

Chairman

In my invitation to appear before this Committee I was asked to give evidence relating to a number of lines of enquiry and in the context of three positions which I held in my employment with the AIB Group in the years from 1999 to 2009;

- As General Manager of the Strategic Development Unit in AIB Bank
- As Managing Director of AIB Bank ROI
- As Director of Group Strategy AIB plc

I want to begin by commenting on each of these roles and their potential relevance to the Enquiry;

Taking the three in turn, I was General Manager of AIB Bank's Strategic Development Unit from Sept 1999 to April 2002. This was a Strategic Marketing role with the focus on the development of innovative Product Offerings for business and personal customers, e-Channel development, Branch Network development, Customer Data and Intelligence, Customer Segmentation and Sales and Marketing strategies. In this role I had no responsibility for credit management or credit strategy. I was appointed as Managing Director of AIB Bank in April 2002 and I held that position until February 2009. I believe that it is principally in the context of this role that I can be of assistance to the Enquiry. AIB Bank was the domestic retail banking division of AIB Group. As its Managing Director I was responsible for all aspects of the Division's activity in accordance with AIB Group policies and governance. Specifically in the context of credit strategies, credit approval and credit risk management, activities were all conducted within policies that were set out by the central Group Risk Management function, endorsed by the Group Executive Committee and approved by the Board of Directors. Thereafter they were supervised by the Group Risk Management function with support from the Group Internal Audit function. As Managing Director of AIB Bank I did not have any credit discretion. My responsibility was to manage the business to the highest possible level of performance in all respects, and to do so within the Credit Risk Policies and Credit Risk Management frameworks that were set and ordained at Group level.

Let me make it absolutely clear that in outlining the Corporate governance structure within which the AIB Bank Division operated, I am doing so for the purpose of clarity. I am not in any way suggesting that I am without a shared responsibility for the failure of the Bank. I was part of the Group Executive Management Committee through this period and I also became a member of the AIB Group Board in 2007. My voice would have been an influential one if I had questioned or challenged our Credit Strategy and Credit Positioning at these fora, but I did not do so. While I had expected a faltering of economic activity and a pullback in the property market, I simply did not foresee the scale of the collapse that was to follow. It is clear now that AIB Credit policies were inappropriate at that advanced stage of the economic cycle. At the time I believed that the economy was on a more resilient and sustainable footing than subsequently proved to be the case. With the wisdom of hindsight, this was a serious misjudgement on my part and on the part of many others, within the Bank and outside. My own failing in this respect is a matter of deep personal regret.

I will come back to comment more specifically on the lines of enquiry that I was asked to address—all of them in the context of this role as Managing Director of AIB Bank but I

want to briefly refer to my appointment as Director of Group Strategy in February 2009 as I was requested to do.

In late January/February 2009, I was informed by AIB Group's Chief Executive that I was being moved from my post as Managing Director of AIB Bank to a newly created position as Director of Group Strategy. However, that position never materialised in the way that was indicated at the outset. I found myself completely removed from discussions at Executive Management and Board level, and without objectives or direction in terms of a work agenda. That situation persisted until I decided to leave the Bank nine months later in November 2009. Throughout my time in this role I had no involvement in the management of the Bank and very little knowledge of developments from a credit risk perspective.

Specific Lines of Enquiry

Turning now to the specific lines of enquiry that I was asked to address; Firstly I have been asked to comment on the **appropriateness of credit policies, delegated authorities and exception management**

Appropriateness of Credit Policies; The foundation of AIB credit policy through this period, as it related to all elements of property exposure, was to:-

(a) ensure that each loan facility had a demonstrable repayment path through its projected cashflows –these would be generated from property sales, rental income or commercial revenues (and included a strong emphasis on cross-collateralising borrowings across customer connections, where possible, and seeking to ensure all earning streams were available to service/repay borrowings)

b) limit loans to 70% of the security value. It was envisaged that all facilities should have a robust repayment capacity in their own right and thus ensure that our security was only required as a fall-back or fail-safe measure.

Within these constraints, Group Business plans were agreed annually and the growth of the loan book was frequently reviewed and approved as part of Group Capital management and Group Liquidity management. The concentration of property lending was an ongoing focus for attention by the Group Risk Management function, as was the growth of individual counterparty exposures. These themes did feature in a number of Board reviews, but did not translate into any significant change in market positioning.

With the benefit of hindsight, the first point of failure came with the collapse of economic activity and the manner in which it undermined repayment capacity—sales agreed to in contracts , while legally binding, did not materialise; rental incomes were much reduced and other commercial revenue streams were compromised.

The second point of failure was the inadequacy of the 70% loan to value constraint on our security. In light of the scale of the subsequent fall in property values, this left the bank with insufficient cover. The Bank's vulnerability was further exacerbated by the high concentration of property risk in the Loan book and the scale of individual counterparty exposure

It is now clear that these failings represented poor judgements from an internal bank management perspective. There were also some external factors which contributed to the scale of the problem that developed. The pro-cyclical nature of the Accounting Protocols that applied at that time resulted in a level of loan loss provisioning at the outset of the crisis that was less than Management would have considered prudent. Additionally there was an unprecedented increase in funding costs which eroded loan margins and capital generation and there was also an externally imposed requirement for increased capital cover as the crisis developed. All of this represented a combination of adverse developments that had simply not been adequately anticipated in the stress testing scenarios.

Delegated authorities; Credit was managed within a Policy framework that was overseen by the AIB Group Risk Management function. All loans were calibrated and graded from a risk perspective (Grade 1 to 7) and Approval processes, Thresholds and Discretions were set relative to the assigned credit grade and constantly reviewed. From memory these were as follows (but I may be subject to correction)

All AIB Bank exposures greater than euro 40 mil (in the period to 2005), and greater than 75 mil (from 2006 to end 2008) had to be referred to the Group Credit Committee for approval. This meant that 66% of the Divisional Property Loan book was approved by the Group Credit Committee or referred onward by them to the CEO/Board of Directors sub-committee for approval.

Within the Bank Division, (referring to the 2006 to 2008 period) all exposures greater than euro 40 mil, and less than the 75 million threshold mentioned above, were approved by the Divisional Credit Committee, chaired by the Divisional Chief Credit Officer, with an independent Group Credit Risk nominee as a mandatory participant.

Below the 40 mil Divisional Credit Committee threshold only ten executives had individual lending discretions of more than euro 8 mil and this level of discretion generally only applied to the higher grade credit cases. These discretions were under constant review by the Group Risk Function to ensure they were used in compliance with Group Policy and guidelines, and were also reviewed periodically by the Group Internal Audit function.

It is my view that Discretion levels were not inappropriate. In fact the credit approval process was very centralised and regimented. The failing was not at the level of individuals, but more fundamentally in the credit policy that we had adopted and the level of property related exposure in our portfolio.

Exception management; AIB lending decisions were based on the belief, now obviously mistaken, that long established, experienced scale-players in the property market represented a better risk than smaller less experienced counterparties. They were seen to have had a track record of performance and built up significant equity through the previous years. This fuelled an appetite to sustain AIB's share of their business in the face of intense competition and did lead to a growing number of large individual counterparty exposures.

Individual Counterparty exposure was regulated by the AIB Group "Large Exposure" Policy...again set with reference to Credit Grades, which indicated the maximum level of credit that was to be advanced to a single counterparty. All exceptions to this were a decision for the Group Credit Committee and regularly referred onwards to a sub-

committee of the Board. These were frequently approved and created a situation where the number of exceptions to Policy was significant—this contributed materially to the subsequent difficulties and was clearly a point of failure.

Exceptions did occur also at Divisional level, but less significantly so. During late 2008 and early 2009 such cases often fell into the category of non-compliance with the 70% loan to value constraint, as a result of a fall in the value of the associated security. These were not, therefore, cases of non-compliance with lending policy at the initiation of the loan. They were generated by subsequent adverse developments in the performance of the loan.

Turning to the second theme I was asked to address, I was requested to comment on the **Adequacy of the Property valuation policies and assumptions in terms of the assessment of loan security.**

Prior to 2006, professional valuations were frequently but not always sought by AIB to evaluate property held as security. In 2006, the AIB Group Audit Committee decreed that all security valued at €5m + had to have an independent professional valuation when loan facilities were considered/approved. While this was seen as a positive step and introduced greater independence into the valuation process, it may have been problematic in another way. It put a greater weight on these professional valuations and may have taken from the focus on rigorous internal assessment of the capacity of the asset to generate cash/income and its capacity to repay the related borrowings. As the market turned, these professional valuations proved to have little substance.

With the benefit of hindsight, the loan evaluation process, at this point in the economic cycle, should have placed much less weight on external market comparable values and focused more exclusively on the viability of property development and investment projects. Specifically their capacity to generate income and repayments should have been subject to more robust challenge and the sustainability of the projected cash-flows should have been stress-tested in the face of a much more adverse economic climate.

Independence of Professional Advisors in valuing Property Assets

I have no reason to question the independence of Professional Property Advisors and Valuers. However, the fact that they had a personal interest in maintaining the health of the market cannot be dismissed. I suspect this may have prompted them on occasion to view market values more positively, but I acknowledge that I have no specific evidence or examples of this.

Looking back, I think the greater lesson is in the limitations of a “market valuation” in a marketplace that is relatively closed and illiquid by international standards and where a change of sentiment quickly means that these comparable values simply evaporate. With the benefit of hindsight I believe that this gave rise to unrealistic and unsustainable valuations through the upcycle, but equally meant that market valuations through the subsequent phase of extreme illiquidity in the crash period may have been unduly deflated.

Internal Controls over perfection of Security. The status of loan security was reviewed as part of the general review of individual loans –a process that took place annually if not prescribed more frequently at the time of the previous review. Additionally there were periodic reviews of loan portfolios by the Group Risk

Management function and the Group Internal Audit function—these included covering the status of the related security.

In general, the practice for larger exposures (20mil+) was to have their security perfected by external 1st & 2nd Tier Legal Firms. This meant that it was consistently well executed and while I am not privy to the “ legal haircut” that was applied to the initial AIB tranche of NAMA loans, I am confident that this portfolio would have been in good standing from a security perspective and would have compared favourably with other institutions.

In the case of exposures of less than 20 million, the perfection of security was managed by the AIB Bank Division’s Business Centres and Branches, working in liaison with the borrower’s solicitors. The volume of transactions meant that there were significant delays with the Land Registry in executing/registering security and the Bank was heavily reliant on formal Solicitors’ Undertakings to see the process completed. Delays with the Land Registry stretched to two years on occasion and this created a constant challenge. In general the perfection of loan security for this second tier portfolio was an area of constant concern and management attention.

Chairman the third area that I was asked to address relates to **the Role and Effectiveness of the Policy Appraisal Regime before and during the crisis**. Specifically I was requested to comment on the **Liquidity versus Solvency** debate

From a liquidity perspective, my Division was not an area of significant concern for the Group right through to early 2009. The flight of deposits and resources was primarily through the Capital Markets Division and the UK Division as International and Institutional counterparties redirected funds out of the Irish banking system.

With respect to solvency, I can only comment on AIB’s position up to February 2009 – the point at which I ceased to be Managing Director of the Division. As I have already outlined, from that point forward I had no access or input to credit strategy, policy or decisions. In the final weeks of my tenure as MD, AIB Bank, I had been tasked with evaluating the loan portfolio, and reporting back directly to the CEO. I believe this was in advance of the Group’s Financial Results and Market update which would have been due at about that time. I was asked to make an assessment of potential losses in the Divisional loan book, arising from both specific and general provisions. That process was conducted with the Divisional Chief Credit Officer and the various Lending Executives, with input from the Group Risk Management function. I recall very clearly that my report pointed to losses across the Division that could be between 2 and 3 billion euro. In carrying out that process, my instruction to the Lending Officers was to be rigorous and to ensure that we did not underestimate the scale of any potential losses. I am satisfied that the result was a genuine and bona fide assessment of the position at that point in time, reflecting the market conditions and expectations that then prevailed.

In the context of that number, any question relating to AIB Groups solvency did not arise for me, and I was never part of any conversation where it was raised or discussed. It did raise questions about the capital adequacy of the bank and the imperative of reinforcing our capital reserves, but the solvency of the bank was never raised or questioned at that point in February 2009, or before.

Finally Chairman I was asked to comment on the **Appropriateness of the Bank Guarantee decision**. I am not sure that in this respect I can offer any perspective that

would be useful to the Committee. I was never party to AIB's engagements and meetings with the Department of Finance. These were managed within a small circle—the Chairman, CEO and Head of Finance—with occasional briefings to the Executive Management Team and Board that will have been minuted.

As I mentioned, my Division was not under pressure in terms of a flight of deposits and in this respect the Bank Guarantee to me seemed a sweeping and radical response. However some of my Executive Management Team and Board colleagues were convinced that it was a very appropriate and necessary measure that was needed to restore international confidence in the system.

In summary Chairman, it is my view that the failure of the Bank was primarily attributable to a failure of our Credit policy: our stress testing of repayment capacity was not sufficiently challenging and our loan to value constraint on security was inadequate. The impact of these factors was exacerbated by an excessive weighting of property exposure in our portfolio and an undue level of exposure to individual counterparties. External factors also contributed to the difficulty—inappropriate accounting protocols for loan loss provisioning, increased funding costs and an external requirement for increased capital cover all added to the strain.

I hope this statement is helpful to the Committee. I am relying primarily on my recollection of events in preparing this material for the Enquiry and this may mean that some points of detail have escaped me. With that caveat I am happy to address any more detailed questions that may arise.