Allied Irish Banks, p.l.c. Statement to the Joint Committee of Inquiry into the Banking Crisis

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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 have 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 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 CEO's 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 €350m 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:

- Lending levels increasing
- Impaired loans and arrears levels decreasing
- The bank's capital and funding levels stabilised and improving
- The bank's organisational structure and risk framework 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.

I would now like to address each of the specific themes raised in your letter of 24 March 2015 in turn:

1. **Effectiveness of banks' board governance, client relationship and business model**
    - **Quality of the business model setting process (b1c)**

I am satisfied that, from a governance perspective, we now have an Executive Leadership Team comprising strong and diverse management capability, with robust oversight provided by a skilled and experienced Board of Directors. We will continue to further strengthen both bodies through targeted appointments as appropriate.

Our overall Governance Framework reflects best practice standards and ensures our organisation and control arrangements provide appropriate governance of the Group's strategy, operations and mitigation of related material risks. The Framework underpins effective decision making and accountability and is the basis on which we conduct our business and engage with our customers and stakeholders.

Clearly upon my arrival at the bank there were concerns about the banks' culture and governance. There was a need to rebuild trust between the bank, the taxpayers and its key stakeholders including the Department of Finance and the Central Bank. Deficiencies had been identified within the Group's Risk Framework and the bank had a significant number of internally and externally imposed issues to work through as part of a Risk Mitigation Programme. The customer model was highly challenged after a significant period of inward focus and there was limited organisational ability to help people in financial distress.

A material change in the overall structure of the bank was needed and there was recognition that a significant culture change was required in the bank.

A significant restructure programme was implemented to transform the Group into a smaller, less complex organisation which included a streamlining and centralisation of control and support functions. A progressive disposal and winding down of non-core assets was continued with a Non-Core unit established to oversee this programme.

The rationalisation of AIB's strategic objective envisaged a sustainable institution, based on placing customers first, increasing lending effectiveness and reducing operating costs. While the bank clearly has more to do, over the last three years the bank has delivered and in some cases exceeded its strategic targets.

During 2012 the bank was strategically repositioned and the balance sheet was restructured. Cost reduction programmes were initiated and an enhanced capability for dealing with customers in difficulty was introduced.

Over the course of 2012 and into 2013, the bank invested significantly in building out and enhancing our capability in bringing resolution to our customers in financial difficulty and we have designated the resolution of customer arrears and the restructuring of customer debt the stated number one priority for AIB. We have over 1500 staff in our Financial Solutions Group directly involved in dealing with customers in financial difficulty and they are further supported in their work by the resources of the Group as whole. We have been realistic and pragmatic in dealing with our customers who have unsustainable debts and have been innovative in the products and engagement channels we have made available to encourage our customer's engagement and bring cases to resolution.

Plans to reduce costs have successfully delivered and the structure of the bank has been reorganised to be more simplified and focused on customers taking account of best practice internationally.

2013 saw AIB return to a pre-provision operating profit as the efforts to deliver a sustainable operating model began to materialise. There was a stabilisation in the asset quality of the loan portfolio as seen by the relative slowdown in the growth of the impaired loans and as the economy began to improve, credit provisions were reduced and lending objectives were met.

During 2014, AIB successfully completed its three year strategy by returning to profitability, namely a €1.1bn profit before tax. The EU Restructuring Plan was approved and the bank comfortably passed the ECB/EBA Comprehensive Assessment without the requirement for further capital. There was a significant reduction in impaired loans and the bank continued to have access to the funding market at sustainable levels.

From a governance, capital, liquidity and business model perspective the bank has now been successfully repositioned to contribute to Irish economic recovery and to better serve customer needs.

2. Effectiveness of banks' credit strategies and risk management

- **Appropriateness of property related lending strategies and risk appetite (b2a)**
- **Appropriateness of credit policies, delegated authorities and exception management (b2b)**
- **Analysis of risk concentration in the base, the adverse economic scenarios and the impact on capital structure (b2c)**

Since 2011 the approach to risk management within the organisation has fundamentally changed. The previous decentralised, Division-led model, in which Divisional Chief Credit Officers and Chief Risk Officers reported into Heads of Divisions was consolidated into a centralised and coherent function under the leadership of the Chief Risk Officer ("CRO"). A complete review of all Risk Frameworks and supporting Risk Polices was completed with all revised polices being made readily available to staff. A gap analysis to industry practice for all frameworks was also undertaken. Tone from the top was critical to the implementation of more effective risk management and culture.

In addition, there is an independent Group Internal Audit function which is responsible for independently assessing the effectiveness of the Group's corporate governance, risk management and internal controls. The Group Internal Auditor has a primary responsibility to the Group's Board of Directors through the Group Audit Committee and has unrestricted access to the Chairman of the Group Audit Committee.

AIB's risk appetite process has evolved. It has by necessity focused on setting the boundaries of acceptable risk taking and is well embedded as a risk discipline. Segmental risk appetite statements are in place and are tailored to each segment while also ensuring that each is within the Group appetite. The segmental risk appetite statements have been condensed since the first iterations in 2012 to focus on levels of risk appetite that are entity specific. Compliance with the Group Risk Appetite statement is monitored by the CRO and reported on a monthly basis to the Executive Risk Committee ("ERC"), Board Risk Committee and the Board. Further work is underway to articulate risk capacity over a longer time horizon as part of the Integrated Financial Planning process, which links strategies, including lending strategies to the annual financial plan. This process involves review and challenge by the Risk function in order to ensure the appropriateness of lending strategies.

The Large Exposures & Approval Authorities Policy sets out the bank's rules and limits for taking on and managing single name loans to avoid too much risk being concentrated in only a few borrowers with very large exposures. It also outlines the loan amounts that can be approved at the different levels of authority from the AIB Board and CEO down to the Credit Committees of the various areas within the bank. This policy replaced the previous Group Large Exposure Policy and greatly reduced the loan amounts that can be approved at the lower levels of authority and any new cases that exceed these limits must be approved by the AIB Board.

Credit Approval and Review Authorities set out the ground rules for how and by whom credit applications can be approved. They have been strengthened in recent years and now detail the specific circumstances where applications can be approved by individual staff members in the Business and where joint approval is needed between the Business and Risk (which is independent of the Business).

To support and strengthen the process of loan approval AIB has a Credit Risk Framework that contains the credit risk policies that details specific rules that must be followed when approving loans in certain categories. These policies have been enhanced over the last 3-4 years and are now much more specific in providing direction to lenders. The current policies relating to new lending are as follows:

- Personal Lending Policy
- Personal Dwelling House (PDH) Policy
- Residential Investment (BTL) lending Policy
- Business Lending Policy
- Commercial Real Estate Policy
- Residential Development Policy
- Commercial Finance Policy
- Finance & Leasing Policy

Property Valuation Policy & Guidelines have been significantly strengthened in the last 3-4 years and are more prescriptive in terms of rules and guidelines when valuing property as security.

Of particular importance regarding loan approval is the emphasis now placed on cash flow assessment. In the past credit assessment was primarily based on security/LTV rather than on cash flow/repayment capacity. Credit assessment now focuses mainly on cash flow as the primary source of repayment with collateral considered as the secondary source. A large emphasis has been placed on credit training over the last number of years in order to improve the ability of the Business and Risk staff to correctly assess loan applications. Specific emphasis has been placed on training Business and Risk staff to use cash flow assessment as the primary means to consider businesses ability to repay loans with security being held as a secondary source of repayment.

The tracking and monitoring of exceptions to these policies is a very important part of how the Bank ensures that the policies are being complied with. Cases involving exceptions to Credit Policy cannot be approved by individual staff members and must be jointly approved between staff members in the Business and those in Risk. In addition, when these exceptions have been approved they must be reported upwards in accordance with the bank's governance arrangements and monitored by the Executive Risk Committee.

Portfolio Monitoring, which in the past was done at a higher and less detailed level has become more granular with analysis undertaken on specific sectors on a regular basis.

3. Impact of remuneration arrangements on banks' risk management

- **Adequacy of the incentive and remuneration arrangements to promote sound risk governance (b5a)**

AIB's Remuneration policies and practices are designed to support the long term objectives of the bank while also providing employees with a fair and competitive remuneration. The Policy is set and governed by the Group Remuneration Committee on behalf of the Board and encompasses any financial benefit available to employees across the Group. The Committee, comprising entirely of non-executive directors, has full access to and takes account of input from AIB's control functions e.g. Compliance, Audit, Finance, to ensure that its decision making process is aligned with the bank's financial performance, regulatory guidelines and stakeholder interests while ensuring against excessive risk taking and supporting the capital and liquidity positions of the bank.

In 2012, the Remuneration Policy was updated to reflect the findings of a Central Bank of Ireland review of remuneration policies and practices.

In 2014, the Remuneration Policy was updated to incorporate the provisions of the Capital Requirements Directive (CRD IV) which came into effect from 1st January 2014. These principally related to setting appropriate ratios between fixed and variable remuneration, the application of Malus and Clawback Arrangements and the introduction of revised criteria for Identified Staff (as defined under CRD IV).

The Remuneration Disclosures which are published as part of our Pillar III Disclosures outline AIB's principal remuneration policies and practices, including the remuneration of those individuals whose professional activities are considered to have a material impact on AIB's risk profile.

Notwithstanding the above regulatory requirements, AIB's remuneration policies have during my time as CEO been governed principally by the provisions of Placing & Subscription Agreements and through commitments provided by AIB to the Minister for Finance in respect of remuneration practices coupled with the financial performance of the bank.

In 2012 AIB also undertook a comprehensive review of pay and benefits across the Group as part of a cost reduction programme. The principal impacts of the review included the closure of the bank's Defined Benefit Pension Schemes to future accrual, reductions in salary and pay related allowances for senior staff and the elimination of long standing peripheral benefits.

The remuneration of the Executive Directors and other Leadership Team members is managed and monitored by the Remuneration Committee in accordance with the provisions of State Agreements.

4. Clarity and effectiveness of the nexus of institutional roles and relationships

- **Nature and appropriateness of the relationship between the CBI (including the Financial Regulator), the DoF and the banking institutions (r3b)**

The day to day relationship between the Bank and the Minister for Finance is governed by the March 2012 Relationship Framework. This document outlines how the relationship is managed including consultation and consent procedures and requirements and the sharing of information in relation to the bank's on-going operations and performance.

More broadly, since my arrival, I have sought at all times to constantly improve the relationship between the bank and the State whilst at all times operating in a commercial and professional manner. AIB exists today only as a result of the support received from the State and recognition of this fact is paramount in our approach to ensuring open and transparent interaction in all relevant dealings with the Department of Finance and the CBI whilst ensuring the bank is managed as a commercial organisation.

In recent years the CBI has provided a high level of regulatory oversight supported by enhanced legislative powers and enforcement capabilities.

A substantial programme of regular exchanges including regular meetings with both myself and the heads of control functions, on-site inspections and thematic reviews across the sector which sustains the programme of continuous oversight. The recent history of the banking sector has required that this process is predominately evidence based for both prudential and conduct of business regulation – banks must not only comply with what the regulations require, they must be able to continuously evidence that compliance.

Our policies and procedures are designed to operate a "no surprises" approach by escalating any issues or concerns at the earliest opportunity, and engaging in appropriate and rapid remediation where appropriate.

The number of Risk Mitigation Programme issues identified by the CBI has been greatly reduced from a peak in 2011.

5. **Appropriateness and effectiveness of the domestic policy responses**
   - **Establishment, operation and effectiveness of NAMA (c4b)**

The Irish Government established NAMA in December 2009 and AIB transferred approximately €20billion of assets to NAMA during 2010 and 2011. As all of this took place prior to my joining AIB I am not in a position to provide any substantive comment under this topic save as to say that AIB fully meets its on-going obligations to NAMA as required under the NAMA Act.

6. **Appropriateness and effectiveness of other EU-wide policy responses**
   - **Basel III (CRD IV) and the impact on capital and liquidity of Irish banks (c6a)**

The bank is fully supportive of the initiatives taken in Europe in response to the crisis which have assisted in providing a framework to increase stability within the sector.

CRD IV came into effect on 1 January 2014 on a phased basis, and included enhanced requirements for quality and quantity of capital, a basis for new liquidity and leverage requirements, new rules for counterparty risk, and new macro prudential standards including countercyclical capital buffers and buffers for systemically important institutions.

<u>Capital</u>

A Group Capital Management Policy is in place, the objectives of which are to at all times comply with the regulatory capital requirements and to ensure that the Group has sufficient capital to cover the current and future risk inherent in its business and to support its future development.

Concluding in November 2013, the CBI conducted a Balance Sheet Assessment / Asset Quality review. The review included a top down mortgage modelling exercise and a review of the classification of mortgage files. Non-mortgage sample file reviews were also performed. The review was conducted in line with CBI impairment guidelines issued in May 2013. No additional capital was required to meet on-going regulatory capital requirements.

In 2014 the EBA/ECB in conjunction with the CBI conducted a Comprehensive Assessment ("CA") European wide stress testing exercise. The capital adequacy threshold used for the baseline stress test scenario was set at 8.0% Common Equity Tier 1 ("CET" 1) and 5.5% CET 1 in the adverse stress test scenario. Both scenarios were assessed for capital under the transitional arrangement as set out in CRD IV over a 3 year period from 2014 – 2016. The stress tests were conducted on a Static Balance Sheet basis where the stress tests were based on how the balance sheet as at the end December 2013 would perform over the three years and on a Dynamic Balance Sheet basis where some assumptions from the EU Restructuring Plan on loan restructuring, cost reductions and new lending were allowed. The results of the CA confirmed that AIB has capital buffers comfortably above the minimum requirements under all stress test assessment scenarios and therefore did not require any additional capital.

The Group's transitional CET1 ratio as at 31 December 2014 was 16.4%, representing an increase of 140bps in the year. Including preference shares the fully loaded CET1 was 11.8%. The preference shares will continue to be considered as CET1 until 31 December 2017. As we have previously disclosed in our market statements, discussions are on-going with the Department of Finance in respect of these preference shares including the possible conversion into ordinary shares of part or all of the preference shares.

Liquidity

AIB has a comprehensive Funding and Liquidity Framework for managing Group Liquidity Risk which is designed to comply with evolving regulatory standards including CRR. The Framework is delivered through a combination of policy formation, review and governance, analysis, stress testing and limit setting and monitoring. A Liquidity Contingency Plan has been established to ensure the Group can manage its business in stressed conditions and emerge from a temporary liquidity crisis.

Basel III recommended two key liquidity quantitative measures that should be attained at the latest by 2018.

1. Liquidity coverage ratio (LCR) to cover outflows over the next 30 days. Banks should have a ratio of > 100% by 2018 starting with > 60% in October of this year.
2. Net Stable Funding Ratio (NSFR) to ensure banks have sufficient available funds, > 1 year maturity, for their longer term illiquid assets. Banks should have ratios of > 100 % by 2018.

At end of 2014 AIB had an estimated LCR of 116% and NSFR of 112% which compares favourably with an LCR of 105% and NSFR of 95% at end of 2013.

In order for AIB to meet the newly proposed Basel III ratios AIB deleveraged the balance sheet to the point where its loan to deposit ratio decreased significantly. As at the end of 2014 AIB has a loan to deposit ratio of 99%. AIB entered into arrangements with NAMA where loans (illiquid assets) were exchanged for Government guaranteed bonds (liquid assets) that were subsequently eligible for funding at ECB and indeed the commercial market. NAMA bonds were confirmed as High Qualifying Liquid Assets (HQLAs) by the CBI and this categorisation has boosted AIB's LCR and NSFR ratios.

AIB now completes a detailed Funding and Liquidity plan as part of overall business strategy planning. This plan is updated in detail annually with regular reviews through the course of the year. It takes into account the projected customer loans over the life of the plan and the optimal funding mix of customer deposits and long term wholesale bond issuance required to ensure compliance with LCR and NSFR.

Summary

I wish to thank the Committee of Inquiry for considering my account. 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.