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AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉI- REACHTA

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Dé Céadaoin, 11 Márta 2015

Wednesday, 11 March 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.

I propose that we suspend until 3.30 p.m., at which time we will meet Professor Honohan

Sitting suspended at 1.45 p.m. and resumed at 3.30 p.m.

Professor Patrick Honohan

Chairman: We will resume in public session. The Joint Committee of Inquiry into the Banking Crisis is now in public session for session 3, which is a public hearing with Professor Patrick Honohan to clarify oral evidence previously given to the committee.

I welcome Professor Honohan, Governor of the Central Bank, to this session. Following his appearance before the committee on 15 January to discuss the Honohan report, he subsequently wrote to the committee on 13 February to provide some additional information and clarifying some of his evidence. In the circumstances, the committee felt it appropriate to invite Professor Honohan back to discuss the issues raised in his correspondence. This letter is available on the banking inquiry website.

Before he begins, I wish to advise him 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 the committee. If he is directed by the Chairman to cease giving evidence on a particular matter and he continues to do so, he is entitled thereafter only to qualified privilege in respect of his evidence. He is directed that only evidence connected with the subject matter of these proceedings is to be given. As informed previously, the committee is asking witnesses to refrain from discussing named individuals in this phase of the inquiry.

Members are reminded of the long-standing ruling of the Chair to the effect that they should not comment on, criticise or make charges against a person outside the Houses or an official by name or in such a way as to make him or her identifiable. Today's proceedings are specifically in regard to the Governor's correspondence to the committee. Other matters in regard to this inquiry that may be relevant to him will be dealt with at later stages. I invite Professor Honohan to make his opening remarks.

Professor Patrick Honohan: Thank you very much, a Chathaoirleach. In my letter of 12 February, I sought to clarify parts of my evidence to the inquiry on 15 January. I have prepared these short introductory remarks on the presumption that the inquiry has invited me back on this occasion to amplify my views on the alternative courses of action that might have been taken by the Government at the end of September 2008. Perhaps I should recall explicitly that I myself had no involvement in the guarantee decision, so my views are based on what I learnt from preparing my May 2010 Report on Regulatory and Financial Stability Policy, as well as on many conversations with other experts and on my general knowledge of banking crises in other countries.

I will start with a critique of the decisions of end-September 2008. There are several features of the decisions at end-September that can be criticised even allowing for the limited information then available to the decision makers. The first was the guaranteeing of some of the subordinated debt. Providing an explicit guarantee to subordinated debt holders is not only potentially costly to the State, but undermines the rationale for allowing banks to meet part of their regulatory capital with subordinated debt. This was a definite design flaw in my opinion. True, thanks to steps subsequently taken, the payout to subordinated debt holders of Anglo in the end was a small proportion of the total fiscal cost; however, that payout was not negligible.

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The second was guaranteeing existing outstanding debt, namely, senior bonds and term deposits, was not necessary to underpin the banks' continuing access to funds. Nor did the government guarantees introduced by other countries in 2008 offer any significant backward-looking protection in this way. It is true that imposing losses on such bondholders would have had a damaging reputational effect on Ireland as a whole, as well as impacting local holders of such bonds; but that is a different question. The decision to impose such losses could not have been lightly taken; but offering a pre-emptive guarantee on already outstanding or what I call "old" debt ahead of a full assessment of what it might cost was essentially gratuitous. Furthermore, because much of this debt entitled the holders to immediate accelerated repayment in what is called "an event of default", the Government was effectively precluded from liquidating or extensively restructuring the guaranteed institutions because it would have to repay the guaranteed debt forthwith, which it would have been unable to do because of the sums being so large. This effectively postponed the drastic restructuring action that was needed until the end of the initial guarantee period, by which time the Government's entry into the EU-IMF programme was actually imminent.

The third was failure to consult. The Irish decision to provide a blanket guarantee without prior consultation triggered immense pressure for guarantees all over Europe. Other governments resented the Irish action and this has made it difficult for the Government to make its case for burden sharing with Europe.

The fourth was the failure to seize immediate control over the management of Anglo Irish Bank. It should be assumed that the existing management of a bank whose business model has lost the confidence of the market and which has run out of cash has neither the expertise nor the incentive to recover the situation safely. The public authorities should have intervened immediately to take control of the bank, for which nationalisation was the available tool in Ireland. Fortunately, nationalisation did follow in January 2009 without evident value destruction having taken place in the intervening period.

How much does this matter? Having made these criticisms, it is important to keep the scale in perspective. The decisions on the night of the guarantee had consequences for Ireland but there has been a tendency to overstate the extent of the impact of that night's decisions on the subsequent welfare of the nation. It would be hard to deny that most of the overall hardship that followed the bursting of the bubble was already inescapably embedded in the situation. I will be put a number on this because quantification is important. While it is not a precise figure, I would hazard that at least between 80% and 90% of the overall hardship was already inescapably embedded in the situation, albeit unbeknownst to the decision makers that night.

The damage had been made unavoidable by the unrestrained credit and property boom. The fiscal austerity measures that had to be taken were not just due to the €40 billion or so in additional net debt that can be linked to the guarantee, which I mentioned the last time I came before the committee, but also reflect the far larger impact of the ending of the construction boom on the Government's tax revenue and spending needs. The fiscal costs are only one aspect of the total damage to Ireland.

In my letter to the inquiry of 12 February, I distinguished between a hypothetical hindsight scenario in which the Government would have been convincingly advised of the actual likely magnitude of the cost of a guarantee and the actual scenario with only the information available at the time. In the actual case, the Government had no information at hand indicating that any of the banks were about to experience losses far in excess of their capital reserves. What I have suggested as the best course of action, given the lack of such information in scenario 2, namely,

buying time for negotiation with partners, seizing control over the two failing banks and limiting the scope of the guarantee, could hardly, unless the negotiations had proved remarkably successful, have reduced the direct fiscal bill by more than a few billion euro. While this is not an insignificant sum, it is a fraction of the actual damage.

The alternative under the hindsight scenario of bailing in some of the bondholders and depositors of Anglo Irish Bank and INBS would have imposed additional disruption to economic activity and capital formation, which would have offset much of the savings to the State from not paying the creditors. This point is made in the report of May 2010. I conclude that the need for austerity measures - the scale of tax increases and expenditure reductions that have proved necessary since - could have been reduced somewhat but not all that much by anything done at the end of September 2008.

It is important to maintain perspective and I would like to bring to your attention and call to mind some points of balance and perspective. First, as I remarked recently in an article in a newspaper, the boom and bust both damaged our economy. The boom and the decisions taken during it meant Ireland had to adjust down from living standards that could never have been sustained, with sizeable and capricious shifts in the distribution of wealth.

Second, the style of banking in Ireland, its regulation and broader economic policy were strongly influenced by comparable styles adopted at that time in countries often used as exemplars for Irish decision makers, in particular the United States and United Kingdom. This was not a solo run but the scale of the excesses in Ireland put its banking crisis in a different league, although they were not as bad as in Iceland.

The third point of balance is that the extent and nature of the guarantee decision frustrated subsequent efforts to minimise the costs and speed the recovery. However, the bulk of these costs could not have been avoided by a different course of action on the night of the guarantee.

Chairman: I thank Professor Honohan. The committee would like to further discuss four or five specific issues raised in his correspondence. The opening paragraph of his letter of 12 February refers to the question: “Did the Governor have the power to issue specific directions relating to a wide range of micro-prudential policies, including credit concentration limits, during the time prior to the guarantee?” When I put this question to Professor Honohan he replied that he needed to give it further thought. On that basis, will he take us through the additional information provided on the powers of the Governor of the Central Bank and their use during the period in question? Which of the powers and actions available to the Governor were not used or taken?

Professor Patrick Honohan: This is a point about the Governor and the Central Bank narrowly thought of, as distinct from the Financial Regulator in whom most of the regulatory powers are vested. It is important that people are clear on that.

The legal opinion is that there are two particular legislative provisions that are very relevant here and give the Governor power to step into a situation which should be managed by the Financial Regulator. When I refer to the Financial Regulator, I am not talking about one person but a whole section of the Central Bank and Financial Services Authority of the time. Section 23 of the Central Bank Act 1971 is a very old provision. In fact, I think it is a slightly modified version of the provision in the 1942 Act. It is a general power to require banks or a particular bank to maintain specific ratios. However, as it does not say what these ratios are, it means any ratios in principle. This is a very wide and old-fashioned type of power, which effectively says,

“We trust you to establish ratios which are for the safe conduct of banking”. These powers are embodied in the Central Bank board and delegated to the Governor. They are, therefore, wide but general types of powers. That is one thing he could have used. He could have said, “Look, the situation is very bad and I am going to appeal to the 1971 Act, intervene and require the banks to have a ratio of not more than 20% of their assets in this type of-----

Chairman: Could that include credit concentration limits?

Professor Patrick Honohan: Yes, it could.

Turning the clock back ten years or so, the legal opinion in the Central Bank would have been that this was mainly used for the purpose of liquidity ratios and it was not ever used in a precautionary way for the balance sheet risks on the loan side. It is clear, however, that the power was there.

The members, as legislators, are aware that when one introduces new and very specific powers, it very often weakens the old, general powers because some bank might challenge them by saying, “You are imposing this power under the 1971 Act but I cannot see why you are doing that because clearly the legislator has decided that there are some specific powers”. However, the advice is that those powers were there and could have been used.

The other provision gives the Governor, having regard to his European responsibilities in the European System of Central Banks or the board of the bank in relation to its objectives, particularly financial stability objectives, the power to issue guidelines to the Financial Regulator as to the principles and policies that it was required to implement in performing functions. That is a different type of action. I think that would have been the first course of action. If the Governor felt he wanted to intervene and change the way the Financial Regulator was doing things, he would have probably used that guidance power, which would amount to a significant interference with the functioning of the Financial Regulator, before using the first power that I mentioned.

I am saying this very much *ex post*. People at the time never imagined the Governor doing these sorts of things, although it is mentioned in an analysis by the ECB, which was required to opine on central bank legislation. The analysis highlighted the importance of this power but I believe it was thinking primarily of the power in connection with the European functions of the Governor and not in relation to concentration ratios or whatever.

Deputy Kieran O’Donnell: I welcome Professor Honohan. What was the Governor’s motivation in writing the letter received by the committee on 12 February, which was four weeks to the day after his appearance before the inquiry? The Governor appeared before us on the 15 January, four weeks ago to the day. Is this appearance substantive or material to the workings of this inquiry? Was it influenced or driven by anyone mentioned in the letter of 12 February that the Governor sent into us?

Professor Patrick Honohan: There were three motivations. One was, obviously, to answer the point we have just discussed about the powers, which I was required to answer. The other purpose was that I was not satisfied when I came away from the meeting, spoke to some people and read newspaper reports suggesting that my evidence on the guarantee had not really been understood in the way I had intended. People asked me whether I had really changed my mind on this. I replied by asking what they meant. Then, I went back, looked at the transcript and listened to it. I realised that it is not clear. What I said was not clear. I interrupted myself, as I

do, all the time, without finishing sentences and by being too colloquial. I said to myself that it was not clear but it was what people were going to refer back to. I said I had better give myself a little time. I am sorry if Deputy O'Donnell thinks it was delayed, but I took the view that the committee had a lot of evidence coming to it and that there would not be a rush on this. I wanted to get it out because it is important. A lot of the questioning focused on that particular date as did a lot of the interest of the public. I am supposed to have talked to all the people and read all the documentation and, therefore, I should know something about it.

The other thing is the little note I made about Mr. Doyle. Mr. Doyle did contact me. He asked me when we talked about that. I started to wrack my brains and wondered whether I actually talked to him about that letter or was it that I had already formed a view of what his opinion was. Then I realised I was unsure whether I talked to him. The impression is definitely given in the transcript that I had talked to him after I saw that letter. I thought that needed to be corrected. I absolutely-----

Deputy Kieran O'Donnell: Did Mr. Doyle contact you directly?

Professor Patrick Honohan: He did, yes. I know him well.

Deputy Kieran O'Donnell: Did he contact you on foot of your appearance before the inquiry?

Professor Patrick Honohan: Yes, he saw the transcript and he contacted me.

Deputy Kieran O'Donnell: Did he believe it was an inaccurate portrayal of his position?

Professor Patrick Honohan: I am not sure I should speak for him. My impression is that he did not think it was inaccurate, but he was puzzled that I appeared to have said that he had said it. No doubt you will be talking to him, but I do not imagine my interpretation of what he thought is any different to what he thought.

Deputy Kieran O'Donnell: You said as well: "My understanding of Mr. Doyle's perceptions of the state of Anglo in September 2008 is based on other previous conversations". When did those conversations take place? What was the content of them?

Professor Patrick Honohan: There were conversations with Mr. Doyle and other people. I had lots of conversations with senior officials of the Department of Finance. Mr. Doyle gave evidence to the inquiry, that is to say to the group of people that I work with. I did not attend all of those conversations. I had a clear idea in my mind of what David Doyle thought. I understood it was the same as the other people, that is to say, there is not a huge hole of €8.5 billion after capital. I think that is what he thought.

Deputy Kieran O'Donnell: Let us go back to the transcripts. On at least four or five occasions the Governor makes specific reference to having spoken to David Doyle. In questioning by Senator O'Keeffe he said, "I asked the person involved-----

Chairman: Can you give us the page reference for that?

Deputy Kieran O'Donnell: It is on page 148 of the transcript. This refers back to the memo of 25 September 2008, which was completed by Mr. Kevin Cardiff and specifically revolves around the statement: "D Doyle noted that Government would need a good idea of the potential loss exposures within Anglo and INBS - on some assumptions INBS could be 2bn after capital and Anglo could be 81/2." In response your response to Senator Susan O'Keeffe

you said:

I asked the person involved if that was what he thought. He replied, “No, that was wrong”. Maybe he meant €8.5 billion inclusive of capital, meaning the shareholder would have covered it all.

Subsequently, on page 161 and 162 in reply to questioning from Deputy Pearse Doherty you refer to discussions with David Doyle on at least three or four occasions. On page 161 you state, “he says he had no concept of” the losses. On page 162 you state: “He said he had no concept that there was a loss.”

Chairman: Can you pose a question now? You are going to run out of time, Deputy.

Deputy Kieran O’Donnell: I am coming at the question. When you finished up with Deputy Doherty, you stated:

This minute came to light quite late in the process, but I think I probably spoke to people. We can check with Kevin Cardiff, who was the author of the minute and from whom I would have understood that he too had not really adverted to this. He felt that nobody thought there was a loss. It is worth further exploration.

Did you speak to Mr. Cardiff since your appearance before us?

Professor Patrick Honohan: No.

Deputy Kieran O’Donnell: Did you not consider it? Have you spoken to Mr. Cardiff about this memo? When?

Professor Patrick Honohan: I have not spoken to Mr. Cardiff about this memo in at least four and half years. I know you may think there is something here, Deputy O’Donnell but-----

Deputy Kieran O’Donnell: No, I have a job to do.

Chairman: Please let the Governor respond.

Professor Patrick Honohan: I know, but when I spoke to the committee I thought I knew in my mind what David Doyle said. I know I had conversations with David Doyle towards the end of the process. Did I speak to him on this? I am saying I am not sure that I did. He is saying that I did not. That is fine. It is not a big issue. That is why I wrote to the committee. I wanted to make it clear.

Deputy Kieran O’Donnell: In your most recent discussions with Mr. Doyle what did he confirm about his view on the memo?

Chairman: I am going to make an intervention here, Deputy.

Deputy Kieran O’Donnell: Sorry. I withdraw that.

Chairman: The issue of the whole engagement around the night of the guarantee will be fully explored as part of the nexus review. Some of the individuals that you have mentioned this evening may actually be physically present in this inquiry room and we could probe into those areas. The matter at hand is to seek clarification on the substance of what the Governor actually said. Was it a reference to Mr. Doyle or Mr. Cardiff?

Professor Patrick Honohan: All I want to say now is that I was convinced and I am convinced that this is what Mr. Doyle thought. I have had no recent conversations with Mr. Cardiff on the matter. Mr. Doyle can confirm this or otherwise, but he says that he does not disagree with my interpretation of what he thought. There is no difference between us on this matter. He is quite clear that I did not speak to him. I am not really all that clear, but I am sure he is right.

Deputy Kieran O'Donnell: Let us go back to the substantive issue of the memo of the 25th, which made reference to potential losses in INBS of €2 billion after capital and potential losses in Anglo Irish Bank of €8.5 billion. Professor, in your professional capacity, if a bank's core tier 1 capital is wiped out, does it indicate a solvency problem?

Professor Patrick Honohan: Absolutely, without a doubt. I will set out where I think the €8.5 billion comes from. Obviously, the banks had a solvency problem and obviously the advisers from Merrill Lynch also believed there were solvency issues. Was the bank insolvent or not? That is a different matter. What they said was that in an extreme stress case analysis, write-offs in Anglo Irish Bank would deplete ordinary shareholders and other lower category subordinated debt by €7.5 billion. I am unsure whether that is €8.5 billion or €7.5 billion. They were saying that under extreme stress, essentially, most of the capital would have been wiped out. But that would have left a scenario where the Government would not have had to pay in a liquidation.

Deputy Kieran O'Donnell: The Merrill Lynch report was e-mailed to Kevin Cardiff on the 29th, the night of the guarantee, at approximately 6.45 p.m. It also stated that Irish Nationwide Building Society, in a worst-case scenario, would have €1.8 billion of a write-off.

Professor Patrick Honohan: Yes.

Deputy Kieran O'Donnell: Irish Nationwide Building Society had only a core tier 1 capital of €1.4 billion with a write-off of €1.8 billion. It would have completely eliminated it. Anglo Irish Bank had only €7.1 billion of core tier 1 capital, with a potential write-off of €7.5 billion. That is almost identical to what is in the memorandum of 25 September that was completed by Mr. Kevin Cardiff, at which everyone was present, including Merrill Lynch, the Minister for Finance, Mr. Kevin Cardiff, Mr. David Doyle, Mr. John Corrigan and various other interests.

Professor Patrick Honohan: Absolutely.

Deputy Kieran O'Donnell: Surely-----

Chairman: The Deputy can ask the question but he should not imply. No "surelys", just ask the question.

Deputy Kieran O'Donnell: In Professor Honohan's professional opinion, is it a fair observation that if one received a report stating that a scenario could arise whereby all one's core tier 1 capital would be wiped out, it was a clear indication of a major solvency problem in both Anglo Irish Bank and Irish Nationwide Building Society on the night of the guarantee?

Chairman: Was that a clear indication?

Deputy Kieran O'Donnell: Correct.

Professor Patrick Honohan: Absolutely and that is why I am saying - people are surprised - that even with the evidence that was there, they should have seized control over Anglo. It had lost the confidence of the markets, had no cash and in an extreme stress situation, it could have

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wiped out its capital. I am not disputing that at all. I actually am making that point and people seem to be surprised.

Deputy Kieran O'Donnell: In the limited time I have, Professor Honohan has not changed his mind from his previous appearance before the joint committee that in his view, based on the evidence that was available on the night of the guarantee, Anglo should have been let go.

Professor Patrick Honohan: I ask the Deputy to please not say "let go" because people do not know what he means by that.

Deputy Kieran O'Donnell: Should Anglo have been nationalised on the night of the guarantee?

Professor Patrick Honohan: It should have been nationalised because that was the only tool available legally for the State to take control. Control should have been taken. It should not have been left in the hands of the management. It was very risky to leave it in the hands of the management. I would have left it to the end of the week using emergency liquidity assistance, ELA.

Deputy Kieran O'Donnell: Does the Merrill Lynch report indicate that on that night, Anglo and Irish Nationwide were both insolvent?

Professor Patrick Honohan: No, they do not say that. What they do say is-----

Deputy Kieran O'Donnell: Would it indicate that there were major solvency problems with both institutions?

Professor Patrick Honohan: There was high risk on solvency. However, even in the stress situation, they had enough capital to get through. But that is not the point. The main point is-----

Deputy Kieran O'Donnell: In fairness, forcible write-downs?

Professor Patrick Honohan: No, it would not be good but-----

Deputy Kieran O'Donnell: Good?

Professor Patrick Honohan: ----- what happened subsequently was between them, they lost €35 billion over the capital. That is what was not perceived. That was the big fiscal cost to the State that was not perceived. If that had been known, then it would have been a different scenario. I absolutely agree with Deputy O'Donnell's point that the signals were clear enough. If one reads that report by Merrill Lynch, it is quite clear that Merrill Lynch, which calls it "State protective custody" because they had just arrived from London, thought the State should seize control over the two banks. Merrill Lynch clearly thinks these banks have no future. In fact the report states at one point:

It is clear that certain lowly rated monoline banking models [guess who?] are likely to be unviable as wholesale markets stay closed to them. ... we believe it is important to act quickly to deal with these institutions to avoid a systemic issue.

Deputy Kieran O'Donnell: There was enough evidence available on the night of the guarantee, with the Merrill Lynch report forming the backdrop for-----

Chairman: Sorry Deputy, if you ask your questions incorrectly, you are using up your time.

Deputy Kieran O'Donnell: I will ask the question again.

Chairman: Please do not ask a leading question because you are not helping the inquiry by doing that.

Deputy Kieran O'Donnell: Based on the evidence that was available in the Merrill Lynch report, which formed a basis for discussions on the night of the guarantee, what is Professor Honohan's professional opinion on what should have been done with both Anglo and Irish Nationwide on the night of the guarantee?

Professor Patrick Honohan: By the end of that week, they should have been nationalised.

Deputy Kieran O'Donnell: I thank Professor Honohan.

Chairman: Before moving on to Deputy Michael McGrath, I wish to round off an issue on that subject. Is the sourcing information on the potential Anglo losses material?

Professor Patrick Honohan: Pardon?

Chairman: Is the source of the information on the potential Anglo losses, whether it was Mr. Cardiff or whoever, material in terms of Professor Honohan's report or the information he gave to the inquiry at his last appearance before us?

Professor Patrick Honohan: No, I do not think so. Absolutely not. I do not think it is material whether I asked David Doyle "what about this afterwards" or if I had just had picked up that his view and the view of everybody in the room was this and that.

Chairman: Is Professor Honohan saying the sum of money is material; not the individual?

Professor Patrick Honohan: Yes, absolutely. In fairness to Mr. Doyle, I want to represent our conversations in a way with which he agrees and with which I am confident.

Deputy Michael McGrath: I welcome Governor Honohan back. When he appeared before the joint committee on 15 January, I asked him if Anglo Irish Bank should have been allowed to fail at the end of September 2008. I refer to page 113 of the transcript. This was in a hindsight scenario and the Governor replied, "Yes". I went on to ask, "Is the Governor saying that that decision should have been made even with the information available at that time or is he saying it with the information we now have about the insolvency?" He replied, "I think that decision should have been taken at that time", and then went on to explain what he meant by that. He referred to ELA and stated we should have said the following to the European authorities:

"We have this bank going down. We cannot afford to guarantee. The risks are too big. You have got to risk-share with us. If you want to wind this down orderly you've got to put European capital into this bank and then we will liquidate it down".

A clear impression was given that the Governor's view was that even with the information available at the time, which did not point to any solvency problem, Anglo Irish Bank should have been allowed to fail, in the sense of ultimately being liquidated. Is that what the Governor meant to say?

Professor Patrick Honohan: This must have been a senior moment because I leapt from one scenario to the other scenario in the middle of my response to the Deputy. That is why I want to make it absolutely clear that there are two distinct things. Different things should have

been done on the night in both scenarios. One scenario is the realistic one, where they had the information available and if they had absorbed it and got the right technical advice-----

Deputy Michael McGrath: Let us deal with the scenario of the information they actually had available. Let us tease out the scenario involving the information available at the time, that is in September 2008, in respect of Anglo Irish Bank.

Professor Patrick Honohan: With that information, they should have nationalised it. But I am not saying they should then have said “we are not going to pay a penny; this is just a wind-down liquidation situation”. The wind-down liquidation situation becomes the thing to do only where one suddenly discovers it is going to be €35 billion or something like that. The problem is, and the reason this gets complicated, is one must think through what would have happened then. One nationalises it, puts in new managers, the old people are thrown out and one starts to evaluate it. There are a number of twists and turns that can be taken after that which were not available because the guarantee had been put in place.

Deputy Michael McGrath: I seek clarity, because what the Governor said on the day was quite different. Moreover, it was in the scenario of the information available at the time and certainly, the clear impression was that Anglo should have been allowed to fail.

Professor Patrick Honohan: On the word “fail” again, in the technical language, they already had failed because they had run out of cash. It was a bank failure which was overlaid by a guarantee, which brought them back to life.

Deputy Michael McGrath: The Governor is clarifying today that what he meant by allowing it to fail was to nationalise it.

Professor Patrick Honohan: I think, with the information available, they should have nationalised Anglo Irish Bank. Would it have saved €40 billion? No.

Deputy Michael McGrath: Sure. On page 133 of the Governor’s 2010 report he states: “Still, given the perceived lack of a solvency problem at Anglo (or the other banks) on balance a guarantee seems to have been the best approach, not least because no other clear and effective medium-term solution appeared available.” He went on to refer to ELA and that it also could have allowed the nationalisation of Anglo.

Professor Patrick Honohan: Yes.

Deputy Michael McGrath: However, in his report the Governor appears to be favouring a guarantee for Anglo.

Professor Patrick Honohan: This is a separate issue. One should consider the Merrill Lynch report because its authors had laid it out. It was not bad and while Merrill Lynch was criticised afterwards, for a few days work it was not bad in terms of giving the outlines. Merrill Lynch stated that one should nationalise and then start guaranteeing. However, they thought one could get away with just guaranteeing Anglo and Nationwide and one would not have to guarantee the whole system. An extensive guarantee would have been necessary and I have not deviated from that. The danger is with terms such as “let go”, “fail”, “guarantee” or “nationalise”. They are all different aspects of the same thing and the way things pan out subsequently depends on exactly which step one takes at which time and how much leeway it gives one.

Deputy Michael McGrath: The Governor is holding to the view that Anglo should not

have been liquidated on the night, allowed to fail the following day.

Professor Patrick Honohan: Given the information, absolutely not. That would have been a terribly disruptive thing to do.

Deputy Michael McGrath: The Government should have stepped in, issued a partial guarantee at least -----

Professor Patrick Honohan: A more limited guarantee.

Deputy Michael McGrath: ----- removed the management, nationalised the bank and then what?

Professor Patrick Honohan: Then it would have to work it down. As I have pointed out today, it would have still ended up with the bulk of the losses but they would have been reduced by the fact that the subordinated debt and the old debt would not have been guaranteed. There was a considerable amount of old debt which was not due to mature for some months or even years and could have been bailed in subsequently. We know how difficult the bail-in debate subsequently became in 2010 when we had our backs to the wall but we might have been the leaders in designing bail-in mechanisms, which we now have in Europe, if we had done it from a strong position when we were still a triple A country.

Deputy Michael McGrath: Much of this comes down to the interpretation of language. When Professor Honohan was asked about whether Anglo should have been allowed to fail even with the information available at the time, and he said “Yes”, the vast majority of people would take that to mean it should have been allowed to hit the wall. That is not what he appears to be saying.

Professor Patrick Honohan: One journalist, whose work I very much respect, wrote that Lenihan wanted to burn bondholders - no, Lenihan wanted to nationalise. That is not the same thing at all.

Deputy Michael McGrath: He also made reference to the investment banks in his previous evidence, when he suggested that in hindsight Anglo should have been allowed to fail. He stated: “all the investment banks that looked at it saw that Anglo’s business model was not credible in the market.” What investment banks were they and what did they say? What was Professor Honohan referring to?

Professor Patrick Honohan: I suppose the one to hand is the Merrill Lynch report, which stated these “are likely to be unviable as wholesale markets stay closed to them”. However, the other investment banks that were advising the Government were PwC and Goldman Sachs, although they were not specifically working on Anglo. Then again, how does one know given that it was a long time ago? These people were of the same opinion that Irish Nationwide’s model and Anglo’s model were broken.

Deputy Michael McGrath: Professor Honohan will be familiar with the memorandum e-mailed from Merrill Lynch to Kevin Cardiff at 6.43 p.m. on 29 September 2008, which enclosed a memo dated 28 September. The member states: “it is important to stress that at present, liquidity concerns aside, all of the Irish banks are profitable and well capitalised.” There was no warning about Anglo.

Professor Patrick Honohan: There was evidence from Professor Eamonn Walshe, and

more colourful evidence from Professor William Black, on what bank accounting can and cannot do. It cannot cope very well with situations of this nature and it gives highly misleading signals. However, that is what people work with and capitalise based on the accounting standards. They presumably said they had checked the capital and, in accordance with accounting standards, it was satisfactory. This is quite important because a lot of legal things attach to the question whether the bank is adequately capitalised, that is, whether the capital is above zero or above the 8% weighted risk. One has to rely on something, and all banking regulators rely on the accounting measures for most practical purposes. However, the memo goes on to note there is a huge risk in a stress scenario that it could lose €8 billion, in which event the wholesale markets would stay closed to them and they would be likely to be unviable. The question of viability and the future business model is a separate and more important issue. The question of whether it was well capitalised is essentially a preliminary health check.

Deputy Michael McGrath: Is it Professor Honohan's view that there were warnings, whether implicit or explicit, from the investment banks about solvency issues in Anglo?

Professor Patrick Honohan: There were warnings about solvency issues but there was no indication that they were going down for big amounts of negative capital. It is the negative capital that cost the State. That is why the €8.5 billion figure mentioned by David Doyle is important. He seemed to say the State could lose €8.5 billion but in my interpretation of what he said, and probably his interpretation, he did not think that. He simply felt that it was going to burn through €8.5 billion of the capital. It had €8.5 billion or something like that.

Deputy Michael McGrath: To clarify Professor Honohan's view on Anglo Irish Bank at the end of September 2008 and the options available to it in a hindsight scenario, he is saying that if there was knowledge about the scale of the black hole in the bank and the potential cost of €35 billion, it should have been let go and liquidated.

Professor Patrick Honohan: I am saying that a high wire exercise would have been done. Those involved could have waited until the end of the week and spent the weekend saying they were going to close the bank and asking Europe if it was going to do anything about the issue.

Deputy Michael McGrath: Within days they would have been liquidating it if they had known the extent of the problem but Professor Honohan accepts that the extent was not known.

Professor Patrick Honohan: That is because it was so huge.

Deputy Michael McGrath: In the actual scenario, with the information available at the time, he is saying they should have taken the bank into public ownership with a partial guarantee on future debts, changed the management and used emergency liquidity assistance to work it out over time.

Professor Patrick Honohan: Yes.

Deputy Michael McGrath: Does he take the view that his report and letter of 12 February are consistent in that regard?

Professor Patrick Honohan: Yes. My letter is more explicit because if in May 2010 the Central Bank had indicated that the guarantee might not have been such a good idea, that might have started to affect the markets. I said it but I did not say it in bright lights. I said it in footnotes.

Deputy Michael McGrath: Does he accept that his evidence in public session last January was not very clear and may have given a misleading impression?

Professor Patrick Honohan: Yes.

Deputy Michael McGrath: In regard to the letter that he sent, the Governor clarified the question on the statutory powers of the Central Bank. Is he satisfied that both the Central Bank, which he dealt with specifically in this letter, and the Financial Regulator had adequate statutory powers to intervene to deal with the build up of losses, the extent of the lending to the property sector, and so forth?

Professor Patrick Honohan: I think they were adequate. They could have asked for more and subsequently we did ask for more, and we have more. The powers that we used recently, with the approval of the Oireachtas, on loan-to-value and loan-to-income ratios were the new powers that we were given. We had discussions internally on why we were not using the old Central Bank Act 1971 but we were advised to use the new powers.

Deputy Michael McGrath: In regard to the reference to Anglo and the figure of €8.5 billion in the note from September 2008, is 25 September the correct date?

Professor Patrick Honohan: I do not know the date.

Deputy Michael McGrath: That is handwritten on it.

Professor Patrick Honohan: It states "Date? about 25/9/08" so we do not know. It is sometime around that date.

Deputy Michael McGrath: It states: "D Doyle noted that Government would need a good idea of potential loss exposures within Anglo and INBS - on some assumptions INBS could be 2bn after capital and Anglo could be 8½.". Does Professor Honohan view that as evidence that people in senior positions knew there was a potential capital shortfall in Anglo and INBS, and were even at that stage speculating on the possible extent?

Professor Patrick Honohan: My interpretation is that it was misleading and did not represent what they thought. It was a scribbled note which might not even have been transcribed correctly. I think I saw it in handwritten form a long time ago, at the time of my investigation. I am not saying it was wrongly transcribed but I do not think it represents the views of those in attendance. I would be astonished if it did because everybody I spoke to at the time were of the same view. They said they did not know.

Deputy Pearse Doherty: Does Professor Honohan think it appropriate that a potential likely witness to this inquiry, a committee investigation set up by the Houses of the Oireachtas, should contact another witness to the inquiry to suggest the evidence he has given is untrue?

Professor Patrick Honohan: Absolutely. I welcomed his intervention and it is very important that the inquiry get all the facts right.

Deputy Pearse Doherty: Does Professor Honohan not think it is more appropriate that the information be related to the committee?

Chairman: Please allow the Governor to finish answering the question.

Professor Patrick Honohan: It is absolutely right and it is a business-like way to do it. I

was satisfied. I looked back at my notes to make absolutely sure I had no evidence.

Deputy Pearse Doherty: Did Professor Honohan not have the conversation?

Professor Patrick Honohan: No.

Deputy Pearse Doherty: On four occasions - once in response to a question from Senator O’Keeffe and three times in response to me - Professor Honohan attributed comments and direct quotes to a conversation that he now acknowledges did not happen. Is that the correct position?

Professor Patrick Honohan: No, it is not the correct position. If the Deputy starts reading out selected parts-----

Deputy Pearse Doherty: If I ask-----

Professor Patrick Honohan: I have already acknowledged that I created a misleading impression of the sequence of events and understandings. We work very quickly here at these meetings and I tried, in a summary way, to convey my understanding. I acknowledged, and I have done so in writing, that I created a misleading impression.

Deputy Pearse Doherty: I appreciate that. The question was on the statement that nobody in the room on the night of the bank guarantee knew how bad the banks were. Professor Honohan said the note we are discussing, note No. 6 released by the Committee of Public Accounts, was “the only evidence that I found written or oral”. On four occasions, Professor Honohan directly attributed a quote to Mr. David Doyle, who said it was wrong. On the second occasion, Professor Honohan said Mr. Doyle had no concept of it; on the third occasion he said he had no concept that it was a loss; and on the fourth occasion he said he did not think it was insolvent. On the first occasion, Professor Honohan did not have the conversation with him. Is that correct?

Professor Patrick Honohan: I have already acknowledged that I am vague about when I picked up my understanding of Mr. Doyle’s position. I had many conversations with Mr. Doyle. The report we are talking about was completed almost five years ago. Deputy O’Donnell has already asked the question.

Deputy Pearse Doherty: I am entitled to ask the questions, with respect.

Professor Patrick Honohan: Fine, but do not expect a detailed answer.

Deputy Pearse Doherty: Professor Honohan referred to four conversations, three with Mr. Doyle and one with Kevin Cardiff, although he said that while he probably spoke to Mr. Cardiff about the note he cannot categorically say he did. I reminded Professor Honohan as follows: “I am sure Professor Honohan understands that it is very important the information he gives to the committee is evidence”. Is Professor Honohan still aware of this? This is what we are trying to gather. Is there a possibility that Professor Honohan did not speak to Mr. Cardiff about note No. 6?

Professor Patrick Honohan: The Deputy will not get very many answers if he asks for evidence of a conversation. In preparing the report very quickly at a time when there were probably other very important matters to be attended to, I spoke to many people. I do not have detailed notes of all the conversations I had with the Second Secretary General of the Department of Finance. I am not going to get into this. It is not material. The Deputy is asking me

about my knowledge of something that happened before. If there turns out to be a conflict of evidence with Mr. Cardiff or Mr. Doyle, the Deputy can call me back. There seems to be no conflict of evidence between what I am saying and what Mr. Doyle is saying.

Deputy Pearse Doherty: Mr. Doyle has not been before the committee.

Professor Patrick Honohan: No, but he has spoken to me. No, he has not spoken to me but he sent me an e-mail. I have to be very careful here because, otherwise, the Deputy will ask me four times and I will say it four times, and then he will say I said it four times. I have to get everything right. I am not satisfied with this line of questioning. I am here to try to help the inquiry.

Deputy Pearse Doherty: I am also here to try to help the inquiry. I am sorry we now appear to be at loggerheads. I am trying to get the facts. Professor Honohan is here to discuss his report, the Honohan report. He stated that the only evidence he found, written or oral, was the note. I asked him whether he asked any of the other nine or ten individuals, including the Taoiseach, the Minister for Finance and the Financial Regulator, about the note. He has confirmed that he did not speak to anybody else but gave the impression at the previous hearing that he spoke to Mr. Cardiff and Mr. Doyle. He is now saying that one of those conversations definitely did not happen and the other probably did. I am asking the question because, in the Governor's words, the only evidence that there may have been knowledge that there were substantial losses was not, in his words, investigated by him for his report. That is what I am trying to find out.

Professor Patrick Honohan: It was perfectly legitimate given that my report was supposed to be on the regulatory structure, not the Department of Finance. The point is that it is perfectly possible for the Deputy to put me in a position where I look as if I do not know anything about anything because I speak very carelessly. The Deputy asked me a question on the spot and I answered it as I remembered it at the time. When Mr. Doyle pulled me up, I said I was not sure.

Deputy Pearse Doherty: It is generally appreciated that Professor Honohan has been very helpful to the inquiry in terms of his availability.

Chairman: I will give the Deputy extra time. There is a bit of confusion over whether there were discussions with Mr. Doyle and Mr. Cardiff, and if so what was the nature of them. If Professor Honohan can conclude the point, we can move on.

Deputy Pearse Doherty: We have dealt with the point. My understanding is that there was no discussion with Mr. Doyle-----

Professor Patrick Honohan: I said there was probably or possibly a discussion with Mr. Cardiff. That is as far as I would put it. It is not very significant because at that stage it was already two years after the note had been written. It was a long period of time.

Deputy Pearse Doherty: The committee will determine what is and is not significant. We appreciate Professor Honohan's work and his flexibility in making himself available to the inquiry. That is not contested. On page 138 of Professor Honohan's report, he stated that on the night of the bank guarantee, nobody in the room knew how bad things were. Regardless of whether it was before capital or after capital, if there was any suggestion that €8.5 billion of capital was going to be wiped out in Anglo Irish Bank at a time when its annual report, which has a reporting date of the end of September 2008, said its core tier capital was just over €5 billion, then in Professor Honohan's words in response to Deputy O'Donnell, there was a solvency issue if this was the case. Therefore, is it not the case that the Minister for Finance, the Taoise-

CONTEXT PHASE

ach and the Financial Regulator, who were at the meeting when the note was discussed, would have knowledge that Anglo Irish Bank had more than a liquidity issue, it had a solvency issue?

Professor Patrick Honohan: It was a solvency issue, but the bank was not insolvent. I do not want to defend the bank, given that the accounting was not particularly impressive. Merrill Lynch referred to an extreme stress case analysis. Sometimes, specialists do a reverse stress test to determine what size of a stress the bank could survive. It is possible to design the stress test to be so big that the bank will fail. It is one way of doing it. I do not know, and I have no evidence, what the extreme stress case was. It might have been very extreme or it might have been implausible. We know it was not implausible, given that the bank did lose the money. We are not in a state where they should have said it was awful and they were going to lose tens of billions of euro. However, they were given enough information to know they should not have left the bank in private hands.

Deputy Pearse Doherty: There was enough information given to suggest there was a solvency issue.

Chairman: I have given the Deputy a lot of space. I call Senator O’Keeffe.

Senator Susan O’Keeffe: I would like to follow up on Deputy Pearse Doherty’s point. We were clear, when Professor Honohan finished talking to the Deputy here, that in his professional opinion, based on the figures that night, the banks should have been nationalised. Is that correct?

Professor Patrick Honohan: Yes.

Senator Susan O’Keeffe: If that was the case, there was enough information.

Professor Patrick Honohan: There was enough information to tell us the bank’s business model was broken, it had no cash and it was in a situation that was unlikely to become viable.

Senator Susan O’Keeffe: In that room that night, while the people may not have known the further extent of the liabilities, they had that much information. Are we all agreed on this? Yes?

Professor Patrick Honohan: Yes.

Senator Susan O’Keeffe: The record will not show a nodding head. Professor Honohan said something in the exchange with Deputy Pearse Doherty. For the record, did he keep detailed notes of conversations he had had when he was making his report, the so-called Honohan report, or not? Will he clarify the matter for us?

Professor Patrick Honohan: Yes, there were records taken of the evidence given to me and a group. I will not call them formal sessions, but the point about Mr. Cardiff and Mr. Doyle is that they were the senior officials in the Department of Finance with whom I had many conversations, in particular Mr. Cardiff, in terms of professional interaction. It would not have been confined to what they had said in that evidence. That was one of the points I went back to. I checked what Mr. Doyle had said when he attended my group. I do not know that I attended that particular session that he had had and there is nothing on it. There is definitely no evidence in that regard.

Senator Susan O’Keeffe: There were formal exchanges with Professor Honohan and the people with whom he spoke, for which there are official records. Informal conversations would

have taken place with a number of other people-----

Professor Patrick Honohan: All the time, on other issues.

Senator Susan O’Keeffe: -----including Mr. Cardiff and Mr. Doyle, or just Mr. Cardiff. Can Professor Honohan remember?

Professor Patrick Honohan: I did not have that many conversations with Mr. Doyle because he had retired early enough.

Senator Susan O’Keeffe: Will Professor Honohan explain what this actual note is? I have read it several times and cannot for the life of me get my head around what it actually is. On the one hand, it appears to be a note. It could be described as a minute. Then again, it refers to a subsequent meeting. I have never seen a minute that referred to a subsequent meeting. I would be glad, given that the Professor has given it to us and told us about it, to have clarity on how it was derived.

Professor Patrick Honohan: My understanding is that it was a note taken, I think, by Mr. Cardiff, but I am not sure. I will have to ask him. Now I am becoming very careful or more careful.

Senator Susan O’Keeffe: I ask the Professor to take the time he needs to be careful.

Professor Patrick Honohan: I think he was at the meeting. He was the number two man in the Department and scribbled down some notes. He is an organised fellow, more organised than I am. He noted the attendance, who was there and then it was over. That is all.

Senator Susan O’Keeffe: That appears to make sense, except for the sentence: “A subsequent meeting took place to present conclusions and possible approaches.” We do not know what that means. Is that what Professor Honohan is saying?

Professor Patrick Honohan: No.

Senator Susan O’Keeffe: No.

Professor Patrick Honohan: Maybe. Knowing the way these things work - the Senator could ask him - it is possible that some of these people left and maybe the Department of Finance officials stayed at the subsequent meeting. One could imagine something like that.

Senator Susan O’Keeffe: How did Mr. Honohan get his hands on this, if he does not mind the parlance?

Professor Patrick Honohan: Mr. Cardiff made these documents available to me towards the end of that inquiry. He made them available to the Committee of Public Accounts at a later date. Everybody can look at them on the website of the Oireachtas.

Senator Susan O’Keeffe: I wish to ask about Professor Honohan’s letter to us about his clarification that was put on the Central Bank’s website before there had been a response from this committee. Was there a particular reason for that order?

Professor Patrick Honohan: It did not go up before the letter was sent to this committee.

Senator Susan O’Keeffe: Was it put up before the response was received from us?

CONTEXT PHASE

Professor Patrick Honohan: Yes, before the response was received.

Senator Susan O’Keeffe: I wondered why that might have been the case.

Professor Patrick Honohan: The Central Bank is in control of its website.

Senator Susan O’Keeffe: Even though it was part of the evidence to this committee.

Professor Patrick Honohan: My remarks today are already on the website. There was nothing sinister about it. I like to communicate what we are doing and get it out there.

Senator Susan O’Keeffe: I thank Professor Honohan.

Senator Sean D. Barrett: I thank the Chairman and welcome Professor Honohan.

Chairman: There are four key points in the Governor’s letter. I remind members that I will not be engaging in repetition or recovering ground. This is with regard to new information or about adding to the information that is relevant to the points made in the Governor’s letter.

Senator Sean D. Barrett: The Governor used, I thought interchangeably, the terms “allowed to fail” and “to nationalise”. I thought they were completely different things. How did that happen on the night?

Professor Patrick Honohan: One thing it is important to bear in mind is that Anglo Irish Bank was not only kept going for four and a half years after the guarantee but there was also for a while a plan to have a new business bank come out of it. One option was to nationalise and then more than nationalise - nationalise and deal with it, wind it down, transfer deposits to one place and assets to another, or both, and so on. There was more than nationalisation envisaged in what I would have done. After the first week I would have said this was going nowhere; therefore, we would have to move the deposits to a different place. In fact, a lot of this is foreshadowed in the brief note of Merrill Lynch to which has been referred.

Senator Sean D. Barrett: The terms were used interchangeably. There are empty shops in every town in Ireland. They were allowed to fail. Why were the terms “allowed to fail” and “nationalise” used interchangeably in this particular example?

Professor Patrick Honohan: One reason is that until recently we did not have any kind of special resolution legislation for banks. All one could do to deal with a bank was nationalise it or put it into normal insolvency proceedings. One cannot do this with a bank because the situation becomes terribly disorderly. That is why the tool of nationalisation was the one available for the Government to seize control and then manage it.

Senator Sean D. Barrett: Page 2 of the Governor’s letter for today’s meeting states: “In the actual case the Government had no information at hand indicating that any of the banks were about to experience losses far in excess of their capital reserves.” Mr. Carswell who was with us yesterday states in his book that the chairman of AIB said on the night that Anglo and Irish Nationwide Building Society should be taken out and were insolvent and broken. He presented this as evidence.

Chairman: Will the Senator deal exclusively with Professor Honohan’s letters? I am not going to delve into other witnesses’ presentations. When we move to the nexus phase, that may become relevant, but I ask the Senator to focus on the four key points in the Professor’s letter to the committee.

Senator Sean D. Barrett: If an eminent banker was telling them that he thought the two banks were broken beyond repair, was that not information people there on 29 September 2008 had in their possession? They could have rejected it.

Professor Patrick Honohan: I absolutely agree. The evidence was sufficient to say these banks had no future. There is no point in making a casual remark and I will not do so because I will have to come back again.

Chairman: As I would like to be able to take a few days off next week, rather than bring Professor Honohan back again, will he, please, not make a casual comment?

Senator Sean D. Barrett: In his report Professor Honohan refers to one of the bodies concerned and the fact that it had a track record, dating back to 2000, of unsatisfactory correspondence and so on between it and the regulator. When he says there was nothing else that could have been done on the night, it was the job of the people at the meeting to watch the situation evolve, over eight years in one of the cases mentioned in his report. Everybody else says things started to go wrong after 2003. Is it any excuse that the people there on the night did not know what was going on? It was their job to have known what was going on.

Professor Patrick Honohan: I think there is an excuse.

Chairman: With respect, Senator, on what we are trying to establish, I am not going into the matter of reading the minds of other people who were in the room that night. When we move to the nexus phase, we will have the opportunity to question those witnesses. The Senator's substantive point is that the committee invited Professor Honohan this afternoon to clarify this for the Official Report. You have given a great deal of time to the inquiry and took responsibility because you were unhappy with your contribution. Has your thinking evolved since you wrote your report? Could you explain what your opinion was then and what it is now? What is your opinion of the facts at the time you wrote your report?

Professor Patrick Honohan: In summary, I may have deepened the analysis a bit but I do not think I have changed my view by much at all, if at all. I think I left a misleading impression because of the way the discussion went. I want to correct that impression. It comes back to an amplified and clarified version of what I had in the report.

Deputy John Paul Phelan: I want to go back to Senator O'Keeffe's question about the publication of the letter. There were two parts to the letter of 12 April, first, a clarification of a question the Chairman asked about the roles of the Governor prior to 2008, second, correction of the record as the professor saw it. Does he think it was appropriate that most of the members of the committee first knew about the letter when it was published in the newspaper and subsequently on the Central Bank's website? I ask particularly because part of the letter provided primary evidence to the committee about the role of the Governor prior to 2008.

Professor Patrick Honohan: No I did not see it like that at all. I wanted to make absolutely clear that I was not in any way causing problems with the flow of evidence by leaving something in the Official Report that was misleading. I wanted to send the letter. I know that in the Central Bank we have scanned 100,000 documents. If this was 100,001 would anybody ever notice it? The Chairman has often emphasised this is something in the public arena, people are watching. It is important to get it right. Maybe that was in my mind, to get it out there. Should I have waited a couple of days for a response? I can see the Deputy might think that. I thought it was a constructive approach.

CONTEXT PHASE

Deputy John Paul Phelan: I am not trying to be critical but given that the first part of the letter was an answer to a question that the professor felt on the day he could not answer and was evidence for the inquiry-----

Chairman: I am not going to give the same weighting to an €8.5 billion question to Anglo Irish Bank with regard to the timing of a letter in this evening's meeting. The Governor can be asked about it but I am not going to allow it be over-pressed.

Deputy John Paul Phelan: I am just reiterating the point. I am not trying to badger the Governor.

Professor Patrick Honohan: My approach and that of the Central Bank is that if something does not need to be kept confidential we put it out there. That is the way: put it out there.

Deputy John Paul Phelan: We received the professor's statement today very late and my questions refer specifically to the letter, scenario 2, as outlined in respect of emergency liquidity assistance, ELA. Did he have any discussions with his predecessor as Governor of the Central Bank about the meeting that took place around the guarantee and whether that ELA was sought? He mentioned in the letter that it would have been a preferable course of action. Did he have any specific discussions about whether he or anybody else raised that matter?

Professor Patrick Honohan: I have to be super careful again in conversations. I know what he thought. When did I talk to him about it and in what context?

Chairman: It is within the gift of this inquiry to speak to individuals in the first party if it so wishes rather than take second-hand or third party advice. The Deputy should move on.

Deputy John Paul Phelan: I have no further questions.

Chairman: I will be cutting members off if they move into repetition.

Deputy John Paul Phelan: That was not repetition.

Chairman: I did not say it was but if any more members repeat any area I will move on.

Deputy John Paul Phelan: It was a question about the letter.

Deputy Eoghan Murphy: At point 4 of the professor's letter of 12 February, the Official Report of 15 January, he notes that he has not attempted to correct inaccuracies or clarify ambiguities in the Official Report of what was certainly a very complex and fast-moving conversation. What inaccuracies is he talking about?

Professor Patrick Honohan: I am not talking about some error of transcription. I have gone through it and there may be a couple of wording issues but it is the impression that is given, the fact that I interrupt myself. I have incomplete sentences that run into other sentences. I could rewrite the whole thing but then it would not represent what I said. It is a kind of impossible situation. I will give one example. I have listened to the video a couple of times because I could not believe that I had said-----

Chairman: You will be the first witness who has referred to the video.

Professor Patrick Honohan: There is one point where I seem to be praising all the bankers to high heaven and saying they were all men of utmost skill and integrity. I think there was some slight rewording, editorially, which was reasonable but I did not want to imply that this

was a rubber stamp on the integrity of every banker in the country. It does read like that now but if one listens to the recording I said something blurred that talks about the impression people had of bankers that they were, and indeed many of them were, but I am not going to give a rubber stamp to every one of them.

Deputy Eoghan Murphy: So is the professor happy now that he has clarified everything that he wanted to clarify from the Official Report of 15 January?

Professor Patrick Honohan: I stand by what I say, there may be some words here or there. I thought: how could I do this? I cannot really.

Chairman: Further to Deputy Murphy's question, there might be Oxford commas, which can change the complete context of a sentence or just an interpretive narrative that can be a bit skewed, but if you believe there is something of a substantive nature we would require you to inform the committee. The video recording gives a better impression of your evidence than a text might sometimes do. Deputies have that difficulty in the House with their own contributions.

Senator Michael D'Arcy: Perhaps the professor could help me out a little bit with the sequencing of the letter, what I am calling the Kevin Cardiff note. That is dated 25 September. Is that correct?

Professor Patrick Honohan: Well there is a question mark on it. "Date?" Something illegible, 25-09-08.

Senator Michael D'Arcy: That is the Thursday before the bailout, the bank guarantee, which was four days subsequent to that.

Professor Patrick Honohan: Yes.

Senator Michael D'Arcy: We have the benefit of having received some additional evidence between the professor's previous visit and this visit. Some of the evidence shows that Anglo Irish Bank was losing approximately €1 billion a day, cash deposits.

Professor Patrick Honohan: Yes.

Senator Michael D'Arcy: On the Monday this note would have been four days out of date. The €8.5 billion could have been, in my analysis, significantly reduced.

Professor Patrick Honohan: No, they are entirely different concepts.

Senator Michael D'Arcy: Could the professor explain that please?

Professor Patrick Honohan: It is like asking how many players were left on the field and how many goals were scored. The cash running out of Anglo is depositors withdrawing their money. The €8.5 billion or €7.5 billion, or whatever it is, refers to the assessment of the valuation of the assets. That would not have changed between Thursday and Monday.

Senator Michael D'Arcy: Would the capital ratios-----

Professor Patrick Honohan: No. The capital ratios would not have changed. The liquidity ratios would have changed.

Senator Michael D'Arcy: I thank Professor Honohan for clarifying that.

CONTEXT PHASE

The other aspect in Professor Honohan's second point is that he refers, in quotes, to "an event of default". It is half way down the page.

Professor Patrick Honohan: Yes.

Senator Michael D'Arcy: Professor Honohan states: "... Government were effectively precluded from liquidating or extensively restructuring the guaranteed institutions because they would have to repay the guaranteed debt forthwith". Is that the ISDA, where it would call an event?

Professor Patrick Honohan: That would be for derivatives. An event of default is something that would be determined in a derivatives ISDA model because that would be written into the contract as they would define it, but for bonds a court could eventually decide. I am not a specialist in the exact process.

Chairman: The Senator knows he should adhere to the Governor's letter and not drift from it, but he might explain the relevance when he is doing so.

Senator Michael D'Arcy: Yes.

Professor Patrick Honohan: The point about this is that if the Government took action and said, "We are liquidating this bank" or "We are cutting them out of most of what they do", a bondholder watching carefully would immediately say, "I think this bond is now payable by the bank and it cannot pay it, therefore, I am going to go straight to the guarantee because the guarantee is written like that and the Government will have to pay it". The Government could say "No" and it could go to court, but it would be very difficult for them to avoid that.

Deputy Joe Higgins: Professor Honohan said in his evidence today that there has been a tendency to overstate the extent of the impact of that night's decisions and that it would be hard to deny that 80% to 90% of the overall hardship that followed the bursting of the bubble was already inescapably embedded in the situation. Would he understand if many people listening to that evidence today, who suffered the hardship he referred to, would be shocked by that evidence? What is his basis for saying that?

Professor Patrick Honohan: I do not think they should be shocked because I believe they recognise, from all the conversation that has been going on in the country, that other things were wrong in society. There was the great expansion of the property boom, the reckless lending and all of that. That is what I am saying. It is the legacy of all of that reckless, insufficiently regulated lending that they are paying for, and not just a snap decision on 29 September. That is all I am saying.

Deputy Joe Higgins: Did the sovereign State accepting responsibility for huge amounts of debt that did not belong to it-----

Professor Patrick Honohan: Here is my point on that.

Deputy Joe Higgins: -----create the burden that caused huge amounts of austerity later?

Professor Patrick Honohan: I will make two points on that. First, as we said, it might be €40 billion that was taken over. The other losses to the Exchequer - the revenue losses and the other costs - were much larger than that so even if they had found a way, on 29 September, of saying, "€40 billion - magic it away to zero" they would still have all those other losses of tax revenue. The collapse of the property bubble created costs to the State which were much larger.

That does not mean the €40 billion was not important. It was.

Second, the hindsight scenario I outlined was that they would have decided they were not going to pay for this, that it was too big and certainly not worth €35 billion or €40 billion. That would have had its costs as well because we know how disruptive it is to proceed to a liquidation and eventually to a bail in of depositors and bondholders, as we have seen in Cyprus. We know it is disruptive. It should have been done in that hindsight scenario but there would have been additional costs to society. We might have got the €40 billion down to €30 billion when one thing or another is taken together, or perhaps more - I do not know - but the other costs would have made the austerity that was needed almost as severe. That is the big shocker, when one realises that there were other tax revenue losses and other expenditure burdens.

Deputy Joe Higgins: First, is it conjecture in terms of the extent of it and, second, even if it was €10 billion or €12 billion, is it the case that very painful cuts to ordinary people in terms of their services could have been avoided with that €10 billion or €12 billion?

Professor Patrick Honohan: Absolutely. There is no dispute about that, but it is only a portion, and a relatively small portion. It does not mean it was not worth doing it. It should have been done in that scenario. What was the Deputy's first point?

Deputy Joe Higgins: That it is conjecture.

Professor Patrick Honohan: It is. Obviously, it is very difficult to put numbers on this, and I hesitated, but from comparisons with other countries, the whole macroeconomic situation and evidence of what has happened to tax revenues and expenditures we can get a sense of the orders of magnitude involved. That is why I am saying we could be reasonably confident that even if it had not been for those banking losses, the pain would have been severe.

Deputy Joe Higgins: I assume Professor Honohan accepts that other people would have a different view on the extent of the hardship that would have occurred, but-----

Professor Patrick Honohan: I do not think so, actually. The evidence that I am giving is in line with expert opinion, maybe not expressed in exactly the same way. Professor Black came here and said it was the worst decision in history. I agree it should not have been done, but did he quantify that? No.

Deputy Joe Higgins: As they say in Africa, the lions have a different view of the hunt than the hunters when they-----

Chairman: And it is nearly dinner time, so we need to focus and then bring this to a conclusion.

Deputy Joe Higgins: Finally, Professor Honohan says that nationalisation of Anglo Irish Bank and INBS would not be the same as burning bondholders. What should nationalisation, as he advocates, have involved?

Professor Patrick Honohan: In the scenario when they did not know, I would have guaranteed a more limited range of the liabilities, nationalised and put in a new management, and that management would have the instruction, given the expectation that this bank was finished, to wind it up in an orderly manner. Having limited the guarantee, some billions of euro could be saved by eventually bailing in those subordinated debt holders and perhaps some of the long-term-----

CONTEXT PHASE

Chairman: I thank Deputy Higgins and call Senator Marc MacSharry.

Senator Marc MacSharry: I have no questions, Chairman.

Chairman: Thank you.

(Interruptions).

Chairman: You are my best pupil. It is all said in jest.

I thank Professor Honohan for coming before the inquiry-----

Deputy Michael McGrath: Can I ask a question?

Chairman: I can allow the Deputy ask a brief supplementary if he wishes.

Deputy Michael McGrath: It is along the lines of where Deputy Higgins was going with his questioning. When Professor Honohan came before us in January, he was asked directly what the bank guarantee cost. He initially said €40 billion and when I contributed I asked him if he meant that this was the cost of the guarantee or the cost of rescuing the banks. Professor Honohan thanked me for correcting him, as he put it. I did not mean to correct him but that is how he put it. Given that today he has put a figure on it and said that between 80% and 90% of the costs were there anyway, irrespective of that decision, would he now care to put a figure on what the additional costs of the decision to guarantee the banks at the end of September 2008 was, as opposed to the costs that would have been involved in another scenario which he might have preferred?

Professor Patrick Honohan: I would prefer to stick to this 80% to 90%, and the reason is-----

Deputy Michael McGrath: So that means €4 billion to €8 billion could have been avoided.

Professor Patrick Honohan: No. The costs of this whole debacle were much bigger. I stopped counting when it got to €100 billion. If the Deputy wants to measure the costs to society of this downturn, it is well over €100 billion so when one gets to that stage, one says that the night of the bank guarantee is not the big story.

Deputy Michael McGrath: The question is that it was widely reported at the time in the media that the bank guarantee decision cost €40 billion. Can Professor Honohan now say in his opinion what additional costs accrued because of the bank guarantee?

Professor Patrick Honohan: I want to leave it at the 80% to 90%. Can I just say two things? I know that the committee is in a rush.

Deputy Michael McGrath: The question is: of what-----

Professor Patrick Honohan: I will not put a number on it because to get that number-----

Deputy Michael McGrath: It is a relative figure.

Professor Patrick Honohan: -----I have to land on what the total cost to society was, which was definitely more than €100 billion. I am not going to land on it because nobody has really done the work in a way that is robust enough. I had an article in *The Irish Times* which showed

how one could go about it.

The two points I wanted to make have now gone out of my head. One of them was a good one though-----

Deputy John Paul Phelan: It will come back to the professor.

Professor Patrick Honohan: It will, but I will not write a letter and certainly I will not put it on the website.

Deputy Kieran O'Donnell: We will have to meet next week.

Senator Susan O'Keeffe: We will wait.

Professor Patrick Honohan: I thought I would have an opportunity to say this - it is worth mentioning - because a lot of people, including me, have been banging on about the subordinated debt. The committee had somebody here who was saying they were well paid to take this risk and that the committee might be interested to know how much more the subordinated debt holders were paid to take this risk of being bailed in. The two last subordinated debt issues made by Anglo Irish Bank, in 2005 and 2006, carried a risk premium of one quarter of 1% - 0.3% in one case and 0.25% in the other. These were tiny margins and there was some legitimacy in the argument made on the night of the guarantee that it was more or less regarded as risk free. It was regarded as risk free because they had such an exaggerated impression of how good Anglo Irish Bank was. It is extraordinary - one quarter of 1%.

Chairman: I will bring the leads back in for a brief supplementary question and then wrap up.

Deputy Kieran O'Donnell: Returning to the Governor's witness statement today, I have two interlinked questions. Is it Professor Honohan's professional opinion that the type of guarantee put in place was such a belt and braces guarantee that it precluded a liquidation taking place quickly in terms of Anglo Irish Bank and Irish Nationwide Building Society?

Professor Patrick Honohan: Yes.

Deputy Kieran O'Donnell: Second, if the then Government had gone with an option of putting emergency liquidity in place, how long would it have been before it and the authorities of the day would have been in a position where they would have been able to make the decision to liquidate Anglo Irish Bank and Irish Nationwide Building Society based on the evidence available? That is the key question.

Professor Patrick Honohan: They could have had weeks and weeks of emergency liquidity assistance. Some people raised doubts about whether ELA would have been given. It would have been given. It was given to other banks. Therefore, they would have had weeks and weeks. However, weeks and weeks was not really enough. It took a long time until NAMA went in. What if it had not been for developer loans? It was very hard to evaluate developer loans. What was the collateral? What was the personal wealth of developers? Nobody knew; it was not until NAMA made the valuation later on.

Chairman: It is a new question.

Deputy Kieran O'Donnell: I wish to ask Professor to clarify the position on the question I am asking.

CONTEXT PHASE

Chairman: It is a new question.

Deputy Kieran O'Donnell: It is not. It is the same one.

Chairman: The Deputy should be brief.

Deputy Kieran O'Donnell: Is it correct to say the type of guarantee put in place ruled out the possibility of liquidation of Anglo Irish Bank and Irish Nationwide Building Society being a tool for the State?

Professor Patrick Honohan: Absolutely.

Chairman: Can the Governor say was it, by its nature, going to lead-----

Deputy Kieran O'Donnell: The Chairman should just ask me-----

Chairman: I do not have-----

Professor Patrick Honohan: I have said it. They really could not have liquidated that bank until after the guarantee ended. Can I quote one letter? The members might be annoyed. It is the letter of 19 December 2008 from me, as a university professor, to the then Minister, the late Mr. Brian Lenihan. I will pass it to the committee. The final paragraph states that, "if this reasoning is correct, it is hard to avoid the conclusion that Anglo should be treated as insufficiently capitalized, intervened and wound up in the manner outlined above, thereby potentially saving the taxpayer billions." If anybody thinks I keep on chopping and changing my mind, I held the same view in December 2008 as I do today.

Deputy Kieran O'Donnell: What date is on the letter?

Professor Patrick Honohan: It is dated 19 December. The letter speaks about dealing with subordinated debt and not putting in capital.

Deputy Kieran O'Donnell: Will the Governor reiterate what was in it for the record?

Senator Susan O'Keeffe: The Governor has just read it.

Chairman: It is on the record and Deputy Kieran O'Donnell can read it later. I am going to bring the proceedings to an end. I thank the Governor for coming before the inquiry following our invitation to him on receipt of his recent correspondence to us. The deliberations of the committee will continue into the nexus phase, at which time we may engage with the Governor again. I thank the Governor for his consideration, engagement and the time he has given to the committee to date.

I propose that the committee go into private session to deal with a number of matters. Is that agreed? Agreed.

The joint committee went into private session at 5.05 p.m. and adjourned at 5.25 p.m. until 9.30 a.m. on Thursday, 12 March 2015.