor bank and the borrowing debtor could give rise to some dirty thoughts, because that is the stage and value when agents' commissions and bankers' bonuses gets earned.

In fact, I would contend that there is a public right to know about these sums, even as a 'How it started; how it's going' exercise. We did after all guarantee and pay for many of the loans, after bonus' and commissions were paid out.

Those loans might have had vastly different originating values to where they now ended up, in an impaired toxic bundle quoting €16 billion in September 2009, that dwindled to €12.235 billion by December, that when matched with its year-end Impairment Adjustment, if you managed to follow it through the notes.(pg 204-205 Note 25) was really €9.457 billion.

The purpose of financial information is to help users make decisions and form opinions. My own confident opinion is that if all their original contract drawdown values were combined, then a value of upwards of €40 billion for that €16 billion AFS bundle is not impossible.

By the end of 2012, when all the different transfer stages were completed, Nama agreed €5.433 billion for this AFS. Paid by using Nama bonds of different shapes.

None of us would have known this, as none of the consideration is lined out as income earned; or as a benefit receipted from the sale of a material asset, even a toxic held-for-sale asset, on the bank's 2010 Income Statement. That is the trading period during which the vast bulk of this loan book moved out from Bank of Ireland.

No matter who was reading those accounts, this AFS asset was most definitely material (capable of influencing a decision) to the financial position of Bank of Ireland as 12% of Total Lending Assets makes it material, even if based on a March 2009 Balance Sheet position; 12% of total lending assets is self-evidently material.

If you were reading those accounts, you might have got the gist of the sales to Nama from the netting and rounding off you can make out within the notes (specifically 15, & 16, pg 240 YE2010). These all declared the impairments and movements in losses, but not the consideration or benefit received.

Likewise in the 2010 Cashflow Statement nothing points you to receipts, only to impairments and losses.

The post-transfer losses of this Bank of Ireland AFS Loan Bundle were now around €10 billion.

There is commentary in notes, small print of course, and there is mention of the loss being limited to €9.45 billion (pg 220 Critical Estimates and Judgements: also, pg 251 Note 28).

When values are reported in millions and billions, rounding can be significant. However, even from the September 2009 market announcement informing the world of Bank of Ireland's newly prepared €16 billion toxic loan bundle, tracking its eventual outcome for Bank of Ireland requires travelling through several years annual reports, and their attached Auditors Report and Financial Statements, plus the hundreds of pages of small print that come with them each year.

Between 2007 and 2010, to a reader or user of those accounts - say a distressed shareholder being forced to make a critical decision about their pension pot in Bank of Ireland shares - specific big-ticket disposals, particularly of income-earning assets that had already cost them significant impairment charges against income, and left them with massive write-downs on the balance sheets, should have been much more clearly flagged.

If mentioning it within the audit report and the published Financial Statements was not technically a statutory and regulatory requirement, then you might still have expected the CEO's report and the Chair's report to have been blunter and more upfront.

Material information was spread around different chapters - the Chair's Report, the CEO's Report, the Operational Review, the Governance Section and then the Auditors Report leading you into the Financial Statements and the miasma of notes.

Village considers this transfer of a loan portfolio from Bank of Ireland to Nama required far more prominence within the annual reports, and with dedicated notices from their Investor Relations division. Its significance should have been explicated from the top table at AGMs and debated on the floor.

Remember not only did Bank of Ireland dispose of material loan assets at significant discounts, it also lost the opportunity to earn further interest income; and that is what really keeps the lights on, and provides assurances for ongoing viability. And viability is what really permits the Going Concern basis for conducting Audits, particularly at a time when there was no secret that the sector was collapsing.

The 2010 Bank of Ireland Annual Report was presented at their AGM on 15 June 2011. Bank of Ireland shares closed at 3.84 (euro cents.)

Earlier in 2011, a General Election resulted in a new Government, and new Minister for Finance.

On 24 July 2011, in his first go as a senior Minister, Leo Varadkar, (Tourism, Transport and Sports) let it be known that "not non-serious" talks between the Department of Finance and a group of international investors were underway. Shares closed on Friday 22 July at 3.03.

His cabinet colleague, and Ministerial elder, Michael Noonan was by then already shaking hands with five as yet unnamed investors. He said he had effected "another very positive development for the Irish economy".

Bank of Ireland would describe the five as "long-term value investors". That group of five would spend €1.123 billion over that July weekend.

Shares closed on Monday 26 July 2011 at 3.06.

The happy investors were eventually named by the Guardian on 28 July 2011 as WL Ross & Co, Fairfax Financial Holdings, Fidelity Investments, Capital Group and Kennedy Wilson.

Michael Noonan had just sold them 20.9% (out of the 36% he held in our name as Minister for Finance) of Bank of Ireland.

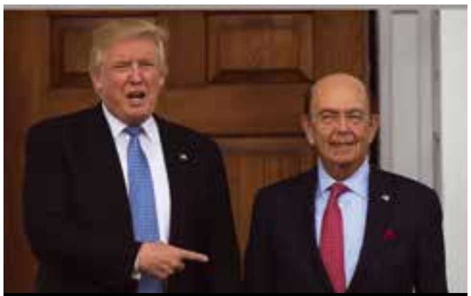
This cinque of billionaires had completed its aggregate 34.9% acquisition of Bank of Ireland for what would turn out be around 10 cents a share.

Within months, the Central Bank provided Bank of Ireland with more reserve-steadying bailouts, and operating guarantees.

The total sum lent to Bank of Ireland between 2008 and 2011 (€4.8 billion) has been paid back to the State with interest (€ 6.2 billion being the number quoted by Bank of Ireland's Investor Relations). However, these bailouts must be costed cogniscent of the financial backdrop of the time.

It was the era of climbing mortgage arrears, of iniquitous emigration desecrating Irish towns, and of escalating unemployment that was met with cruel cuts to social welfare.

In February 2013, the influential Nama Wine Lake (NWL) website posted that €4.438 billion was what that €16 billion AFS turned out to be worth to Bank of Ireland - the same AFS that became €9.4 billion, that then eventually shrank to €5.4 billion.The €995m gap between the two lowest figures quoted above was described as a "premium" to recognise that



Not in it for the public interest

property values might recover and the underlying security amounted to something. Nama were very kindly giving Bank of Ireland the benefit of maybe-improved sales prices. NWL correctly called this premium State aid.

Of course, Bank of Ireland were not the only Irish bank to be pampered like this, but it is important for this story to identify it as State aid, as Bank of Ireland was now over one-third held by foreign-owned private-equity funds.

In Nama Wine Lake's own words "No Wonder Wilbur is Happy".

To recap, the sum written-off this transfer to Nama now looks like a sale reduction of €11 billion (69%) from its introduction at €16 billion. A sum in itself to induce collywobbles.

It is obvious that a reader of the accounts may not have been aware of how that AFS ended up for Bank of Ireland. Everything to do with the financial management and reporting for this once material asset (12% of total loan book remember) was disguised as impairments and losses that got danced up and down the reports; even with the State aid gratuity of €995k.

By 2012, Wilbur Ross and Prem Watsa (Fairfax) were now sitting on the board. Or, as it likes to be called, the Court of Directors.

In March 2014, perhaps to prepare for his move into the public sector to help Make America Great Again (2017-2021), Wilbur Ross began to liquidate. His first sell-off was at 33 cents, more than triple what Michael Noonan had sold the bulk of them for. Shortly after, he closed out his BIRG position on 26 cents a share.

Wilbur Ross trousered roughly €500 million profit, plus director's fees, (June 2012-June 2014: €124K) and possibly expenses fit for a billionaire.The *Irish Independent* reported that the future US Secretary of Commerce had "pulled off the deal of the century".

Because of his place on the board, the issue of conflict of interest and having information to which only a director would be privy will always shadow these share disposals, allowing the allegation of insider trading to flicker. However, not only was Wilbur Ross's appointment to Bank of Ireland's Court of Directors signed off by the Central Bank of Ireland, it was also confirmed by more than one AGM.

Voting shareholders and their appointed Auditors always knew he was classified as 'not independent', because the Annual Report said so. The voting shareholders and the regulators and the external auditors all had that information, yet they voted and approved him anyway. This was egregious reticence, by any yardstick. Governance standards and Probity were sidelined.

By all accaounts, Wilbur Ross was very proud to share his Bank of Ireland experience, and there is chatter suggesting gloating anecdotes about his adventures in Dublin at an unlikely modest Florida gathering of fellow hedge oligarchs in the Trump 2016 run-up.

Prem Watsa would see more profit than Wilbur, tipping over the half a billion, €560 give or take a few million. When he stepped down from the court, in July 2013, he was replaced by Fairfax' Vice President Brad Martin.

So now we come to the part of our story where private equity investment funds of all shapes and sizes, from pension funds to hedge funds, wanted what the first five got when they bailed-out-the-bailout for Michael Noonan and Fine Gael.

By now Michael Noonan, along with everyone else in Fine Gael, was crowing and spinning that they had fixed the banks and brought in foreign investment and big-tech jobs.

It is generally accepted that the private equity layer of regulated financial services is occupied by bosses and figureheads who get bonus payments measured in millions, and occasionally billions. Many of these funds are ego-driven, and even named after the ego itself.

Therefore, you can safely assume that they would never let themselves be fooled by small print, or easily teased by 'contingency collateral'. Nor would they put out by disapproving looks from any Banking Culture Board. There was never going to be a risk of failure for the investors here.

The early warning signal came in The *Financial Times* on 14 June 2011; "UK Pensioners 1 Irish Bank 0" .

The bank was Bank of Ireland, which, as it happens, held an AGM the following day on 15 of June 2011.

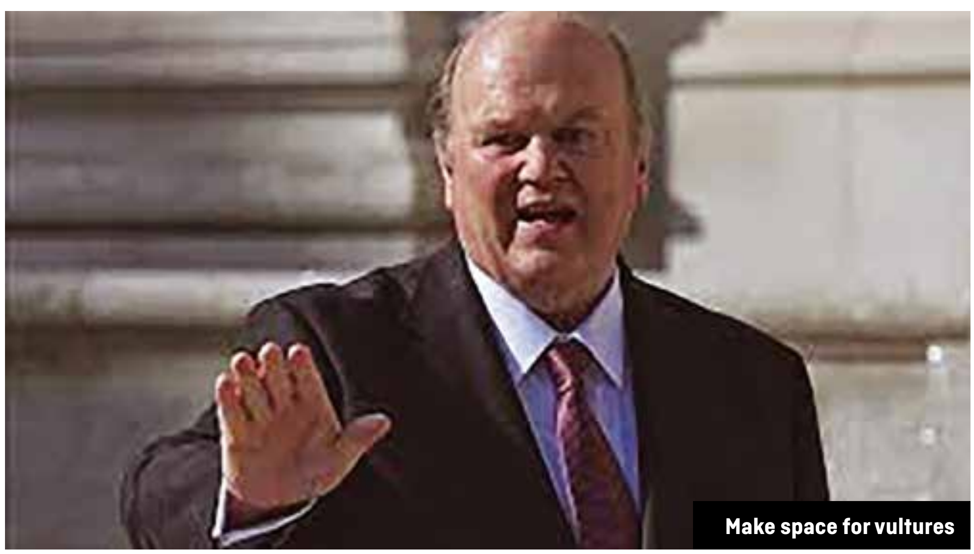
The story said that pensioner-holders of perpetual subordinated bonds in Bank of Ireland were not prepared to accept a change to its equity structures. So, they had gone to Court in a class action opposing "coercive terms".

All that was presented to shareholders the following day on the matter of legal provisions was a mention of an increase due to a Property Investment gone bad. Other than that, the annual report contains nothing more than your standard flatpack for Legal Contingencies.

Just days later, 20 June 2011, FT readers read "Hedge Funds v Bank of Ireland".

23 Plaintiffs – all exactly who you think they are - launched proceedings as a class action against Bank of Ireland.

David Tepper, who would become notorious on his own for being the world's



Make space for vultures

> The €995m gap between the two lowest figures quoted was described as a "premium" to recognise that property values might recover. Nama were giving Bank of Ireland the benefit of maybe-improved sales prices. NWL called this premium "State aid"

> After our decision-makers failed to do due diligence, the private equity funds did the tedious research that earned them the leverage to buy almost 21% of Bank of Ireland from Noonan for 10c a share, to sue Bank of Ireland, and to get a Ministerial U-Turn removing unintended constraints on their profits

highest-earning hedge-fund manager in 2013 and again in 2014, is quoted in a 2013 Bloomberg interview on how he dealt with his Bank of Ireland investment.

"We invested in the Bank of Ireland, and we bought their bonds, subordinated bonds, they wanted to cram us down. So we took them to court. We were gonna go into the English and Irish courts to fight the Bank of Ireland and fight the Irish Government for that matter".

Underpinning this gaudy solo was the indignation building within the sector that the decisions within Bank of Ireland were politically motivated, driven by the Irish Government, and through them, the EU.

So, 23 hedge funds with managers who measure up to each other by the size of their respective super yachts, come together under one legal team.

By December the decision to burn these 'Junior Bondholders' - these 23 Hedge Funds and the 2,000 or so UK pensioners - was reversed. In other words, the Minister for Finance, Michael Noonan TD and Bank of Ireland settled.

On 11 December the FT quotes Noonan: "We will by the end of 2013 introduce legislation to remove unintended constraints on banks to realise the value of loan collateral under certain circumstances".

It was not just repossessions Michael Noonan was promoting, he also was laying the first slab in the pathway to today's housing crisis though he was barely six months into the job of Minister for Finance.

It was then a free for all since nobody was able to say stop without getting sued for past deeds of incompetence, cronyism and corruption.

Because our decision-makers never did the due diligence, the private equity funds did.

They did the tedious tricky deep background research that earned them the leverage to buy almost 21% of Bank of Ireland from Michael Noonan for 10c a share, to sue Bank of Ireland, and to get a Ministerial U-Turn removing unintended constraints on their profits.

This U-Turn facilitated a speedway.

By mid-2012 Ireland was welcoming more private equity investors intent on securing bargains from our retail banks' uncertain, badly written, and mostly delinquent, loan books.

Some may have been primed by a Private Equity Seminar hosted by Grant Thornton in Dublin in November 2012. The *FT* reported that 200+ "industry operators" registered to attend the event.

These private-equity vehicles saw a bright future in the Irish Government's submissiveness to big money, and in its establishment's regulatory blind eye and indulgence of flimsy enforcement.

But most important: private-equity money does not rely on traditional bank debt to finance itself.

Blackstone, Cerberus, Promontoria, Lone Star, Carlyle, Beltany, Oaktree and the like were teased and titillated by the great fortunes accumulated by the First Five.

Unlike the earlier Bank of Ireland investors Wilbur Ross brought in to meet Michael Noonan who took their profits early, the remaining Hedge Funds used patience to sweat us out.

Steve Schwarzman, Blackstone's Founder, Chair and CEO, openly demonstrating dominant influence within Blackstone's board and management, said its Irish/ EU operational model was: "Waiting to see how beaten-up people's psyches get, and where they are willing to sell assets".

So private equity got to screw the Irish retail banking sector and by proxy the Irish taxpayer. There were no more toxic assets for it to mainline, so it went straight to Irish builders and developers to finance their working capital needs.

This is a lot more than private money acquiring whole blocks of residential developments straight off the plans to add to their rental assets. .

This should be profitable lending activity for retail banks, but private equity is cutting them out and taking the bread from their tables. The retreat of Ulster Bank and KBC out of one of the most expensive, therefore lucrative, mortgage markets in Europe symptomises this latest wave of banking calamities.

Private Equity won't suffer losses here, not a single cent, because they got to write their own rules. Nor will they run the risk of legacy burdens, like staff-pension schemes, or future PAC appearances.

What Ireland promises today: a gig economy and a workforce of hand-to-mouth workers, an emigrant youth taking their dynamism and talent abroad, a country of dead cities as their character gets rebuilt as hotels and unaffordable buy-to-rents, low quality of life, incendiary cynicism and throbbing anger, is the cost of mishandling global capitalism. Above all, generation that can't afford housing is the price of deference to the wisdom of bankers..

The hedge funds knew what they were looking for, they did their due diligence: the representatives of the State did not.

As long as Financial Statements continue to be the small print at the back of 200+-page glossy annuals, supported by the same signatures from the same four firms, we are still not taking care of ourselves by exerting any control.

Pension-benchmarked Government politicians and their senior department officials don't have to pay the real costs of their decisions. We do.