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AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉIREACHTA

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Déardaoin, 5 Feabhra 2015

Thursday, 5 February 2015

The Committee met at 9.30 a.m.

MEMBERS PRESENT:

Deputy Pearse Doherty,	Senator Sean D. Barrett,
Deputy Joe Higgins,	Senator Michael D'Arcy,
Deputy Michael McGrath,	Senator Marc MacSharry,
Deputy Eoghan Murphy,	Senator Susan O'Keeffe.
Deputy Kieran O'Donnell,	
Deputy John Paul Phelan,	

DEPUTY CIARÁN LYNCH IN THE CHAIR.

Deputy Kieran O'Donnell: Where is your mother from?

Chairman: Thank you very much Professor Black. We can discuss that over coffee.

Sitting suspended at 11.50 a.m. and resumed at 12.05 p.m.

Mr. Mario Nava

Chairman: I welcome Mr. Mario Nava from the European Commission to discuss banking regulation, supervision and financial stability. Mr. Nava is currently the director of the regulation and prudential supervision of financial institutions directorate in the Financial Stability, Financial Services and Capital Markets Union Directorate General, formerly the Internal Markets and Services Directorate General. Mr. Nava has been in the European Commission since 1994. His previous posts include acting director for financial services policy and financial markets, member of the group of policy advisers to Commission President Romano Prodi and a member of Mario Monti's cabinet. He studied economics at Bocconi University and at Louvain and has a PhD in public finance from the London School of Economics. Alongside his work at the Commission, he is active in research and teaching. He is a visiting professor at Milan's Bocconi University and occasional lecturer in many universities across Europe.

I wish to advise the witness that by virtue of section 17(2)(*l*) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to this committee. If the witness is directed by the Chairman to cease giving evidence on a particular matter and the witness continues to do so, the witness is entitled thereafter only to a qualified privilege in respect of his evidence. The witness is directed that only evidence connected with the subject matter of these proceedings is to be given and, as he has been informed previously, the committee is asking witnesses to refrain from discussing named individuals in this space of the inquiry. Members are reminded of the long-standing ruling of the Chair to the effect that members shall not comment on, criticise or make charges against a person outside the House or an official by name or in such a way as to make him or her identifiable.

I welcome Mr. Nava again and ask him to make his opening remarks.

Mr. Mario Nava: I wish the Chairman, Deputies and the Senator a good afternoon. I am very pleased and honoured to have been invited to the Oireachtas to assist this committee in its inquiry into the banking crisis. I have been asked to provide the European Commission's perspective on the fitness of the European Union regulatory framework for banks and the supervisory policies, systems and practices in the run-up to the financial crisis, the lessons learned and improvements made in the past two years.

The regulatory framework for banks in the EU has evolved considerably over the past 15 years. A number of factors have driven this evolution. These include the need for the EU Single Market, international developments, rapid changes in the banking sector and shortcomings in bank risk management and the regulatory and supervisory framework. The EU regulatory framework takes into account the global standards for prudential regulation and supervision set by the Basel committee on banking supervision. These standards have been updated several times since 1988, most recently in December 2010 when the Basel III standards were adopted. Each of these updates has been implemented in EU law.

In 2000, the EU regulatory framework followed the principle-based approach which was embodied in a minimum harmonisation. Directives were used as the main legislative instruments, setting minimum requirements for prudential supervision. Member states were required to transpose those directives into their respective national legislation.

The use of directives as the main legislative instruments and the minimum harmonisation principle gave member states a degree of flexibility in setting the regulatory framework for banks, as long as they did not go below the minimum standards required by the euro. However, in line with the principles-based approach to regulation, member states typically did not resort to implementing over-prescriptive rules which would provide specific and detailed guidance to supervisors for exercising their duties. During this same period, national supervisory authorities were responsible for applying and enforcing the prudential requirements set out in the directives, which empowered each national supervisory authority to take the steps it considered necessary to implement prudential measures to safeguard the resilience of the banks and to supervise the financial stability of the banking sector as a whole. National supervisors had a considerable degree of discretion to apply stricter requirements than the minimum standards set out by the directives. In other words, nothing in the directives prevented member states and their national supervisors from taking appropriate measures to reduce further the risk of a bank failing or risk to the stability of the financial system as a whole.

The crisis has taught us a great deal about the failure of some European banks to manage their risk prudently and of some national regulators and supervisors to exercise their powers with sufficient rigour. Many studies and reports have been produced to analyse the consequences of the principles-based approaches pursued by national regulators and how national supervisors exercised their oversight and enforcement duties in the pre-crisis period. Reliance on soft and light touch approaches and low supervisory intensity encouraged by the principles-based approach to regulation, inadequate resources and insufficient attention to banks' corporate governance systems represented the most prominent causes of the various supervisory failures observed in several member states. Too often, national supervisors took a narrow focus on credit risk and underestimated the importance of other risks, such as concentration risk, liquidity and funding risks. Too little attention was given to market prudential considerations and effective early warning mechanisms which could have helped national authorities to detect emerging risks early and prevent bubbles from growing.

The EU capital requirement directive, which is known in the jargon as the CRD, was adopted by the European Parliament and the Council in 2006. It required national supervisors to conduct a thorough assessment of the risk management systems and governance of the banks they supervised and to take measures corresponding to the specific risk profile of the banks in question. The directive also stipulated explicit requirements for management of liquidity and concentration risks as well as risks arising from exposures to real estate markets. If national supervisors had used those powers to the full extent, a number of major difficulties could have been prevented. Robust risk management in the governance structure in banks and an effective oversight and control system represented the two indispensable conditions for the success of principles-based regulation. In the absence of those two preconditions, the regulatory effect intended by the directive could not have been delivered.

These deficiencies also revealed important shortcomings in the governance of the institutional framework for supervision itself and it sparked a period of unprecedented reforms in the EU, backed by an international consensus on the causes of the financial crisis and responses needed to address it. The reforms, therefore, had two distinctive dimensions - the regulatory dimension and the institutional dimension. I will discuss them in turn.

On the regulatory side there has been, in line with international developments, a pronounced shift to a more rule based approach, introducing a more detailed guidance in the regulatory framework for the supervisors to ensure that they step up their supervisory scrutiny. As a result, the new regulatory requirements have been made more prescriptive, the coverage of risk has been expanded and the prudential treatment of those risks has been strengthened. These regulatory reforms were carried out in two phases. The first phase, which is called CRD 11 and CRD III, which were adopted in 2009 and 2010, respectively, introduced quick fixes for some of the most pressing deficiencies highlighted by the crisis, namely, liquidity management, large exposures, remuneration, management of securitisation, trading exposures and supervisory co-operation. For example, banks were required to develop robust strategies, policy, processes and systems for the identification, measurement, management and monitoring of liquidity risks and funding positions. In the interbank market, banks were not allowed to lend or place money with other banks beyond a certain amount to limit the risk of contagion, which also increased the diversity of borrowing banks' funding sources. National supervisors were required to review banks' remuneration policies and empowered to impose sanctions if these policies did not meet with the new requirement.

The second phase, which is probably the most well known and goes under the name of CRR/CRD IV in the jargon, was adopted in 2013 and represented a more fundamental revision of the regulatory framework, responding in particular to the review of international prudential standards in the Basel III framework. This includes new rules regarding the quality and quantity of banks' regulatory capital, more detailed and harmonised rules dealing with liquidity, funding risks and excessive leverage, and measures improving banks' corporate governance, including rules realigning incentives. Supervisors have obtained enhanced sanctioning powers and are required to carry out their duties in a more intrusive, intense and forward-looking manner. Particular attention was given to measures improving supervisors' capacity to take appropriate remedial action at an early stage by putting more emphasis on macro prudential consideration.

This latest revision also aims to establish a single rule book to respond to the need for a more harmonised set of rules across the Single Market, to provide a true level playing field on which EU banks can compete. The degree of flexibility previously granted to member states and national supervisors, as I mentioned earlier, had led to divergent transposition of EU rules into national law. This created opportunities for regulatory arbitrage and hampered legal clarity. To achieve greater convergence, various options and discretions have been removed. Most provisions have been moved into the regulation known as CRR and that becomes directly applicable.

Parallel with the new prudential measures to reduce the probability of a bank failure, measures were also necessary to minimise the impact of possible failures and to equip resolution authorities with effective tools to deal with those situations. The new harmonised bank resolution regime embodied in the bank recovery and resolution directive, adopted by the European Parliament and the Council in 2014, was introduced in recognition of the fact that the normal insolvency regimes were not well suited to deal with bank failures. It was also a response to the need to protect certain critical stakeholders, for example, deposit holders, in functions of a failing bank and to reduce moral hazard in banks.

This legislation includes a requirement for banks and resolution authorities to draw up a recovery and resolution plan, gives bank supervisors an expanded set of powers to enable them to intervene in cases where an institution faces financial distress, provides the resolution authorities with a credible set of resolution tools, including bail-in, and improves co-operation between the respective resolution authorities.

Another initiative which should be mentioned in this context is the Commission proposal on banking structural reform dealing with the systemic risk of too-big-to-fail banks heavily engaged in trading activities. The proposal, which is still under negotiation in the Council and in the European Parliament, would provide for a ban on proprietary trading and empower supervisors to separate banks' risky trading activities from their retail operations. That is the regulatory side.

On the institutional side, the crisis demonstrated the need to adapt the institutional framework for financial regulation and supervision to a fast moving and inter-connected banking industry. First, the institutional reforms revolved primarily around the creation of the European Banking Authority. Its creation was necessary to promote convergency of supervisory practices in the EU and to improve communication and mutual trust among supervisors. In addition, the European Systemic Risk Board was created to respond to the failure of the national competent supervisory authorities to anticipate adverse market prudential developments and to prevent the accumulation of excessive risk within the financial system.

Institutional reforms went a step further at the euro area level and led to the creation of a banking union. The crisis clearly showed that in addition to a common set of reinforced rules for our banks, a single and independent supervisor to enforce those rules was also essential. Thus, the Single Supervisory Mechanism was created, with a view to breaking the link between banks and sovereign and ensuring the highest standards of quality and impartiality of supervision. While the European Central Bank, ECB, has taken over supervisory responsibility for the 120 largest banking groups in the euro area, day-to-day supervision of the smaller banks remains, for reason of efficiency, the task of national supervisors under the general guidance of the ECB.

The second, equally essential, element of the banking union is the single resolution mechanism. The single resolution board, the new single resolution body, will ensure that banks participating in the banking union are resourced, if necessary, in an efficient and centralised way, with minimum impact on taxpayers. The cost of any such resolution procedures will be paid for by the private sectors and backed by a single resolution fund financed by bank contributions.

To conclude, taken together, the reforms I have mentioned represent a significant strengthening of the regulatory and institutional framework underpinning the EU banking sector. It would be presumptuous to claim that these reforms have consigned financial and, in particular, banking crises to history. However, it is undeniable that, if properly enforced, these reforms equip supervisors and the resolution authorities with a more robust set of tools, making a future crisis less likely, and, if one were to happen, less costly. I thank the members and look forward to their questions and the debate.

Chairman: I thank Mr. Nava for his opening statement. I would like to acknowledge that he has come here representing the European Commission, and I thank the Commission, as a significant EU institution, for its co-operation with the inquiry.

I note that Mr. Nava comes from Milan. In that regard, I might use a comparison to explain what the European Commission does. Milan is very famous for its football teams. If I could describe banks as football clubs and central banks as national football associations, is Mr. Nava's role in the Commission comparable to FIFA or to UEFA in terms of setting the rules?

Mr. Mario Nava: I come from Milan, the land of two famous football teams. I do not quite get the equation between the two, but I am very happy to explain our role.

Deputy Kieran O'Donnell: Mr. Nava is interested more in banking than in soccer.

Chairman: But would the UEFA-----

Mr. Mario Nava: I like the idea of trying to bring-----

Deputy Kieran O'Donnell: We are more interested in speaking about soccer.

Chairman: The Deputy will have his opportunity to speak.

Mr. Mario Nava: What we do is this. The European Commission is the body in charge of drafting legislation, so we draft legislation, particularly in the area of banking legislation. We get the legislation after having participated in the various discussions in the global forums. We then draft the legislation. The legislation that is drafted is brought to the Council and the Parliament. The Council and the Parliament have their ways of adopting legislation, but, broadly speaking, the Council works its own text and the Parliament works its own text. There are then meetings called trilogues at which the Council, Parliament and Commission try to find a common version of the text. Once the text is adopted and put in place, if it is a regulation it is directly applicable. If there is a directive, the Commission is still responsible for checking that the directives are well transposed - that is the technical word - into the national legislation. Essentially, that is our role. I would say it is a role of initiating the regulation and making sure, unless the regulation is directly applicable, that if the legislation needs transposing to the national legal systems, this transposition is correct and the Commission watches over that. Typically, one would say the Commission is the guardian of the treaty in doing that job.

Chairman: I thank Mr. Nava. In summary, to use my own analogy, Mr. Nava is UEFA and he sets the rules for Europe in terms of banking institutions and national regulations.

Senator Sean D. Barrett: I echo the Chairman's welcome to Mr. Nava and his football analogy. Many Irish people will be in Rome this weekend for rugby, and we have many happy memories of Italia '90, even "Toto" Schillaci. We got one back four years later when Ray Houghton got the goal. Terrific friendships were formed at that time, and I join the Chairman in welcoming Mr. Nava here.

Mr. Nava also represents a very important academic tradition in that the Italian school of economics, *scienza delle finanze*, includes eminent people in economics to which Richard Musgrave has drawn our attention, and Mr. Nava is in that tradition. I see references to these people in his academic works. One of them, Maffeo Pantaleoni, was a very good economist who was elected to the Italian Senate but died soon afterwards, so I am hoping not to follow that precedent.

Mr. Nava was very pessimistic at the end of his contribution when he said that it would be presumptuous to claim that these reforms have consigned financial crises, and banking crises in particular, to history. When is the next crisis due? Should those watching this on television be worried if somebody of Mr. Nava's knowledge and eminence says we have not got this correct yet?

Mr. Mario Nava: The Senator may take my last statement in various ways. I would say it was probably more of a British-style understatement. I did not want to come before the committee and claim that there will never be another crisis because I did not want to be proved wrong by what may happen and what we have not foreseen. However, it is very clear that with all the reforms we have done we looked in academic terms to the two important components of a crisis. One of these is the probability that a crisis will come, and we have put in place all possible mechanisms to reduce that probability by essentially ensuring better risk re-pricing. One way to look at the crisis is that the pricing of the risk in the banking institutions was not always correct, so we have put in place a number of regulations that allow for a more truthful risk re-pricing. However, it is important to understand that the project does not consist only of new rules on capital, concentration risk and liquidity, but also new rules on supervision and resolution, and resolution is what makes an eventual crisis have much less of an impact on taxpayers than anything else. Those are the two pillars we have addressed.

The Senator asked where I would see the next crisis coming from. That is part of the work that the Commission needs to do in the next five years. In his opening statement the Chairman asked what we could expect from the Commission in the next five years. He should not expect the same volume of regulation from the Commission in the next five years as he has seen in the past five years. That is very clear. What he should expect from the Commission in the next five years is much more reviewing of what we have done, evaluation, and calibration of all of that.

Let us be clear. The financial reform we carried out has allowed us regain financial stability. Financial stability at some moments seemed truly in peril. The work we did allowed us to regain financial stability not only on paper and by law but also in the markets. Bank capitalisation has increased massively following the new regulation. Because that was done and because we have regained financial stability, it is possible now to look at how this new financial stability and these financial reforms can contribute to the major objectives of the current Commission, which are growth and jobs. In a word, there is no growth without financial stability, but there is certainly no financial stability without growth. That is the type of thing we will look at in the next five years.

Senator Sean D. Barrett: What does the truthful, risk-free pricing Mr. Nava mentioned mean in application? How do we get better performance from bankers than has been the case heretofore?

Mr. Mario Nava: One way of doing that is by increasing the capital requirements for the various activities. When the capital requirements are low, it may well be that the risk is not priced sufficiently. If we increase the capital requirement we may not get the exact risk pricing, but we certainly set a floor for risk pricing so that it is not too low. There is one point I should make very clear. As the Senator knows, the objective here is not to eliminate risk because lesson No. 1 in economics is “no risk, no return”. The objective is not at all to eliminate risk but to allow people to take risks in such a way that if something goes wrong they pay for it. They can take a risk but they assume the risk. The aim is to avoid people taking risks and then shovelling that risk onto someone else. That is the objective.

Senator Sean D. Barrett: Why has it taken so long, given that the euro was established as a financial currency in 1999 and an actual currency in 2002? It is now 2015. Should these rules not have been in place when the currency was introduced?

Mr. Mario Nava: When the currency was introduced in 1998, a committee was set up for banking supervision at the euro area level. The committee was set up at the initiation of the then board member, Mr. Tommaso Padoa-Schioppa. Interestingly, the committee was chaired by the deputy governor of the Bank of England, Mr. Brian Quinn, who was also very involved in football. Once he retired from banking, he became chairman of Celtic Football Club in Glasgow which won many cups and leagues and so forth. The committee was set up in 1998 or 1999 and was tasked with examining the question of whether, together with a common currency, we should have common banking supervision.

Things take time, however, and as we say, Rome was not built in a day. I have a slide here which illustrates the key milestones. Obviously, in the initial period from 2002 to 2006 we had quite positive economic developments and clearly that meant less pressure. Not only did positive economic developments mean less pressure, however, they also hid the potential difficulties to a degree. It was only with the arrival of the crisis that we were able to see the shortcomings and deficiencies. Then, I would say that we acted quite rapidly, as fast as we could. I was very happy to read a report by the House of Lords yesterday which found that given the very difficult circumstances in which the European institutions had to act, they acted appropriately in general. The report states that the work they did was to be "admired". Clearly it takes time to pass a directive. I have explained the mechanism - the Commission drafts, the Council and Parliament adopt and so forth. To return to my slides, members will see that from 2006 onwards we have been very productive.

In response to the question of whether we could have foreseen the problems, it is more difficult to do so in good times.

Senator Sean D. Barrett: In the context of the 2006 capital requirements directive, we have heard evidence that by that stage in Ireland the damage was already done so the fact that nothing happened between 2000 and 2006 was very serious. In Mr. Nava's presentation he said, with regard to EU directives before the crisis, that "nothing in the directives prevented member states and their national supervisors from taking appropriate measures to reduce further the risk of a bank failing or risks to the stability of the financial system as a whole". Was the EU just standing by at that stage? With regard to the EU capital requirements directive, he stated that "if national supervisors had used these powers to the full extent, a number of major difficulties could have been prevented". I think the crisis was out of control in Ireland by that stage and those missing years, between the creation of the currency in 1998 and 2006, are crucial. Did the EU know what the Irish Central Bank was doing at that time or that there was a crisis in Irish banking? Did it report adequately and sufficiently?

Mr. Mario Nava: I hope I have explained clearly in my opening statement that the directives were based on the principle of minimum harmonisation. The role of the Commission is not supervisory. The Commission's role, as I said in response to a question from the Chairman, is to initiate legislation, to see that the Council and Parliament adopts it and then to make sure that it is well transposed. The supervisors, however, do not have to report to the Commission. In those years there was clearly, with the minimum harmonisation rules, subsidiarity so there was no legal power by which the supervisors should report to the Commission about one or other of the banking rules.

Senator Sean D. Barrett: Mr. Nava says that nothing prevented national authorities from taking appropriate measures. In retrospect and with hindsight, one might say that it is a pity that there was not somebody saying "By the way, you should ---

Chairman: Do not lead the witness. Ask the witness if that was appropriate but do not make a judgment yourself, Senator.

Senator Sean D. Barrett: I am just acknowledging what the witness said, that it was a period during which the responsibility was national.

Mr. Nava in his own book, *Economics and Policies of an Enlarged Europe*, has cast doubts on whether there were sufficient gains from a common currency, with the benefits to be a mere 0.5% of EU GDP in the mid-80s, while other authors put this figure at 1%. Ireland trades primarily outside the common currency area. Mr. Nava's view was that "the undoubted benefits achievable for the single market" through the effects of the single currency are probably "not enough to justify the endeavour of renouncing the national currency". Was that a consideration at the time? The euro project is doubted in Mr. Nava's book, published in 2005. We have had a single currency since 1999 and the nation was still in charge. In Mr. Nava's opinion, the benefits of a single currency were small. Could Ireland have solved the problems itself during that period?

Mr. Mario Nava: As I said, there was a single currency but there was not a single supervisory system. There were capital rules and those rules were based on the principle of minimum harmonisation, meaning that members could not go below the minimum thresholds but could reinforce them on the basis of their own needs. This ability to reinforce common laws on the basis of needs still exists in some areas today, for example, even under the maximum harmonisation approach, in real estate. Real estate is very different from one country to another. Real estate in Dublin is not the same as real estate in London or Paris. In real estate, lots of freedom has been left to the national supervisory authorities to take measures, typically macro-prudential measures, that might help.

In the period from 1999 to 2006 or 2007, the national supervisors had the responsibility, no doubt, for their own banking systems. Therefore, they also had the latitude, when considered necessary, either to go for more stringent rules or to do what is known in the jargon as Pillar II, which means supervision on a bilateral basis between the bank and the supervisors. Or they could do supervision on a bilateral basis of a particular bank that was exposed to a particular sector, region or counter-party, and ask for more requirements. All of this was certainly in the hands of the national supervisors at that time, but I repeat that the national supervisors did not have to report to us in the Commission on what they were doing.

Chairman: I will bring Senator Barrett in again later.

Senator Sean D. Barrett: I thank the Chairman and Mr. Nava.

Deputy Kieran O'Donnell: I welcome Mr. Nava. I wish to raise a couple of points. The first two pages of his testimony deal with the whole area of supervision, mostly in a European context. Mr. Nava said it was up to the regulators in the individual countries. In terms of risk management and effective early warning systems, how would he view the Irish system? To use football parlance again, was there a situation in which the offside rule, in terms of the way the banks were operating, was not being properly enforced by the referee - that is, the Irish regulator? Was it effectively being misinterpreted?

Chairman: No leading questions may be asked. Otherwise, the Deputy will be offside.

Mr. Mario Nava: I thank the Deputy for the question. If I gave a response I would be contradicting what I have just said. The Commission was not at the receiving end of the analogies of the supervisors. Of course, we looked at it in the framework of controlling the national economies. I am aware that in two weeks' time another witness from the Commission will be discussing the issues with the national economy leading up to the crisis. We were not privy to those discussions that should have taken place between the national supervisor-----

Deputy Kieran O'Donnell: But Mr. Nava said that if national supervisors had used their powers to the full extent a number of major difficulties could have been prevented.

Mr. Mario Nava: That is our statement, which we made clearly with insight.

Deputy Kieran O'Donnell: Obviously, Mr. Nava was making a statement. In an Irish context, what would it be? Mr. Nava is here as a representative of the European Commission, but in an Irish context, can he elaborate on that statement?

Chairman: On what the intentions were or could have been.

Deputy Kieran O'Donnell: Correct.

Mr. Mario Nava: If the issue is what interventions there could have been, I think that when a national supervisor sees some sector growing at an excessive pace or some particular counterparty to which the banks are excessively exposed, he or she - without referring in particular to one sector or the other, or one bank or the other - certainly has the power to intervene. Supervisors had the power to intervene in two possible ways: first, by stepping up the legal requirements that were provided as a minimum by the directive from Europe-----

Deputy Kieran O'Donnell: Capital requirements.

Mr. Mario Nava: Yes, capital requirements. That was the first way. Second, in their supervisory discussions with the banks, they had the latitude to step up the requirement only for one particular bank or for a group of banks exposed to that particular risk without necessarily raising the legal requirement - that is, targeting one particular bank or one particular group of banks that were at risk. This is what the supervisors could have done. More detailed guidance on what supervisors could do came later. The realisation of the move from principal base, minimum harmonisation and subsidiarity and the need to give more guidance came with time, so there was nothing that prevented them from doing these things. Also, there was not very detailed guidance as to what they could do.

Deputy Kieran O'Donnell: What about the interaction of the ECB with the individual central banks in each country? Was there no interaction in terms of an overview from the ECB?

Mr. Mario Nava: As far as I know, the ECB-----

Chairman: The Deputy asked the question rather than saying what intervention-----

Deputy Kieran O'Donnell: What oversight role, in the European context, would the ECB have had over individual central banks?

Mr. Mario Nava: We were discussing the ECB before. There was no supervisory responsibility until very recently, November 2014.

Deputy Kieran O'Donnell: So any decisions taken by the ECB would be entirely down to its own decision-making process, and it would not in those circumstances be reliant on the decisions or advice its gets from the individual country's central bank?

Chairman: Is that what Mr. Nava is saying?

Deputy Kieran O'Donnell: For clarification purposes, is Mr. Nava saying that, effectively, the ECB and the Irish Central Bank operate independently of each other?

Mr. Mario Nava: I am sorry; that is not what I am saying. What I am saying is a different thing. What I am saying is that the ECB was the monitoring authority and had that responsibility. The Irish Central Bank was the exclusive supervisory authority until very recently. There were committees at those times at which all the supervisory authorities were put together - committees that were particularly useful for dealing with cross-border banks, where banks were active in more than one country and account must be taken of interactions between the different countries. That is what I am saying. The supervisory responsibility lay with the national authorities. There were committees and ways to bring supervision to the level of where economics was. The later move to the banking union - where banking union means central supervision - was dictated by the simple fact that the economics had moved ahead of the regulatory institutional framework. The banks were much more integrated than the regulators and the institutions were. We found ourselves where the European banking sector, which is a very large sector. As the committee is aware, the European banking sector alone, depending on the year, represents between 40% and 50% of the world banking sector and is about four times as big as the American banking sector. The European banking sector is very large and is very economically integrated. There are banks that are present in many countries, and often are more important in the host countries than in their original country.

Deputy Kieran O'Donnell: In the limited time available to me, can I move on to something in which the European Commission is directly involved. I do not know if Mr. Nava had the opportunity to view the contribution of Professor Black, who appeared before the committee this morning. Professor Black spoke about the impact of Basel II and said its outcome was preposterous. He said that the level of capital required in Europe was a third less than what would have been required in the US. He said the US effectively requires three times the level of capital weighting reserves that would apply in Europe. Also, the Basel III agreement will allow banks to have loans - effectively assets - to customers of 33 times their core Tier 1 capital. It is similar to the leverage of Lehman Brothers prior to its bankruptcy. Can Mr. Nava give his view? As that is very much within his domain, how does he respond to Professor Black's criticism of Basel II?

Mr. Mario Nava: Definitely. The story I am trying to tell you this morning is a story of evolution. It is a story of trial and error and improvement over time.

Deputy Kieran O'Donnell: With due respect, the trial and error has resulted in a situation in Ireland-----

Chairman: Deputy O'Donnell-----

Deputy Kieran O'Donnell: Mr. Nava speaks about trial and error-----

Chairman: There are consequences on the ground.

Deputy Kieran O'Donnell: -----but there are consequences on the ground for the Irish public because up to €64 billion of bankers' debt, which is on the public record, has come about, potentially, because of these trials and errors. How does Mr. Nava respond to Professor Black's criticism this morning, which is in the public domain, that he regards Basel II, which falls under Mr. Nava's remit, as preposterous because the level of capital required is less than a third of what it would be in the US?

Mr. Mario Nava: What I was trying to say is that Basel II no longer applies. It has not existed since 2010. Now we have Basel III, which has multiplied the capital requirements, which means that not only within the remit of the European Commission, when we make the banking directives, but at a global level, there has been an awareness, or recognition, of the fact that the capital levels set by Basel II were too low. We moved to the capital level set by Basel III. What I have said before, and must repeat, is that once the capital level of Basel III came about, once the Commission proposed the capital requirement directive, which has been adopted by the Council and Parliament, the market reacted. This is a very important point-----

Deputy Kieran O'Donnell: I need Mr. Nava to-----

Chairman: The Deputy asked a lengthy question, so I will give the witness-----

Deputy Kieran O'Donnell: I want-----

Chairman: I will let the witness respond, because the Deputy's question was quite lengthy. Mr. Nava, please complete the answer. I will give you some time.

Mr. Mario Nava: The important thing is the "fully loaded" concept under Basel III. It refers to the requirements that will exist in 2018. Forget the regulators: the market today, and the numbers in the banks, ask that all banks live under the so-called fully loaded requirements. I take that as a recognition of the fact that the regulatory reform we put into law has been welcomed by the market. I am sorry to have taken so long.

Chairman: The Deputy has four minutes.

Deputy Kieran O'Donnell: This allows the same level of leverage that applied when Lehman Brothers went bankrupt. How does Mr. Nava respond to that?

Mr. Mario Nava: The leverage ratio is an indication of Basel, but it is not yet a binding law in Europe. It may be used from 2018. I am sure the committee knows that when we brought this concept of the leverage ratio to the Council and the Parliament, they added a little more, so it became leverage ratios, and then it added leverage ratios depending on the business model. It acknowledged the fact that the leverage ratio may be different depending on the business model. The leverage ratio as a binding law - not as a discussion between supervisor and banks, not as a Pillar II concept but as a binding law - will be there from 2018, and so I cannot anticipate today exactly what it will do.

Deputy Kieran O'Donnell: Mr. Nava's submission states that "the Single Supervision Mechanism was created with a view to breaking the link between banks and sovereigns" so that effectively the taxpayer would not be on the hook. In what circumstances will the conditions be such - in an Irish context - that Europe can provide money to purchase shares in banks that the Irish Government has already recapitalised and put money into? Under what conditions will the European Stability Mechanism, ESM, step in and purchase the shares that the Irish Government had to purchase to put money in the Irish banks on behalf of the taxpayer?

Mr. Mario Nava: It is important to understand how the Single Supervision Mechanism, SSM, and the Single Resolution Mechanism, SRM, work. They dramatically reduce the probability that a country will be obliged to use public money. For example, the first articles of the SRM, which few people pay attention to, speak about resolution plans. The first articles try to de-dramatise the famous weekend of resolution and to make sure that at the moment of resolution, which will be a difficult moment, the resolution authorities, who have to intervene, know exactly what to do because they have planned what to do in advance. Those plans differ from one bank to another. That is the resolution plan. There is another point in the Bank Recovery and Resolution Directive that I quoted - the ability to contain losses.

Deputy Kieran O'Donnell: In the limited time, I am aware-----

Chairman: I will bring the Deputy back in at the end.

Deputy Kieran O'Donnell: Please, Chairman; I want the questions I asked answered.

Chairman: I will give the Deputy time later. He will have a chance to come back in at the end of the session.

Deputy Kieran O'Donnell: No; I actually intervened because I want Mr. Nava to speak purely about the Irish context. In what circumstances could retrospective recapitalisation apply under the ESM?

Mr. Mario Nava: I am not here to speak about the Irish context. I am here to speak about the European legislation. What I know about the European legislation is that the potential retroactive application of the direct recapitalisation mechanism is decided on a case-by-case basis and by mutual agreement of all the ESM. In making this statement, which is a bit general and simple, and is to be found in the rules with no reference to any particular country, I am repeating what the rules say: on a case-by-case basis and with the general agreement of the ESM members.

Deputy Kieran O'Donnell: Thank you.

Deputy Eoghan Murphy: I would like to come back to the idea of minimum harmonisation, which Mr. Nava spoke about in his opening statement. He said this provided the minimum requirements for the enacting of prudential supervision in each member state. To his knowledge, did any country enact less than the minimum requirements or attempt to enact less?

Mr. Mario Nava: No. There is a minimum level in the rules that a country cannot go below, although it can go above that level. The issue is not going below; it is going above. There has been a global movement away from giving a little guidance and giving only the principal base to a more rules-based system under which we tend to say much more of what countries could or should do. There is no issue with regard to countries going below the rules that have been set.

Deputy Eoghan Murphy: To Mr. Nava's knowledge, did any country, at the beginning of the last decade and in the years leading up to 2006, when the directives were transposed, go above the minimum recommendation?

Mr. Mario Nava: If they wanted to, they could have done.

Deputy Eoghan Murphy: Is Mr. Nava aware that anyone did? The Commission follows this up.

Mr. Mario Nava: There are some countries which - when implementing, but especially when supervising, even in the absence of precise guidance for supervision - went for more intrusive practices. When it comes to supervision - I am really simplifying this to give the Deputy the idea - there are two types. One is a more intrusive type of supervision, with supervisors physically in the bank, going residential, checking the numbers. In other countries they had softer supervision and less day-by-day supervision. These were two schools. I am simplifying because there are intermediate positions. For clarity, these were two schools of supervision that we saw progressing in Europe in different countries. Maybe that is one of the reasons we recently came up with more guidance for what supervisors can and should do in particular circumstances.

Deputy Eoghan Murphy: As you watched this happening throughout the 2000s into 2006, and the crisis in 2008, did you find a correlation between those countries that had gone further than the minimum and the success or robustness of their banking system?

Mr. Mario Nava: Supervision certainly helps to contain risks, and more intrusive supervision, which results in better knowledge of banks' risk management and the internal measures they take, has helped. One can look for the correlation. The crisis was general in Europe but it is clear that it has hit some countries more than others.

Deputy Eoghan Murphy: We then come to 2006 and the capital requirements directive. Mr. Nava said in his opening statement that had these powers been used "to the full extent, a number of major difficulties could have been prevented." He is not talking about one particular country. Is he saying the directive was not being properly implemented or followed?

Mr. Mario Nava: No, what I am saying is that the directives were transposed and the Commission checked over the transposition of all the directives. What I am saying is that there could have been moves by the national supervisors which were not prevented by the directive. They were not even guided and they were not prevented. The reason there was not a precise guidance is exactly because there were different situations in different countries and therefore subsidiarity applied and depending on the economic and banking situation in a given country, the response would have been different from the response in another country.

Deputy Eoghan Murphy: Is it fair to say that the 2006 capital requirement directive was sufficient but that the national authorities-----

Mr. Mario Nava: It is fair to say that the 2006 capital requirement directives implementing Basel I, were done in the spirit of the time which was the spirit of going mainly for principle-based regulation. It is not fair to say that we did not realise that it was not enough. I have made this argument before in reply to a question from Deputy O'Donnell, which was that indeed, Basel II was then essentially scrapped and Basel III came. As I said it has been a history of evolution where there has been a constant improvement of the regulation and the supervision by learning from crises that emerged.

Deputy Eoghan Murphy: I refer to something Mr. Nava mentioned earlier about credit concentration limits. Are we going to have harmonisation at EU level on credit concentration limits or will that be left to national authorities in new supervisory structures? I was not clear from Mr. Nava's earlier statement if there was going to be an EU-wide directive on credit concentration as part of new structures or whether it will be left to the national authorities.

Mr. Mario Nava: No, credit concentration is certainly part of the capital requirement directives. Credit concentration may be looked at in different ways, for example, moving from micro to macro. The most obvious mechanism of credit concentration is excessive concentration to a counter party; for example, a bank lends me too much or a bank lends too much to a particular company. There can be credit concentration to a sector whereby a bank lends too much to a sector. There can also be credit concentration to a region whereby a bank lends too much to exposed activities in that region. This is a movement from micro to macro. One of the things we learned from the crisis is that national supervisors were more on a micro level and for good reason. Among the institutions which were created in 2011 was the European Supervisory Risk Board. This board's specific task is to help countries to carry out macro-prudential supervision and to carry it out in the context of the Single Market. Definitely, credit concentration is an issue but what I am trying to say is that this issue has both micro and macro aspects. Therefore, this issue can be tackled either at the level of one single counter-party by one single supervisor or it can be tackled at higher level and can necessitate some co-ordination of the measures.

Deputy Eoghan Murphy: I was not clear on the answer. The responsibility for identifying those risks lies with the national supervisor.

Mr. Mario Nava: Now that we have the system of single supervision, the ECB is responsible for the 120 largest banks in Europe and it will be able to identify for those banks if there are risks of credit concentrations.

Chairman: On Deputy Murphy's point, is there a suggestion or a recommendation that the ECB needs be moving to a more micro-prudential examination in this regard?

Mr. Mario Nava: The ECB is the supervisor for the 120 big banks so the ECB definitely does all the micro supervision for all the largest banks. With regard to the macro aspect, national macro-prudential authorities have been set up in the past two to three years. The ECB and the national macro-prudential authorities work together to determine the macro-prudential tools - the macro-prudential values.

Chairman: Is it the Commission's view that the ECB will move towards a more micro-prudential examination?

Mr. Mario Nava: Micro, for sure, because the ECB is micro-prudentially responsible for the 120 banks.

Deputy Michael McGrath: I welcome Mr. Nava and I thank him for taking the time to attend the committee. Does the European Commission accept any responsibility for the regulatory framework within which the banking crisis developed in Ireland and elsewhere in Europe?

Mr. Mario Nava: I am not here to accept responsibility; I am a witness. What I have tried to explain is the way in which we have worked, in some cases, at full steam, to continuously improve the regulatory framework with respect to the evidence provided by the economy. I hinted at it before but I will say it again: Let us not forget that during the good years, during the period 2000 to 2006, it became difficult for the Commission to intervene and make suggestions because, typically, those interventions were returned on the grounds that things are going okay and there is not much need for them. The job I am describing to the committee and the work we do here is very much a regulatory job of observation of the places where the crisis can emerge. That is why I was pleased to be asked one of the initial questions which was my opinion of where the next crisis will come from. It is a job of monitoring, understanding and adapting the regulatory system to it.

Deputy Michael McGrath: I accept that. If Mr. Nava will not accept responsibility is it then a statement of fact that the European Commission was responsible for the regulatory framework and the setting of minimum regulatory standards in the member states? Is that a statement of fact?

Mr. Mario Nava: As I explained, the European Commission is the draft legislator but it is not a co-legislator in Europe. The legislation is then set by the Council and the Parliament because they are the co-legislators and they act on the basis of our draft legislation.

Deputy Michael McGrath: Senator Barrett alluded to the period of 2000, maybe even 2002 to 2006. We heard evidence from the Governor of our Central Bank that by 2006 and

2007, essentially the damage was done, in terms of the losses being inherently in the system. Was principle-based regulation a mistake during that period?

Mr. Mario Nava: I can provide a clear example. With Basel III we introduced a capital buffer which is called, "counter-cyclical capital buffer". That buffer increases the capital requirements when an economy is in good times. Basel III and the CRR, introduced this clear mechanism which made the capital requirement higher in good times. This was done in recognition of what the Deputy said, namely, that most of the excess leverage and most of the errors may actually happen in good times because in good times the economy is booming and so banks tended to lend more. It is interesting to note the ESRB report which stated that in spite of the fact that we are clearly now not in a boom period, all countries have set their counter-cyclical buffer at zero for the time being but in all countries there is the possibility that if the economy booms again, a country will move its counter-cyclical buffer. Currently, only one country has moved its buffer out from zero.

The Deputy makes the point that most of the banking errors are made in the good times because of the excess of lending. That point has been recognised very much, both at the global level in Basel and in our legislation in the CRDCRR, by the introduction of this counter-cyclical capital buffer which allows more capital requirements in the good times.

Deputy Michael McGrath: Mr. Nava referred in his statement to minimum standards below which countries could not go but they were allowed to set a higher standard of regulation. Did Ireland meet the minimum standards of regulation during the period in question?

Mr. Mario Nava: Yes, of course. Everybody met the minimum standards.

Deputy Michael McGrath: Was that checked by the European Commission during those years?

Mr. Mario Nava: The European Commission checked that national law was accurately transposing the directive. That is what the European Commission checked. On this, there was no possibility of being wrong.

Deputy Michael McGrath: So the banking directive at EU level was adequately transposed into Irish law and in terms of oversight, was that the limit of the European Commission's role during those years? There was no additional supervision and the Commission's only job was to ensure that the directive was transposed into Irish law. What about the implementation of the law? Was that entirely a matter for domestic authorities or did the Commission have a role in that?

Mr. Mario Nava: The Commission has the legal role of verifying the two items of law and making sure that they are equivalent. It is responsible for ensuring that the national law transposes exactly what the European law says. At that point, the law then becomes a national matter; it is a national law which is verified by the national court, if needs be.

Deputy Michael McGrath: I will move on to the present time and the measures that have been put in place to prevent a future crisis, particularly the single resolution mechanism and, as part of that, the single resolution fund. Is that fund live as we speak?

Mr. Mario Nava: It is interesting that when we speak about the single resolution mechanism, everyone focuses their attention on the single resolution fund. The fund is unique and a first in European legislation and is deserving of attention but if one looks at the directive, one sees that this comes at the end. What comes before are resolution plans and especially important, the possibility of using private sources - bail-ins - in order to make sure that eventual losses are contained within stakeholders and do not spill over to taxpayers. The single resolution fund will be constructed over eight years. Final agreement on that was reached a little less than a year ago in the European Council and Parliament. It will be constructed over eight years and by the eighth year, it will be at its maximum level. It is being progressively constructed. I must stress the point, which is well known, that the single resolution fund is made up of private contributions from the banks and is not made up, in any way, shape or form, of public money.

Deputy Michael McGrath: Very quickly, on the June 2012 summit agreement regarding separating banking debt ---

Chairman: I was going to let you move on with the single resolution fund but if you are opening a whole new line of questioning ----

Deputy Michael McGrath: It is a very quick question and it is not really about Ireland either.

Chairman: Fine. Proceed.

Deputy Michael McGrath: Is the European Commission satisfied with the progress, or lack thereof, on the implementation of that June 2013 summit agreement?

Mr. Mario Nava: Sorry, which summit agreement?

Deputy Michael McGrath: The June 2012 *communiqué* from the European Council on the separation of banking debt from sovereign debt. Is the European Commission satisfied with progress in that regard?

Mr. Mario Nava: The Deputy is referring to the *communiqué* on 29 June 2012, which launched the banking union. On that date, the Heads of State and Government called for a breaking of the links and on 12 September, nine weeks later, the Commission put a proposal on the table for the single supervisory mechanism. So, over eight weeks during the summer we were able to produce what was asked for. We have taken major steps to break the links between banks and sovereigns. I would point to at least three: greater capital in the banks, the Single Supervisory Mechanism, and the Single Resolution Mechanism and the possibility of using bail-in tools to avoid any possibility of a link between the two again.

Chairman: I want to round off something that Deputy McGrath raised with you, Mr. Nava. How much does the single resolution fund require to be operational?

Mr. Mario Nava: The single resolution fund is supposed to reach 1% of deposits, which has been estimated at €55 billion.

Chairman: So €55 billion is the requirement of the fund. How much is in there at the moment?

Mr. Mario Nava: At the moment it is being constructed and is at about 12.5%. It is not exactly at that point, but it will be constructed over eight years and one can assume that it will go up, roughly, by 12.5% per year.

Chairman: At present the fund would not be able to cope with a crisis if one were to happen in the short term. Is that correct?

Mr. Mario Nava: The fund is not meant to cope in the first place with a crisis. The Chairman is talking about the overall fund, which I have said will reach €55 billion. If one takes the assets of the European banking system, however, the figure is approximately €46 trillion, while the assets of the euro area amount to about €30 trillion. On the basis of those assets, bail-ins are possible and that is the second line of defence. The first line of defence comprises the higher capital requirements and the regulatory plan. Then comes the bail-in possibility and then, only at the very end, the fund. We need to move away from the idea that the fund alone will do it. What will do it are all of the measures combined - greater capital requirements, greater supervision, resolution plans and bail-in possibilities. That is really what will defend taxpayers.

Chairman: Thank you, Mr. Nava. Deputy Phelan is next.

Deputy John Paul Phelan: I welcome Mr. Nava to the meeting. In response to Deputy McGrath's question about the years when the crisis first hit here, Mr. Nava said that Ireland met the minimum standards that were laid out by the Commission.

Mr. Mario Nava: The law of Ireland met the minimum standards.

Deputy John Paul Phelan: Does that not beg the question as to whether those minimum standards served any purpose, in light of what we know now in terms of what was going on in financial institutions in Ireland and elsewhere? What was the purpose of those standards?

Mr. Mario Nava: What I said, to be precise, was that the law of Ireland met the minimum standards. Does that beg the question as to whether the standards were too low? I think you have had a very explicit reply by the global institutions and the Commission to that question, given the fact that those standards have now been multiplied by three. In the space of a few years, the minimum standards were multiplied by three and on top of the minimum standards we now have other buffers, like the counter-cyclical buffers which we spoke about earlier. We also have another buffer which is called the capital conservation buffer which makes it impossible for the banks to distribute dividends unless they are comfortably above the minimum and there are also systemic risk buffers which protect them. Rather than speculating about whether the standards were too high or too low, I would say that the pragmatic reply is very clear. We have had an explicit reply that we needed higher standards.

Deputy John Paul Phelan: I understand that but it is of very little consolation to the Irish taxpayer that the standards were increased subsequently. In your opening report - and I do not want to be insulting to what Mr. Nava said ---

Chairman: Do not be insulting, please.

Deputy John Paul Phelan: I am not going to be.

In his opening statement, he outlined a system of trial and error. There is a strongly held belief in Ireland that we have been at the thin end of the wedge, to use an Irish phrase, in terms of that trial and error process. While changes may have been made subsequently, regulation for which the Commission had an oversight responsibility was wholly inadequate and not fit for purpose until quite recently. It has since taken a more in-depth responsibility for the 120 biggest institutions.

Chairman: Do you have a comment on that, Mr. Nava?

Mr. Mario Nava: The Commission is responsible for bringing forward the regulation and that is what it always does, in all instances. I do not think that the Commission can be said to have waited excessively long. Banking regulation is something which is discussed at a global level. At that global level, one must think of Basel I and Basel II. In global fora, the Commission has always followed that and has always been at the forefront of the debate. What has happened is a progressive move away from a national situation to a European situation. That is what has happened and that is what we have tried to gauge with regulation.

Deputy John Paul Phelan: I understand but were any sanctions meted out to countries which did not meet the minimum standards prior to the development of the single supervisory mechanism? I ask Mr. Nava to give examples of that.

Mr. Mario Nava: If directives are not properly transposed, then the Commission opens what is called an infringement procedure. That infringement procedure may lead to sanctions.

Deputy John Paul Phelan: Did it?

Mr. Mario Nava: I do not exactly remember. I am happy to submit something in writing on that if the committee wants.

Deputy John Paul Phelan: I suspect the answer may be "No".

Mr. Mario Nava: As I said, I do not exactly remember, but I do not think so.

Deputy John Paul Phelan: Since the Commission assumed responsibility for the largest 120 institutions-----

Mr. Mario Nava: Not the Commission, the ECB.

Deputy John Paul Phelan: The ECB I should say. Have there been sanctions handed out to any of those institutions that might have infringed the minimum standards?

Mr. Mario Nava: We have to be clear on who infringes what.

Deputy John Paul Phelan: The banks. Since the change to having the largest 120 directly supervised by the ECB have sanctions been imposed?

Mr. Mario Nava: Wait. We need to clarify one thing, if I may. Sanctions are when a country does not transpose correctly a piece of law called the directive. That is a sanction. If a bank goes below the minimum, the national supervisor withdraws the licence or accompanies the bank toward the process of resolution. That is what happens.

On the 120 banks, there is a big distinction between the country and the banks. On the 120 banks that were moved to the ECB, before being moved to the ECB, the Deputy may remember that the week before the stress test and the so-called comprehensive assessment of the assets were made. So the ECB "acquired" - I am sure it is not the right word - or got power to supervise those banks after having had a thorough assessment of their assets and liabilities. This is the exercise of the stress test and the banks data-----

Deputy John Paul Phelan: I was using "sanction" in the widest possible sense and not specifically related to transposing.

Chairman: I wish to clarify one thing. The Commission deals with national structures. Sanctions with individual banks is not a matter for the Commission; it is a matter for national supervisors.

Mr. Mario Nava: Absolutely.

Deputy John Paul Phelan: It is a matter for the ECB for the largest 120 banks.

Earlier this morning Professor Black outlined that the United States had introduced a cap on the annual growth of bank balance sheets - I think he mentioned 25%. Is there any proposal at a European level to look at the level of growth in bank balance sheets annually and have a similar cap at a European level? In Ireland one of the banks in particular was growing at a much faster rate than 25%.

Mr. Mario Nava: There are no global standards to limit the growth of the banks. There is, however, a global standard that was asked before on the indebtedness of the bank - on the leverage of the bank. That is a static value; it is not a dynamic value. So there are no global standards or European standards to limit the growth but, having said all of that, it is exactly the job of the supervisors to understand what is driving the growth of a particular bank.

The situation the Deputy describes is a situation that is more, let us say, idiosyncratic - so referring more to a particular bank than a general situation. It is typically the job of the supervisor to look at one particular bank. In the case of that bank, if it observes a growth rate which may be due to the effect of having found a particularly good business sector or a growth rate which can probably not be sustained, that is the duty of the supervisor. There is no global idea for that cap.

Deputy Pearse Doherty: Cuirim fáilte roimh Mr. Nava. I ask him to clarify the role of the Commission and the minimum requirements set for member states. Is it correct that the Commission sets the minimum standards through the process Mr. Nava outlined earlier? When the minimum standards were applied they were transposed into national law and the Commission stood back and did not check whether those minimum standards were being fulfilled.

Mr. Mario Nava: If I may be precise, it would be correct to say that the Commission proposed those minimum standards to the Council and Parliament. The Council and Parliament adopted the minimum standards. Then the Commission verified that the national law was in compliance with those minimum standards. So the Commission verified that the national law said that banks must have so much capital. Then once the law is there, it is for the national laws for the national supervisor to make sure the banks would respect that minimum standard.

Deputy Pearse Doherty: Would it be correct to say at that stage the Commission washed its hands with regard to the application of the minimum standards?

Chairman: There is an application of prejudgment in referring to washing hands.

Deputy Pearse Doherty: Did the Commission stand off? It had no other involvement in the application of the minimum standards once they were transposed and it had been assured they had been transposed accurately into national law.

Mr. Mario Nava: We are the guardian of the treaty. So we make sure the treaty is respected, but we are not supervisors. It is not our role; it is not our competence to go and check the banks. We do not have the resources. We do not have the people. The Commission is not a supervisory agency.

Deputy Pearse Doherty: What were the minimum standards in 2008 and 2009? What was the core tier 1 ratio for risk-rated assets at that stage? What was the percentage?

Mr. Mario Nava: At those times the overall ratio was 8%, both before and after Basel III, but before Basel III the 8% was more generously calculated by a composition of the core tier 1, which needed to be only 4% and tier 2. The great reform of Basel III was exactly to increase the amount of capital that can unequivocally and in any moment absorb losses.

Deputy Pearse Doherty: Does the European Commission have a role in approving capital injections for banks under EU state rules?

Mr. Mario Nava: The European Commission has responsibilities over state aid.

Deputy Pearse Doherty: It had to approve capital injections. More specifically on the request to inject capital into Anglo Irish Bank in January 2009, when the Irish Government informed the European Commission that Anglo Irish Bank was capitalised above the 8% rule, did the Commission have no obligation to check whether that was accurate?

Mr. Mario Nava: Chairman, I cannot-----

Chairman: It is not Mr. Nava's area of expertise.

Mr. Mario Nava: It is not in my area of expertise. I do not deal with competition policy and most especially I cannot talk about particular cases.

Deputy Pearse Doherty: I have looked at the European Commission's website regarding the letter sent to it on 14 January by the then Minister for Foreign Affairs, Deputy Martin, which stated that the regulator assured that Anglo Irish Bank was capitalised above the minimum rates. I appreciate this was a competition issue, but regarding the division Mr. Nava heads up, is it correct that there was no requirement to assess whether the bank was in compliance with the minimum capital requirements at the time?

Mr. Mario Nava: If I understand what the Deputy is asking, the division I lead is the division of regulation. So my duty is to check the law. The Deputy is asking a question that has to do with competition. What he is asking is the verification of the statement of whether that particular bank was above or below a particular number. That, I repeat, is a case-by-case issue which I am not competent to discuss and I cannot discuss.

Deputy Pearse Doherty: I appreciate that.

Mr. Mario Nava: My department is a regulatory department and will look at law. We do not look at particular cases.

Deputy Pearse Doherty: I wish to clarify this. Mr. Nava's department deals with regulation. The request by the Irish State sought approval for the guarantee, which the Commission approved in mid-October. Is it correct that the request for all of the capitalisations of the banks, which would have been approved by the Commission, did not need input from the department Mr. Nava heads up?

Mr. Mario Nava: The request was sent to the competition department. The competition department does all the analyses the Deputy asked about and I do not want to speak about the analyses it did because I am not fully aware of them. Once it made the analyses, given that any decision of the Commission is collegial, it submitted them to the different departments.

Deputy Pearse Doherty: A restructuring plan was required as part of the recapitalisation of Anglo Irish Bank. Does the competition arm of the Commission, as opposed to its regulation arm, deal with this issue?

Mr. Nava indicated he has read the report by the House of Lords on the response of the European institutions to the crisis which was published on 27 January. The report was not completely uncritical of the EU institutions. It includes a section on the politicisation of regulation and identifies a number of areas where it suggests regulation was politicised. In the period leading up to 2008, was politicisation of regulation or deregulation an issue in terms of national supervisors?

Mr. Mario Nava: The Deputy asked two questions. On the first question, the restructuring plan is discussed with the competition department. While discussing the restructuring plan, the competition department takes into account all the rules we have. There is no disconnect between the two. There is an apportioning of responsibilities. Each department is responsible for its own areas but we obviously take into account what the other departments do. It is not possible to have a restructuring plan which does not take into account the rules we have made.

The second question was on the politicisation of decisions. As I stated, the Commission brings a draft proposal, a draft capital requirement, to the table of the Council and Parliament. Let me cite a concrete example. The last draft capital requirement - the capital regulation requirement that is in application today - was brought to the table of the Council and Parliament in July 2011 and finally adopted in April 2013. The process lasted a little less than two years, which was quite a fast process for a document of 1,000 pages. The discussion in the Parliament and Council is done by those who are entitled to make law, who I understand are the legislators. I understand they are the political masters, the elected and appointed persons who make legislation. There may be an interpretation that one or other aspect is excessively political but, as a European citizen, I find it democratically correct that we have a clear process of adopting a law and it is adopted by political people.

The members of the committee are political people who have all been elected. They are the legislative power and they make legislation. I do not find it particularly strange that politicians make legislation. Actually, I think it is their duty to make legislation. In doing so, they may introduce political considerations because that is exactly the area in which politicians are involved. Let me give a concrete example. When the capital regulation requirement, CRR, went through the Council and Parliament, given the particularly difficult economic situation, the Council and Parliament introduced a rebate for the banks that were lending to small and medium enterprises. A rebate of about 25%, which was not in our proposal, was given on the back of a particularly difficult economic situation and the need to sustain the credit flow to small and medium enterprises. Was that a political decision? Yes, it was a political decision. Was it something the Council and Parliament had the right to do? As a European citizen, I would answer “Yes”. I must also say that, as a European citizen, I take comfort in the fact that the politicians looked not only at the piece of paper we brought to the table but also looked outside the window and saw what were the needs.

Deputy Joe Higgins: On the minimum regulation laid down by the European Union, Mr. Nava states that member states “typically did not resort to overly restrictive rules”. He also notes:

> The degree of flexibility previously granted to member states and national supervisors, as mentioned above, had led to divergent transposition of EU rules into national law. This created opportunities for regulatory arbitrage...

Chairman: To what is Deputy Higgins referring?

Deputy Joe Higgins: I am citing page 3 of Mr. Nava's opening statement.

Mr. Mario Nava: I recognise that.

Deputy Joe Higgins: Will Mr. Nava briefly explain, in the English language, what the term "regulatory arbitrage" means?

Mr. Mario Nava: "Regulatory arbitrage" means there are different rules in different places and those rules can be arbitraged. This means that the banks can shop, if one likes, in those rules and choose the place where they are more favourable. In a single market, this creates economic decisions which are based on rules rather than economic grounds and therefore introduces a distortion in the Single Market. It is exactly to avoid the possibility of using different rules in different places that we went towards the single rule book. The sentence the Deputy read comes immediately after a sentence on the creation of the single rule book, which is the capital requirement regulation. The logic of this regulation is exactly to avoid circumstances in which one has different rules in different places for the same activity. This would create an advantage in going to one place rather than another, which would not be compatible with the Single Market.

Deputy Joe Higgins: In one definition the term "regulatory arbitrage" is described as a practice whereby firms capitalise on loopholes in regulatory systems in order to circumvent unfavourable regulation. Did that happen?

Mr. Mario Nava: Once again, the fact that one has different rules in different places for the same activity - lending, for example - makes it possible, given the free circulation of capital in the Single Market, to go and shop in the place where more favourable rules are in place, according to the Deputy's definition.

Deputy Joe Higgins: Would very favourable taxation policy on the financial industry, for example, a much lower rate of taxation, qualify as regulatory arbitrage?

Mr. Mario Nava: No, my statement refers to regulatory arbitrage. What the Deputy is hinting at is the fact that there are other types of arbitrage. He is hinting at fiscal arbitrage, namely, the possibility that there are different fiscal regimes for similar types of activities, which determines the movement of firms.

Deputy Joe Higgins: Are regulatory and fiscal arbitrage related?

Mr. Mario Nava: They are two types of arbitrage. However, the implementation of the single rule book is only responsible for eliminating regulatory arbitrage. The other type of arbitrage goes back to the issue of fiscal laws. As the Deputy knows, fiscal laws in Europe have a different degree of harmonisation from banking laws. It is a completely different debate for which I do not have responsibility and which is not in my remit.

Deputy Joe Higgins: In the pre-crisis period, did Ireland have a reputation in the European Commission for regulatory arbitrage?

Mr. Mario Nava: Regulatory arbitrage is not an issue for a country but refers to the possibility available to firms to move to a given place. Once again, this is not an area where one moves by reputation. I do not feel I need to respond to that question.

Deputy Joe Higgins: I was a member of the European Parliament for a while. Mr. Nava is correct that the Parliament and Council sign off on legislation. It is true to say that the Commission is very influential in the production of legislation. In that regard, what type of influences lead Mr. Nava to make proposals? Mr. Nava will probably be aware of the Corporate Europe Observatory, which is a type of watchdog of the European Union institutions. It states that the European Commission operates an open door policy to lobbyists from the finance industry and that there are 1,700 finance industry lobbyists who spend €120 million per annum in lobbying the EU institutions. In contrast, civil society spends only a fraction of that amount. Was the decision to set only minimum standards in the pre-crisis period influenced by such lobbying by financial institutions?

Mr. Mario Nava: In regard to what we do in relation to the transparency of debt, this Commission has made clear from the beginning that it wants to be super-transparent. There is a register, which is available, in which is recorded all meetings with consumer associations, stakeholder companies and so on.

Deputy Joe Higgins: With whom do they meet?

Mr. Mario Nava: A Commissioner or the director general.

Deputy Joe Higgins: But not staff. Is that true?

Mr. Mario Nava: Normally, the senior manager who is in contact with the companies or stakeholders attends. There is no staff contact level.

Deputy Joe Higgins: Between end 2013 and mid-2014 there were 400 meetings between finance industry representatives and the Commission. Is that usual? Is it excessive, or not?

Mr. Mario Nava: I cannot make that judgment. I can say, however, that if that number of meetings did take place they were in relation to different areas. Today we are speaking about banking. The Deputy will be aware other areas such as corporate governance, markets and so on come within our remit. The areas we regulate are many and different.

It is important to make the point that all those contacts are transparent. It is probably not correct to claim that any particular outcome - the Deputy referred to minimum harmonisation - comes from those contacts. The counter-proof, which I think is relatively solid, is that the minimum harmonisation logic prevailed at global level. Clearly then a global level logic was in place at the time of the banking directives. The move from banking directives to banking regulation, which led to the move from minimum standards to maximum harmonisation, was made in 2011 in recognition of the need to preserve the Single Market, to have a single rule book and to avoid arbitrage. I would not definitely link them.

Senator Marc MacSharry: I welcome Mr. Nava and thank him for taking the time to be with us. The Commission's role is the drafting of legislation as opposed to making decisions. Would it be fair to say that given the amount of new legislation drafted since the crisis, the Commission's work in regulation up to that point was disastrously unfit for purpose?

Chairman: Senator MacSharry's contribution is very colourful but he should stick to asking questions.

Senator Marc MacSharry: I asked a question.

Chairman: The Senator also answered it.

Senator Marc MacSharry: I did not. I asked if what I was suggesting would be fair or not.

Mr. Mario Nava: It would be fair to say that legislative production in the last five years as compared with the five years previous to that has changed. In the last five years we produced 41 pieces of legislation. In previous years we did not produce so much legislation. This is in recognition of different elements, including the state of the economy, the global consensus on banking legislation and so on. If the Senator's question is whether the Commission produced more legislation in the period from 2009 to 2014 than it did from 2004 to 2009, the answer is "Yes".

Senator Marc MacSharry: So Mr. Nava agrees.

Mr. Mario Nava: I agree with the Senator that we produced much more legislation between 2009 and 2014 than we did between 2004 and 2009. That is a fact.

Senator Marc MacSharry: I am pleased that it is. In the period running up to the crisis the Committee on Economic and Monetary Affairs of the European Parliament met many times. The then head of the European Central Bank, Jean Claude Trichet, would attend those meetings and answer questions. At that time Irish MEPs, most notably Mr. Eoin Ryan and Mr. Gay Mitchell, consistently raised with Mr. Trichet whether, because asset price inflation at that time was extremely worrying for countries like Ireland, it was prudent to be lowering interest rates. It was even suggested by some people at the time that this would not be sufficient. All of this information is available from the minutes of the meetings and as such there is nothing that is not in the public domain.

Mr. Trichet was very specific in pointing out at that time that Ireland was performing very well and that while the focus of the ECB was very much on price stability, asset price inflation should remain its main focus and mission. Has that changed? From the Commission's perspective, is there greater focus than heretofore on the effects of asset price inflation given what that led to, as opposed to the traditional ECB mission which is arguably more German-focused of price stability?

Mr. Mario Nava: On the ECB mission, it is not for me to comment on that. The ECB mission is clearly defined in Article 104 of the treaty. It is not for me to comment on whether the ECB-----

Senator Marc MacSharry: I will try to be more helpful. In the reality of asset price inflation contributing to the difficulties we have experienced over the past seven or eight years, what has the Commission drafted to ensure we are adequately monitoring this situation for European citizens?

Mr. Mario Nava: One of the most well known pieces of production by the Commission is the so-called country specific recommendations, which touch on every country in Europe, and include many and different considerations of the specific economies looked at, including asset pricing. If the Senator's question is whether the Commission is looking holistically at the economics of all countries then the response is "Yes". However, it might be more appropriate to ask that question of the director general who signs off on the country specific recommendations when he is here in two weeks time. As a contributor to those specific recommendations I can say consideration is given to all those issues. I cannot as I said comment on ECB policy.

Senator Marc MacSharry: As pointed out, decisions are made by the Council and Parliament rather than the Commission. Has the Commission drafted a position or suggestion that

Ireland should allow a bank to fail?

Mr. Mario Nava: This is not within my remit. My remit is, clearly, regulation. This is not within my remit; it is within the remit of the country specific recommendation. I do not exactly remember. When the person who made the country specific recommendation-----

Senator Marc MacSharry: To whom in the Commission would one put this question?

Mr. Mario Nava: This is an issue one finds in the country specific recommendation. It is not within my remit of regulation.

Senator Marc MacSharry: I appreciate that and I am sorry. I am just asking-----

Chairman: The witness may not be able to answer the question.

Senator Marc MacSharry: I appreciate that. I certainly do not know who to ask. Could Mr. Nava suggest who might be more appropriate?

Mr. Mario Nava: In 15 days time the Directorate-General for Economic and Financial Affairs, which signs off country specific recommendations, will come before the committee.

Senator Marc MacSharry: Thank you.

Senator Susan O'Keeffe: On a scale of one to ten, how much confidence does Mr. Nava have in the regulation now in place?

Mr. Mario Nava: My confidence has increased, and if I may I will give two replies. On a scale of one to ten my confidence is at nine in the regulatory reform in place. At the opening of the Brisbane G20 summit, the chair of the Financial Stability Board stated regulatory reform is substantially complete and what remains are banks which are too big to fail. My confidence has increased threefold with the work of recent years.

Senator Susan O'Keeffe: In 2006 Mr. Nava would have said his confidence was at three.

Mr. Mario Nava: In 2006 and 2007, we realised when the crisis came that we had many things to do, and certainly we have done many things. It is not by chance, and it was mentioned by Deputy Phelan a moment ago, that we have produced 41 pieces of legislation in five years. Clearly at global level there was recognition that more needed to be done. In Europe, particularly in the euro area, we went beyond the global level by introducing two specific elements of banking union, namely, the single supervisory mechanism and the single resolution mechanism. These are game changers and massively increase the confidence we should have in the system.

Senator Susan O'Keeffe: In the drafting of the legislation and the preparation of those mechanisms, how many times, if at all, did Mr. Nava, his colleagues and his team speak with Professor Black, or listen to or appreciate the argument he has put forward about the way banks and bankers have behaved and what regulation he believes would be a game changer?

Mr. Mario Nava: I did not have the chance to hear Professor Black.

Senator Susan O'Keeffe: I do not mean here this morning, I mean in Mr. Nava's work in recent years.

Mr. Mario Nava: In the work of the past two or three years we spoke with and took evidence from the authors of all of the academic papers that were available. We looked at-----

Senator Susan O'Keeffe: Did that include Professor Black?

Mr. Mario Nava: I do not remember discussions with Professor Black.

Senator Susan O'Keeffe: Probably not.

Mr. Mario Nava: Probably not. I certainly did not have discussions with Professor Black. We had a seminar with Admati and Hellwig, who propose a much higher standard. We measured the various proposals at international fora. Frankly, it is important for banking regulation to remain in tune with what is global because the banking market is global. What drove us was, very clearly, the necessity to step up not only with regard to what was happening in the banks but also the supervisory mechanism and the resolution mechanism. I do not think we have come up with a system which cannot be defined as safe. We have come up with a system which is very safe and which has significantly reduced the likelihood of failure and the impact of any failures which may occur.

Senator Susan O'Keeffe: Given his criticism of the system previously, and his criticism of the current system, would it be useful for Mr. Nava and his colleagues to engage with Professor Black, at least to hear what he might have to say, not only at our hearing but in a broader context, because he is very specific that he does not have faith either in the system that was there or the system that is here now?

Mr. Mario Nava: The European Commission is one of the most open organisations with regard to listening to all those who want to contribute. I would definitely welcome Professor Black if he wants to engage with us and come to speak to us.

Senator Susan O'Keeffe: It was Mr. Nava's mechanism that changed supervisory responsibility for the 120 largest banking groups. If I understand it correctly from his statement, this supervision is now with the European Central Bank.

Mr. Mario Nava: That is correct.

Senator Susan O'Keeffe: What is the benefit of giving the 120 larger banks to the European Central Bank and setting the others in a separate place? Does that not give us more belief in the idea of banks being too big to fail and that they need extra special help, supervision or status?

Mr. Mario Nava: There are various ways to look at it and the easiest way is probably what I tried to hint at earlier. These banks are not all super big. There are banks from every country. Most of them have grown outside their countries and are active abroad. They are no longer national banks. If one wants the economics to be European, so to speak, then the vision of those who control the economics needs to be a European vision. It made a lot of sense to have equivalence between the level of supervision and the level of the banks' activities. In some countries there are very small local banks and it is questionable whether a supervisor in Frankfurt would be as efficient as a supervisor closer to the bank who knows it better. Such banks are clearly of a smaller dimension. However, one point which I did not make and I should have is that the ECB has the power to supervise any bank, no matter how small. The ECB is responsible for the 120 larger banks, which account for 75% of European assets, and it has the potential to be responsible for the joint supervision, along with the national supervisor, of any of the other banks, which represent the remaining 25% of the assets.

Senator Michael D'Arcy: I welcome Mr. Nava and thank him for coming. What was the ultimate sanction for a bank which did not meet the capital requirements?

Mr. Mario Nava: It was withdrawal of the banking licence. If a licence is withdrawn, that is it.

Senator Michael D'Arcy: Who withdrew the licence?

Mr. Mario Nava: At the time it was the national supervisors, and today it is the ECB with regard to the largest 120 banks.

Senator Michael D'Arcy: Did any bank have its licence withdrawn under the initial Basel directive of 2000?

Mr. Mario Nava: A number of banks had their licences withdrawn, and the mechanism foresees that when a national supervisor takes a decision to withdraw a licence of one given bank, it communicates data to the European Commission and the European Banking Authority, which keeps a register of European banks which one can see at any time on its website. At present there are approximately 7,700 European banks.

Senator Michael D'Arcy: Of how many banks which had their licences withdrawn is Mr. Nava aware?

Mr. Mario Nava: I cannot recall the number, but it has happened in the past few years. At some times, the number was higher and other times the number was lower. The information is publicly available.

Senator Michael D'Arcy: What reasons would there be for the withdrawal of the banking licence apart from not meeting the Basel requirements?

Mr. Mario Nava: That has nothing to do with Basel; it does not meet the law. Basel are only guidelines and they are then transposed into law.

Senator Michael D'Arcy: Into CRR.

Mr. Mario Nava: Exactly. These affect the data. The breaching of the law cannot be recorded. The breaching of the capital requirements cannot be recorded and the bank has no possibility to go back above the line.

Senator Michael D'Arcy: Does Mr. Nava's role involve analysis of the ratings agencies?

Mr. Mario Nava: Not specifically my role. The ratings agencies are done by the corporate governance department and, in terms of the agencies, the work that the Commission did over the past few years was essentially it wanted to make their decisions more transparent and to make sure their decisions were taken on the basis of justified elements and with proper advance warning justification and so on, but credit rating agencies do not come under my remit.

Senator Michael D'Arcy: Do they come under the entire section Mr. Nava operates?

Mr. Mario Nava: No, they are in a parallel section where they deal with corporate governance.

Senator Michael D'Arcy: Do the big four auditing firms come under Mr. Nava's section?

Mr. Mario Nava: No, I am afraid not. They are together with the credit rating agencies under that section.

Senator Michael D'Arcy: Banks complained that they had to allocate too many staff to adhere to Basel rules, particularly Basel II. Were they reasonable?

Mr. Mario Nava: We have heard the statement many times that the compliance costs have increased. Let us say the increase is connected with the fact that the rules have increased. What I said, even in my statement, is that the two essential elements of a good financial sector which citizens can trust are good bank governance and their own ability to respect the rules and then check the rules. Without being able - because it is not my job - to judge whether an increase was too much or too little, it is clear that as there were more rules, banks were probably wise to step up their ability to comply with them.

Senator Michael D'Arcy: The Bank for International Settlements conducted a survey recently. It gave a number of banks a model and asked them to comply with it. Much of the information they supplied was different because each bank has a separate risk modulation. How can that modelling anchored on that basis that a model was provided but many different answers came back?

Mr. Mario Nava: The Senator is referring to the risk modelling issue and this is a central issue that we need to address. Since Basel II moved to the concept of risk weighted assets and not unweighted assets, the rationale for data is that if you do not move to risk weighted assets, you implicitly assign the same risk to any activity you do and, obviously, that is not correct. Obviously, there are activities that are more risky than others and, therefore, assigning the same risk to any activities you do is not correct. The way forward is to try to model the risk. Then comes the risk modelling issue. The models are internal models of the banks but the supervisors verify the different models and we have initiatives both at the European level, at the EBA, and at the global level, the Basel committee or the BIS, to try to make sure that this modelling is not too far apart. I am happy to quote here that during the CRR approval, the parliament introduced the concept of benchmarking, essentially trying to benchmark and compare the models as much as possible.

The other extreme would be to go to a standardised model where it is equal for all and, again, that is probably too much of a simplified assumption.

Senator Michael D'Arcy: Mr. Andy Haldane, the Bank of England chief economist, has a dog and frisbee theory. Is he off the mark?

Mr. Mario Nava: Mr. Andy Haldane is a colleague at the Basel committee. He puts in evidence the difficulty of having good risk modelling. Risk modelling is not easy. There have been a number of initiatives since that influential paper was written and I welcome initiatives that make risk modelling safer and in a way more comparable. The problem is that going for a too simplistic alternative to risk modelling, which is not risk weighted at all, is unsatisfactory.

Senator Sean D. Barrett: I thank Mr. Nava for attending. In reply to Senator O'Keeffe's question, he said he was 90% happier than when he took up office. He then said it is presumptuous to claim that these reforms have consigned financial and particularly banking crises to history. He gave an optimistic view and I hope that will the case, but I refer to the legacy issues faced by the committee. Living standards data for Ireland were published last week. Every person in Ireland is €2,500 worse off since 2008. Mr. Nava can imagine what that does to a family of four. I am not satisfied that the correct approach was adopted in applying the principle of subsidiarity to bank regulation in the crucial period between 2000 and 2008. The euro was a project that should have been implemented at a higher level and not under this principle. We have to examine those legacy issues, including the debt that has been mentioned. Are there design faults in the euro? How would Mr. Nava tackle legacy issues? His reforms are too late for our constituents and the people of Greece, Portugal and Spain. They are eminent and worthy but mistakes were made and the people on the streets have paid massively for them. Our duty as legislators is to try to recoup their losses.

Mr. Mario Nava: I sympathise a lot with what the Senator said because the curse of the legislators and the regulators is that they have few instruments to tackle what he calls, appropriately, "legacy issues". What we can do is go forward. Now with 15-year insights, there is common recognition that they were flaws in the design, which we have tried to cope with and improve, but, unfortunately, the fact of the matter is that in a difficult job like mine, the job of regulation has this curse of being unable to deal with what has happened. We can make sure that it does not happen again, and that has been my statement. We try to make sure that it does not happen again but what has happened has happened and we need to find a way to make it least difficult for the people who have suffered a lot through it.

Deputy Kieran O'Donnell: Mr. Nava referred to the single supervisory authority and the Single Resolution Mechanism Fund as game changers. When will the fund become active? Mr. Nava referred to €55 billion. At what level does it become active? When will it reach the level of €55 billion? What is the timeframe?

Chairman: If you have a supplementary-----

Deputy Kieran O'Donnell: I would like an answer to those; I may have to ask a supplementary question.

Chairman: You may not, because we may run out of time. Mr. Nava has to be gone by 2.20 p.m.

Mr. Mario Nava: The question is very similar to the one the Chairman put.

Deputy Kieran O'Donnell: I just want full clarification.

Mr. Mario Nava: This is the first year where banks are contributing to that fund. The constitution of the fund will take eight years. It is more or less linear, at one eighth per year. That is the time it will take and it will take exactly eight years. Please retain what I said. That fund is only the very last line of defence.

Deputy Kieran O'Donnell: I know, but the point is that the fund has to be at €55 billion before it becomes active.

Mr. Mario Nava: No, that is not what I said. I said it will arrive, in eight years, at €55 billion-----

Deputy Kieran O'Donnell: That is the peak.

Mr. Mario Nava: -----but that is the top.

Deputy Kieran O'Donnell: When can a country actively apply to that fund?

Mr. Mario Nava: That is exactly the type of decision the single regulatory mechanism, which the Deputy mentioned, takes. When a bank goes down, we have a resolution plan which will involve so much of bailing, equity taking and so on. If needed, the use of the resolution fund is a decision the single resolution mechanism will take on a case-by-case basis.

Deputy Kieran O'Donnell: It is active, as of now.

Mr. Mario Nava: It is.

Chairman: As we move to concluding, Mr. Nava may have some final comments he wishes to add. I want to deal with a couple of matters. I am not too sure if we have a matter concretised. In regard to the credit concentration limits which are coming down the track and on which the Commission is currently working, is there a recommendation on what banks have to have in terms of credit concentrations?

Mr. Mario Nava: The credit concentration issue is inside the CRR. It is part of the main regulatory environment of banks. It is no different from other risk.

Chairman: The reason I am pinning you down on this is that this is an issue which this inquiry has been looking at and will continue to look at. In 1996 the Central Bank in Ireland, in its winter bulletin, gave very clear recommendations to specialist areas with regard to sectoral credit limits. By the early 2000s, it looked as though, particularly with the testimony which has come before this inquiry, those concentrational limits were no longer being overseen or enforced. It is questionable whether they were even being breached at that stage. At no time were the sectoral concentration limits lifted by the Central Bank. To use Governor Honohan's phrase, it was a dead letter. In your latest set of rule making, is the Commission setting out clear concentration limits? Can you tell us what the percentage is? Is it 25%?

Mr. Mario Nava: There are clearly large exposure limits, no more than I would give a percentage of the capital or assets. They, clearly, are limits that the supervisors ought to control, and they will. I was just about to say one thing before the Chairman clarified his question. This does not impede the supervisors if, in some particular cases, they see that for a bank there is excessive growth, as was hinted before, or a particular concentration at the macro level in a given sector or country, with different counterparts. It does not impede the issue of the concentration limit being part of the supervisory pillar.

Chairman: We began with a football analogy and you introduced the football team Glasgow Celtic. Glasgow Rangers got itself into trouble because it obeyed some very basic accountancy rules in running a football club and ended up getting itself regulated into a new league. We have a situation where, because a football club becomes insolvent, a very measurable outcome happens. This is football. Bill Shankly might have said it is far more important than life, but banking is certainly a very important factor in life.

In Professor Black's testimony this morning and Professor Kane's testimony the week before, both stated there was £180 billion paid out in fines by American and European banks since 2008. These are banks that are breaching rules and regulations you are setting out. In euro terms, it is in excess of €200 billion. This inquiry is not just about looking at the past; it is about learning from the past. You concentrated on that this morning. It is about focusing going into the future.

In your presentation to the inquiry this morning, you talk about banks that are too big to fail and sanctions that would be applied. I think it was on page 3 of your report. You say that national supervisors were required to review remuneration policies, which are bonuses in lay-persons' terms, and to impose sanctions if these policies did not meet the new requirements. You then go on to state that supervisors have obtained enhanced sanctioning powers going into the future, which are more intrusive and so on and so forth.

Are we ever going to arrive at a stage where the Commission will say it will continue with a fine-based system, but it will move into a legislative code which identifies bankers, as Senator O'Keeffe said, as opposed to banking institutions? Would there be strong recommendations in regard to the changes in the criminal code, where we would criminalise some of this behaviour as opposed to the sanction involving fining an institution?

Mr. Mario Nava: First of all, my forecast is that because of the increased efforts by the bank to comply with the rules and the increased personnel mentioned by Senator D'Arcy to comply with the rules, instances of the need to sanction banks will probably be reduced because it is very clear that we have stronger rules and banks are making efforts to respect that. The Chairman is referring to matters in addition to the current individual responsibilities of the people who are on the board. In a banking institution there are still individual responsibilities for the people on the board. On top of that, one could move, presumably, towards straight individual responsibilities and make the supervisor fully accountable. That is a debate which may take place at some point.

What we wanted to do with the construction of the new system we have constructed, which has capital rules, supervision and resolution, was to make sure that the instances where one needed to impose punishments were as few as possible. This was for one simple reason, namely, that one had more people within the banks checking and more effective supervision checking that. We tried to move away from a system where there is damage and one applies a sanction to recoup the damage, to one where there is no initial damage. There are lots of lights which tell one to be careful and it is risky to go somewhere.

Chairman: To conclude, I can appreciate that your new rules would have the expectation that you would have less of the behaviour that causes banks to crash and that may result in fewer penalties. Maybe I am misinterpreting what you are saying. Are you saying that the Commission is not looking at increasing the tariff, which is the penalty in terms of moving from a fine to a criminal sanction? Is that not on its agenda after what has been probably the largest financial crisis globally in modern history?

Mr. Mario Nava: This has been the largest crisis in modern history. It has been dealt with at the level of national supervisors. Now we have European supervisors who are responsible for checking compliance with the law. The Chairman is asking a question about the future to which I am unable to respond. He asked whether we will have some more legislation stepping up sanctions. That is a question to which I am unable to respond and which the Commission will need to address. An important point is that this year we will do a review of the SSM. At the end of this year, we will review what has happened during the first year of the centralised supervision. As I said at the beginning in response to the question, what countries can expect from us in the next five years is maximum alertness to different situations that may arise in regard to the economy, the banks and the supervisory mechanism. We will watch carefully to see what further rules are necessary.

Chairman: Thank you, Mr. Nava. Is there anything further you wish to add or have you concluded?

Mr. Mario Nava: I have concluded. I thank the Chairman and the committee for listening to me and hope my contribution was helpful.

Chairman: I thank Mr. Nava for his participation at this inquiry and I thank the European Commission for co-operating and engaging with the inquiry's hearings. I know Mr. Marco Buti will attend in a few weeks. Again, on behalf of all the members of the committee, I thank Mr. Nava for his valuable, informative and detailed engagement with the committee.

The joint committee went into private session at 2.25 p.m. and adjourned at 2.30 p.m. until 9.30 a.m. on Wednesday, 11 February 2015.