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AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉI-REACHTA

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Dé Céadaoin, 29 Aibreán 2015

Wednesday, 29 April 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.

AIB - Mr. David Duffy

Chairman: As we have a quorum, can I propose that we go back into public session? Is that agreed? And we'll now commence with session 2 of today's public hearings with Mr. Duffy, chief executive officer, Allied Irish Banks. The committee of inquiry into the banking crisis is now resuming in public session and can I ask members and those in the public gallery to ensure that all mobile phone devices are switched off?

We will now hear from Mr. David Duffy, chief executive officer at Allied Irish Banks. David Duffy joined AIB Group in December 2010 as chief executive officer, chairman of the leadership team and board member. From 2006 to 2011, he served at Standard Bank where he was head of strategic projects. Prior to this, he served at ING Group and at Goldman Sachs International. Mr. Duffy, you're very welcome before the inquiry this afternoon.

Before I begin proceedings, I just wish to advise the witness, Mr. Duffy, 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 you're directed by the Chairman to cease giving evidence in relation to a particular matter and you continue to do so, you're entitled thereafter only to a qualified privilege in respect of your evidence. You are directed that only evidence connected with the subject matter of these proceedings is to be given. I would also like to remind members and those present that there are currently criminal proceedings ongoing and further criminal proceedings are scheduled during the lifetime of the inquiry which overlap with the subject matter of the inquiry, so I've been advised that the utmost caution should be taken not to prejudice those proceedings.

Members of the public are reminded that photography is prohibited in the committee room. To assist the smooth running of the inquiry, we will display certain documents on the screen here in the committee room. For those sitting in the gallery, those documents will be displayed on the screen to your left. Members of the public and journalists are reminded that these documents are confidential and they should not publish any of the documents so displayed.

The witness has been directed to attend the meeting of the Joint Committee of Inquiry into the Banking Crisis and you have been furnished with booklets of core documents. These are before the committee, which will be relied upon in questioning and form part of the evidence of the inquiry.

So, if I can now ask the clerk to administer the oath.

The following witness was sworn in by the Clerk to the Committee:

Mr. David Duffy, Chief Executive Officer, AIB.

Chairman: Okay.

Mr. David Duffy: Chairman, just one quick comment.

Chairman: Sure.

Mr. David Duffy: I think in your introduction you mentioned I joined AIB, December 2010.

Chairman: Yes.

Mr. David Duffy: I think 2011-----

Chairman: Okay.

Mr. David Duffy: -----just lest anybody miss that.

Chairman: Sorry, I'll just go through it. You joined in December 2011?

Mr. David Duffy: That's correct.

Chairman: Yes, okay. My apologies if I misread that. Okay, so with that said, Mr. Duffy, if I could invite you to make your opening remarks to the committee, please.

Mr. David Duffy: Thank you, Chairman, and, what I proposed, if it's acceptable to the Chair, is that I do an introductory page and a summary page with a brief reference to the six themes, rather than read the whole document, thereby allowing as much time for discussion as possible.

Chairman: That would be very assisting, Mr. Duffy, and just that you know as well that the full document itself will be published by the committee-----

Mr. David Duffy: I've been advised so.

Chairman: -----over the course of the afternoon. Thank you.

Mr. David Duffy: Thank you very much, Chairman. As CEO of AIB since December 2011, I welcome this opportunity to outline to the Joint Committee of Inquiry into the Banking Crisis my own experience of joining a bank that was in a significantly challenged state and leading its return to stabilisation and recovery over a three-year period. I've worked in banking for almost 30 years, specialising in managing and restructuring banks through challenging times. Though I grew up and was educated in Ireland, I spent most of my career working abroad. From 1987 to 1997, I worked with Goldman Sachs International in various senior positions, including head of human resources Europe head of general services Europe and business manager for information technology. From 1998 to 2006, I held various positions at ING Group, including the position of head of global wholesale banking network. This role included the management of a team of CEOs covering all of the bank's regions globally.

Prior to that, I was president and chief executive officer of the ING franchises in the US and Latin America. From 2006 to 2011, I worked with Standard Bank PLC-Standard Bank International, including holding the position of CEO. In 2007, I took responsibility for the full international franchise. I relocated to Asia in the summer of 2010 and in October assumed the role of head of strategic projects. Leaving Standard Bank in 2011, I established Celtic Advisory International, providing capital raising and development advisory services to corporate and emerging companies.

I was asked to return to Ireland at the end of 2011 to become CEO at a troubled AIB that had been rescued by the Irish taxpayer following investments of €21 billion. Together with the then chairman, David Hodgkinson, who joined in late 2010, we set about a daunting task that involved a radical restructuring of the bank and its balance sheet, the implementation of a €350 million cost-cutting programme, an overhaul of the bank's funding and pricing models, governance enhancements, and creating the ability to effectively deal with our challenged loan book.

Today AIB is a profitable organisation with key performance metrics in 2014 trending positive. In particular: our lending levels are increasing; our impaired loans and arrears levels are decreasing; the bank's capital and funding levels have stabilised and are improving; the bank's organisational structure and risk framework have been restructured; the bank has received approval for its restructuring plan and passed the ECB-EBA comprehensive assessment; the bank has placed significant emphasis on meeting the expanded and enhanced regulatory environment across Europe. Having returned the bank to profit and stability, it is my expectation that AIB will be in a position to return capital to the Irish State over time, subject to economic conditions and the wishes of our majority shareholder.

In conclusion, as mentioned, I have covered the six topics here. I think the effectiveness of the bank's board governance is fairly well documented here, so I won't spend much time on that and we'll just deal with that in questions. Our bank credit risk strategies and risk management strategies are significantly updated here. I'd draw your attention to cash flow, credit lending, which is the most significant difference. There are many other complementary and important adjustments that have been made in the bank, but that area is one of particular emphasis, versus what has been a practice in the past.

With regard to remuneration arrangements and bank's risk assessment, I'd just draw your attention to the fact that we are under the bank's placing agreement and restricted in that matter, but I have documented our philosophy with regards to that for the purposes of discussion, although it has been in practice not applied due to the restrictions that we have.

On the clarity and effectiveness of the nexus of institutional roles and relationships, I think one area of emphasis that I will discuss is the fact that we are supervised in reality by the SSM, and so all decisions on capital funding, appointment of senior persons up to and including my replacement as a CEO, are at the behest of the European supervisors. I think those were the four that I particularly wanted to mention out of the six.

I would say that the liquidity and capital will be an extensive discussion, so I won't try and select components of that. And with regards to item 5, on the appropriateness and effectiveness of domestic policy responses, and in particular NAMA, I don't have much experience of the history prior to my arrival, but I'll endeavour to answer questions as best I can.

In summary, I wish to thank the committee of inquiry for considering my account as documented. I fully appreciate the difficulties you face in dealing with such a weight of information from so many witnesses. The banking and economic crisis in Ireland has indeed been staggering, the impact of which I could not fully understand until I returned to Ireland and witnessed the consequences first hand. I hope that my statement to you has assisted the committee in appreciating how, in spite of the depths to which it plunged, the bank has been stabilised and restructured and should go on to support the Irish economy and the Irish people, as it should rightly do. Chairman, that concludes my comments. Thank you.

Chairman: Thank you very much, Mr. Duffy. And to commence proceedings if I can invite Senator Michael D'Arcy, and please, Senator, you've 25 minutes.

Senator Michael D'Arcy: Mr. Duffy, you're welcome, thank you for coming. I'm going to start where you have finished, Mr. Duffy. "The banking and economic crisis in Ireland has indeed been staggering, the impact of which I could not fully understand until I returned to Ireland." It's a term not that often used by bankers, who tend to be more conservative with their language, the term "staggering". Could you explain why you chose that term?

Mr. David Duffy: Well I think the thoughts leading to that kind of phraseology would not intentionally have tried to be inflammatory or excitable. They refer to the significant scale of the financial numbers involved in the rescue of AIB. The original €21 billion which was invested in AIB as capital was only part of the equation. In the first year of my taking on the role we had an additional obligation to deleverage a further €20 billion of assets under the direction of the troika regime. So that was another €20 billion, an almost coincidental number. Prior to that we had to deliver a very significant portfolio of assets to NAMA at a very significant discount with another capital impact. In addition, assets had to be sold in various other jurisdictions, notably, most significantly, Poland, but also the US. So if you look at the cumulative effect of all of those numbers it was a shockingly large number, and in addition it wasn't just about those sales, those disposals, and those injections of capital. The requirement to reduce the staff by pretty much a further 4,000 since I took over on a gross basis, and a further cut of €350 million of costs, plus an overhaul of the entire structure, governance, culture, and leadership and executive levels, I would put all of those into the rare situation of having to do all at once in one bank as being exceptional and perhaps, therefore, staggering in terms of the scale.

Senator Michael D'Arcy: Thank you. In your page 3 of your statement that you furnished us with, "I am satisfied that from a governance perspective we now have an executive leadership team comprising strong and diverse management capability." Can you expand upon "now"?

Mr. David Duffy: I'm sorry, Deputy, expand on?

Senator Michael D'Arcy: "Now"?

Mr. David Duffy: Yes. In terms of that executive leadership team?

Senator Michael D'Arcy: And yes, and if you could reflect backwards on those who went before you. I'm not allowed lead a question, Mr. Duffy, so I think you could see what I have in mind, please?

Mr. David Duffy: Thank you for the clarification. When I refer to the team, as I have referred to them, I refer to the mix of skills, very importantly, as the first element; secondly to the experience base; and thirdly to the international experience base of the team. I think it's very important, particularly sometimes when you're in a smaller universe, that you have best practice experience and benchmarks from within the universe, but also externally, and those who have the experience of crises perhaps before, perhaps not on this scale. The recruitment effort that we had sought to find the best in class for each position, and in each position we looked to see if there was a capability that had experience of how to manage significant change management programmes which was, as I mentioned earlier, fairly massive in its scale, and also had the competence to deliver on a model which we were designing which was, in our minds, being structured to prevent a recurrence of any similar catastrophe in the future. That skill base and that intellect and that experience, domestically and international, was something we took two years to put together, it was challenging, but we succeeded, and I'm very confident in that team today.

I think the comparisons to the past are not directly linked, because what we are faced with is a challenge as a change management universe and a restructuring universe is very different than a business-as-usual management universe, so regardless of whether somebody was competent or not in the past, the skills required to do what we had to do, where every single action was almost simultaneous and in a very short window of three years, were different skills than existed in the team at the time.

Senator Michael D'Arcy: You quoted the figures in terms of the reorganisation of AIB.

You didn't quote the figure for the shareholder value loss. Do you have a final figure on that?

Mr. David Duffy: I don't have a final figure for the totality. I just know of all of the components that I had to deal with, and there was shareholder loss before my arrival, so I can't quantify that exact amount.

Senator Michael D'Arcy: Okay, thank you. Also in your opening statement you state, "Clearly upon my arrival at the bank there were concerns about the bank's culture and governance." How far did those concerns that you identified go back within the bank?

Mr. David Duffy: Senator, I don't think there was a particular timeframe of reference. What I am implying by that comment is that on my arrival, when I met with the regulators, there was some dissatisfaction with our process, our control, the quality of our relationship, our communications. The bank had, during the period prior to my arrival, seen a number of CEOs and new heads, so there was a bit of disarray. There were impending material programmes, such as severance, which were outstanding 16 months at the time of arrival. That level of uncertainty and changing leadership meant that the organisation was not in a sufficiently effective place from a regulatory interaction perspective as regards the regulator's opinion. Similarly, our shareholder in the Department of Finance in the shareholder management unit did not yet have the confidence on what the strategy would be to recover the bank as we had not obviously had time to explain that so there were concerns about how we would approach that and how effective we could be in delivery. So it was that level of interaction that led to my comment where there was a concern. Did we have the right skills, as I mentioned earlier? Did we have the right leadership? Did we have a strategy that would be agreeable to, and comply with, the requirements of both the regulator and the troika? All of those elements were uncertain at the time. I myself did not know the full extent of the problems until I had spent a bit more time there but those were very clear issues that were relayed to me by the individual stakeholders at the time.

Senator Michael D'Arcy: And if you were to do a one, two, three of what were your three greatest concerns starting with your greatest one, two, three?

Mr. David Duffy: I think my greatest concern relates to what is necessary to run a bank well and that starts with culture. I think there was an organisation that had been through too much change in leadership, had been through a shocking crisis in terms of shock to the system of internal as well as external. There was a huge amount of uncertainty. There was a fear about the individual roles. It was so much of a distraction that we needed to be able to be very clear up front that the bank is not there for itself, it's not there to worry about itself; it is there to serve customers and delivering a customer culture. In other words, every thing that gets done in the bank, every process it serves, the customer had to be prioritised. How could we do that? That meant customers not just in the normal course of banking, but it meant the significant population who were in distress and arrears at the time for which we had no capability ... so creating that culture which recognised that the priority was not necessarily an internal focus, the priority was an external focus and that meant shifting the culture of the bank to an external lens and then applying all the lessons that we needed to recover the bank to that lens. So that would be the first issue.

The second issue was, I think, operational risk. You had a bank that had been through so much recent turmoil, it was not yet certain of the outcome. We had very many staff leaving, senior people leaving, and an awful lot of the organisation was in stasis. It was unable to move, it wasn't sure which direction to go, it wasn't sure of its future. So that uncertainty and operational risk that it generates ... Are people doing their job? Are they managing the processes?

Are they implementing the controls that we should have?

The third area would have been the functioning of the bank in its purpose, which primarily is to lend to customers, that risk aversion was very material at the time. People weren't sure of what the capital structure was, whether our funding was stable and, therefore, were very, very adverse to taking decisions on lending. So there was a very significant adversity to taking risk in the bank and that aversion meant that I couldn't be sure where the revenue profile and the cost profile was going to end up in the first six to 12 months. So I think if ... you know, I'd want to reflect in time if I whether there was any change in that priority but I think culture is overarching. It's overwhelming in terms of success or failure and then the other two follow from that.

Senator Michael D'Arcy: And are you satisfied with where AIB are currently in relation to -----

Mr. David Duffy: I am, Senator. I don't believe that by any manner of definition that you would apply that it is complete and finished work. I believe that we have stabilised return to stability, applied all of the appropriate governance that we would wish to have to prevent reoccurrences of this magnitude, but I still think we are on a journey in terms of deeply embedding a culture which is about delivering for our customer rather than the lifestyle or livelihood that you have by being in a bank.

Senator Michael D'Arcy: And is there any further change that is required to put in place the ultimate culture or ultimate structure that AIB should have that you haven't currently put in place?

Mr. David Duffy: I don't think so, Senator. I think what is required is experiential learning. It is embedding everything that we have put in place. The governance model covering every aspect of the bank from credit risk to our operational risk to lending and trading risk needs to be practised at all levels of the organisation. The ultimate test of this will be time and tone at the top is where we have focused such that will be fed through the organisation through all aspects of the organisation. So it was ... I don't think there are material new developments to be implemented. I do think there is a significant amount of practice of best in practice governance that needs to be applied and learned from before we can be comfortable that it is a fully completed exercise.

Senator Michael D'Arcy: ''Since 2011, the approach to risk management within the organisation has fundamentally changed''. That's a quotation from your opening statement. Credit assessment now focuses mainly on cash flows as a primary source of repayment with collateral considered as the secondary source. Could you explain why in your opinion this had not been the case before 2011?

Mr. David Duffy: It's difficult to answer that not having been in the bank and also not having been in the country so I would be observing from a very far distance. I think my observation would be more limited to what was happening internationally. I think there was a crisis that was sown a long time before it happened. When you originally had Glass-Steagall allow retail and investment banking come together, that created a potential significant leverage and, ultimately, greater risk in the system. When you add to that the techniques of distribution around the globe and securitisation of asset classes where the well known subprime category and many others were combined in tranches of debt which were sold around the world, you spread that risk. which was already highly leveraged. Then on top of that, the light regulation or principles-based regulation, as it was mentioned, in numerous forums existed and the covenants and documents for loans became less restrictive and lighter and more forms of collateral were acceptable in any circumstance. And that principally allowed collateral on real estate to be offered up as part of the credit process. If you look at all of those taken together I think it was common practice across the globe to use real estate as collateral hence the subprime crisis that occurred globally. And that then was something of a cultural herd mentality that existed around the world in many countries and was no different here in Ireland.

Senator Michael D'Arcy: If risk appraisal had focused more on the cash flow analysis, would the impact of the crisis have been so severe on AIB?

Mr. David Duffy: I'm sorry Senator, could you repeat that?

Senator Michael D'Arcy: In your opinion, in relation to the statement you made about the credit assessment being focusing mainly on cash flows as a primary source of repayment, if the appraisal, the risk appraisal, had focused more on cash flow ... analysis, would the impact and the crisis have been as severe on AIB?

Mr. David Duffy: It's judgmental, but my own opinion on it would be that the principle of cash flow-based lending is around affordability. You can't borrow unless you can afford to repay it and, therefore, I think the level of borrowing perhaps would not have been as extreme or as large and significant individual cases as the cash flow would have to be demonstrated. With collateral you tend to have value rather than cash flow so it's not provable that you can repay the loan; it's implied that you can pay the loan based on future values. Those future values are subject to, as we've seen, asset class corrections. So I think, judgmentally, I would say if you are lending on the basis of cash flow, that evidence is an ability to pay, you won't be absolutely able to avoid any crisis but you would certainly be able to be in a stronger position for repayment on your loans.

Senator Michael D'Arcy: Mr. Duffy, you hadn't taken up your position within AIB very long when you publicly stated that AIB would consider writing down loans, debt forbearance. In terms of debt forbearance, and a moral hazard between mortgage write-down and-or SME corporate write-down, could you just outline your view why you so quickly moved to that position?

Mr. David Duffy: I think the philosophy we adopted at AIB in respect of any compromise on debt was again around the simple principle of affordability. We started out with two principles. If we wanted to keep people in homes wherever possible and if we wanted to protect SME jobs, what would the best approach be? We didn't necessarily take the view that someone would have to stay in their home. It may be a suitable home. We took the view that SMEs should be protected only when the business was viable and then when we applied those principles and looked at the financial aspects of each of the cases, we took the view that if it was clear that the debt was simply unaffordable, there are many extremes. You can have an SME that had a property investment strategy on multiple buy-to-lets in concert with two other businesses or individuals in a small town where the income ratio would imply that to recover the debt might take something in the order of 50 to 100 years, depending on your assumptions. If there were extreme cases where you could not see any circumstance of repayment, we thought that on balance it was better to be realistic about that debt structure and to put ourselves in a position where the SME could return to supporting its business and its employment that it had originally started out with, and that would be constructive and positive for the economy. Secondly we would be, in the case of an individual and the home and looking at exactly the same situation, there are many examples of cases where it was more attractive for the individual and for the bank, for the individual to remain in the home. If I may give you an example. If an individual had purchased a house, as was in one case for €400,000, and if you were to evict the individual in the house - on sale in the market at the time was valued at €100,000 - and at the same time you could agree with the individual on €200,000 or €250,000 as an affordable long-term debt repayment, then you would maybe compromise on the residual debt but at the same time the individual remains in their home. They are functioning in the economy and they are repaying far more for the shareholder than would have been obtained by a simple repossession and eviction. It was that thinking that we constructed around all of those. They were very exceptional and treated all individually, very consistently.

Senator Michael D'Arcy: Mr. Duffy, you are about to leave AIB. You are about to move to another jurisdiction, you are probably in a better position than most now to offer a view in relation to the establishment of NAMA. I am not sure if you have seen the transcripts from NAMA's evidence to the inquiry to date. Could I ask your view ... was the establishment of NAMA helpful or unhelpful towards the banking crisis?

Mr. David Duffy: I still remain as CEO of Allied Irish Banks so I can't really comment.

Senator Michael D'Arcy: You are about to leave.

Mr. David Duffy: I am not being released just yet, despite my relaxed demeanour. I am in a position though, however, to say that from my involvement with NAMA, which was necessarily close both in terms of asset transfers that had happened and the ongoing servicing of the residual assets for which the staff of AIB were still retained, I think the experience I had was that it was extremely helpful to us in our ability ... the scale of what we had to do ... when you look back, it was extraordinary - the volume, complexity and concurrent nature of it and I think it was of immense assistance to AIB that we had that circumstance where we were able to execute all of our other initiatives with the support of our involvement in NAMA. Also, the NAMA exercise for us gave us a better understanding on crystallisation of losses, of what the capital deficit was and what necessary actions needed to be taken. So from the narrow view of our execution relationship with NAMA, I would have to say that on balance it was beneficial.

Senator Michael D'Arcy: Since nationalisation of AIB, prior to you becoming CEO ... AIB, have they used external consultants for advice, outside of your own banking knowledge and expertise?

Mr. David Duffy: That they used?

Senator Michael D'Arcy: Have they ever used external consultants?

Mr. David Duffy: Prior to me there were a number of external consultants used and I think the one comment I would make there is that consultancy may often be, whether in crisis or in business as usual, a requirement of a bank if you are looking for expertise that you don't have internally. So I don't necessarily see consultants as always a bad answer.

Senator Michael D'Arcy: Do you have any ... do you have the knowledge of how much was spent on external consultants by AIB since nationalisation?

Mr. David Duffy: Do you know what Senator, I don't have that level of knowledge, cumulatively or in detail.

Senator Michael D'Arcy: Millions?

Mr. David Duffy: It is hard to quantify. I would just say that the usage of consultants since I have arrived is materially reduced. Once you can bring the expertise into the bank, the corollary of that is that you can significantly reduce your dependence on external consultancy. And I think at the same time you will have external bodies continually operating if you have outsourced within a bank, so that's another aspect of this. So I ... it's too complex to come up with an exact number but I would say that on balance, if the question is are there material amounts of expenditure and consultants contributing to AIB today, the answer is "No".

Senator Michael D'Arcy: Can I ask what is a safe level of growth for a balance sheet, year on year, for a bank? Mr. Bill Black, when he gave evidence, said ... his term that he used was "grow like crazy" is 30%. AIB's figures from balance sheet growth from 2001 to 2008 was 29% year-on-year. What, in your view, is a safe level of growth?

Mr. David Duffy: I am not sure that I can say that there's any safe level of growth because I don't think growth targets are the criteria by which you would manage a bank. I think you have a simple ... when you wake up in the morning running a bank you worry about liquidity, No. 1. Secondly you worry about capital and they are the two priorities.

If you are going to lend, you have to have a threshold minimum of capital, which is not just the minimum regulatory capital but is probably that plus a buffer, where you would look to have a very conservative view on a stressed environment as to what that capital could become. And that is your starting point. You can then determine what your lending can be, providing that it doesn't breach those hurdles. Secondly, your lending composition has to be understood in terms of your funding. The history of lending had no regard necessarily to the composition of funding and you have two choices: retail longer term sticky funding as it is referred to, and wholesale funding. If it is a short term, as wholesale often is and can be subject to flight in a very quick fashion as happened in Ireland, then long-term lending without short-term funding is going to put you significantly at risk.

So I think you start off with two very careful principles - what is the minimum threshold of capital - which when in a stressed environment based on rapid asset deterioration, what is that level you should maintain - and is your funding correlated to that profile? If you have confidence in those two then you can set a target of growth which doesn't breach either of those two objectives. So I would never start with a number, I would start with the capital and the funding and then allow myself grow according to those definitions.

Senator Michael D'Arcy: And Mr. Duffy, during the period from 2001 to 2008 which were the highest level of balance sheet growth by AIB, based upon the liquidity within AIB ... at the time I know it is before your time but I'm sure you must have done some analysis in relation to that period, what was your opinion upon the operation of the bank at that stage, outside of your opening statement?

Mr. David Duffy: Senator, not to be difficult but I don't really have an opinion because I haven't, contrary to popular views, spent a lot of time studying in the past. Not through any lack of enthusiasm or effort but when we arrived we were already on 18 hour days trying to define the future so I didn't spend a lot of time on the past, and what I looked at was what I just described to you in my previous answer - what are those thresholds that we need to safely run the bank for the long term. So I don't really have a considered opinion on the efficiency of the management prior to my arrival.

Senator Michael D'Arcy: In terms of the bank guarantee, do you have an opinion on the bank guarantee? Again, I know it was before your time, but you are exiting I keep telling you - you are going soon. You may be able to offer an opinion. I think it is important that you are probably best placed to offer an opinion. You are CEO of what was the largest bank in the country and I do think it is important Mr. Duffy that you put your opinion on the record. I know you haven't gone just yet.

Mr. David Duffy: Thank you, Senator. I would be thoughtful about how my opinion ... I think when I look at the bank guarantee I look at the international world which I was more relevantly a participant in at that time. I think in Ireland's situation you were suffering the consequences of what was happening globally, which was then exaggerated by the composition of the assets which each bank had here at the time. Many of those situations involved banks being allowed to go under and many of those situations involved banks being rescued. There were different logics applied in each of the circumstances. I think in Ireland's case, were one or two banks allowed to go under, that probably would have created quite a risk for this country but maybe it would have been a position where there was finality a lot sooner ... but is impossible to predict.

There was no question in my mind that a guarantee of sorts had to be applied. Banks don't make anything, they offer a service which is providing funding for commercial activities. If there is a failure or a lack of confidence in a bank then there is no control that you have over that and your deposits will run out of the bank. So if there wasn't a guarantee of some kind - I can't form an opinion as to whether it was the right guarantee or not - but if there was not a guarantee of some kind, the confidence in the banking system here didn't exist and it could have led to a more dramatic and severe outcome.

Senator Michael D'Arcy: Do banks not make profits?

Mr. David Duffy: They do make profits but I mean physical goods, so what you are really ... you're doing ... in those circumstances ... you're not selling off your physical goods but you are going to be at risk if your deposits run and that's what a guarantee is intended to stop.

Senator Michael D'Arcy: Just to finish, Chairman, the drive to keep up with a market share, to protect the franchise, there are terms ... a number of terms that have been used, can I ask your opinion in relation to the attempt to keep up with, potentially, another institution?

Chairman: In what timeframe, Senator?

Senator Michael D'Arcy: From our terms of reference, going back to '91 to 2013.

Chairman: All right, final question. I'll bring you back in if you need further clarification on that at the end.

Mr. David Duffy: Yes, well, as a teenager at the time, I'm not so sure. I can say though that, very explicitly, you don't chase market share and you don't chase competition. What you do is you manage your bank to the limits of what your capital and funding is. I think, if there's any lesson that can be learnt, it is that your priority as an executive, or a chief executive even, is mainly risk management. You manage risk of the bank and everything you do in the bank. And that starts with capital and liquidity and then you allow yourself any indulgence you would like sufficient to maintaining those thresholds. So if somebody said to me, "You must double your market share," the very first question is: there's a lot of commercial discretion around that target, do you understand why? But the very first question is: do we have the capital and the funding to do so whilst maintaining a conservative position in the event of stress?

Chairman: Thank you very much, Mr. Duffy. Thank you, Senator. Deputy Pearse Doherty, 25 minutes.

Deputy Pearse Doherty: Go raibh maith agat, a Chathaoirligh, and welcome, fáilte, Mr. Duffy, chuig an coiste. Mr. Duffy, we've been privileged to have a number of bankers before the committee in the last number of days and each of them have apologised to the Irish people for the mistakes that were made in your bank. As the previous speaker had indicated, you're probably best positioned, as somebody who came after the bailout, after the transfer to NAMA, but has an overview of what was going on within the bank. In your view, what was the key areas that led to the bank costing the Irish taxpayer over €20 billion?

Mr. David Duffy: I think it was relatively straightforward. If you have an over-concentration in a particular asset class, and in this case property, and you have a funding profile that has too much short-term funding in it and you are suffering what would be then a global liquidity crisis, then you are not well positioned to respond to that because you are going to see a very correlated reduction in the asset values which are going to burn through your capital very quickly and that uncertainty that that creates, without appropriate diversification, leads to an exit of deposits which turns a global liquidity or a domestic liquidity crisis into a solvency crisis. So a concentration risk and a funding structure that was subject to too much short-term departure of your funding.

Deputy Pearse Doherty: Can I ask you in relation to the global liquidity - because this has come up in evidence - and the crisis at that time; if there wasn't a global liquidity crisis at that time, would AIB still have lost ... well, we know it's well in excess of €20 billion, but would it still have cost the taxpayer €20 billion?

Mr. David Duffy: Deputy, it's hard to quantify an exact number. I would say that my opinion would be there would have been still significant pain. I think the issues remain. You had a short ... too high a content in terms of short-term funding and you had too large a concentration in single asset class, and either of those could have caused you pain.

Deputy Pearse Doherty: Okay, and I'll come to some of those points. But it's been suggested again before the inquiry, and the suggestion goes something like this, that the global liquidity crisis actually could have saved this State money in the long term because there was no indication that the banks were going to stop their concentration into the property and development and commercial property sectors. Do you subscribe to that notion or do you reject that notion?

Mr. David Duffy: I just need to clarify, Deputy: the global liquidity crisis, because it happened, helped us see the problem earlier?

Deputy Pearse Doherty: Basically, the suggestion is, is that there was no ... there didn't seem to be a let-up from the banks of investing into concentrated areas such as commercial property, development property, and that what the global financial crisis brought on was basically a realisation that assets were overvalued and would eventually have to be written down.

Mr. David Duffy: Well, I believe that the answer is "Yes," that the global liquidity crisis helped accentuate that reality and helped quantify it in many cases, in many countries, and I think Ireland ... when I was in previous banks there was a view across some of those banks that the asset class of real estate, particularly even private homes ... there were many others, but private homes were reaching unsustainable levels across a number of European countries, and that was observed a couple of years before the crisis hit. It was very different than sub-prime, which was part of the global liquidity crisis in the US, but when you have an income, and if your income is rising 5% or 10% a year and the cost of a home is rising 30%-40% a year there's an elasticity problem. At some point that breaks. And so I think there are ... definitely the liquidity crisis put people at risk where there was over-concentration.

Deputy Pearse Doherty: As a banker, Mr Duffy ... we know that AIB were beginning to breach the standards of concentration limits in 2006. We've also been told that this was being worked out with the regulator and that this process may change in the future, but, as a banker, with the interest of your shareholders and that concern as one of your core priorities, is it prudent to go above the limits that were in place at that point in time or was it imprudent?

Mr. David Duffy: I'm not entirely familiar with the detail of those limits. It depends on whether ... I'll make it very black and white, Deputy: if there are limits that are around the sustainable nature of the bank's existence, those are limits that you have to define as a banker, not somebody else. Limits in the past I have seen, have been either indicative, guidelines, or tacitly accepted as too low, many different practices in different countries. But, again, I regard that as interesting but not the criteria that you manage a bank by. You yourself have to look to the sustainability of the bank under your fiduciary responsibility and in so doing you have to set the minimum capital and other thresholds that you have, and included in those are concentration risks. The model which we have in the governance of AIB now is very explicit. You are going to set limits, with the board's full involvement, to understand in all areas what your limits are at a maximum, whether by sector or individual. Any breaches of those have to be escalated to the board risk committee, which is chaired by a non-executive, not the executive. They are raised by the chief risk officer who, in our climate now, does not report to me but reports independently to the chair of the risk committee, who is a board member. So I think you have to say: is the right answer whether you can or can't breach? No. The right answer is: what is the right concentration? And you should not breach that if you think it's the right concentration. You set those limits based on your minimum capital and funding thresholds. That's the way I would work.

Deputy Pearse Doherty: In your opinion, what was the main weakness in the bank's risk appetite process prior to 2011?

Mr. David Duffy: I think it was a combination of a couple of things. I think the fact that it was so heavily geared towards collateral and so concentrated in one asset class. So I think the reality there is what you're doing is you're implying that there's a value in the future. You're relying on third-party valuations for that value that you might obtain in the future and if it is such a large portion of your assets then any hit has a highly correlated negative. If you don't have a large portion of that lending in that category or sector or individual based on cash flow, you have no real certainty. You have an asset valuation model, not an income model to repay your debt. So I think that's part of the problem. There was a whole load of small issues you could consider, but in reality-----

Deputy Pearse Doherty: The liquidity issues.

Mr. David Duffy: -----if you're doing collateral and you're over-concentrated, that's a problem.

Deputy Pearse Doherty: And, in your opinion, Mr. Duffy, why weren't those issues addressed by the incumbent management?

Mr. David Duffy: Very hard to comment on that, Deputy, because I wasn't here. They may have addressed it or tried to address it or failed to address it. I don't know. I'm not familiar with their internal workings during that period.

Deputy Pearse Doherty: Is it obvious to you that those issues were serious issues, if you were in that position? Would it be obvious to a banker that they were serious position ... serious issues?

Mr. David Duffy: I think a herd instinct is a lot to do with this. When I was looking at this, before I got to AIB, this was happening in many jurisdictions in many countries, and the faith in asset prices rising and the encouragement by almost every professional in the industry to chase after the best market share in that area, those were the prevailing cultures at the time and those were the prevailing thoughts at the time. It should probably have occurred to people that, like anything else, it can't ... asset prices, any prices, can't move in one direction forever.

Deputy Pearse Doherty: What is your view in relation to the challenge presented by the risk function to lending strategies? Were they sufficiently strong in the period leading up to the crisis in 2011?

Mr. David Duffy: It's hard to observe on an individual case level. I would tend to look at it as allowing such concentration in an asset class would suggest a weakness. I don't know the individuals or the process, but I think there are many issues which I would look at today as being best practice which perhaps the industry didn't have at the time, not just AIB, but having a chief risk officer who is independent and having risk managers who are independent of the business, not allowing the business to originate and approve its lending, having all exceptions to any limit automatically escalated and supervised by the board directly. Those are the things which probably didn't all exist at the time and certainly, for best practice, should exist.

Deputy Pearse Doherty: Okay, in the revised 2002 EU restructuring plan and it's on AIB B1, Vol. 2, pages 39-40, I won't read the whole paragraph but, it says: "AIB acknowledges that its decision to expand into property was misguided and that's its risk management and internal government systems were not as effective as they should have been in controlling that risk." Do you believe, Mr. Duffy, that is a fair assessment of AIB's position leading up to the crisis?

Mr. David Duffy: Well, if it is a statement from the people who managed it at the time, then it... it has to be a reasonable opinion.

Deputy Pearse Doherty: And can you further... you are of the view that AIB now has the appropriate structures and controls in place to ensure that we are not seeing a repeat of that type of scenario.

Mr. David Duffy: I do believe we have. I mean it is important to define what I mean by that, Deputy, the important differentiation, for me, is the chief executive or the executive cannot be the arbiter of your risk accumulation. They can contribute, and the board contributes to a strategy, but when you are operating the bank, the people who originate must be separately accounted for in terms of those who approve. So independence of the risk function is fundamental. On top of that, the chief risk officer should not be reporting to the chief executive. If you were, as in some banks in the world today, or as accepted, you were the chief executive and you have a chief risk officer and you are paying his bonus or variable compensation, then you cannot say with absolute confidence that there would not be a conflict of interest at some point. So I think, one of the first things we did was, for both audit and risk, made sure the independence of reporting directly to a board member, non-executive, who chairs the risk committee is a fundamental principle of how you should operate. So that, and then our ... all of our policies, all of our guidelines which I have tried to document in my statement, with limits, with exception reporting explicitly mandated and required to be reviewed at the board, with all of those elements I believe we have the appropriate governance to prevent a re-occurrence.

Deputy Pearse Doherty: In relation to your opening statement on page 3, paragraph 7, you say that the large exposures and approval authorities policy "replaced the previous Group Large Exposure Policy." Can you tell the committee why you replaced the group large exposure policy?

Mr. David Duffy: Well, what we did, Deputy, was we felt that best practice governance would tell you that you need to have a strategy which is informed by a risk appetite and therefore you need a risk framework. So if you'll forgive me just taking you through the latter, so in your strategy there is no commercial strategy unless you have understood your risk appetite and the framework for that and then that derives your capital funding. In that risk appetite, we replaced everything, not just large exposures. And we sat down and said, for a bank whose purpose is principally to serve Ireland, and that's is its sovereign obligation, if that is its sovereign obligation, what is the risk appetite? And every policy should be resized and reformulated to align with that intent. So that is what we did. So every single sector and for single names and every asset class, we reformulated and put the policy in place that aligned to our sovereign strategy and at the same time, massively reduced the levels of limit in each of those categories so that the escalation was required at a much higher... a much earlier level in origination than would have been the case before.

Deputy Pearse Doherty: Thanks Mr. Duffy, we know from... again evidence that has been provided to the committee in relation to the transfers from AIB and other institutions to NAMA, that the vast majority of the sum total of that money came from a small number of borrowers. And AIB is no different in this regard, did you see any issue with the group large exposure policy as contributing to the loss that AIB experienced?

Mr. David Duffy: I think the whole asset class contributed in many different ways, but certainly it was additionally exacerbated by large concentrations with individuals were effectively in a risk scenario like that, bankruptcies and even personal guarantees weren't going to be viable and so you were liable to lose a more material amount of the individual loan that was lent to a person in a large exposure category. So I think it can have, certainly an exacerbating influence.

Deputy Pearse Doherty: Okay, the ... again in your opening statement, you talk about the need for continuous oversight saying that: "The recent history of the banking sector has required that this process is predominantly evidence based for both potential and conduct of business regulations - banks must not only comply with what the regulations require, they must also continuously evidence that compliance." How does this process compare and contrast with what you first saw when you arrived at AIB?

Mr. David Duffy: I think, Deputy, the previous era was a regulatory one where lighter supervision and principles-based regulation were the fashion. And much was made of it, I remember during my time in the UK, much was made of a leading financial centre because it operated a principles-based regulation. Those were far less forensic and far less, you know, controlling. I think, when I arrived, we could see that we were going to have to move to a world where we were absolutely clear in our mind as to what our risk framework and appetitive would be by sector and individual. And we were going to, internally first, be very explicit in our evidence into the board and to the executive supervisory committees that we were compliant with those. It then followed that obviously, and logically, the regulators moved to a point of wanting also to see the evidence of that. If you fast forward to today, AIB is as I said, jointly supervised but by the SSM in Frankfurt. And that is entirely an evidence-based system, so I think both internally and externally, evidence had to be your philosophy.

Deputy Pearse Doherty: Okay. I am not sure if you have followed the proceedings so far, we have had contributors from NAMA in, which talked about, and there has been quite a bit of discussion at the committee in relation to loan-to-value ratios and what were the real loan-to-value rations that were being offered. The suggestion has been made in many cases that the loan to value were 100%. I want to put to you the evidence to the committee of Donal Forde and he said in relation to security and loan approval, it is on page 137 of his evidence and he... the quote is:

> the difficulty arose because the security that we held, which in many cases was equity, also began to devalue very quickly. So I think it's true to say that in the way things ultimately developed, we were left frequently where it wasn't cash that we had recourse to, but they were assets that were of much less value.

NAMA has made the point, Mr. McDonagh and Mr. Daly who has been before, is that the loan to values in many cases and what they have seen transferred into NAMA were close to... were 100% in many cases. Do you subscribe or dissent from either of those views presented by Mr. Forde or by the witnesses from NAMA?

Mr. David Duffy: I don't have a detailed knowledge of all of them, but I am not surprised by that. I think there were circumstances that I saw of that nature. I think the problem that I could see there is that, a bank should never be the first loss in any lending and putting equity into a transaction puts you in the position of being a first loss there in many circumstances. Secondly, loan-to-values have to be very carefully considered; they should not be at 100% in any asset class even with guarantees. I have seen in the crisis, in my previous bank, a loan-to-value of 40% become 100% in a matter of five weeks. So they are an element but they are a spurious element, they cannot be the defining criteria of your lending. And as I go back to the point, if you are relying again totally on asset valuations, and loan-to-values against an asset valuation and you have equity in the deal and no cash flow comfort, then you have a much higher risk. So... hence our model today is cash flow lending, minor collateral but mainly cash flow lending.

Deputy Pearse Doherty: Okay, in relation to NAMA and I know you mentioned NAMA bonds on page 7 of your statement in paragraph 3, and I am also aware that you weren't at AIB at the time of the transfer of the loans to NAMA, but you were there while AIB held the NAMA bonds. Can you tell the committee for what purpose did AIB use the NAMA bonds? How did they work? What were the steps involved?

Mr. David Duffy: Well they were ... that's what we were provided with in place of assets and they became collateral which we could use with the ECB for liquidity. So it wasn't that complex. They were just a qualifying asset for which we could have access to liquidity.

Deputy Pearse Doherty: How important for your bank was it that the NAMA bonds became available to AIB to access that liquidity?

Mr. David Duffy: I think, for the residual value of the transfer, we had to have an asset that was something in terms of the value that we were retained, you know, for the transfer that was applicable as a liquidity driven funder, so it was very important because, at the time, we had, I think, close to €30 billion of funding from the ECB and we had to repay all of that through the asset deleveraging and the wind-down of the NAMA bonds themselves so I think they were an important part of the construct of our funding at that time.

Deputy Pearse Doherty: Okay. Mr. Duffy, you weren't obviously at AIB; indeed ,you weren't in the country at the time of the bank guarantee. You mention in your opening statement you were born and educated here, you worked as CEO for Standard Bank International. I'm aware that that was a Standard Bank plc who we might recall in 2009 suggested that Ireland and Greece would end up going into a bailout by the end of the following year, or out of the European Union. Unfortunately, one of them proved true. Did you keep an eye on developments in Ireland from your role back in Standard Bank International? Did you keep an interest in what was happening during that period?

Mr. David Duffy: I had a peripheral interest because whilst I was not here, I spent my weekends in west Cork, and as those of you will know, you are not short of an opinion in west Cork, so I was given plenty of updates as to what was going on. But on a serious note, I also in operating the role I had, would look at funding allocations around the world for our surplus liquidity and where it would be housed and ,in that analysis, our risk team would come up with, as I referred to earlier, countries that they felt were suffering asset bubbles and asset risk.

Deputy Pearse Doherty: That's an important point that you make there in terms of asset bubbles. Did any alarm bells go off with you in that period of 2005 up to 2008 that the banks were often lending into a concentrated sector, that we were in the middle of a property bubble or any of those observations or others?

Mr. David Duffy: I think to be honest, Deputy, my level of knowledge was sort of publicly informed confusion a little bit. There were lots of tables out there which were accessible to anybody in the public, indexes of property versus income, pricing movements across a high to low of Europe and, in all of those, Ireland and Spain were right at the very top and consistently so. There was much commentary in the two years prior to the crash in the *Financial Times*, in other magazines, in *The Economist*, people making humour of it; that the difference between Ireland and Iceland was six months and a spelling mistake. I mean, so there was a lot of commentary before the event.

Deputy Pearse Doherty: I am aware of the commentary but I'm interested in your own views in relation to this here. In terms of an asset bubble, did you believe prior to 2008, prior to the guarantee, that there was an asset bubble in Ireland?

Mr. David Duffy: I wasn't certain of it. I was concerned with how long the elasticity between the growth of income and the growth of property go. I was again, being anecdotally informed. Very many of my colleagues, friends, college, otherwise spoke about what they were paying for houses and how much they made in a year on a house, not unlike the '80's in the UK.

Deputy Pearse Doherty: Finally, on the last issue I want to just raise with you, we had earlier on, one of your former colleagues, Mr. Sheehy, before the committee. We've talked to him about his memo that he dictated on the 2 October 2008 in relation to the night of the guarantee. In that there's a reference to a draft Government guarantee, which he says, "copy attached". He informed the committee that that memo went to AIB. In your time in AIB, did you see the memo that he dictated or the copy of the draft guarantee that seems can't be located?

Mr. David Duffy: No, I've no idea where that was stored or kept. We have sourced over 50,000 documents through every crevice of AIB in support of the committee's inquiry, and there is no evidence of any such document that I have seen to date. It may well exist. It may have been given to somebody else. I don't know but I have never seen such a note.

Deputy Pearse Doherty: Did the bank ... during your time did the bank carry out any review in relation to the issues that led up to the bank nearly becoming nationalised with the State taking a majority shareholder, 99%? Did the board or did yourself commission any study in relation to this?

Mr. David Duffy: Directly no. I mean it's hard to articulate the environment at the time but, on arrival, the train was already travelling at 200 miles in a negative direction so the future was all you had. It almost didn't matter what happened in the past or why it happened. You didn't ask why did it happen, what lessons you learned; you asked what's the best in class in the world for those that survived this crisis and how do we put it in place as quickly as possible, so that was my disposition. So I didn't get involved in historical reviews.

Chairman: Okay, thank you. Just on that matter, just to clarify that Mr. Duffy and we'll wrap up and take a break then ... So you're saying AIB itself did not carry out any report as to what went wrong in the bank?

Mr. David Duffy: It may have done. I know there were previous studies done before, I'm not exactly sure of the content, there were Pricewaterhouse reports things like that ... but I think, and the Deputy's question if I understood it correctly, did I engage in any such activity. The board may have before my time but I didn't engage in it nor was I accessing such documents to define our strategy going forward.

Chairman: However there were reports done, and maybe you could establish your relationship with them ... that under the EC treaty state aid rules. the bank was obliged to submit a restructuring plan to the EU Commission. There was one finalised in April 2010, it was updated again in July 2011 and was further revised in 2012, which would have been during your period.

Mr. David Duffy: Correct.

Chairman: And if I can maybe just quote some of that to you ... If I can the witness document that's up there on the screen. It's page 39 and 40 of Vol. 2, AIB Bank 1. In the document - this is a report that was carried out - it says, in the summary and conclusions of the EU report in the ... it's paragraph 3.9 of it, it says: "Prior to the current financial crisis, AIB was a profitable bank with good growth prospects and the characteristics of a fundamentally sound bank". This report you would have had sight of this I assume yourself. It says:

> A key element of AIB's pre-crisis market positioning was its involvement in the Irish property sector which was the fastest growing segment of the Irish economy and this strategy was regarded as reasonable at the time. AIB's enterprise bank, risk management and governance systems did not act as a sufficient constraint on this growing level of exposure to the Irish property sector. This shortcoming resulted from weaknesses in the assessment of portfolio risk under stressed conditions, the inconsistent implementation of risk limits and poor credit management processes within the Republic of Ireland division. AIB acknowledges that its decision to expand into property was misguided and that its risk management and internal governance systems were not as effective as they should have been in controlling this risk.

This is in internal documentation produced by AIB. Would you care to comment upon those value judgments that were made with regard to AIB's business model and model of governance?

Mr. David Duffy: I think that those ... that restructuring plan was to receive approval for the going forward plan and, as part of that, the team had to contribute the views from risk, etc., as to what they thought had changed versus the past in terms of reasons why we might have failed. So I wouldn't disagree with any of the comment in there. I was quite happy with that report to be submitted or that proposal to be submitted to the European Commission.

Chairman: This question was put to Mr. Forde last week and again put to Mr. Sheehy this morning. It was put to them in the context of the - and Deputy Doherty has referred to this earlier - witness statement given by Mr. Daly and his opening comment when he says that:

> While internal bank lending documentation may indicate that loan-to-value ratios were typically less than 100%, when the loan was drawn, the reality in many cases was that a developer's equity contribution was in form a rolling up of unrealised paper profit from other developments. This was presented as an equity position, rarely if ever was it in the form of cash.

And Mr. Daly then goes on to say

> In effect, therefore, the banks were providing all of the real cash funding for both acquisitions and development. It is safe to say that quite often the borrower's paper equity position never paid for an acre of land or concrete or scaffolding or a worker's wage at the end of the week. The safety zone of a borrower's equity usually existed only on paper. The result is that the borrower was typically not the first to lose in the event of a crash. The bank stood to take 100% of the losses and that's what's happened.

Are those two documents more or less saying the same thing, or not?

Mr. David Duffy: I think there is a correlation between them, for certain. I think the documentation kept by the bank in terms of its process was inadequate in many respects. I think the composition of some of the loans were rolling up, loans which were classified as equity, it was poor practice if you look at a commercial norm. I think when you look at a bank, it has lending and trading risk, it has operational risk and it has funding and capital risk. The operational risk is something that will damage a bank materially. If you do not have good process in a bank then all the other things in the world can go horribly wrong. I experienced, as did the team on asset transfers, very poor documentation in lots of cases and we had a huge initiative within the bank to restitute that inadequacy. Solicitors' undertakings would be a classic example.

Chairman: By recall, could you maybe give the inquiry some examples of what you mean by poor documentation?

Mr. David Duffy: It is very random, to be honest, Chairman. It would depend on the asset and the particular loan.

Chairman: I am not asking for a specific portfolio. Maybe an example that would typify in general terms what a bad example was.

Mr. David Duffy: Solicitors' undertakings is a very specific example. A lot of loans were issued on the back of solicitors' undertakings and then we are still struggling with the final access to all of those documents, so there was a laxity in the obtaining of and clarification that there were appropriate documents and storing of those documents. That is a failure of the bank.

Chairman: Okay. Can I now propose that we would take a break for 20 minutes, returning at 4.20 p.m.? In the meantime, can I just remind the witness that once he begins giving his evidence, he should not confer with any person other than his legal team in relation to his evidence or matters that are being discussed before the committee this afternoon? With that in mind, I now suspend the meeting until 4.20 p.m. and remind the witness that he is still under oath until we resume.

Sitting suspended at 4.02 p.m. and resumed at 4.22 p.m.

Chairman: All right. So, I now propose that we go back into ... and resume the public hearing with Mr. Duffy, is that agreed? And in doing so, the next member for question time is Deputy John Paul Phelan. Deputy, you have ten minutes.

Deputy John Paul Phelan: Thank you, Chair. Mr. Duffy, welcome. Following on from the discussion before we broke with the Chairman, I want to raise the issue of solicitors undertakings. It was raised with Mr. Gleeson and Mr. Forde last week. I want to, I suppose, try and get a handle on how many of these outstanding matters in relation to loans that were entered into prior to your time in AIB, still remain on the books. Has there been significant losses incurred because of difficulties surrounding loans involving these undertakings and in your 30 years' experience - almost - banking, is it or is it not unusual that seven years after the banking difficulties first emerged that such cases would still be outstanding at this juncture?

Mr. David Duffy: Okay, maybe, Deputy, if I could deal with those in reverse order. In 30 years, it only gives me four periods ... seven years, but I have been through a few crises and I can tell you that a crisis usually generates chaos in an institution and the ability to access and find documents and other parts of history usually get very confused. So there is always a chaos around documentation, the degrees vary significantly, obviously depending on the institution. That being said, it was a material concern for us in terms of the absolute level and back when I joined the bank, there were in the ... probably thousands, quite a few thousand, that were, you know, were really just not in our possession or at the level of satisfaction that we would like to have in our possession. And, it has taken at least three years, to the first part of your question, to materially resolve that issue. We still have some outstanding issues but we have an agreement in process to try and resolve those and that's going well. But, nonetheless, a very unsatisfactory issue for an extended period of time. A little bit ... the cause of it tended to be a disaggregated model where everybody was originating locally and storing their documents locally and it was in a file or in a drawer ... somebody said, "I'll get that to you next week", and it was never followed up. Typical of a one-way traffic, high-volume type environment, without discipline and process.

Now with regard to losses, I couldn't tell you what the accumulative number is - I haven't looked at that - but it has not been a major issue for the bank. It has been an issue case by case, but cumulatively not, I don't think, a material one.

Deputy John Paul Phelan: And in relation to your own experience, would it be ... would it have happened before that six or seven years later this issue would still be not fully resolved, at least?

Mr. David Duffy: There are occasions where I have seen that. Typically, when you have something this dramatic ... there are historical references to, you know, the Japanese crisis.

There was ... I've been through an experience of a Mexico collapse, a Russian collapse, an Argentina collapse and it usually ... maybe the best case is three or four years to resolve everything but it can be longer-----

Deputy John Paul Phelan: Are you satisfied that a system is in place now or are you not satisfied - I can't ask the leading question - that this cannot recur again in Allied Irish Banks?

Mr. David Duffy: My view on our ability to engage in a process of lending where we will have adequate documentation and appropriate documentation, not just adequate, for enforcing the terms of the loan, I'm confident that the process we put in place will allow us be, you know, able to deal with all of those issues, going forward, without concern.

Deputy John Paul Phelan: Can I ask in relation to a question asked by Senator D'Arcy in relation to the growth targets for AIB in the years prior to you coming into your position, you said and I quote: "I'm not sure that growth targets are the way to manage a bank, rather capital levels and liquidity". I'm asking you really for your opinion as to the previous holders of your position, do you believe that they held a similar view to yourself with regard to growth targets versus capital levels and the question of liquidity?

Mr. David Duffy: Deputy, I'm not really qualified to give an opinion because I don't know their position. I haven't spent any time with the individuals discussing a position nor would I refer to documents which might outline their position. I think that, you know, all markets, all commentators, all regulators, all others, felt that all banks were capitalised adequately and funded well in the run-up to this crisis and that is not an Irish-specific comment, that is all countries that were involved in the crisis.

Deputy John Paul Phelan: As a matter of interest, since you've become chief executive of AIB, have you had any discussions with either of the two previous witnesses today, Mr. Buckley and Mr. Sheehy?

Mr. David Duffy: I have not sat down with any of my former executives and discussed anything commercial about the history.

Deputy John Paul Phelan: Okay. I can ask you then again in relation to your previous experience ... this morning and last week and I refer to core document AIB B1, Vol. 1, page 87 ...sorry, I should say AIB B1, Vol. 1, page 16, in 2004 Jim O'Leary, who is an economist who was board member of AIB at the time, raised the issue of credit concentration in the construction and development sector. This morning under questioning, Mr. Buckley, who was then the chief executive, stated that while the issue was raised in January, it was dealt with by the board in October. In your previous experience, did you ... you know, does it tend to take nine or ten months for a commercial board of a bank to act on an issue being raised at board level and being minuted as a decision, ultimately, of the board to look into it?

Mr. David Duffy: Just reviewing the document, Deputy, there, it was agreed that the policy in respect of lending in that sector should be reviewed by the board in the near future, as far as I can read it, so that was a suggestion that sometime in the future it should be looked at it, so there may be reason that I don't understand why it took a while. If it there is an area of concern in a well-practised, well-governed bank, you will tend to respond very quickly, as quickly as required. I don't know the circumstances of that delay but typically you would look at urgent matters on an urgent basis.

Deputy John Paul Phelan: Okay, I want to refer to AIB B2, Vol. 1, page 6 ... previous speakers have referred to it. It's a reference to the then standards that existed, the Central Bank's licensing and supervision requirements and standards for credit institutions. And, this was particular focus on the 200% threshold for lending into one particular sector of the economy and 250% for two related sectors. The answer that has been given by most of the previous witnesses is that there was a process of change going on in relation to Basel II and Mr. Gleeson, last week, stated, and I want to put it to you, a direct quote, that "... this was not a regulatory standard. It wasn't a statutory instrument or a rule; it was a guide to assist us in supervision of the banks." First of all, I want to ask you did you see Mr. Gleeson's evidence last week?

Mr. David Duffy: No, I was engaged in the bank.

Deputy John Paul Phelan: Can I ... can I ask you, in terms of an indication given by a financial regulator that standards had been breached, again this is ... I suppose is a reference to your previous experience ... would it be common practice that the chairman and the board would not act to ensure that the breach would be addressed, or would it have been common practice that, you know, such rules would be seen as merely guidelines?

Mr. David Duffy: It's a very difficult one to answer Deputy, but to do my best, in that environment, if they are ... a regulator is saying to you, as an institution, "It's a guideline", then you may probably behave in a way that could treat it as a guideline. I refer back to my statements previously which is that it is not for the regulator to set a guideline and for you then to just slavishly follow it, you must take into account that ... and if it's a rule you don't breach it, and report it if you do ... if it's a guideline, it's an input into your own risk management of the institution. So I would take a view that, at that time, if it's being implied that it was a guideline, not a rule, and there was some suggestion that it was viewed as out of date, people may have taken a position in the bank, but I'm not qualified to comment on their rationale at the time.

Deputy John Paul Phelan: A final, brief, last question. As somebody who has vast experience before you came to AIB, and having looked back at, I'm sure a number of the loans that were made, maybe the larger ones in the period 2003 to 2008, by the bank, do you believe that any of the lending practices engaged by AIB in that period were reckless?

Mr. David Duffy: "Reckless" is a complex word. I believe that the issue of over-concentration was a bigger challenge than the terminology applied to it, allowing that concentration to get through to such a significant level was-----

Chairman: Mr. Duffy, if we could ask you to give your own value judgment on whether the interpretation of the loan is ... and to use your own language really in that response. Yes, and I'd ... maybe defer from using the word "reckless" within ... in terms ... what is your view?

Mr. David Duffy: No, as I was saying, I think determining to be clear, I was saying that although the term "reckless" was used, it is not a term I could apply or comment on. So to be very specific on that, I am saying I couldn't comment on the terminology. I would talk about the asset concentration being the challenge that the bank faced, rather than any individual loan being reckless, or whatever the word would be used. So I don't have an opinion on the word "reckless".

Chairman: Thank you for that clarification. Sometimes in reviewing evidence a word can be inserted by a witness in response and then it gets applied-----

Mr. David Duffy: Thank you for the guidance.

Chairman: Okay. Deputy Joe Higgins, ten minutes.

Deputy Joe Higgins: Yes. Mr. Duffy, you say that you worked for ten years at Goldman Sachs International. Can I ask you was that a good or appropriate training ground, do you think, for being subsequently in the most senior position of a bank that crashed following a property bubble? And, perhaps by way of context, you'll be aware that Goldman Sachs was very heavily criticised in the wake of the crisis in the United States for allegedly speculating heavily on the subprime mortgage situation and crisis and famously or infamously, depending on one's point of view, was described in *Rolling Stone* as a "vampire squid ... [with] its blood funnel [jammed] into anything that smells like money".

Mr. David Duffy: In the *Rolling Stone*.

Deputy Joe Higgins: *Rolling Stone* magazine. Are you not aware of that article?

Mr. David Duffy: No, I am, I was just recalling it as you were saying it, I was remembering.

Deputy Joe Higgins: Yes. The question was-----

Mr. David Duffy: So, in your specific question, I won't comment on Goldman Sachs's, or any firm's involvement in a crisis or not a crisis, I would answer the question in specific terms around "Was my time at Goldman Sachs beneficial to my banking experience when applied in the future?" At the time it was a private partnership and it was ... in any circumstance if it had a loss, it was a loss of its own account, and the culture was obsessive about the customer and obsessive about the quality of your execution and I learnt a lot of good things at the time. That has nothing to do with whether they did or didn't do anything subsequently in markets when they were no longer a private partnership. But, my experience there was quite formative and instructive and quite helpful in future days.

Deputy Joe Higgins: Mr. Duffy, you say on page 1 of your introduction, that Allied Irish Banks made €1.1 billion profit in 2014. Can I ask you to reflect a little bit on that, in the sense that the recapitalisation by taxpayers of AIB was €20.7 billion. On 26 February, the day before the general election in 2011, a further €1.5 billion ... it is not commonly known by taxpayers, in my view, was transferred to AIB in NAMA bonds and deposits from Anglo, and Mr. McDonagh, the chief executive officer of NAMA, estimated that all the covered banks got effective state aid to the tune of €10 billion by virtue of being overpaid €10 billion from what the market might pay for the loans, and if we ascribe a proportion of that proportionately to AIB it would be €2.83 billion, so that would be about €25 billion in total in state assistance of one kind or another. So, would it be more appropriate to rephrase your profit statement that there is at the end of 2014 ... the loss to the taxpayer has been reduced from €25 billion to €24 billion? Would that be a more appropriate way to put it, perhaps?

Mr. David Duffy: Well I think that would be a matter of opinion for the shareholder and the markets but I would look at this as very simply returning AIB to a sustainably profitable bank, to allow it to generate capital to lend and to allow it generate a shareholder return, which allows in turn a valuation to be ascribed to the bank, where it is not just profits that repay the taxpayer, it is the valuation of the bank in the sale. So, it is still my belief that we will return all those funds to the taxpayer over time. It is a matter of opinion as to how you should characterise it, but the output is that the State will get repaid all of its funds no matter how we characterise it in the interim.

Deputy Joe Higgins: Is it the case, Mr. Duffy, that AIB will pay no corporation tax in 2014 on the €1.1 billion profit?

Mr. David Duffy: It is likely to be true, but it is a very important context that one must understand as well, that is because of our deferred tax assets, which I think you are referring to, and those deferred tax assets are incorporated in the calculation of our capital, so those deferred tax assets have avoided the State having to invest capital in the bank, so I think there is a value. It is not just about the tax repayment, there is a value by capital not having to be invested.

Deputy Joe Higgins: To explain to the people out there, maybe you might, if I am correct that ... until, if the present tax arrangement remains, all the losses at AIB, which is let us say, €20 billion, can be written off against the taxes, and that, therefore, going into the future AIB would have to raise, or could raise roughly €20 billion in profit before it would pay a penny in corporation tax. Would that be the way to explain it?

Mr. David Duffy: It is a matter of technical fact, I am not quibbling with that at all. That is entirely true. The value to the State is 100% of that, as the primary owner of the bank, and it is not without regard to the fact that the deferred taxation assets are the cause and have been of significant benefit to the State in terms of the bank's capital.

Deputy Joe Higgins: Yes. You referred to the opinionated people of west Cork, Mr. Duffy. Would you say that the people in west Cork or, indeed, west Dublin might think that not paying a penny tax on profits until €20 billion in profit is realised is paying twice for the same losses that the taxpayer has bailed out already? Do you think they would be ... feel somewhat aggrieved, and do you think that might be a just, or not, grievance?

Mr. David Duffy: Well, I think for anybody in Ireland, regardless of their particular jurisdiction, notwithstanding west Cork is my home, I would say to those people that if AIB paid a few hundred million in tax to the Government, and paid the tax, is one case, if it doesn't because it has a tax allowance for a period of time, but then distributes that as a dividend to the Government, it is still coming to the Government and to the State and the taxpayer, by definition.

Deputy Joe Higgins: Is it the case that if AIB is privatised that that tax credit will go on to the private owners?

Mr. David Duffy: That is a matter of discussion at the time, but it would be very much taken into account in the valuation of the bank.

Deputy Joe Higgins: What's the current value of AIB would you say now?

Mr. David Duffy: Well, I don't ... we don't do evaluation, but the valuation of the bank, according to the NTMA and the State, would be around €12 billion, €13 billion.

Deputy Joe Higgins: €12 billion or €13 billion. Mr. Duffy, in 2014, NAMA redeemed €6.3 billion in bonds held by AIB ... sorry, NAMA bonds that you held and you paid ... NAMA paid you €105 million ... on top of that, €105 million in interest.

Chairman: Just be mindful now, Deputy, that we could be stepping outside the terms of reference of the inquiry. I'm just giving a bit of leverage here, in that NAMA is inside the terms, but activities that might be going into 2014 and 2015 may be beyond it but-----

Deputy Joe Higgins: Yes, I'm-----

Chairman: Just, okay, would you proceed?

Deputy Joe Higgins: Yes. Well, we are talking about the terms of reference also about the policy responses and preventive reforms.

Chairman: And legacy issues and all, yes.

Deputy Joe Higgins: And if the witness is happy to-----

Chairman: Sure, sure.

Deputy Joe Higgins: -----comment briefly. And there were various other interests, interest payments that were paid to AIB, perhaps a total of €6.5 billion. What did AIB do with the €6.5 billion that it received from NAMA?

Mr. David Duffy: The majority of that is a reduction in our borrowing from the ECB.

Deputy Joe Higgins: Okay. So, again, Mr. Duffy, to ask you, the taxpayer has bailed out AIB to the tune of €20 billion-plus. There are ... there is no corporation tax for 20 years perhaps and the billions that come in from NAMA's activities go into AIB, go straight to the ECB loans. Again, could I could ask you would the taxpayer out there be justified or not in feeling deeply aggrieved at this, considering the pressure on their public services, health, education etc., and yet everybody is ahead of them in the queue, it seems to them?

Mr. David Duffy: I think the only comment I can make on that, Deputy, is that all of the activities of the bank are designed to create the maximum value of the bank to the taxpayer, such that the sale, at the Minister's discretion, will allow the full value of the investment to be returned.

Chairman: One minute, Deputy; last question.

Deputy Joe Higgins: Yes, Mr. Duffy, final question then: you were brought in from foreign fields where ... because you had no hand, act or part, personally, in what was going on here in the course of the bubble, the crash etc. Was your role or is your role, which is now coming to a conclusion, fattening up Allied Irish Banks for privatisation?

Mr. David Duffy: The role ... the short answer is "No". My role was to stabilise the bank and prevent it from collapsing; to make sure that we could lend and support the Irish economy, without which the Irish economy couldn't grow, given the number of banks in the country; and, lastly, to address the issue of arrears and people in distress and try to recover as much of the livelihoods of people in homes and in businesses. Those were the primary roles. All of my actions are prioritised around those, as are the objectives of the board.

Chairman: Okay, thank you. Deputy Kieran O'Donnell, ten minutes.

Deputy Kieran O'Donnell: Thank you, Chairman. Mr. Duffy, can I just ... what have AIB learned from the crisis in terms of the banking model and in terms of their behaviour with customers?

Mr. David Duffy: I think the primary learning is around the issue of culture. If you run a bank, truly run a bank with a customer lens, it changes every behaviour and every process in the bank. If you are running the bank in service of a customer, it changes the disposition of the staff and I think, if you are looking outside and you see that you are in a bank entitled to nothing other than the service of a customer, and if you do well you're entitled to an existence, if you get that culture into the bank, then many of the mistakes we made will be avoided and that's the single biggest lesson. We need a culture in the bank that respects the fact that our job is the service of a customer.

Deputy Kieran O'Donnell: And how do you reconcile that with the view amongst many of the general public that banks will revert to being banks and that, effectively, that people got into large mortgage arrears, with mortgages in some cases they feel they should probably have not been extended by the bank? How do you get to that point where people will have faith in the way banks operate, when banks are now beginning to recover, into the future?

Chairman: Mr. Duffy's view on that?

Deputy Kieran O'Donnell: Yes, your view on that?

Mr. David Duffy: My view on that is that banking as an industry has been irreparably damaged in many ways. It is going to take a considerable amount of time to rebuild trust as, referencing your example, I think that in rebuilding that trust you have to address the conduct issues, which are a regulatory, topical subject at the moment. Conduct risk and how you behave, how you lend to customers, what you sell or don't sell to customers, the fitness for purpose of the product you sell to a customer. That philosophy must become appropriately and deeply embedded in the culture, and if you do that you will start out well, and over time you will re-earn the trust of your customers.

Deputy Kieran O'Donnell: And in terms of ... you've spoken about governance, are there any set of circumstances where the crisis that happened in terms of the Irish taxpayer picking up €64 billion for the banking system, that we could find ourselves in that position again into the future?

Mr. David Duffy: As a matter of just macroeconomics and war, you can never be absolute, but if you look at the more normalised expectations of all of us, everything we have done in the bank is to make sure that we are lending appropriately, that the risk associated with the lending is predominantly cash flow model driven, that the capital thresholds are the minimum regulatory plus a conservative buffer, and that our funding is long-term matched to our liabilities, not short term. So if you look at the primary influences, they are in a shape that I think will prevent a risk occurring again, and, on top of that, we stress as a board quite extremely, as does the SSM independently of our board, the asset changes in pricing. So I believe that all of those taken together will leave us in a relatively secure position, notwithstanding another crisis.

Deputy Kieran O'Donnell: And going back, we'll say, over the years where you had this rapid growth in loans with property loans with AIB in construction, between '04 and, we'll say, '08, where it went from being, as a percentage of the loan book overall, from being 25% in '04 up to 37% in '08, what do you regard as a sustainable level of a property and construction being as a percentage of the overall loan book? I know you've spoken earlier about growth not being the only parameter, but in terms of a percentage of loan book, what do you regard as sustainable?

Mr. David Duffy: I think, Deputy, with respect, it's very hard to give an exact percentage. What I would say is there are many different classes of property-----

Deputy Kieran O'Donnell: I'll put it this way to you. I suppose the point is, do you view that the level of the percentage of the loan book being property and construction being at 25%, '04, rising to 37% in '08, was too big of a risk factor?

Mr. David Duffy: I think it proved to be in terms of an asset correction and the correlation between all of the asset bases.

Deputy Kieran O'Donnell: But you're a professional banker-----

Chairman: Leave him time to respond.

Mr. David Duffy: And so my point is, there are very different asset classes in property. Someone in a home is very different than development land that's undeveloped. One has an income paying a debt, and the other has none. It has an asset value. So it is too generic a description. That being said, any single asset class or correlated asset class, like in property in general, being too high an overall percentage of your portfolio is risky.

Deputy Kieran O'Donnell: Have ye put ... in terms of looking at your business model into the future or currently, you must have put a benchmark level at which the percentage of the entire loan book that property and construction can take.

Mr. David Duffy: We don't disclose in an open market, for perspective, what exact percentages we have in each component, but I can tell you that for every single property component, and for every single borrower who may have property plus other assets, we have set very conservative limits and very early thresholds for escalation to the board.

Deputy Kieran O'Donnell: And what ... are we talking single digit figures, are we talking-----

Mr. David Duffy: Depending on the asset class it varies but they are extremely conservative versus history.

Deputy Kieran O'Donnell: Can I talk about, because ultimately we are here, in terms with AIB, the fact that there's over €20 billion of taxpayers' money has gone into AIB to save that bank; where do you see the ... into the future, the date deadlines in terms of the taxpayer getting back, or the Irish citizen getting back, the €20 billion plus they've put into AIB? Over what timeframe do you see that?

Mr. David Duffy: The starting point is at the Minister's discretion. Our objective in the bank was at the end of this three year cycle, or three and a bit year cycle, to create a bank that investors would find attractive, and that begins the process. The exact duration is a function I can't predict. How much is sold and how much is retained and then what the dividend will be can vary it quite significantly but I do believe over time, however long it takes, in whatever construct the Minister wants to sell, the money will be returned.

Deputy Kieran O'Donnell: Is the bank in ... in terms of the financial well-being of the bank at the moment. What's generated the perceptions of the markets in terms of ... the type time of timescale that would ... is AIB in the position at the moment financially that ... you could do a large flotation on the market?

Chairman: Okay we are drifting into kind of what ... commercial issues for a start -----

Deputy Kieran O'Donnell: Yes. Given the parameters-----

Chairman: I ------

Deputy Kieran O'Donnell: ... getting the taxpayers' money back...

Chairman: Yes, there is indeed, and there are legacy issues, there are share concerns and all the rest of it here. In terms of a legacy issue, I'll take it that we are not going into what is day-to-day current banking inside AIB, Mr. Duffy.

Mr. David Duffy: The perspective we have is that the bank had a strategic objective to return to sustainable profitability, to pass the stress test, to align with the troika obligations and we have done that. And so therefore it is an investable proposition as we stated in the public domain.

Deputy Kieran O'Donnell: And in terms of your ... I suppose international experience ... do you believe in terms of the structure of the guarantee ... I suppose two very quick questions. Do you believe that AIB would have survived without the guarantee? And do you believe that if burden-sharing had been a feature in terms of the construct of the guarantee, what impact would that have had on AIB?

Mr. David Duffy: My opinion would be that in a circumstance where there was no guarantee with the lack of confidence in the system there was a significant risk as deposits would leave and there was a preponderance of short-term deposits. I don't know what the final outcome would be because I can't predict that. But certainly there would have been a high risk. With regard to the second element of burden sharing, obviously if there was burden-sharing there would have lessened the burden for us and that would have helped the position but I don't know what the rationale for the decisions were as I wasn't here so I can't comment further.

Chairman: Okay. Thank you. Thank you very much. Next questioner is Deputy McGrath.

Deputy Michael McGrath: Thank you very much Chair. You are very welcome Mr. Duffy and thank you for your engagement. Just if I can pick you up on a question asked earlier on about I think by Deputy Doherty and the Chair as well. When you joined the bank in late 2011 you said you didn't initiate any review or any internal inquiry as to what happened in AIB and how it came to the fate that it met. Can you say why ... why would the board not have considered doing its own inquiry as to why a once traditionally conservative bank ended up having to be bailed out by the State with a bill of €20 billion?

Mr. David Duffy: I'm not 100% knowledgeable but I know there were reports produced -----

Deputy Michael McGrath: Yes -----

Mr. David Duffy: ... in the past which may have satisfied those obligations. If I can put it into context, Deputy, in terms of what we were faced with. In my first month I was sitting with a Troika and sitting with a shareholder and trying to understand the amount of time we had to come up with a solution and what we had as obligations to deliver. To be honest every hour we spent looking backwards trying to understand the problem would be an hour wasted when we had to understand what the best model would be going forward. And that's what we were spending all our time on. So it's not that we were being careless it's just that we were being very considered around the future.

Deputy Michael McGrath: Nobody is suggesting carelessness on anyone's part but the board could have requested somebody else to do the review. I don't think anyone is suggesting that you would have come in and prioritised doing a backward looking review, but the board should that had taken over governance who had a lot of new members ... do you know if they considered conducting any internal inquiry or review as to how the bank ended up with a very large bailout?

Mr. David Duffy: I'm not aware of any review entered into under my period of time.

Deputy Michael McGrath: Okay. Thank you. Can I ask Mr. Duffy in your experience how rare or how exceptional were the confluence of events and factors both domestic and international which lead to the banking crisis in Ireland and indeed elsewhere in September 2008? How rare or exceptional an event was it or was it entirely predictable?

Mr. David Duffy: I think there was an element of exceptionality around it. It's a once in a generation circumstance where the availability of a huge amount of liquidity including retail bank liquidity which wasn't available before in the sense that it was made available as well as geopolitical events where China in order to grow was very much a supporter of a cheap cost of capital through its purchasing of US debt despite the overall levels of debt. That meant that the US consumer became very heavily indebted and that was a contributor to the property boom. So there were many macro or geopolitical events that were fuelling cheap funding and property escalation of pricing. With that there was also a light regulatory universe which ... of all of the asset classes in property many of which were sub-prime, they were packaged and securitised, distributed around the world with a mix of good and bad assets in those packages. And rating agencies on top of that were rating the majority of these triple A. So, bad risk was distributed globally with a high rating. I don't think in history there has ever been a confluence of events around the scale of cheap money and the distribution of risk and the unknown element of risk contained in the securitisations. That cheap money was allowing every market to chase property and when it collapsed in the sub-prime and then was further influenced by allowing banks to go bankrupt in the US, there were many more banks were very close to going bankrupt. So the extraordinary measures of the US Government at the time, both negative and positive, if you put all of those together, it is an exceptional period of time. Ireland's problem was that we were very badly positioned to react to that given our concentration.

Deputy Michael McGrath: And relative to our size as a country, was Ireland's banking crisis the worst of 2008 and the subsequent years?

Mr. David Duffy: I think it's hard to quantify because of the ... if you look at Spain and you look at Greece and you look at other economies around the world, and some of the US distress in housing, but I can say it was certainly high up on the list of extreme impact.

Deputy Michael McGrath: In terms of the changes to the regulatory regime and the legislation that has been introduced in recent years, do you think that we have struck the right balance in terms of those changes and do you believe that we now have a strong and robust regulatory system?

Mr. David Duffy: I think we do because I think it's not only the regulatory process itself but it is the disposition of what the regulator sees as the purpose of a bank. I think the original mistake that started all this that was made, was that Glass-Steagall was unwound and that prevented retail deposits being given to investment banks. Now once you put the two of them together you had a whole lot more money, a whole lot more leverage and a whole lot more risk. A retail bank ... its purpose is, I think Lord Turner many years referred to it as "socially useful". But it is serving the economy you reside in, for the purpose of growth of the economy that you reside in. Doing so in a way that you're selling products that are suitable to those customers and frankly you should be a boring utility. That's what banking should be. It lost the run of itself, it got into all kinds of leverage and chaos that it should not have been in. So, if you ask the question “Are some of the regulations better today?” - yes. “Is the process better?” - some of it’s a pendulum swing and maybe it’s going too far in terms of the bureaucracy sometimes, but the spirit of what the intent is, I fully support.

Deputy Michael McGrath: Can I ask you about the appropriateness of the transfer in August 2012 of €1.1 billion from the company’s balance sheet into your pension fund. The pension fund at the time had a deficit of almost €1.5 billion.

Mr. David Duffy: The assets at the time were part of a €20 billion deleveraging requirement mandated under the troika restructuring programme. The disposal of those assets was going to happen regardless and was done at arm’s length market pricing. The pension trustees purchased those, as would anybody else within the market and that allowed them create a reduction of the deficit, so this was extremely open, fully public and at arm’s length.

Deputy Michael McGrath: So in return for transferring the assets from the company to the pension fund, what did the company receive in return? Are you saying it received a commercial -----

Mr. David Duffy: The commercial value of the assets.

Deputy Michael McGrath: The commercial value?

Mr. David Duffy: Yes.

Deputy Michael McGrath: So it was fully arm’s length, a market transaction -----

Mr. David Duffy: A fully arm’s length, commercial transaction.

Deputy Michael McGrath: What was the gain so, from the point of view of the pension fund, if it paid market value -----

Mr. David Duffy: Income earning assets which we were allowed to give them a ... or create a reduction of a deficit. But I don’t ... to be honest Deputy, beyond that I don’t have much of the detail of that. I know the construct of the transaction but not the mathematics of the equation.

Deputy Michael McGrath: Sure. Okay. And you don’t know how much was paid for the face value of €1.1 billion of loan assets?

Mr. David Duffy: Off the top of my head no, but we could provide that.

Deputy Michael McGrath: Okay. So it would have been open to the fund to purchase any other assets outside the bank?

Mr. David Duffy: As they often do and the assets were in the available open market for bidders as well.

Deputy Michael McGrath: Finally, can I ask you about the issue of former executives? And I know that again back in 2012, and I think subsequently, you wrote to about 30 or in excess of 30 former executives suggesting that they consider making a voluntary reduction in their own pension. Would you like to elaborate on the outcome of that? I know you won’t give any details about individuals, nor am I asking you to, but in aggregate terms can you give us any information as to the nature of the response you received?

Mr. David Duffy: Deputy, the only limitation I have is that there are confidentiality agreements, but I could say that there was a positive response and a reasonable number of people responded positively over the period of time and have agreed to reductions in pensions, etc. So there was a positive response.

Deputy Michael McGrath: Are you prepared to elaborate on what that means? Is that 50% of people agreeing to a reduction, is it?

Mr. David Duffy: If I give any statistics I'm at risk. I've been advised of being at risk. I don't think there's necessarily a value in that. I would just ask you to accept my judgment that there was a satisfactory response given the circumstances.

Deputy Michael McGrath: And just to clarify, aside from the numbers, the individuals that you wrote to, were they people who had a senior management role within a defined period of the bank's recent history? How did you choose 30-plus names to write to?

Mr. David Duffy: Again, we looked at all executives for a period. I can't remember the exact period, but going back quite a number of years, where they were in executive positions which might have a bearing on the outcome, and that was the guiding principle.

Deputy Michael McGrath: Thank you. Thank you, Chair.

Chairman: Senator Marc MacSharry.

Senator Marc MacSharry: Thanks very much, and thanks, Mr. Duffy, for coming along. Earlier we had some predecessors in the bank and we were talking to them, or I was asking them about targets, and you had mentioned here earlier that the bank ... that the company ... you must run the company through the customer lens, and that changes everything, you said. And you also said - if I can find it here - that growth targets is not the criteria by which one would run a bank, it's about liquidity. So all of us probably have friends that worked in banks and different things and ... so how does it operate in branches then? Are people given targets for sales or-----

Mr. David Duffy: It ... yes, it depends on the product. So there are a lot of different products.

Senator Marc MacSharry: Okay. So let's say a mortgage; what way does that work?

Mr. David Duffy: Well, mortgages go through the branches where people walk in and ask for a mortgage, they go through the online activities, and then some send in manual applications direct to the head office. So you have all three sources. And they are doing so based on the requested criteria for affordability and completing the documents in person or online accordingly. That's how it works.

Senator Marc MacSharry: There'd be mortgage officers in each branch?

Mr. David Duffy: In most branches there would be, depending on the size of the branch.

Senator Marc MacSharry: And would they have targets?

Mr. David Duffy: No, they don't have formal targets to create X number of sales, they have the responsibility to provide advice to customers who want to do a mortgage or a loan.

Senator Marc MacSharry: Does anybody in AIB have a target for sales?

Mr. David Duffy: To be honest, I couldn't answer that absolutely. I think there are targets for sales within the bank, within our overall portfolio at regional levels, but I couldn't tell you exactly what level those targets go down to. I'd have to refer back to our retail managers and let you know.

Senator Marc MacSharry: So how would you, as a member of the board, pursue profitability on behalf of shareholders?

Mr. David Duffy: What we do is manage our margin. So we have ... when you look at a net interest margin, which is the criteria by which our margin is measured, we would look at the cost of running the bank, the cost of our funding, and the cost of risk, and the requirement to generate a shareholder return. We would subtract them from the aggregate revenue we receive in the bank, and the difference between those two is our margin. And that's what we call the net interest margin. That's what we look at at the board.

Senator Marc MacSharry: Would it be fair to say that the more applications that are made, the more mortgage products will be purchased, or loans taken out, and, therefore, the potential to gain more profit would be more? Is that a fair statement or not?

Mr. David Duffy: I'm not sure I understand.

Senator Marc MacSharry: Okay.

Mr. David Duffy: The more you sell, the more profit you can possibly make, yes.

Senator Marc MacSharry: That's the case, is it?

Mr. David Duffy: I'm not sure I understand your question. If you-----

Senator Marc MacSharry: No, no, because I ... it doesn't matter what I think, because I can't lead you. It's what you think. So what I'm trying to get to the bottom of is, if nobody in AIB ... because this is consistent actually with what your predecessors are telling us earlier. They said nobody had a target, that you run the bank, in your view, based on liquidity. And nobody had sales targets, so what I am trying to get to the bottom of, really for the people at home is... are branches set up and people put in place purely "Now you sit in there and you service the public if they come in" or are there targets given to regions or branches or individuals to say, "Now look what we want to try and do this month is sell X amount of investment products and Y amount of loan products" and so on? In essence the question is, did a targeted environment, albeit phrased in a different way ... I know that there was the... the people profit index, is that what it was referred to? Your predecessor mentioned something like that earlier on. I may be getting it wrong and the record can correct me. Did a target culture - and you have mentioned a cultural change - have an unintended...albeit unintended consequence to drive more mortgage product sales?

Mr. David Duffy: Okay, I think I understand a little bit better. I think, from the observations of the previous market, there was a competitive universe, including many overseas competitors coming in with more attractively priced and higher LTV products and driving a market share battle which led everybody down that path. If you look at what are we doing today to be more specific, our position is controlled by our risk appetite. As you've said, I've correctly said, the liquidity in the capital are your baseline thresholds which you must maintain adequate resources for. And then, beyond that when you sell, you can't just sell any amount of anything, there has to be limits within each part of your portfolio and those are strictly monitored and then obviously that's the margin.

Senator Marc MacSharry: I get that, thanks very much. It's just that my time is short and I know it has taken me a while to get... to ask my questions.

Again, we know we are talking about your tenure, but again given your international experience and while you have pointed out to other members that you focused on the future and getting things right and I'm sure you that you've done that very well, but in your international experience, was the culture of that time that, you know, target driven, sales driven? I'm not going to allow the incoming foreign bank to eat my lunch, so get out there and lend more products, lend more money. Was that happening?

Mr. David Duffy: To be honest, Deputy, I can't be absolutely clear about that because I didn't have enough knowledge of that marketplace but I can tell you that from a distance when you have so much competition with so many banks - there was a huge number of banks all offering 100% mortgage type things at high LTV - it created a market environment where people were forced to compete. And I can say one thing that I take away from that environment, what it did was drove market share chasing and margins come down and products were inappropriately priced. And that is where you have got high volume trying to compensate for what was a declining margin over ten years. And in today's environment we have barely crawled out of it, and we are already starting to talk about how much all the margins or rates should be cut. We have to be very careful. The issue is not so much whether you are volume selling; the issue is concentration risk and the issue is having appropriate margin to have capital to protect you in the downturn. That's my observation from that period.

Senator Marc MacSharry: And again, to the extent that it is possible to give a "yes" or "no". Did the culture of the era, before your tenure, lead to unnecessary amount of lending?

Mr. David Duffy: To be honest, Deputy, or Senator, I can't answer that because I don't know. I don't have the facts.

Senator Marc MacSharry: Okay, that's fine. Former chairman of the bank, Mr. Gleeson mentioned in his testimony that interest rates during the crisis period were too low and suggested that using the Taylor rule, that they should have been between 6% and 12% or thereabouts and he further said that under the ECB's statute, article 14.3, that the ECB could and should have directed the Central Bank here to introduce measures to cool the market, let's say. That was the thrust of what he was saying. Would you have a view on that?

Mr. David Duffy: Well, I think the Central Bank has an important part to play. I think that's been evident by their actions on setting mortgage limits, so there is a role for a regulator to play. You can't regulate a commercial market, but you can contribute to the common sense applied in that market. The mortgage limitations, the loan-to-value, etc., I think, are sensible, so there is a value to that input from a regulator.

Senator Marc MacSharry: So, let's say, with 2% tracker mortgages available, and 8% growth rates in the real economy, what could the ECB have directed our Central Bank to do in your experience, internationally?

Mr. David Duffy: I haven't any experience of a European Central Bank directing other countries.

Senator Marc MacSharry: Exactly but I suppose we're trying to get a picture or an explanation of what may have been possible. We don't know but you're an expert in the field.

Mr. David Duffy: But I think what may have been possible ... it isn't down to the regulator to tell you that. What was at risk was a commercial model were you relied on volume to compensate for declining margin. And at the end of the day a 2% tracker mortgage is below your cost of funds. And that means you're loss making at tracker levels and that cannot be healthy for the bank in the long term.

Senator Marc MacSharry: So ... just, so that I'm clear, we did rely on volume to compensate for the lower margins and that lead to the crisis?

Mr. David Duffy: I think the growth in the economy and the amount of property .. the property boom ... the amount of selling and of loans in that environment disguised the fact that margins were declining for a considerable period of time.

Senator Marc MacSharry: That's all. Thanks ... thanks very much.

Chairman: Thank you very much. If, maybe, I could just refer to two items just following on from Senator MacSharry's questioning. I just want to refer to document reference AIB B1, Vol. 1, page 87. And what there are here are a summary of main findings. These relate to review focused at enterprise at Republic of Ireland level. This is an AIB document and if you scroll down the page there, it's about the fourth line, it says in there, Mr. Duffy, that in short "the main trust of the Business in ROI [this is the AIB Republic of Ireland model] was to focus and volume [I presume that there's a spelling error there, that should be focus "on" volume] market share-driven loan origination. This was achieved by growing property advances and related income in an unbalanced manner." Would you care to comment upon that?

Mr. David Duffy: I can only give an opinion, Chairman, as an observer. What I saw was a very ambitious growth market share level in all banks and every adviser that I have seen reports of or heard of spoke to the banks encouraging them to compete with each other on a more aggressive basis. So it would not surprise me to see a comment like that.

Chairman: So, just to summarise, in short what we're seeing there is the main trust of the business of the Republic of Ireland model was to focus on share-driven loan orientation, so there was a practice in the bank that would relate to the questioning line that Senator MacSharry took with you. There was a practice there ... or not?

Mr. David Duffy: I don't know that for a fact, I didn't look at it. If this is an internal document of AIB, well then it would represent that to be the case.

Chairman: Okay. Just on the broader context ... and to ... just a comment that you made earlier with regard to property diversification and that these are separate, stand-alone silos and that the risk is separate in all of these and so forth. I want to challenge the ...that assumption if I may and put it to you ... is that the subdivision of property portfolios into different classes, i.e. development land, office block, housing ... are they not actually both in the lead-up to the crisis and in the post-crisis period and even now ... but in the downturn ... or in a downturn or crisis ... these subdivisions, are they not actually quite closely correlated and related to one another? And they're not actually diversified, as we would say, in that when the prices drop in one sector, they usually drop in the other sector as well.

Mr. David Duffy: Absolutely. The perspective we have on that is that at a high level we have a portfolio management approach, which is that all of those assets are correlated. And in a small country in an open economy with the connections between those different assets and the borrowers, you have to be extremely sensitive to that fact. So I fully agree, Chairman, that is a high correlation risk that you must be very attentive to. Why we do the segmentation is to make sure we limit each of them and to make sure that we understand that you don't want to have too much development land or too much mortgage or too much retail, you want to have a balance between them, with income coming from them rather than asset valuation protection. But we absolutely accept that correlation risk has to be very conservatively managed.

Chairman: Okay, thank you. Senator O'Keeffe.

Senator Susan O'Keeffe: Thank you. Mr. Duffy, we heard from Donal Forde - on page 129 of his evidence - that all the colleagues in the Republic of Ireland division were eligible for some kind of bonus, they may not have all got it. What is the current position now in relation to those colleagues, if you like, at that level? I'm not talking here about executive or senior.

Mr. David Duffy: Yes, under the subscription agreement we have with the shareholder there's no variable compensation available at all, of any kind.

Senator Susan O'Keeffe: Okay. What sort of benefits were available to staff when you arrived? I mean, benefits above and beyond any kind of bonus, you know, like mortgages or sports club or insurance.

Mr. David Duffy: There were mortgages at attractive pricing structures, there were pensions defined benefit which we closed for future accrual in 2012, company cars which we eliminated. In some cases there were medical benefit allowances, which we also eliminated. There was a variety, not non-traditional, but certainly a healthy variety of benefits available. We addressed all of those. There is no variable and all of the other benefits were either curtailed or eliminated. In terms of salaries and associated elements. We cut a lot of the salaries. I cut mine and senior guys, and then all through the organisation. So I think approximately €230 million is the amount of salary-related cuts we made in the organisation. Benefits and salaries were all cut and there is no variable compensation.

Senator Susan O'Keeffe: Were you surprised at the level of salaries, particularly at very top level, when you arrived into the bank?

Mr. David Duffy: I was more surprised that they were still believed to be an acceptable part of the environment despite the stress we were going through and there would be a difficulty with negotiations with staff and unions to try and cut them, but, you know, we addressed that quite quickly.

Senator Susan O'Keeffe: The salary that you now earn is less than €500,000. Is that the sort of salary you believe might be appropriate into the future?

Mr. David Duffy: Mine is in the sort of low €400,000s, after the pay cut I took. I don't have a view on what is appropriate. I think the market has to determine that. If you look at the small community of banking in Ireland, there's a bank CEO on twice my income. There is another bank on twice that income, CEO. So same jobs, same street, a bus stop away, massively different. I think it is very specific to the circumstances. The one thing I would say about compensation and I believe this passionately; it is not so much the number, it is who bears the risk with that number. My practical example, if you will forgive me for a second, Senator, is I am used to a culture where I was paid a variable amount of compensation. It was deferred for three years pending the performance of the bank. It was put in the shares of the bank, and if the shares of the bank tanked then I lost it. At the end of that, it was also subject to a malice clause which is matching the duration of risk to the duration of my bonus and could be ... and

100% could be clawed back. So philosophically, I believe that is the only way you pay variable compensation and if there was a model in the future that allowed for that, the market drove it, investors drove it, I would very much believe that that is the kind of structure you put in a bank. The shareholder does not bear the risk, 100% recovery for staff.

Senator Susan O'Keeffe: Deputy McGrath raised the fact that you had written to some former members and asked them about their pensions, I believe. You also said I think you had not spoken to any of the former members of the executive or the board, so you did not ever invite them in and have tea or lunch or breakfast and say, "Guys, tell us the short cut, what happened here" ?

Mr. David Duffy: I would have to go back and check. I had a coffee with Mr. Gleeson once for about 20 minutes just to say,"Hello". Politeness. Mr. Conway, who was not part of these hearings, for just half an hour to get his perspective. But I really, you know ... no substantiative commercial discussion with any party, as that was just not a priority for me.

Senator Susan O'Keeffe: Has the bank during your tenure made any corporate write-downs?

Mr. David Duffy: There have been a number of corporate write-downs where the debt has been unsustainable, that is correct.

Senator Susan O'Keeffe: Can you give us any indication of the measure of the extent of those?

Mr. David Duffy: It is very difficult to do that in the corporate world and the SME world and the definitions of those but I can tell you how it works.

Senator Susan O'Keeffe: We probably sort of know how it works, but in terms of its significance for the bank or loss to the bank.

Mr. David Duffy: We categorised the one portfolio as SMEs and corporates. And across that, there are a number of billions that have been written off ultimately or reserved for potential write-down. It is significant.

Senator Susan O'Keeffe: It is significant. You said that one of the reasons you did not talk to people was that you were looking to the future but you also said that you were talking to the troika. So what sort of priorities did the troika ... what were they saying to you when you were sitting with their representatives?

Mr. David Duffy: The troika really were not trying to direct too much but they were asking you to deliver a plan which would be viable. They defined certain levels of capital as the norm in the market, now how did we think we could go about it? The engagement was exploratory. What do we think was necessary? What do we think could be achieved? Then they were judging in their opinion whether it was successful. Their purpose was to monitor and review your performance and execution on the strategy to a point where they were satisfied that the bank was sustainable. It was almost like a monitoring engagement.

Senator Susan O'Keeffe: So they didn't set you strict targets that you, just to be clear, I'm sorry ... they didn't set you straight targets? They-----

Mr. David Duffy: No, we-----

Senator Susan O'Keeffe: ------talked with you about the targets.

Mr. David Duffy: We and the board had to set the targets and then bring them in and they had to agree to the targets.

Senator Susan O'Keeffe: Okay. And then when the targets were agreed, have you ... did you achieve all those targets? Was there anything that didn't-----

Mr. David Duffy: Yes, we had a quarterly presentation with them, Senator, and we had to report on every quarter's progress on every metric and we met or exceeded every metric in every quarter for the three years.

Senator Susan O'Keeffe: Okay. When Mr. McDonagh was here, in page 44 of his evidence, from NAMA, he said that: "The colleagues concluded that when the loan-to-value ratios were examined, they were probably closer to 100% rather than the average that they'd averaged out at 77%." I know you'd nothing to do with that, but, as a banker, if you look at that, how could it happen that a bank, a series of banks, could be so out of sync with what was found? How do you arrive at that position?

Mr. David Duffy: It's a little difficult without specific knowledge of the cases, but I have seen circumstances where a loan-to-value starts out at, let's say, 50%, 60% in some environment that someone was lending to an individual and then the asset price declines and it goes to 75% or 80% but along the way, equity had been put in, but it would've been in the form of debt and suddenly it's 100%. It's not right, you have to be ... And that's where I go back to my principle, if you are not doing your loans on a cash flow lending basis, this LTV process can be very risky.

Senator Susan O'Keeffe: Did you find any evidence in your tenure that AIB had invested equity in any of the property transactions for which it had also provided debt funding?

Mr. David Duffy: To be honest, Senator, I didn't ... I wasn't looking at the individual transaction structure so I couldn't comment positively on that.

Senator Susan O'Keeffe: Okay. How much then, looking at it, did the bank contribute to its own downfall?

Mr. David Duffy: I think it contributed materially to its own downfall due to the position it arrived at with, you know, excessive concentration in an asset class that was materially reducing in terms of value and then, you know, in that environment having a huge dilution of its capital and its funding base was very volatile. So I think, you know, it was a contributor due to the concentration risk.

Senator Susan O'Keeffe: And could you say that it contributed ... but roughly, look, these things are not accurate, but is it ... did it contribute 30%? Was the bank responsible, if you like, for 30% of the downfall, or 70% or what figure might you attribute? And I appreciate it's-----

Mr. David Duffy: Senator, I think it'd be hard for me to say that because I'd be very specifically commenting on how the bank was managed in the past. I'd rather limit my observation to the fact that, I think, arriving at a portfolio of that concentration was the contributing ... I don't know, because there's so many other variables in it, what precise percentage that might reflect.

Senator Susan O'Keeffe: Obviously when you arrived and you took on the job, you took it voluntarily, so you knew it was a difficult position. How much more difficult, if it was, was it, when you walked in and suddenly saw ... because of course you couldn't have been privy to everything ... was it worse than you thought it might be or was it better than you thought it might be?

Mr. David Duffy: It was worse, I would admit, Senator, in a sense that not only were the numbers, which I was privy to material and compounding, the urgency that was required to recover was probably more than I had anticipated and certainly the uncertainty and somewhat the disarray internally with constantly changing senior leadership and uncertainty about the future ... the combination of those was a little more onerous than I might have anticipated when I went in.

Senator Susan O'Keeffe: What will be AIB's profit driver in future, do you believe, given that your ... the bank is clearly going to be more cautious about how it lends to property and it was driven into that position by the need to become profitable because of the competitive environment in which it was operating? So, what is ... what can it do now if it can't have that market anymore? What's it left with?

Mr. David Duffy: I think it will operate a traditional model of a retail bank, which is a balanced portfolio of lending in all sectors of the economy. I think it is also a requirement given our status in the economy so that will include consumer lending, it will include SMEs, and it will include corporates and some elements of property. So I think it will be all asset classes and-or borrowers of the economy will be served for the bank ... by the bank, and in that context, there should be, not excessive, but reasonably margins available.

Senator Susan O'Keeffe: It'll go back, more or less, to what it perhaps was in our ... in our, sort of, memory?

Mr. David Duffy: Perhaps what it was like when I was a teenager trying to borrow money from them.

Chairman: Deputy Eoghan Murphy.

Deputy Eoghan Murphy: Thank you, Chairman. And thank you, Mr. Duffy. I still have a few questions in relation to NAMA, if I can. When you came into the bank, NAMA had just finished ... or was in the process of finishing the transfer of loans from AIB into NAMA. So did you review their work over that previous 12 to 20-month period?

Mr. David Duffy: I didn't review the work but I had to spend a bit of time on the transfer, given that the ... NAMA had requested that our staff set up a separate entity, as our staff, to service and manage those loans on behalf of NAMA. Whilst they had all decisioning rights, we had provide the support and resources.

Deputy Eoghan Murphy: This is part of the service level agreement?

Mr. David Duffy: That's correct.

Deputy Eoghan Murphy: So you had to establish a relationship with NAMA.

Mr. David Duffy: I'm not sure what that means.

Deputy Eoghan Murphy: In terms of with the CEO, say with ... or the chairman. Did you have to then go and formally meet them and-----

Mr. David Duffy: I had to meet them once ... approximately once every two or three months just to hear their critique of whether we were performing on our service level agreement.

Deputy Eoghan Murphy: And would they have raised any concerns with you in those meetings about some of the loans they were encountering or the performance of those loans or the treatment of those loans?

Mr. David Duffy: We didn't get into specifics a lot but they would indicate that in certain cases they felt that there was going to have to be either a further recovery from us if the process they were engaged in ended up in a certain way. But it was directional and just advising us that they would be engaging with the bank in due course if that became an event. So, high level only if it was material and only occasionally.

Deputy Eoghan Murphy: NAMA in their evidence raised two issues with us in relation to what they discovered from the loans when they brought them across from the various banks, and one was as the crisis hit, the extent to which banks were attempting to collect income, it was going to debtors and not the banks, so rental income from shopping centres or office blocks in the millions, and they gave us two figures - 20% of income from investment assets was being mandated to the banks, 80% of income was being diverted away. And NAMA said that nobody seemed to be following up on it, so they followed up on it. Is it the case in AIB that no one was following up on this income?

Mr. David Duffy: I think it's probably not nobody but I think far less than should have been or could have been but that comes down to a very simple issue, we had not yet built a 2,000-strong division whose capabilities existed in that regard. We had to build a restructuring unit which had to address all of those. And those issues of income coming through larger real estate developers or others had been diverted, manifested themselves across the entire spectrum including individual homeowners or by-to-lets in other cases. So we had not yet ... and it was one of my first priorities and, in later term, one of the top priorities of the bank to build a capability across all asset classes to address that and many other similar issues. So, it was not being effectively done at the time of the asset transfer as we didn't have the capability.

Deputy Eoghan Murphy: So it comes down to personnel issues?

Mr. David Duffy: And expertise. Traditionally, the bank expertise was not built around massive restructuring complexity, it was built around selling and lending.

Deputy Eoghan Murphy: Okay. The other issue I raised was in relation to advances to debtors by AIB, once NAMA was announced, until the loans were acquired by NAMA. The Central Bank had said that it would be acceptable if NAMA deemed those advances to have been made on a commercial basis. So, this is to the debtors that are moving into NAMA from AIB and AIB advanced €595 million in that period but only 62% of that was deemed as being eligible and, therefore, as being made on a commercial basis. Can you explain that?

Mr. David Duffy: To be honest, I really don't have any expert knowledge on that ... on those numbers or those particular advances. So, I apologise, I can't give specifics on that.

Deputy Eoghan Murphy: Okay, they drew our attention to this quite particularly ... that AIB had been told that it could advance money to debtors that were transferring to NAMA as long that money was advanced on a commercial basis. And when NAMA did its review, it found that only 62% of that had been advanced on a commercial basis - 62% of €595 million, so the amount that was eligible was €367 million. I mean that's a significant amount of money.

Mr. David Duffy: A significant finding but as I say, Deputy, I don't even know what the definitions were in those transactions nor the numbers so it would be unwise of me to try and speculate.

Deputy Eoghan Murphy: And NAMA didn't bring this to your attention when you took over as CEO?

Mr. David Duffy: Not at the time, no.

Deputy Eoghan Murphy: Okay, thank you. Thank you, Chairman.

Chairman: Thank you. Senator Barrett.

Senator Sean D. Barrett: Thank you, Chairman, and you are very welcome. Just to explore with you the transition to "boring utility banking" as you call it, what loan-to-deposit ratio would you have in mind to illustrate success in that regard?

Mr. David Duffy: We would guide between 100% and 120%, that would be our limit. Today, we would be around 100%. I think that level of loans versus deposits keeps you in a ... quite a conservative space and that is what we have now published as market direction in the market domain.

Senator Sean D. Barrett: And on the property concentration, I think that went to 390% when combined with development and the target was 250%, so again it's a ratio where AIB was out of line before the path to boring utility banking. So, what have you got in mind for that particular one?

Mr. David Duffy: Well, we don't publish at all, but, I mean, our total portfolio is going to be incredibly conservative versus those numbers, but more importantly, the risk governance around being able to exceed limits, which you had, which is very much part of what this number became, don't allow you to do that without prior discussion and approval at the board. So I think a conservative governance and independent risk model, and a very careful segmentation, will lead us to a much safer place in that regard.

Senator Sean D. Barrett: Has the function of internal audit strengthened since you've come in? Because I see, in the 2006 report it says that when they examined the independent valuation they found that 13 of 25 cases tested were without valuations. One in particular, Glencairn Homes, was for €93 million. So have you tightened valuation procedures in line with what the internal auditor found?

Mr. David Duffy: We have indeed. The internal audit function is ... Frankly any CEO who doesn't have a first class internal audit function puts themselves at personal significant risk. That person is also an independent reporting person in that they don't report directly to me; they report to the chair of the audit committee, who is our SID and is also a non-exec, and a board member. So, I have ... I can't direct audit. So what I do is agree with the board audit chairman what exactly the priorities are for the year ahead and make sure they're executed, but that independence is fundamental. All those policies behind your statement there were also revisited in light of that.

Senator Sean D. Barrett: You mentioned the perks, I think, to Senator O'Keeffe. The core documents found at B1, pages 5 to 8, the absence, until 2011, which I think was your time, of a central register for hospitality, entertainment, marketing expenditure. Was that an innovation that you introduced or had it been taken in a matter of months before?

Mr. David Duffy: It was being started and being addressed but we made absolutely, explicitly clear, to the board our accountability in that respect and put the centralised governance in place, because it's just unacceptable ... one of the key issues which we framed in our culture is having the integrity very visible and tested in the marketplace around everything we did. And if we were going to be engaged in that space and have no control over, and no authority and approval, over those elements, we would never be able to protect that integrity.

Senator Sean D. Barrett: The internal auditor also found, in 2006, I think that Deputy Eoghan Murphy referred to it, not collecting money from people who owed it to the bank and, in particular, they mentioned in their internal audit that there were only three staff members in place in the Galway office who had the skills to manage cases on a daily basis and then they say, "The consequences would be ... would"-----

Chairman: Can you just give me a reference for that so I can get it on the screen there, please, Senator?

Senator Sean D. Barrett: Thank you, Chairman. AIB B2, Vol. 1 and it's page 21.

Chairman: Page 21, thank you.

Senator Sean D. Barrett: And ... and it had just three people in what seems a major part of the Irish economy, particularly in the Celtic tiger era, and they ... what your internal auditor said, "This could lead to the bank missing significant credit events on accounts and the subsequent financial loss".

Chairman: Sorry, Senator, can I just get a page number, not the reference page number that the document is coming out of, the page number in the booklet?

Senator Sean D. Barrett: Yes, the page number in the booklet is 21, Chairman.

Chairman: All right, thank you.

Senator Sean D. Barrett: And it's AIB B2, and I hope I've ... I've described that accurately, or correctly.

Mr. David Duffy: I believe Credit Support is the heading-----

Senator Sean D. Barrett: Credit Support, that's the one, Mr. Duffy, yes. Was that a problem that was encountered?

Mr. David Duffy: Yes, this relates to ... I'm just reading it, I'm sorry, Senator, just to make sure.

Senator Sean D. Barrett: There seemed to be a shortage of staff in Galway, and you spoke earlier about the change in corporate culture. Well, to the outsider, it seemed that up and down the country, management was ... the bank manager, who was an important figure in towns and cities, that his powers were all transferred centrally. Have you gone back to the Galways and the Tralees, and so on?

Mr. David Duffy: It's an important issue, Senator. There were two events that were driving the circumstance of change, the first being that the regulators required us to concentrate back into the centre and centralise many of the governance and approval and risk principles around this. Secondly, from my perspective I wanted the risk governance to be brought into the centre and the authority to be brought into the centre, whilst we fixed it. To answer your question then in detail, we then decided that once we had control over it, and once we had confidence in our processes and our governance, we would allow certain decisions being made in certain categories of clients for specific reasons. I can give you an example. We said that we would approve an amount of money in 48 hours to an existing customer, provided we understood their credit history, and that would be at the delegated authority of the branch manager, so they could make that decision independently of the centre. So that was what we introduced, but first we brought everything to base, restructured, put in the appropriate governance and only when satisfied with that, redelegated some portion of it.

Senator Sean D. Barrett: Some commentators and I think some of the institutions didn't much like the Central Bank rules on deposits, but I take it from your evidence you're a supporter of that rule.

Mr. David Duffy: Yes, at the time I made a ... I think it was in - not that I am picking on it, but the *Cork Examiner* made some comment that I supported the rules, because, in effect, our portfolio for the entire bank was better than each of the ambitious targets that they had in its total. And, secondly, I believe you go back to cash flow borrowing. Borrowing for a house, you have to be able to afford it, and I remember exactly what it was when I was looking to do the same in Ireland when I was young. It was more or less what was announced recently. So, again, it is consistent with my own philosophy on the utility nature of banking.

Senator Sean D. Barrett: How does your present regulation, SSM, work? Do you send data to them? Do they come to see you from time to time?

Mr. David Duffy: Yes, there is a joint supervisory team, comprising of the SSM representative, that is the single supervisory mechanism in the ECB model, and then the national competent authority, as it would be referred to, which is our current regulator. All issues are reviewed jointly and those issues involve capital decisions. They involve the approval of my replacement. The meetings, typically, are monthly. I have one next week. They are, typically, quite extensive. They have a very large on-site presence, with frequent forensic reviews of different topics which they schedule throughout the year. So it is a very very intrusive and intense engagement.

Senator Sean D. Barrett: The last one, if I may. The pillar bank, does that present the danger to the wider Irish economy of a duopoly between the two pillars?

Mr. David Duffy: I think that that is going to be resolved in the not-too-distant future. I think Ulster Bank has stepped back significantly into the marketplace. You have seen PTSB regain some strength in its franchise through its raising of capital and its ambitions around its own market presence. KBC has also made some further inroads and opened up some branches, so I think whilst it is not yet at a level that is truly, fully competitive, it is emerging, and I hope it will get stronger.

Senator Sean D. Barrett: Thank you very much. Thank you, Chairman.

Chairman: Thank you very much. I am going to move towards the wrap-up and before I bring in Senator D'Arcy and Deputy Doherty ... west Cork has been referenced a couple of times this afternoon, Mr. Duffy, and there is the kind of colloquial saying down there if somebody was to ask for directions they will tell you, "Well, I wouldn't start from here". Maybe your career, in arriving in AIB was a bit like that as well. Maybe you could tidy up one matter for us. Deputy McGrath referenced it and Deputy Doherty referenced it and some other people referenced it as well. Was AIB on the road to collapse regardless of what was happening in the international financial markets? Was the model ultimately unsustainable, and regardless of what happened with Lehman's and other international factors, was AIB going to hit the wall at some stage or other?

Mr. David Duffy: Chairman, I think that it was certainly going to suffer a big hit. I don't quite know what that is ... there are too many other variables in the marketplace.

Chairman: Okay.

Mr. David Duffy: And why do I say that? I just say that if you are so concentrated in one asset class, and that the pricing of that asset class was disconnecting rapidly from the income evolution in the country, there was bound to be an inflection point where there was a revaluation of those assets downwards materially.

Chairman: Yes.

Mr. David Duffy: Whether that was going to move 20% or 40%, I can't say, but certainly there would have been a material event.

Chairman: And, because of the timing with Lehman's and everything else, that eventually, then ultimately became the guarantee and so forth, because of the business model that was in place in AIB at that time, if those events didn't actually happen, and maybe something else triggered the type of sequencing you're talking about, would the exposure to the Irish taxpayer have actually been higher, given the model that was being operated, if let's say the model continued for another 18 months, two years or so?

Mr. David Duffy: Very hard to be really precise on that, Chairman. I would just say that if you continue to build the level of concentration or, more importantly, I imagine, if you look forward, the leverage, so there were larger amounts to individual add, then the quantum could have been greater in terms of exposure.

Chairman: Okay. So the intervention at that particular time, in or around ... or what was happening ... it was not an intervention, but the event that happened in 2008 determined the extent to which the bank was then exposed, but there was potential that, if that event didn't happen, that the event ... that the exposure could have been greater?

Mr. David Duffy: Yes, I think I characterised it, Chairman, as there was a silver lining in the cloud; that Ireland, with so many banks competing, with so many products at LTVs 100% and so much asset concentration in property, that something needed to be done to stop it.

Chairman: Okay, thank you. Senator D'Arcy.

Senator Michael D'Arcy: Mr. Duffy, thank you again; I think we're nearly there now. At the start, you used the term "staggering": €21 billion Government guarantee; €20 billion deleverage; €11.5 billion NAMA write-down; the sale of other assets and the shareholder loss. Was AIB badly managed prior to your takeover of the bank?

Mr. David Duffy: I find it very difficult to answer that, Deputy, because it was a very successful bank for a long period of time. The two years before I arrived, or year-and-a-half, involved multiple CEOs changing and then the executive chairman, David Hodgkinson, who took over. I think my narrow lens on that, not having been here to observe it, would have been that the concentration that was built up was probably ill-advised and led to the exacerbation of the issues that the bank faced when the crisis hit, so from that perspective, I think that was unwise.

Senator Michael D'Arcy: Is that a "Yes" or a "No"?

Chairman: Well, the witness can answer the question how he wants. You can ask the question.

Senator Michael D'Arcy: Well, I've asked him "yes" or "no".

Mr. David Duffy: I think my answer is ... I mean, if I'm just being a commonsense human being, I was abroad the entire time, so looking at what decisions were made and how people managed, I can't genuinely opine as to the capabilities of individuals previously.

Senator Michael D'Arcy: Okay, but you're probably in the best position than anyone else in the country for an opinion.

Mr. David Duffy: Well, I think ... I just think that the ... commenting on individuals that you've no knowledge or sight of, or participation in and hardly ever met in your life is a risky business. I would just say that the banking community, both foreign and domestic, in this country got into a position which was extremely unwise.

Chairman: Senator? Deputy Doherty?

Deputy Pearse Doherty: Go raibh maith agat. Mr. Duffy, we were talking about asset bubbles earlier on and concentration of lending into a certain area which had an asset bubble. Do you believe that there's a property bubble under way at this point in time?

Mr. David Duffy: My answer to that is I don't believe there's a property bubble. I think there is an imbalance in Dublin. I don't think that's representative, by any stretch of the imagination, in all other areas of the country. The imbalance is a complex one of supply and demand. I think the regulation from the Central Bank will have an impact slowing it down. I think rents are too high because of that demand issue. The requirement for the deposit size to make an entry into the housing market will have a material effect on first-time buyers. If you go down to the other major cities of this country, you will see much less of a rise and much less pressure on housing and then there are other parts along the middle spine of this country where there is no pressure on the house pricing. So, on balance, I don't see this as a property bubble.

Deputy Pearse Doherty: Now, if we just take Dublin alone, and you mentioned the Central Bank's measures, which dampened house prices for three of the last five months, house prices have again began to increase, as we see from the CSO, at 1.1% in the last month, with a 22.8% increase over the last 12 months. If that were to be repeated in the next year, house prices in Dublin would exceed where they were in 2005. Like, when should the alarm bell, or what would the level be that an alarm bell should go off in relation to a property bubble in Dublin?

Mr. David Duffy: I think you shouldn't be seeing, on a medium-term basis, double digit growth every year, but the balancing side to that right now is there is a supply equation being solved, so we are engaged with quite a number of builders, etc., developers, to make sure that there is a supply. I think, if you start to build between 15,000 and 20,000 and 25,000 houses, depending on the ... it'll take a while to build to that, over the next three or four years, that continuum, you might have some spikes up and down but, on balance, you will have a more normalised market. We do need that housing supply.

Deputy Pearse Doherty: Yes, because a bubble can be caused by a number of reasons, am I correct in saying that? It can be in the past caused by credit, or in the future caused by, or in the present caused by lack of supply. And to take me onto that question you mentioned about the interaction that AIB is having with six developers. I think you've mentioned last July that you were looking to fund 5,000 houses in the Dublin market. Has that shown any traction, as you expected in 2015 that there'd be significant traction?

Mr. David Duffy: It has. A lot of it is now either shovel ready or processes of development that has started the building. A lot of complexity in getting infrastructure approval and getting zoning licences and planning permissions recalculated for the purpose that they were now intended. But that is getting traction, and I think, like us, other banks will be engaged in the same activity, and I think you will see an escalation in the number of developments over the next six, 12 months, and that will build to a peak probably in three years' time.

Deputy Pearse Doherty: And you talk about the confidence that the public needs to have in the institution, and your institution serves the public. I know you haven't released names of the developers and I'm not expecting you to release names of the six developers that you are, I think, talking about between €500 million and €1 billion of funding to be made available, but are you concerned that there may be a reaction from the public that AIB is back into funding major development in this way?

Mr. David Duffy: I would be concerned if I had any doubt about the risk management of the process of our engagement with developers. I don't. We are ... they have to put in equity and we will put in debt, and it will be very much geared around their ability to repay. So I think the changed model gives me confidence that I could articulate that to the general public.

Deputy Pearse Doherty: Okay, in your opening-----

Chairman: Sorry, just in terms of reference now, Deputy, just remain within the terms of reference.

Deputy Pearse Doherty: Sorry? Yes, yes, well that was kind of looking forward for how do we prevent what's happened in the past. But in relation to your opening statement you talk about the need to deleverage to meet the newly-proposed Basel III ratios and also the demands of the Troika. How has AIB deleveraged its loan portfolio, and can you give us a sense of the type of loans that AIB deleveraged? In your view, if it wasn't for the Troika's demand would AIB have been better to hold on to them for a while longer?

Mr. David Duffy: I think the answer to that, Deputy, is that of the €20 billion of loans there was a lot of overseas UK property, which was non-core to our activity at the end of the day. There was some miscellaneous property portfolios around this country which we probably would have sold, and there was some which, in the benefit of hindsight, if we'd seen the speed of the recovery, you might keep. So there's no explicit black and white answer, it's a combination of the above. But I think the significant portion of that portfolio would have been for sale in any case. It has allowed us, additionally, create the space in our capital structure to lend at the levels which we're seeing today, which is new lending stimulating the economy, and more valuable therefore, so a little bit of positive comes out of it in any case.

Deputy Pearse Doherty: Thank you.

Chairman: Very, very last question, Mr. Duffy. In your view, having been at the helm of AIB for a number of years now, given that the bank was a publicly owned ... or privately owned bank, it is practically now in full public ownership, and has potential to return to private ownership again, do you believe that it's in the best interest that the bank would now become a private bank once more, or would be developed into a publicly owned bank on behalf of the State?

Mr. David Duffy: Can I give a personal opinion on that, if I may? I think that running an institution like the AIB is very complex. It isn't as easy as it looks. You need smart people, you need to get the best people for the market, you need to pay them what you need to pay them to do it right. I think that in that circumstance, you know, opening up to a participation, I'm not saying sell the entire bank, but selling a material amount that allows you freely operate on commercial terms in the marketplace, with a significant participation by the State, that hybrid of the future would, I think, be the appropriate model.

Chairman: And that was just to bring me to a kind of space of recommendations. If there's anything further you'd like to add, or that you feel that you might like to comment upon before I close proceedings?

Mr. David Duffy: Chairman, I would just say thank you for the opportunity for today, and my engagement with many of you has happened on a number of occasions, so thank you for all of those past engagements, and I've enjoyed my time immensely.

Chairman: Thank you very much, Mr. Duffy. Just for members, there's just one item in regard to tomorrow's proceedings that has to be dealt with, so we just need to go into private session just for a couple of moments for that. What I'm proposing now is to suspend just for a few moments, to excuse Mr. Duffy before I make the suspension, to thank Mr. Duffy for his participation before the inquiry today, and to formally excuse you.

Mr. David Duffy: Thank you very much.

Sitting suspended at 5.50 p.m. and resumed in private session at 5.52 p.m.

The joint committee adjourned at 6 p.m. until 9 a.m. on Thursday, 30 April 2015.