

HOUSES OF THE OIREACHTAS

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Morning
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Afternoon

AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉI- REACHTA

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Dé Céadaoin, 06 Bealtaine 2015

Wednesday, 06 May 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.

That's it in summary.

Mr. Richie Boucher: And that's been pointed out to me.

Deputy Joe Higgins: So, what's the value of saying to people that the witness has absolute privilege if he hasn't?

Chairman: In the Irish State he has absolute privilege.

Deputy Joe Higgins: I know, but any witness can then come and say, "Sorry ----"

Mr. Richie Boucher: Chairman, I answered very openly ... I have given very, witness statements, on broad issues, within my interpretation of this.

Chairman: Okay.

Mr. Richie Boucher: When it comes to a very specific customer issue, whether or not the work of the committee turns on that, I have tried to be as helpful as I can, but I have to point out I do not have that privilege outside this jurisdiction, and it has been pointed out to me. So I could be sued. Being straight about it. If the Chairman says, "You must answer that question because it is vital to the work of this committee", I will answer that question.

Chairman: Okay, alright. I am going to bring matters to a conclusion now Mr. Boucher. The purpose of this inquiry is, as I have said in earlier engagements, is not just about learning the lessons from the past, but also applying some learning into the future. Do you have any final comments you'd like to add in that regard? And then I'll bring matters to a close.

Mr. Richie Boucher: No, I think ... you know ... in Bank of Ireland we made a lot of mistakes, we've worked very hard to repay the taxpayers. We can never fully repay in moral terms. We've tried to do it in financial terms. We've restructured our bank, we have a viable sustainable bank. Some of the lessons we learnt is not to follow a strategy we don't think appropriate. We are a strong bank. We hugely regret the loss a lot of people took on decisions we make, we hope that people can have now much more confidence and faith in how our bank will keep going forward, our contribution to the economy and the value we create for our shareholders, but we can never, never absolutely undo some of the moral issues that were a consequence of some of the decisions. We tried to do that financially. And ... I try to do my job in that context.

Chairman: Okay Mr. Boucher. With that said I thank you for your participation and for your engagement with the inquiry today. I would now like to formally excuse you and in doing so propose that we suspend until 2.30 p.m. Is that agreed? Agreed.

Sitting suspended at 1.05 p.m. and resumed at 2.38 p.m.

Ulster Bank - Mr. Cormac McCarthy

Chairman: Okay, so we're now proposing that we go back into public session. Is that agreed? Agreed.

So the committee of the bank inquiry is now back into public session for session 2 of today's hearings with Mr. Cormac McCarthy, former group chief executive and director of Ulster Bank. The Committee of Inquiry into the Banking Crisis is now resuming in public session and can I remind members and those in the public gallery to ensure that their mobile devices are switched

off.

Today, we continue our hearings with senior bank executives who had roles during the crisis. This afternoon, we will now hear from Mr. Cormac McCarthy, former group chief executive and director, Ulster Bank. Mr. McCarthy was group chief executive and director, Ulster Bank Group, from 2004 to 2011. Previously, he was head of finance and then chief executive at the First Active plc. Mr. McCarthy is currently a director and chief financial officer of Paddy Power plc, a position he has held since October 2012. Mr. McCarthy, you are very welcome before the committee this afternoon.

Before I hear from the witness, I wish to advise the witness that by virtue of section 17(2) (I) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to this committee. If you are directed by the Chairman to cease giving evidence in relation to a particular matter and you continue to do so, you are 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 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. Therefore, I would urge 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 screens here in the committee room. For those sitting in the Gallery, those documents will be displayed on the screens to your left and right and 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 this 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 and will be relied upon in questioning and form part of the evidence of the inquiry. So with that said, if I can now ask the clerk to administer the oath.

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

Mr. Cormac McCarthy, former Group Chief Executive, Ulster Bank.

Chairman: Thank you again, Mr. McCarthy, for being with us this afternoon, and if I could invite you to make your opening statement please.

Mr. Cormac McCarthy: Thank you, Chairman. Good afternoon Chairman, members of the inquiry. I welcome the opportunity to appear before the inquiry and I'll be as helpful as I can to assist you in your work. I've submitted a witness statement to the inquiry which addresses the lines of inquiry, as requested.

As you all know, Ulster Bank is a universal bank operating primarily in the Republic of Ireland and Northern Ireland. It is owned by the Royal Bank of Scotland. My own background, as it relates to the inquiry, as the Chairman said, is as follows. In 1998 I joined First Active from Woodchester Investments as head of finance. Two years later, I was appointed chief executive. Following the acquisition of First Active by Ulster Bank in January 2004, I was appointed to the position of chief executive of the enlarged Ulster Bank Group. I left Ulster Bank and Royal Bank of Scotland in May 2011. The objective of Royal Bank of Scotland in combining RBS ... Ulster Bank with First Active was to form a credible third force in Irish bank ... in the Irish banking market, to enhance competitiveness and to challenge the dominance of AIB and Bank of Ireland in particular. You will all recall that the need for a credible third force in Irish bank-

ing was strongly promoted by politicians, the media, business groups and consumer advocacy groups.

As chief executive of the Ulster Bank Group, I was responsible for all of the operations of the bank. On assuming the role I was tasked with combining and integrating a management team from Ulster Bank and First Active, whilst maintaining the two brands, working with RBS to move the bank's technology platform to those of RBS, developing and executing a strategy to avail of the growing Irish economy and creating a real universal banking alternative to AIB and Bank of Ireland. I was very much enthused by this opportunity, believing that by being a part of RBS, the Ulster Bank and First Active combination could bring something to the Irish market that was both needed and unique. The scale and sophistication of RBS, allied to the on-the-ground capability and experience of the existing indigenous banks, underpinned the opportunity. At that time, all of the economic indicators in Ireland pointed towards sustained growth. I was assured by RBS following my appointment as CEO that capital and funding support would be made available to support growth, obviously with the appropriate group risk framework. I'd like to spend a couple of minutes explaining the governance structure at Ulster Bank Group, as it does differ from the other banks appearing at this inquiry.

The RBS governance model which was in place before the First Active acquisition remained unchanged. Integral to this was significant RBS oversight of and involvement in the Ulster Bank business, particularly where credit, regulatory and operational risk was concerned. Ulster Bank management in each of these areas had solid and dotted reporting lines into senior RBS management. This also applied to the CFO, the head of HR and the head of internal audit. Members of RBS senior management were either formal members of Ulster Bank boards or committees or had rights of attendance. In addition, the Ulster Bank Group had a board of directors comprising independent, experienced and high-calibre people. This board also had RBS representative members. The chairman of the board had open access to the chairman and chief executive of RBS and engaged with them regularly, independent of Ulster Bank management. Ulster Bank Group had three legal entities in Ireland, each of which had a separate board of directors with independent chairpersons and non-executive directors. The bank had what is called a high-level controls framework, which underpinned the RBS governance model. The governance structure at Ulster Bank Group was identical to the governance of all RBS subsidiaries. It was, and is, entirely appropriate for a bank with a single shareholder. Having both a local board and RBS governance felt like we had the best of both worlds, with the benefit of being part of a significant global bank and the comfort of having local boards populated by respected and well known business and public figures.

The approach to strategy was also dictated by the same high-levels control framework. This included, amongst other things, an annual off-site strategy session with the board where the proposed business strategies and five-year plans were reviewed and challenged. The outcomes were fed into the RBS strategic planning and budgetary process, which was a detailed and rigorous exercise in itself. Performance against plan was closely monitored by RBS on a monthly and quarterly basis. The business plans were constantly evolving, based on detailed reporting and forecasting. And this was subject to detailed engagement between myself, our CFO and the RBS CEO and CFO. I was required to report directly to the RBS board annually on Ulster Bank strategy and performance. In a nutshell, the bank's strategy was to grow all aspects of our retail business and corporate business throughout Ireland, North and South, availing of strong economic conditions and positive indicators. Each of us is looking ... each of us in the room is looking back at the period between early 2000 and 2008 with the benefit of knowing what happened. It is a sobering perspective, particularly given the impact the outcome has had on so

many people's lives. It is, however, important to consider what the prevailing perspective actually was back in 2004 to put in proper context the development and adoption of strategies and decisions. All of the economic indicators in 2003 to 2007 regarding the demand for housing in particular over the median ... medium term were positive. This included underlying demographics, particularly in the household formation bracket, numbers per household, economic growth, migration and interest rates. It was estimated in 2003 that a minimum of 40,000 housing units a year would be required through the period to 2010, following which there would be a lower but still significant ongoing requirement. In aiming to become a genuine third force in Irish banking, Ulster Bank lent too much money to too many people on the basis of assumptions which turned out to be seriously flawed. This was not to say that we adopted a cavalier or reckless approach to banking, we didn't. What is clear is that our strategy, while genuine in its motives and ambition and backed by one of the worlds largest banks, was ultimately proven the have been ill-judged and mistaken in the light of what transpired in 2008 and beyond. I deeply regret that this happened while I was chief executive of Ulster Bank. I'd like to spend a couple of minutes guiding you through the banks approach to risk and credit.

Business divisions in Ulster Bank were given general, non-specific growth targets that were to be achieved within acceptable risk policies, appetite parameters and lending caps. Hence, as a full service bank, there was no formal sector-specific lending focus. Sector risk appetite over the period was set out initially at a high level. Appetite didn't set limits but articulated the bank's view of a sector which influenced business development. Over time, sector reviews and appetite statements became more detailed and prescriptive. The only property-related portfolio cap was in respect of speculative lending on commercial property. This was set at 3% of total loans and this cap was adhered to throughout my time in the bank. The Ulster Bank Group had a risk policy and controls committee. Policies were structured around rules and guidelines. Rules had to be followed and if breached, were strictly subject to exception reporting and higher level approval. Guidelines which were exceeded had to be justified. All credit policies were subject to annual review. Under the Ulster Bank credit committee and delegated authority policy, the most significant credit risks were presented to the most senior credit committee for approval. Delegated authorities to other committees were based on a combination of the aggregated amount of facilities and the borrower's credit grade. Credit authorities for the credit committees were approved by the RBS risk committee. Loans above certain thresholds had to be submitted to an RBS credit committee for approval.

In retail banking, Ulster Bank branches had no lending authority and every loan application was referred directly to credit. First Active branch managers had authority to approve mortgage lending up to certain limits, subject to policy rules. A detailed process was put in place to deal with exceptions to lending policy. All policy rule exceptions had to be reviewed and approved by the appropriate credit authority as set out in the policy. Exceptions within retail, were reported monthly to risk policy and controls committee and RBS Group credit risk and also presented to the relevant board. Responsibility for monitoring sector concentration risk rested with the risk policy and controls committee. Reports in this committee were presented to the board. The nature and purpose of concentration analysis evolved throughout the years to 2008. In 2004 and '05 residential lending, commercial real estate and construction accounted for over 60% of the bank's lending portfolio. We did introduce a sector exposure framework in 2005 to develop a more systematic approach to concentration analysis in line with Basel II and RBS Group policy requirements. In 2006 a policy of producing quarterly operational reports was introduced to provide a risk-focused approach to the management of sector concentrations in the lending book. This was supplemented by periodic reviews.

Stress testing was carried out as part of the Central Bank and regulator's biannual process. This examined baseline versus shock scenarios provided by the Central Bank and regulator. The return for July 2008, following shock scenario testing, showed minimum tier 1 and total capital ratios of 7.9% and 8.8%, compared to base case ratios of 8.6% and 9.9%. These stress-testing processes were supplemented by macroeconomic stress testing, involving input from Ulster Bank Group economics and John FitzGerald of the ESRI. They tested three global shock scenarios and John FitzGerald used the ESRI HERMES model to simulate the impact on Ireland over the period 2006 to 2010. The results of the medium-term shock scenario were used as a basis of the Ulster Bank 2007 ICAAP return to the Financial Regulator.

I would like to address the issue of the introduction of 100% mortgages, because I know that it's a concern of the inquiry. In 2004 the First Active mortgage market share was coming under pressure in the first-time buyer segment, where mortgage brokers in particular were gaining increased traction. Following market research and customer feedback, two things became clear to us. Firstly, whilst dated market maximum loans to value were already at 92%, some of our competitors were increasingly prepared to stretch LTVs to 100% or more to secure first-time buyers' business. Secondly, our customers were increasingly having to rely on expensive short-term debt, through credit cards and personal loans, to fund the excess between the maximum LTV and the house purchase price. We already had a 100% mortgage product in existence for some years for professionals on which our experience had been very good. Given this experience, together with factors to which I already referred and the positive economic and demographic backdrop, we decided to recognise the market reality through publicly introducing 100% mortgages in what we judged to be a controlled and restricted way - no exceptions policy, reduction in maximum term. Before launching it, we put the mortgage through a rigorous risk assessment program in RBS and we notified the regulator of our intention. In the three years between mid-2005 and mid-2008, Ulster Bank and First Active combined advanced €1 billion worth of these mortgages to approximately 4,000 customers, which amounted to 4% of our total mortgage lending in this period. The introduction of 100% mortgages had little impact on our market share of mortgage lending, for which the period between 2004 and 2008 remained at 16%. In reality, the collapse in house prices has been of such a magnitude that almost any mortgage written after 2004 with a loan to value in excess of 50% subsequently went into negative equity. With the benefit of hindsight, the introduction of 100% mortgages was a detrimental initiative which became all too apparent as property values collapsed.

I appreciate that much of the inquiry's work has been taken up with the bank guarantee and in my witness statement I have touched on the difficulties which it created for Ulster Bank. I should also confirm, Chairman, the first I knew about the guarantee was when I heard about it on the news on the morning of 30 September 2008 and I was surprised, since I had been in touch with the Financial Regulator on two occasions in the preceding two weeks because of the obvious stresses in the funding market. Following the putting in place of the guarantee, we immediately made significant efforts to address the difficulties this was causing us. In the end, we were afforded the opportunity to enter the scheme but the terms involved proved impossible for us.

In conclusion, Chairman, I can say to you today, hand on heart, that all of the decisions I made were made in good faith on the basis of the best information to hand at the time. I never anticipated the circumstances that transpired in 2008 and beyond and I was mistaken not to have done so. I greatly regret that decisions I made while chief executive of Ulster Bank have had the impact they have had on so many peoples' lives. Thank you, Chairman, I'm happy to take questions.

NEXUS PHASE

Chairman: Thank you very much, Mr. McCarthy, for your opening statement. And if I can now invite Senator Sean Barrett to open the lead questioning. Senator, you have 25 minutes.

Senator Sean D. Barrett: Thank you, Chairman, and welcome, Mr. McCarthy.

Mr. Cormac McCarthy: Thank you, Senator.

Senator Sean D. Barrett: On the 100% mortgages, there was a dissident at the board, Mr. Livingstone, isn't that correct?

Mr. Cormac McCarthy: That ... Mr. Livingstone attended the meeting as would RBS members generally and, yes, as the minutes note, he had some reservations.

Senator Sean D. Barrett: He found supporting the proposal difficult. Did you get a response from the regulator?

Mr. Cormac McCarthy: We had effectively a non-objection, Senator, so the regulator did not object. We engaged in some correspondence and dialogue with the regulator over a period of months, where the regulator raised some questions but essentially there was a non-objection to the product.

Senator Sean D. Barrett: When you say over a number of months, how long was that correspondence?

Mr. Cormac McCarthy: Approximately six months, to the best of my recollection, Senator.

Senator Sean D. Barrett: So after six months you proceeded on the basis he did agree?

Mr. Cormac McCarthy: There was further dialogue. I mean, I think it's been a matter of record that the regulator in time imposed higher capital requirements on higher loan-to-value mortgages. So that sort of developed over time but, in terms of our own particular dialogue, it was roughly a six-month period.

Senator Sean D. Barrett: And while ... the bailout for Ulster has come from the Royal Bank of Scotland, is that right?

Mr. Cormac McCarthy: That is correct, Senator.

Senator Sean D. Barrett: €14.3 billion between 2009 and 2013. Has it been more since?

Mr. Cormac McCarthy: I think the total amount, if I'm not mistaken, Senator, is about €14.9 billion. Subsequent to that ... that was to the end of 2013 ... I believe Ulster Bank had write-backs of about €1.5 billion in 2014. So, the provisioning has been reduced so the capital may follow in time.

Senator Sean D. Barrett: Page 6 of your presentation ... the one you sent in to us. The Irish Financial Services Regulatory Authority also set a commercial real estate cap at 250% of the capital base. In July 2007 the financial regulator agreed to a cap of 500%. Could you give us the background to ... was that your request ... to raise it to 500%?

Mr. Cormac McCarthy: Certainly, Senator, and the papers that have been presented show a narrative on this. The cap was 250% from the early 2000s and it became clear to us that there were challenges around that limit in a number of institutions, so there was a sense that that was

honoured more in the breach than the observance. We engaged in a conversation with the regulator as to whether that limit could be changed. As Basel II was coming along, and portfolio analysis was increasingly getting more detailed, it would have been possible to change the risk profile to such an extent that you would get a greater allowance above the 250%. So there was an ongoing discussion with the regulator over a number of years and after ... in 2007 the regulator agreed to increase the cap to 500%.

Senator Sean D. Barrett: And did ... just Ulster or did the other banks join you in that episode?

Mr. Cormac McCarthy: I have heard that to be the case, Senator, but during our time in discussions with the regulator, there would be no insight - as one can understand - into what was happening in other institutions.

Senator Sean D. Barrett: Were there concerns about the inflationary aspect of such a large increase?

Mr. Cormac McCarthy: Not to my knowledge, Senator, no. It was believed that it was, particularly with Basel II coming along and the risk weightings that were being applied to greater portfolio analysis ... that the 500% was something that the regulator had been looking at for some time.

Senator Sean D. Barrett: Could I refer to B1 for Ulster Bank, Chairman, on page 6?

Mr. Cormac McCarthy: Sorry, I-----

Senator Sean D. Barrett: It should come up on your screen.

Mr. Cormac McCarthy: Thanks, Senator. Sorry, I was trying to find it in my documents ... I have some notes, so.

Senator Sean D. Barrett: It concerns a-----

Mr. Cormac McCarthy: Sorry, I have nothing yet, Senator. My apologies.

Senator Sean D. Barrett: UBI, page 6 ... it's the board meeting that is held in Carrickmacross, County Monaghan-----

Mr. Cormac McCarthy: I have it, Senator. Thank you.

Senator Sean D. Barrett: "Professor [Niamh] Brennan queried the level of sanctions outside limits, especially with regard to those which breached the loan to value and the debt to service ratio limits.", and she raised those concerns in June 2004. And when we look at later documents ... for ... on this occasion ... to UBI - B2, page 21 ... that three years later the problem that Professor Brennan raised didn't seem to have been addressed. That the loans to value outside policy had gone from 6.5% to 13.6%. And there is also an increase ... it is not a complete series in the DSR outside policy. There are also concerns by the regulator that the Dublin Mortgage Centre was not a very well run operation, to put it mildly. So there's a number of things there, but why did it take so long to respond to Professor Brennan's concerns?

Mr. Cormac McCarthy: Well starting in ... if you'll forgive me, it may take me a few minutes to explain this Senator so if you'll forgive me, feel free to interrupt me.

In 2004, we commenced a process of reporting exceptions to mortgage policy to the board,

so this was the first time that the board members would have seen it so it was new news to them. A typical mortgage, a standard mortgage underwriting has a standard policy and there is typically exceptions allowed to that, so the core portfolio management limits, and we would have allowed exceptions of 10% for loan to value and 10% to debt service ratios. And what we did is in all the cases even though they were, if there was somebody looking to lend outside those particular limits that we had in place, it had to come into the centre. And in doing that we managed these exceptions so in the loan to values, it would not have been unusual for there to be a 10% variation or within a 10% variation. For example, a good chunk of those, as I understand it from my research, were very small changes in loan to value they weren't significant amounts, and on the debt service ratio, for example, if someone, 50% typically of those outside policies would have been for people with incomes of €75,000 and greater, so the greater your income the greater your debt service capacity so we had very clear policies on these but we had portfolio management exceptions that we allowed but they had to be underwritten centrally and then these were reported to the board.

As an aside it's interesting that even with the new rules that the regulator has in place there are exceptions allowed of anywhere between 10% to 20% as I understand it for loans to value and debt service ratios, so that accommodation has continued into the current environment. So what we were doing was, as was entirely appropriate, we were reporting these to the board. And having done the research and having presented to Professor Brennan and the board in 2004, as the minutes indicate she spent time with Mr. McDonnell outside the meeting and satisfied herself on the matter. And those reports would have gone to the board serially subsequent to that over the coming periods and the board minutes don't show until 2007 that there were concerns.

In 2007 as you rightly point out, the board again brought up the issue of outside policy and we agreed that we had exceeded loan-to-value policy in March 2007 in particular, again going back to my 10% limits, following which action was taken to deal with that and the records show that subsequent to that date, the LTVs outside policy and debt service ratios outside policy all declined further. So what we were doing was doing the right thing in reporting these to the board. We were managing within portfolio management limits that exist to this day, and reporting them to the board, there was good debate and discussion at the board and to the best of my knowledge, the minutes reflect this, reflect this subsequently, the board was satisfied with the explanations it received from management.

With that said Senator, I accept that we let our standards slip in many ... in some occasions and I do regret that but we were managing within, you know, tried and tested and understood limits.

Senator Sean D. Barrett: Because the regulator reported in February 2006, there is "no evidence that ... exceptions to policy ... are being reported to the board".

Mr. Cormac McCarthy: With respect Senator, that was erroneous. So they were being reported to the board and the records show that.

Senator Sean D. Barrett: I see. Now could I come to the other regulatory issues, which are in the same volume beyond that one, UBI - B2, page 23. Now the first item on page 23 is a letter from the regulator dated 24 July, pointing out that correspondence of 12 March about regulation hadn't been replied to. Was that normal? What's that, about four and a half months without a reply?

Mr. Cormac McCarthy: Senator it was actually, it was too long and let me explain if you'll

forgive me, if I can explain the circumstances. Firstly our reply crossed, so our reply to that letter which has been submitted to the inquiry was sent out two days before that particular letter, so our letters crossed with the regulators. Yes it took too long, if I could explain why it took too long. Typically, what the regulator did in their inspections was they visited your institution, they did their work independent of discussion, there was limited enough discussion with management. Typically, they would take files away they would look at those files they would return those files, then they would finish their inspection, go back to the Central Bank or their own offices and write their report. It was a matter of continuing frustration that there wasn't on-the-ground discussion with management at the completion of their review. So typically, what would happen is, you'd expect there to be a dialogue that would say, "We found this, can you help us with that?". That didn't happen and typically you got a letter and then we would have to spend quite a bit of time going back over the individual files that the regulator would have pulled to see exactly what the nature of the query was and if the documentation had been in place. And what the reply to the regulator that we issued on, I believe, 22 July, indicates is that in a number of cases we were able to say to the regulator, well actually this document was there or that had been done. So unfortunately, the process was elongated by the fact that there was very limited dialogue at the conclusion of a review and it resorted to paper. I do regret that it took as long as it did to respond but the reality was that we had to do a lot of work after we received the regulator's report to make sure we got a full response in.

Senator Sean D. Barrett: Because the queries raised in their documentation to you from the banking supervision department, March 2008, included their concerns for security of loans, reluctance of large developers to provide an independently-certified net worth statement, group exposures, that UBIL understanding of the wider group is extremely disappointing, wider group liquidity, the bank not at a position to have full understanding of liquidity, the lack of robust credit review and a 15-month gap between inspections, which the regulator wanted to have at least annually, the absence of valuations, no forward-looking cash flow statement, no development cash flow statements, no information for the purpose of potential equity release and the extent which UBIL expected its relationship managers to be aware of the purpose of funds being sought from the bank. That was the banking supervisions department. I mean, it's quite a list. I don't know if it explains how long it took to reply but it would certainly give rise to concerns about the way in which the bank was operating, and in retrospect it's not surprising that financial problems were just around the corner.

Mr. Cormac McCarthy: I'm sorry Senator, if the question is what my response to that is, as I said at the outset, the reply to that letter has been submitted to the inquiry and unfortunately, the nature of the engagement was such that a lot of those matters that arose could have been dealt with at the time of the review. We replied in full to that letter on 22 July. The response to that ... I mean if it serves I'm happy to go through each individual one, but we responded to each individual point that the regulator made and in some, in some occasions the assessment and the comment were wrong. We accepted some of their findings, I mean I said at the outset that we definitely made mistakes but a great deal of what was in that letter from the regulator was responded to and answered and following that, there was no further communication from the regulator so I don't know how best to deal with this, other than to say there is a very full lengthy response to that letter included in the papers we have submitted, which deal with most of those questions.

Senator Sean D. Barrett: Because you can appreciate that this was going on in March to July 2008 and the banking system was pretty soon going to get in all these problems and the regulator did have, did have those concerns. The regulator was also concerned about the low

percentage of your funding raised from deposits and in particular that you were bringing resources in from the Royal Bank of Scotland. Was that ... what was your deposits-to-loans ratio at that stage?

Mr. Cormac McCarthy: I think our loan-to-deposit ratio for the group in Ireland as a whole was of the order of between 150% and 200%. So that would not have been at odds typically with the system at the time, as wholesale funding had increased significantly in the previous five to ten years. But in addition Senator, as the liquidity crisis hit in late 2007, increasingly funding fell into the wholesale environment so that was our ratio at the time and that was not atypical of institutions at the time. And we had limits, RBS had Financial Services Authority in the UK limits imposed on how much they could lend us as well and they were observed at all times.

Senator Sean D. Barrett: Is it possible to regulate the sector in Ireland if banks with connections outside the jurisdiction can finance their lending from that source ... has the regulator control over that?

Mr. Cormac McCarthy: It's a ... I mean, I can't speak for the current environment, I've been out of banking for four years now, Senator. But the regulator, both the Financial Services Authority and the Irish Financial Regulator would've had full visibility of our balance sheet, our funding and would've had a lot of, I suppose, conversations between themselves as regulators. So there would've been a lot of visibility and the regulator would have ... ultimately had sanction on any of those things, such as, for example, the 250% limit that you referred to earlier. So, it's complex, no doubt, and I cannot comment on what the current environment is like, but certainly at the time, despite the complexity, it was manageable. I mean, it would have appeared to me at the time that the regulator was comfortable with the fact that, you know, an institution such as Ulster Bank had significant external parentage and support. It led a lot of comfort to the capital strength and liquidity of the local institution.

Senator Sean D. Barrett: But was it an ingredient of a property bubble, that was happening at the time?

Mr. Cormac McCarthy: I don't believe so, Senator.

Senator Sean D. Barrett: Thank you. On 29 September, were you aware of the momentous events that were taking place in Dublin on that day?

Mr. Cormac McCarthy: I wasn't, Senator. As I said in my opening statement today, I'd had a number of conversations with the regulator in the previous two weeks, since Lehman's collapsed, because stresses were apparent, just to reassure the regulator that we were sound as we could be and asking the regulator for any insight into what may be happening. But I was unaware on the 29th of what was happening.

Senator Sean D. Barrett: And did you form a view afterwards of the guarantee?

Mr. Cormac McCarthy: I wasn't there, Senator, so it would be wrong of me to give an opinion. I didn't have all the facts, I wasn't in the room. All I can comment on was the impact it had on Ulster Bank and I've done that in my statement. It would be wrong of me to make any further comment on the guarantee itself.

Senator Sean D. Barrett: Should any bank be allowed to fail?

Mr. Cormac McCarthy: Well, that's moral hazard and I think there's been enough papers written on that over time to give more opinion than mine, Senator. I think all I can say is that there is no doubt that the collapse of Lehman's and allowing Lehman's to fail had very significant consequences. As to what the right answer to that one is, it's a good question. I think that ... I think a lot has been done by regulators and governments since the crisis to shore up the system and to make sure that banks are either right-sized or insulated with capital and liquidity to make sure it doesn't happen. But it's ... I mean, it would not be ... it's a very, very difficult question for me to answer, Senator.

Senator Sean D. Barrett: Was there sufficient value from auditors to bankers in Ireland during that period?

Mr. Cormac McCarthy: Well ... all of our audit opinions were clean audit opinions and they were ... you know, our accounting policies in Ulster Bank, which is the only ones I can speak for, were the accounting policies of the larger group, Royal Bank of Scotland, and our audit opinions and our accounts have been submitted to the inquiry. There has been some debate as to the appropriateness of provisioning policy through IAS 39 but it was what it was, so in the circumstances and with the policies that were in place at the time, you know, all I can say is our audit opinions were clean. And circumstances, you know, changed after the event.

Senator Sean D. Barrett: And was that true of the internal audits also?

Mr. Cormac McCarthy: Again, internal audit in Ulster Bank was a pretty strong function and did a lot of work that was governed by RBS group internal audit. We had a very strong audit committee that was independently chaired. Again, the papers have been submitted to the inquiry. It acted independently and behaved independently, including separate reporting to Royal Bank of Scotland, so we had a very strong functioning internal audit function as well.

Senator Sean D. Barrett: The internal audit report of December 2006 found lax controls under the disbursement of mortgages, inadequate and ineffective control of documentation required to obtain legal title over mortgage properties and no clearly defined process or controls for the handling of non-performing debt. Was there a response to that?

Mr. Cormac McCarthy: Yes there was. That report was brought to the board and the audit committee. Just to explain, we had converted our systems earlier that year from Ulster Bank's old systems to Royal Bank of Scotland systems and it's a matter of record there were challenges after that in the mortgage area. So there was a significant amount of oversight and insight into that particular challenge and a lot of work was done, so that by the following year ... there's an internal audit report of December 2007 that indicates that all of the issues that were brought up in the 2006 report had been dealt with. So yes, there were issues. Yes, I spent, personally, a huge amount of management time appropriately, making sure that these were addressed and within 12 months or shorter, these matters had been fully addressed as the audit paper of that time shows and the subsequent meeting of the audit committee covered. I think that was a early 2008 audit committee of the group.

Senator Sean D. Barrett: Could you describe for us, then, and those at home, the outcomes of the round table discussions held with the Central Bank in relation to the financial stability reports from 2004 onwards?

Mr. Cormac McCarthy: Sorry, Senator, would you mind referring me to the appropriate document?

Senator Sean D. Barrett: Now, it's on page 15 of ... it is ... so maybe I should make the question general, in the absence of putting my hand on the document, Mr. McCarthy.

Chairman: We can come up with the supplementary later on.

Senator Sean D. Barrett: Yes. Right. Thank you, Chairman.

Mr. Cormac McCarthy: I'm happy to take a general question, Chairman, if-----

Senator Sean D. Barrett: Yes. The financial stability meetings from 2004 on ... if you could tell us your participation and what generally went on and what were the conclusions. Thank you very much.

Mr. Cormac McCarthy: They weren't, in particular, financial stability meetings, Senator. I mean, our engagement with the regulator was typically periodic and you know, it was more situational or thematic. So there would not have been a regular dialogue that I can recall around that particular matter with the regulator. There would've been regular meetings, I would've met the Governor, I would've met the chief executive of the regulator, at least on an annual basis and we would've had broad general discussions about banking matters generally, but, unless you can draw my attention to this specific paper, I'm not sure I recall what you're talking about.

Senator Sean D. Barrett: Okay, thank you. You referred to, in your presentation, when First Active was acquired by the group, that some 700 jobs were lost. You also referred to the Ulster integration project which was to transfer functions into the Royal Bank of Scotland. Was there much job losses on that occasion also?

Mr. Cormac McCarthy: I'm not sure about the 700 job losses, Senator. I don't recall that. We ... definitely after the crisis, we put in place a plan to resize the business for the new reality and there were significant job losses unfortunately as a result of that. But during the integration of First Active and Ulster Bank, over that period of time, the employment numbers in the Ulster Bank actually grew.

Senator Sean D. Barrett: Was there much transfer of functions from local branch managers to the centre?

Mr. Cormac McCarthy: There wasn't ... there wasn't anything particularly new. I mean, there was a theme in banking generally, of automation. Credit authorities generally, were vested in centre-independent credit. That would've been the case in Ulster Bank and that stayed the same. Other than a general drive towards automation and centralisation of processing which was thematic in the industry, there was nothing particular done. In fact, in my time in First Active and in my time in Ulster Bank, I always believed in the importance of the local branch and the local service and the community side of that. So, thematically, we were keen to make sure that local service was delivered locally and as best done locally, but there would've been, as a matter of course with greater systems automation, there would've been increasing centralisation, yes.

Senator Sean D. Barrett: Because some people might say that when that was the system that banks were solvent and that the managerial reorganisation, integrations and transfers of functions, lost the connection between the manager and what risks were worthwhile in the local community and which ones were not.

Mr. Cormac McCarthy: It's ... I've heard that comment before. All I can say is, in the case

of our own institution, nothing changed. When I took over as chief executive of the group in January 2004, the credit authorities remained the same as they had been beforehand, so there was no ... there was, as you've referred to in the exceptions reporting, there was appropriate hierarchies of people who were looking for, you know, to override a policy. But there was no change in the local authority or local, in fact we believed fundamentally that the connection between our branch manager or our business centre manager was a very important one. In my time in the bank, we actually opened more branches and we opened more business centres across the country to that effect.

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

Chairman: If I can just deal with two matters here before we bring in Senator O'Keeffe, Mr. McCarthy. One is just to clarify something you were saying about the round table meetings that was facilitated by the regulator from 2004 onwards. Were you saying that Ulster Bank were not part of their process, or you were not part of that process?

Mr. Cormac McCarthy: I ... my memory may serve me, but I don't recall any particular ... if you're referring to a meeting that took place with the chiefs of all the banks, that we were not included in any meeting like that that I can recall, no. Our engagement with the regulator was very much institutional and one-to-one, Chairman, if that's the question you're asking.

Chairman: Okay. And I've just one other matter if I could deal with this as well, it's just, it's in regard to the property related lending strategies of the bank, and bring your attention to core document UBI - B2, page 13. And as you can this, this is-----

Mr. Cormac McCarthy: Yes, Chairman, I see that, yes.

Chairman: It's an Ulster Bank presentation.

Mr. Cormac McCarthy: Yes.

Chairman: And it's, it ... a presentation of what I can gather, is a strategy document, Our Goals and Customer Strategies. These are where Ulster Bank sees itself going into the future. They ... it would appear, as outlined in this - I think this was presented to the board on 27 April 2007, and the question I'll be putting to you it was to become ... the target for Ulster Bank was to become the No. 1 new mortgage lending by tripling current account volumes, and secondly to double your share of corporate lending in the Republic of Ireland from 15% to 30%. I may be asking your views on the ambition of that in a moment. But in deciding the strategy, did you have any concerns that this could potentially lead to a degradation in credit quality in the drive to gain market share?

Mr. Cormac McCarthy: It's a good question, Chairman. Just to explain the background to this: in 2006 we had come through a significant integration programme with Royal Bank of Scotland, and as had been the case when I took over as chief executive of Ulster Bank, our ambition was to take on AIB and Bank of Ireland, so being No. 1 in the island of Ireland was the stated ambition. What this programme tried to do was rally the flag and get, you know, the organisation united round a unified ambition to be the No. 1 bank. And what these numbers were purporting was to say that if you were the No. 1 financial institution in the country this is what the numbers would look like. So none of the shares that are up there, or indeed the numbers if looked at, the market leading position in the market at the time would've been different. So, we were not seeking in any way to be bigger than the existing leader in the marketplace. And so what these set out was what that ambition in five years, if we were to achieve the ambition

of becoming No. 1, that's what it would look like. Governing all of this is risk. So as a table stake in our business, as I explained the structure at the outset of how things worked is none of this would have done without the appropriate reference and paying the appropriate attention to the risk parameters and the risk structures in the institution.

Chairman: Is there an implied statement, or not, in the strategy document that this is grow the bank as fast as you can?

Mr. Cormac McCarthy: No, Chairman. I mean, you know, it would ... everything we would have done would have been done-----

Chairman: Okay.

Mr. Cormac McCarthy: -----within a very strict and rigorous framework that was joined into the parent. So even if, even if I had wanted to go and grow to your - to use your language, the way you described it - I would not have been permitted to do it because I would have had to be able to fund the institution appropriately; I would have had to make sure that my lending was done appropriately; that my customer acquisition was done appropriately. So, all this tried to do was say if we were No. 1 these ... this is what the numbers would look like.

Chairman: Now, in your own testimony earlier you said up to 2004 onwards, and mortgages issued after that were going to be, most likely, in negative equity. Now I'm assuming what you're talking about is first time buyers coming in, not people who are taking equity from previous properties, in the main?

Mr. Cormac McCarthy: Correct. Well, the first-time buyer market, Chairman, was typically 25% to 30% of the market, and the majority of the market was refinancing, people upgrading, but-----

Chairman: And was this targeted towards the first-time buyers market?

Mr. Cormac McCarthy: This would have been the overall market, so this would have been the total market.

Chairman: Okay. Now we do know that Ulster Bank were giving 100% mortgages loan-to-value ratios of 100%. You had the tracker mortgage, as well, which was a part of your product mix, and your mortgage schedule, the traditional mortgage schedule would have been in and around 20 years. What was your mortgage schedule around this time? What would it have gone out to?

Mr. Cormac McCarthy: Well, typically it never varied much because the majority ... I mean in typically in loan to value, the majority written would have been around the 70%. So, typically you could get a mortgage at that time with anything of terms up to 40 years.

Chairman: Up to 40 years? Okay.

Mr. Cormac McCarthy: That was, that was generally available in the marketplace, Chairman.

Chairman: But the traditional prudential practice for banks that had been in existence for decades, if not centuries, was in around 20 years. Would I be right in saying that?

Mr. Cormac McCarthy: On average it would have been around that amount, but-----

Chairman: Okay.

Mr. Cormac McCarthy: And typically the portfolio would have had that, so in a balanced portfolio you would have had an average life. In fact, the average life would have been a lot less than that, because typically in mortgages you get early repayments of capital. So actually, the life is a lot less than that. But the typical term, on average, would have been of the order of 20% to 25%.

Chairman: And we had lending ratios back in the day as well, where it would have been maybe two and a half to three times the principal earner's and one time the secondary earner of the household. Did that rate increase or did it multiply by any factor in Ulster Bank during that period?

Mr. Cormac McCarthy: It changed, Chairman.

Chairman: To what amount?

Mr. Cormac McCarthy: So typically in the 1980s and 90s it was two times gross income or, two times the principal earner and one times the secondary earner. What that didn't take account of particularly was the improvement in personal take-home pays as tax rates fell. So the industry as a whole switched to a debt service ratio, which was a net disposal income.

Chairman: Yes.

Mr. Cormac McCarthy: So people stopped doing the two times gross income because it couldn't take account of the take-home pay, and switched to a net disposable income, and that typically fell in around the 40% to 45% level. And if you look at the typical mortgage portfolio that was written in Ireland say between the mid-90s and say, 2008-09, that typically would have been around the 45% level. So 45% of net disposal income was the typical, typical stress test or hurdle for repayment.

Chairman: But at the time the affordability rate of entry into the market for first-time buyers required Government intervention through the affordable housing programmes, and in parts of the country we were seeing subsidised entry at in and around €250,000 in urban areas, probably more in Dublin. So, at this time we had a mixture of 100% LTVs, tracker rates, mortgage schedules going from 20 years out to 40 years, as you said this morning, and lending ratios increasing severalfold, and we had to have State intervention to get people into the market because of earnings levels at the national industrial rate. Did anybody in Ulster Bank say that there's a problem here?

Mr. Cormac McCarthy: Chairman, at the time all of the indicators were positive. So, you know, in hindsight, as I've said, we've made mistakes, I acknowledge that. We definitely got it wrong, but at the time all of the economic indicators were positive. House formation was increasing, there was considered to be a deficit in house formation in Ireland. There was net migration, economic growth was strong, employment was full. The general sense of, you know, house production for the foreseeable future was strong, and we did stress test those as has been indicated. But, you know, we clearly got it wrong, Chairman.

Chairman: But there was nobody in Ulster Bank at the time ... we know ... you said you got it wrong, but at the time was there anybody in Ulster Bank saying that this could be wrong? And if there wasn't, why was that concern not being expressed? That's not with the benefit of hindsight, but just anybody at the time saying that there could be a problem here?

Mr. Cormac McCarthy: There wasn't Chairman. I wish I could say that, you know, there was. I wish I could go back and change things, but at the time the general consensus view that prevailed, and the view within our own institution was that there'd been a paradigm shift and that there was, you know, very strong growth, you know, for the foreseeable future, both politically ... it wasn't just within, you know, within Ulster Bank. We had our, we had RBS Group economics, who are an independent view, as well. We had third party economics, we had stress testing from the Central Bank, we had stress testing from the ESRI. Unfortunately, Chairman, no.

Chairman: Well, we know from earlier testimony here that some of the stress testing wasn't looking at the property sector at all. We know that from earlier testimony given here. But looking specifically at Ulster Bank, what was absent in your risk assessment that this wasn't showing up?

Mr. Cormac McCarthy: I don't think we gave enough account of the ... we took enough account of the potential for extreme events to happen. We accepted the conventional wisdom that a soft landing was the logical outcome. The view was that Ireland, having come into the euro environment, had a very stable currency now that it hadn't had before. There was an infrastructural and economic deficit in Ireland that was being rebuilt, and low interest rates prevailed. So, that, for want of a better phrase, groupthink, or consensual view, prevailed throughout the period, and any of the stress testing that was done did not take enough account of potential for, let's call it catastrophic events, to occur. That was the mistake was that we didn't challenge ourselves enough as to what the potential outcomes would be if there was a significant, major shock to the system.

Chairman: But I'll bring in Senator O'Keeffe after this, so just the traditional banking model that has sustained banks for over a century in this country and for several centuries, the prudential rules had changed completely. Did it require an external factor outside the Republic of Ireland for Ulster Bank to actually run into difficulty with these products now coming on line?

Mr. Cormac McCarthy: I'm not sure I ... with respect, Chairman, I'm not sure I understand the question-----

Chairman: If a person bought a house in the 1980s, albeit with a different interest rate at the time, they would have had a 20 year schedule, the ratio of their income would have been more measurable to the mortgage they were taking onboard, they would have had to come up with 90% ... or they'd be on an LTV of 90%, they'd have to come for a 10% deposit, there ... there wouldn't have been a tracker rate, that would be subject to all the variables coming down the line, so regardless of any external stimulus that might have been happening outside the Republic of Ireland, given these significant changes away from traditional banking practices, was there or not a danger already in place in the Irish banking sector because of the product and how the product had changed over two decades from the 1980s into the 2000s?

Mr. Cormac McCarthy: Inherently, yes, but the circumstances were we had very low and stable interest rates so that was something we'd not experienced before and we even stressed those interest rates for 2% to 3% so stress tests were performed. In addition we had significantly reduced personal tax rates so take home pay was higher than it had been before. So the economic circumstances had changed dramatically, Chairman, but you are right, you know, we did not take enough account of potential stress, so we let our standards slip.

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

Senator Susan O’Keeffe: Thank you, Chair. Mr. McCarthy, when we go back to the Financial Regulator, forgive me, in 2003, in this ... I’m sorry I don’t know what the reference is, this is this additional document, 2003, the letter that the Financial Regulator wrote to the chair, Mr. Burgess, and basically outlining quite a number of deficiencies at the bank. “Ulster Bank unable to provide details as to the precise level of exceptions outside policy directly from their systems” and so on, “loans in breach”, “insufficient evidence of income on file”, and so on. You’re familiar with this document?

Mr. Cormac McCarthy: I ... I got this document last night, Senator, thank you.

Senator Susan O’Keeffe: I know. Yes. Yes, and you’re familiar with it. So then again in 2004 we have, again to Mr. Burgess, in January, so that’s seven or eight months or so afterwards, again, difficulties arising with ... with the Ulster Bank. So this is quite a long time ago, 2003-2004, and then, of course, we come up to 19 June 2006 - I think my colleague has mentioned this - and again a whole series of events, so I ... I’m really very puzzled that this would have been going ... I do appreciate these things take a long time, there’s lots of paperwork and so on, but it does not appear from the reading of those documents that any substantial progress was made by the bank, the similar problems arising all the time. And people have been very critical in the public domain about the Financial Regulator, in fairness, they have. And here is the Financial Regulator saying to you, “You haven’t done this, you haven’t done that, and you haven’t done the other”, but they’re saying it over a period of three years.

Mr. Cormac McCarthy: Yes, Senator, I can see how that can be interpreted from these documents, so if I might provide some context, again, in the time I had available since last night. I actually did recall this when the letter came in. The regulator wrote to every institution, so the letter you see went to 11 institutions, as did the following letter, both the letter of 31 July and 15 January were general institutional letters. So they went to everybody in the marketplace, not just to Ulster Bank.

Senator Susan O’Keeffe: Yes, but you’re just speaking for Ulster Bank.

Mr. Cormac McCarthy: Yes, I am. But all I’m saying is that the ... just to give some context, this wasn’t just about ... this wasn’t just about Ulster Bank.

Senator Susan O’Keeffe: Yes, I know. I know. We’ve had that testimony before-----

Mr. Cormac McCarthy: I think the second point is, again, the ... and we did ... we did discuss this with the regulator at the time, the methodology that the regulator chose to use was to come and do the review, not discuss the matters that they had found on the review with management, in other words, can you explain this, can you show me this, go away, and then write the letter in. That was a matter of some frustration over time, and so we replied to this letter and many ... I don’t ... in the time available to me I haven’t been able to find a copy of it, but from the board minutes that I’ve been ... managed to get a hold of in Ulster Bank and First Active subsequently, again, I am satisfied that we answered the regulator’s concerns. The regulator asked us to raise things at board, we did that; it asked us to bring policies to board, we did that; it asked us to report exceptions to board, we did that. On the individual file by file cases, we would have gone back to the regulator on each one of those, and, in many cases, as subsequent reviews have shown, we were in a position to be able to answer, and, in some case, correct the regulator’s misapprehension about files, because when you look at mortgage files or loan files,

they can be quite thick and lengthy. They're not one page on a computer document or an A4 sheet, so there can be quite a degree of paperwork involved, and sometimes you need someone to guide you through it. So we took these letters very seriously. Every year the regulator would do thematic reviews. We always brought them to the board, we always replied, we took action where it was appropriate, and the evidence of that is in the regulator's either lack of follow-up or follow-up subsequently, but these particular letters, again, were thematic industry letters, and the points that were made regarding Ulster Bank were addressed and followed up with the regulator.

Senator Susan O'Keeffe: But, just to be clear, was Ulster Bank in breach, as per those letters notwithstanding they were sent to other people? I don't care about them, I care about you. Were you in breach according to those letters?

Mr. Cormac McCarthy: In breach of ... of-----

Senator Susan O'Keeffe: Of what they said?

Mr. Cormac McCarthy: Specifically, Senator, I don't believe in most cases we were. There would have been instances, yes, where they would have found things, certainly, and we would have corrected them, and, indeed, our board minutes would show discussion and correction, but in the main, my recollection is, we were able to respond on most of the points to the regulator, addressing their concerns. And indeed, if the regulator brought something to our attention that we were in breach of, or doing wrong, we would have corrected it. We took our responsibility seriously in that regard.

Senator Susan O'Keeffe: So, as a banking inquiry, we should set these letters aside and not consider them as being relevant to the behaviour of Ulster Bank at that time, is that broadly what you're telling me?

Mr. Cormac McCarthy: I can't, Senator, all I can give you is the context in which they came, so, looking at the letters ... looking at the letters cold, you're correct. All I can say to you is that we responded to every one of these letters, we answered all of these questions. I don't have the responses to hand. What responses I've been able to find to some of the regulatory letters that were presented to me I have given back, and it shows, as do our board minutes, that we ... we took the matter seriously and we responded. Contextually, the point I make about process is it is very challenging if you're in a situation where someone does a review, takes a load of files, and doesn't ask you a question at the time, goes away, writes a letter, and then it comes into you, and it's clear that they have missed something, or not got something right, that's the challenge.

Senator Susan O'Keeffe: Okay, well then you will ... I think my colleague, Senator Barrett, did refer to the Dublin Mortgage Centre and the six significant issues that were mentioned there. That, correct me if I'm wrong, was an internal document created by Ulster Bank itself, not by the regulator, and it was ... discusses very serious elements that are going wrong, so I'm ... am I right in that?

Mr. Cormac McCarthy: That's correct, Senator.

Senator Susan O'Keeffe: Yes, so ... So that's your own guys telling you things are wrong.

Mr. Cormac McCarthy: Correct.

Senator Susan O’Keeffe: So now you’re saying to me that the Financial Regulator’s letters really aren’t wrong but your own guys were wrong, or not, or were they wrong too, or right?

Mr. Cormac McCarthy: I ... I’m sorry, my apologies, Senator, I’m not saying either. I’m simply saying that we took these letters from the regulator seriously. There is context for each of the letters, which doesn’t appear. We replied to all of the issues. The fact that the regulator, in these particular letters, did not follow up with us subsequently indicates to me that they were satisfied with our responses. As regards the Dublin Mortgage Centre we had issues post a conversion of a system which we self assessed and raised. I believe I asked for internal audit to do that review myself, but I may be incorrect in that. And as those issues arose, we subsequently corrected them and fixed them. As issues came to our attention, Senator, we took them seriously and we fixed them.

Senator Susan O’Keeffe: But they ... in fairness, they were very serious issues. You know, non-performing debt, “clearly defined processes or controls for the handling of non-performing debt is not currently in place”, “mortgages are processed to completion without sufficient consideration being given to whether all terms and conditions and documentation requirements have been satisfied”. You were, after all, a bank. It ... these things are quite ... they seem to me to be quite serious breaches of your own, normal kind of business. Or maybe I’m wrong.

Mr. Cormac McCarthy: That’s ... no, Senator, that’s ... as regards the internal audit report, if that’s what you’re reading from, that’s correct, and we absolutely had issues after that. We self ... we self-raised them, the regulator was aware of them, we took significant steps with Royal Bank of Scotland to fix them, and by the end of 2007 they were fixed, in fact they were fixed largely early. So, yes, we had issues, I regret that it happened, but we self-assessed them, we told everybody who needed to be told about them, and we fixed them.

Senator Susan O’Keeffe: You talked earlier on about the 100% mortgages and we heard testimony that Mr. Goggin said he had a visit from the Financial Regulator. This was in his own testimony, page 19, “I had a visit from the Financial Regulator who himself was expressing concern about the development of 100% mortgages in the marketplace”, and Mr. Goggin remarked that it was odd because the Financial Regulator came to visit him and that wasn’t normally the case. That’s why he remembered it very particularly. And I think you’ve said to us ... to my colleague, that you didn’t think that the Financial Regulator had any concerns, so maybe ... you might just clarify for me.

Mr. Cormac McCarthy: The Financial Regulator did not object to us launching the product. We had a dialogue with the Financial Regulator about aspects of the product. They asked us some questions and we replied. I think the ... the thing that Mr. Goggin was referring to was the Financial Regulator did talk to all the financial institutions about introducing higher capital charge for increased loan-to-value products. So, what happened subsequent to the introduction of first ... 100% mortgages and higher LTV mortgages, was the regulator put a higher capital requirement on those loans. And that, I think, I may be mistaken ... I think that’s what Mr. Goggin referred to because the regulator-----

Senator Susan O’Keeffe: Well he says, “I had a visit from the Financial Regulator who himself was expressing concern about the development of 100% mortgages in the marketplace”.

Mr. Cormac McCarthy: I can’t speak for Mr. Goggin, Senator, I’m sorry.

Senator Susan O’Keeffe: No, I’m not asking you to. I’m saying that he’s observing that

the Financial Regulator was concerned. You're saying that that didn't happen for you.

Mr. Cormac McCarthy: I'm saying the regulator did not object to our launch of the product.

Senator Susan O'Keeffe: Do you believe, Mr. McCarthy, as the chief executive officer, that you were satisfied with the level of financial information you received? I'm talking here about the board. Did the board have the capacity, did it have sufficient information to carry out its duty of oversight effectively, do you believe?

Mr. Cormac McCarthy: I believe so, Senator, yes.

Senator Susan O'Keeffe: Okay. You've nothing to add to that, no?

Mr. Cormac McCarthy: We had, you know, there's no doubt we had issues when we converted the systems from Royal Bank of Scotland on to Ulster Bank in 2006 around just classic computer conversion stuff, where we had some information gaps but they were fixed in time and there was never a gap that was systemic or in any way would have put the situation in trouble.

Senator Susan O'Keeffe: Just to clarify, in relation to Professor Brennan having that conversation outside the room, that's Vol. 1, B1, page 6, where she had raised her concerns again and my colleague has raised this with you - it was agreed that Mr. McDonnell would meet with her outside the meeting to address her concerns. Was that something that routinely happened? You know, why would she be asked to leave the room if she had a view that was contrary to the other views?

Mr. Cormac McCarthy: I think the minutes may not serve that well. Typically, what would have happened is in ... if something was lengthy or complicated, it was often better to take it ... for a board member to come in and have a separate long conversation about a matter and we encouraged that, so if a board member had something they wanted to learn more about or understand more about it, it was not unusual and that would have been the chair, so William Burgess, who was the chair at the time, would have decided that. It would be better if the board member had a conversation with the team member of management, excuse me, outside the room and then bring back to the board any subsequent concerns.

Senator Susan O'Keeffe: But not minuted that meeting ... those meetings wouldn't have been-----

Mr. Cormac McCarthy: I don't have sight of the following minutes but if there had been an issue, it would have been recorded in the minutes that the non-executive member of the board had a subsequent issue and it would have been raised and minuted accordingly, as, you know, our minutes were quite detailed.

Senator Susan O'Keeffe: Is that good practice at a board level of a publicly quoted company to have ... sort of ... outside meeting ... I'm asking, I don't know the answer?

Mr. Cormac McCarthy: It's not unusual, you know, in trying to run a meeting to a certain time period, if a matter becomes, you know, either detailed or complex, it's not unusual for there to be an agreement either to have, you know, in some cases either a sub-committee meeting or for a board member who has a particular interest to go and inform themselves about something outside the meeting. That would be quite normal and then it would be normal if that board member had further concerns to come back to the board and say to the chairman "I met with

X, I was either satisfied or not satisfied”. The absence of any minute to the effect would seem to indicate that there would be satisfaction and that has been the case with this particular point having been raised by Professor Brennan.

Senator Susan O’Keeffe: Okay, thank you. On Vol. 1, B2, pages 9 and 10, there was the group risk credit policy and strategy committee minutes of the meeting held on 28 July 2005 and this was a meeting, Mr. McCarthy, to discuss, I think, the whole first ... the whole ... the 100% mortgage introduction and, at the end, there is a decision and it says “JM summed up by confirming that all parties were in agreement to support the product”, the product being the 100% mortgage-----

Mr. Cormac McCarthy: Yes.

Senator Susan O’Keeffe: -----”BL stated that the decision should be recorded as ratified as the product had already been released”. Now I understand from that the product had already been released by First Active and this was now Ulster Bank having a look at the same product, is that correct?

Mr. Cormac McCarthy: That’s correct, Senator, yes.

Senator Susan O’Keeffe: Is it the case the board of Ulster Bank would have been likely, or not the board, the group risk credit policy and strategy committee, would they have been likely to overturn a product that was already on the market with First Active, a company that you owned?

Mr. Cormac McCarthy: It’s unlikely that they would have, Senator, yes.

Senator Susan O’Keeffe: So this was a kind of a ... was this closer to a rubber-stamping than a

Mr. Cormac McCarthy: I don’t think so, the process was different. So the underwriting process in Ulster Bank would have been different and, therefore, it would have been appropriate that the Ulster Bank would have gone through the appropriate process for Ulster Bank, so, no it wouldn’t have been, but given the fact that the product had already gone through an internal new product approval process, it had gone through the RBS risk process, then it would have been ... it would have been reasonable to expect that there that product would have been launched. It was not unusual to launch products across brand but, for good governance, it was important that the Ulster Bank risk committee went through it and if they had concerns or issues, that would have been escalated as well.

Senator Susan O’Keeffe: I mean, given that 100% mortgages were literally handing somebody, you know, *carte blanche* to buy a house, what was going through Ulster Bank’s mind at that time that they thought this could possibly be a good idea, given that you had, I imagine, in the bank quite a number of people, possibly including yourself, who had been bankers for a very long time and had always known that there was a kind of practice there about mortgages that, you know, don’t give 100% because people need to have saved something and so on? What on earth happened at that point that somebody said “Bingo, this is a good idea”?

Mr. Cormac McCarthy: Well, as I’ve explained, Senator, I do regret that we did it, so I accept that we made a mistake. That said, the circumstances at the time were that this product was generally available in the market; it wasn’t publicised. And what we were finding with our customers was that well, No. 1, from a competitive position, we were losing share of the first-

time buyer market because others were doing 100% mortgages. The second thing was we had seen customers who were to try and get the deposit for a house, were extending themselves on personal loans and credit cards, which is not the right way for people to find deposits for houses, and those two combined with the fact that we already had a 100% product in existence for some time for professionals, so typically you know, people who had significant income, more income flows coming, you know, with their businesses, doctors whatever it may be. So we had experience of the product, so it was a combination of those factors led us to believe that it was the right thing to do. In hindsight, it was the wrong thing to do, but those were the motivators at the time.

Senator Susan O’Keeffe: So, basically, you felt under pressure competitively and wanted to keep your market share or increase your market share at that time?

Mr. Cormac McCarthy: There was ... candidly, Senator, there was a degree of that, yes.

Senator Susan O’Keeffe: You were ... you’re members ... I don’t know if ... assuming you still are of IBEC, the Irish Business & Employers’ Confederation?

Mr. Cormac McCarthy: We were at the time, Senator-----

Senator Susan O’Keeffe: You were at the time----

Mr. Cormac McCarthy: I don’t know now.

Senator Susan O’Keeffe: In 2008 and this is the one I have the note for, you paid €194,000 in annual fees to IBEC, of course along with other banks, but again you’re Ulster Bank. What did you get for your €194,000?

Mr. Cormac McCarthy: Well, I can’t attest to the number but if you say that’s the number, I take it as read. It would have been ... I mean there would have been IBEC would have done a lot of work on the industrial relations front, so we had a significant union presence, unionised staff cadre, so IBEC would have been the employer representative in negotiation around national wage agreements, things like that. So it’s very difficult for an individual institution to do those things independently, so that’s a simple case of ... IBEC would have been the employer’s representative in doing negotiations around national wage agreements, etc., and so in engaging with our union, we believed it was helpful to be part of the employers’ confederation so that we could make sure that we had, you know, a seat at the table when national agreements, etc., were being discussed. That’s one simple example. There were other training courses that IBEC did, they did a lot of consulting work as well and so there was a raft of services they provided, but the one that occurs to me most is the industrial relations side.

Senator Susan O’Keeffe: Thank you. In Vol. 1, B2, page 3, it says that, “Additional risk transfers [are] required by [the] end of April”, and a memorandum to the board dated August 2007, also in that book on page 16, notes that risk transfers had amounted to €4.5 billion, exclusive of some “notes which are transacted for Large Exposure risk diversification purposes”. So, I’m wondering if you can explain to us what is happening here, what was going on?

Mr. Cormac McCarthy: Senator, this goes back to 250% limit that’s been discussed and so as part of the capital planning for RBS Group, RBS would maintain minimum capital levels in its various subsidiaries, so it’s not comparable with, say AIB or Bank of Ireland, who had the total capital in the public company and so for capital planning reasons, more of our group capital was held in Ulster Bank Limited, which was a Northern Ireland company, than in Ulster Bank Ireland Limited and the regulator had this 250% limit of own funds which you could lend

into property. So, what we did was, with the agreement of the regulator, we did risk transfers to house some of that exposure and any of that exposure in excess of 250% was held on the balance sheet of Ulster Bank Limited through risk transfers, and again this was approved and agreed with the regulator and so what happened subsequently was that when the regulator agreed to the 500% limited, we then unwound those risk transfers and took them on the balance sheet of Ulster Bank Ireland Limited, the Republic of Ireland bank, and put additional capital in to support that, so it was largely a group ... RBS Group capital planning exercise.

Senator Susan O’Keeffe: Did that mean that Ulster Bank in Ireland, that your regulatory returns were an inaccurate picture of the bank’s true exposure to the property market in the Republic of Ireland, you know?

Mr. Cormac McCarthy: No, Senator, because the risk transfers took that risk onto the Ulster Bank Northern Ireland or Ulster Bank Limited balance sheet and, as I said, the regulator had full visibility and transparency of those transfers.

Senator Susan O’Keeffe: And approved that you could do that?

Mr. Cormac McCarthy: I mean, it was ... it was a non-objection, Senator, which was effectively an approval.

Senator Susan O’Keeffe: On the ... you just spoke briefly about the guarantee, the night of the guarantee, and you said that you learned about it, I think, the next day; is that correct?

Mr. Cormac McCarthy: That’s correct, Senator, yes.

Senator Susan O’Keeffe: So, obviously in the day leading up to the night, there were obviously all kinds of meeting, Anglo Irish, the Central Bank, all kinds of people were on the phone. Bank of Ireland and AIB obviously decided to go in and see the Government because they felt things were really, really running into the wall. How was it that Ulster Bank was just completely not in that loop?

Mr. Cormac McCarthy: I can’t answer that question, Senator. I can speculate: the fact that we were not an indigenous Irish bank was ... you know, that we had a foreign or international shareholder was a factor in that, but, as I said in my opening statement, I rang the regulator after Lehman’s collapsed. I rang the regulator each week before the 30th, just to ... just to reassure the regulator that RBS took its responsibilities seriously and that we were acutely aware of, you know, the stresses that, you know, that may have been there and to also ask the regulator if there was anything that we should know or be aware of, but I got no ... I got no indication back from the regulator to that effect, so essentially, on the night of the ... I learned about the guarantee and all that went with it on the morning of the 30th.

Senator Susan O’Keeffe: Did anyone ask you to buy Anglo Irish?

Mr. Cormac McCarthy: No, Senator. There was some conversation subsequent to the guarantee about institutions merging and doing, you know, transactions. I think there’s been some evidence to the committee about that and there were some conversations held with us as to whether we, as a group, would be interested in participating in consolidation of the Irish banking sector.

Chairman: Final question, Senator.

Senator Susan O’Keeffe: And what about Irish Nationwide?

Mr. Cormac McCarthy: No, Senator.

Senator Susan O’Keeffe: No, okay. So, did you ever make any phone calls to the Department of Finance, or did anybody from the Department of Finance ever contact you, in and around this period of time while you were talking to the Financial Regulator? Was there any conversation?

Mr. Cormac McCarthy: Not prior to the 30th.

Senator Susan O’Keeffe: Not prior?

Mr. Cormac McCarthy: Not prior to the night of 29 September, Senator, no.

Senator Susan O’Keeffe: Okay. When you talked about wanting to be the third force, as a bank, did your company spend much on marketing, or how did you ... was that something that was internal idea or did you externalise it? How did that manifest itself?

Mr. Cormac McCarthy: It was very much an internal ... you know, I mean, when we would produce results, or, you know, our annual results for RBS, we would have kind of reiterated our ambition, but we did no more than advertise our product and our services, as others would have done, so there was no ... there was no kind of branding externally to that effect. It was a generally held ... there was a lot of talk in the market over many years as to the need for a third force. It became kind of the *lingua franca* of the time, so we didn’t go out and post that on posters.

Chairman: Senator, I need to move you towards a final question.

Senator Susan O’Keeffe: Yes. On Vol. 1, B5, page 4, you talk about incentive schemes and you say they “included Commercial [and] Residential real estate loan volumes” and I’m just trying to establish whether or not the incentive schemes were linked to volume.

Mr. Cormac McCarthy: Incentive schemes would have had multiple facets, as I think the papers we submitted would say, so typically we would have incentive schemes that were what were called a balanced score card, so there would have been ... there would have been targets for income, there would have been targets for deposit raising, there would have been targets for staff satisfaction, for customer satisfaction and, typically, one of those, you know, would have been loan growth, so ... but it wasn’t of itself. There would have been multiple. We used quite a number of RBS variable rate and incentive scheme products that they had existing in the UK bank and RBS, so they would have been very, you know, balanced score cards and people would have had targets for multiple things at the start of the year, not just one thing, Senator.

Senator Susan O’Keeffe: No, I appreciate it’s not one thing, but it does specify, “included Commercial/Residential real estate loan volumes” and I’m just trying to-----

Mr. Cormac McCarthy: Yes. Yes, Senator.

Senator Susan O’Keeffe: Yes.

Mr. Cormac McCarthy: That’s correct, yes.

Senator Susan O’Keeffe: Okay, okay. Just coming to the end, on page 4 of your statement, you say: “I was assured by Royal Bank of Scotland that capital and funding support would be made available to support growth. In this regard, capital and liquidity management were not considered to be a critical, local Ulster Bank priority.” Do you think that this may have had, or

did it have, an effect on the behaviour and attitude of Ulster Bank executives in the local market, in other words in the Republic of Ireland?

Mr. Cormac McCarthy: I don't believe so, Senator, because the risk parameters that we were subject to would have defined our capability and our appetite, so the advantage of that was simply the fact that we didn't have to have a full service, you know, treasury. We had a local, smaller treasury. As it transpired over time, as the FSA put in more limits on the amount of inter-company lending RBS could put in place, we actually had to beef up our own treasury so, as time passed, notwithstanding the commitment at the outset, and as the papers will show, we had our own group asset and liability committee, so we were very heavily exercised in our own funding as time passed, but we couldn't have done anything that was outside the risk framework that was put in place for us.

Chairman: Final question, Senator.

Senator Susan O'Keeffe: So you don't think that the combined facilities available to Ulster Bank of risk transfer and funding support mimicked the sort of function of cheap credit following the EMU that you yourself raised in your opening statement?

Mr. Cormac McCarthy: I don't believe so, Senator. There's no doubt that liquidity was readily available in the system.

Senator Susan O'Keeffe: Yes.

Mr. Cormac McCarthy: It wasn't just for Ulster Bank, it was readily available generally and I think that's been witnessed. It was comforting to know that you were part of a bigger group and that you had access to funding, if and when you needed it at points in time, but again within the constraints of an overall risk framework that you had to manage too.

Senator Susan O'Keeffe: But comforting, rather than that it gave rise to risk?

Chairman: This is your last question now, Senator.

Senator Susan O'Keeffe: To make people more reckless? Yes, I'm just clarifying.

Mr. Cormac McCarthy: Yes, absolutely, Senator, the two are separate. Treasury and capital management were entirely separate to credit risk.

Chairman: Okay, thank you. Senator Marc MacSharry.

Senator Marc MacSharry: Thanks, and thanks, Mr. McCarthy, for coming in and being here. You said there were three legal entities here in Ireland and each with a board of directors; isn't that correct?

Mr. Cormac McCarthy: That's correct, Senator, yes.

Senator Marc MacSharry: Okay. There are 27 registered companies for Ulster Bank between Dublin and Belfast. Why would that be necessary?

Mr. Cormac McCarthy: It's not unusual in large groups and in banking groups to have multiple subsidiaries, so, without wishing to over-complicate it, so, for example, in Ulster Bank we would have had Lombard & Ulster, which would have been the leasing business, that was actually part ... that was one subsidiary. There would have been other subsidiaries put up for a whole variety of reasons and there would be legacy subsidiaries. In fact, one of the things we

did after the Ulster Bank and First Active merger was the group had a programme put in place to reduce the number of subsidiaries because once you set up a subsidiary, it's actually very hard to close it down, or deal with it. You end up with trapped capital and dividend issues, so it's not unusual in large groups, and not even ... not just in banking groups, for there to be multiple companies in a group. A lot of those companies would have been dormant.

Senator Marc MacSharry: Were you responsible for all of these 27?

Mr. Cormac McCarthy: I wouldn't have been on the board of all of those 27. I would have been on the board of a number of them, but we would have had a variety. So, we had a treasury business in the IFSC, we'd an IFSC company, so that would have been part of the group as well and there would have been board members on that so, you know, ultimately, as a director and chief executive of the holding company, I would have had responsibility as chief executive for the group as a whole.

Senator Marc MacSharry: And would these 27 all have been in the group?

Mr. Cormac McCarthy: To the best of my ... to the best of my knowledge, Senator, some of them may ... I don't have the chart in front of me, but some of them may have been RBS subsidiaries, so RBS may have had ... would have had IFSC businesses, international businesses, that would have been outside the Ulster Bank Group and may have been in the RBS chain. I wouldn't have any involvement in those. But any of them that were subsidiaries of Ulster Bank, in logic, as the top company chief executive, I would have had responsibility for them, but a good chunk of them, Senator, would have been dormant companies.

Senator Marc MacSharry: And whether they were registered in Belfast or Dublin, would that have-----

Mr. Cormac McCarthy: Obviously, in terms of regulation and legal entities. I mean the companies law is different in Northern Ireland and in the Republic of Ireland, so there are different obligations for companies registered in Northern Ireland and registered in the Republic of Ireland, so, therefore, one would have had to pay attention to those obligations and, indeed, the regulatory obligations that went with the different jurisdictions.

Senator Marc MacSharry: They would be different, would they, the regulatory-----

Mr. Cormac McCarthy: Yes, they would. The Financial Services Authority, Senator, was the governing regulator for Ulster Bank Limited, which was a Northern Irish company. The Irish Financial Services Regulatory Authority was the governing regulator for First Active plc and Ulster Bank Ireland Limited, which were the Republic of Ireland banks.

Senator Marc MacSharry: Was entities on either side of the Border ever used to distribute concentration, to keep a lower level of, say, construction or-----

Mr. Cormac McCarthy: As I said in response to the Senator's question, there was ... the regulator in the Republic of Ireland had a 250% own funds limit, so we didn't want to breach that and, therefore, what we did was rather than inject capital into the Ulster Bank Republic of Ireland business, which was expensive for the RBS group, we used the capital base in Northern Ireland to transfer the risk in there and again, as I said, that was all done with the knowledge and agreement, for want of a better phrase, or non-objection of the regulator. So, the regulator was aware of what we were doing.

Senator Marc MacSharry: So is it fair to say then that the regulator endorsed, or not, that you would split the business, if you like, between one regulatory system and another in order to stay compliant?

Mr. Cormac McCarthy: That's one way of looking at it. Let me put it a slightly different way: if the regulator had insisted that we do something else then we would have injected the capital into Ulster Bank Ireland Limited to deal with that. So if the regulator had come to us and said, "We don't want you to do this," and could support that argument ... "We want you to actually hold the capital in Ulster Bank Ireland Limited," then the capital would have been provided, as it was in 2007 when the regulator increased the limit and we supported the transfer with capital.

Senator Marc MacSharry: While I know you left in 2011, up to that date was there any difficulty, because of the number of entities, in retrieving assets?

Mr. Cormac McCarthy: Not ... to the best of my knowledge, Senator, no.

Senator Marc MacSharry: Not at that stage?

Mr. Cormac McCarthy: No, I don't believe that was ... most ... again, a lot of the companies that you refer to would have been dormant companies or what are known as special purpose vehicles, and most of the, kind of ... most of the lending and the banking would have been done in either of those three legal entities you mentioned. So to the best of my knowledge, certainly by the time I left, there was not an issue with multiplicity of companies causing security or collection issues. And I'm not aware that there was any subsequently, although I may be wrong. I very much doubt it.

Senator Marc MacSharry: Okay. In terms of targets within the company, you had mentioned - and Senator O'Keeffe had touched on it there - where there was, you know, a series of ... your colleagues from other banks had been in and there seems to have been a theme throughout that there were never any targets, that people just went to work and they did their job and loan book and credit card book and so on grew. So in your time as CEO, did ... how did you drive the sales business if there were no direct targets on tellers or foot soldiers, for want of a better expression, in branches?

Mr. Cormac McCarthy: Well it's not fair ... it's not true to say that there weren't targets.

Senator Marc MacSharry: Okay.

Mr. Cormac McCarthy: There were multiple targets. There wasn't ... if anyone thinks there was, you know, one loan target and that's it - go and get it - that wasn't the truth. To my point about the incentive schemes, we had balance scorecards. So, typically, a branch would have a target for current accounts, for deposits, for non-interest income, for credit cards.

Senator Marc MacSharry: For the full sale-----

Mr. Cormac McCarthy: For the full suite of products.

Senator Marc MacSharry: The full suite of products.

Mr. Cormac McCarthy: Correct.

Senator Marc MacSharry: And then would staff then have cross-selling targets? So, I'm

an employee in the branch in town A, and my boss is saying, “Now, your job today is to go out and sell two credit cards and four current accounts and two mortgages”; does that-----

Mr. Cormac McCarthy: Cross-selling, Senator, was the norm in the industry, and there would be have been-----

Senator Marc MacSharry: And would there be remuneration linked to that?

Mr. Cormac McCarthy: Well, typically what there was was either ... there was either a branch incentive scheme or individual incentive schemes. And to that point those schemes would have dealt with any particular targets. But, again, everything would have been done within a risk framework that had to be observed.

Senator Marc MacSharry: Would the manager have a bonus structure that was linked to meeting these targets?

Mr. Cormac McCarthy: Typically, managers would have bonus capability, again ... excuse me ... depending on the achievement of multiple things in the balance scorecard, which would include deposit raising, it would include, to your point, cross-selling, it would include new current accounts, it would include customer satisfaction, which we measured on a regular basis. So there was a series of these things that the branch manager would have had a bonus or incentive scheme based on.

Senator Marc MacSharry: Okay. In your opinion how much was Ulster Bank Ireland Limited’s strategy driven by the activities of competitors rather than assessing fully the quality and impact of the strategic decisions made? So, in your opinion, was the bank’s business strategy over-reliant on property and construction loans?

Mr. Cormac McCarthy: In hindsight, Senator, yes.

Senator Marc MacSharry: Okay.

Mr. Cormac McCarthy: We ... you know, we were over-exposed, as were many others, to the property sector.

Senator Marc MacSharry: Around the time of the guarantee, and indeed preceding that, Mr. Goggin, from another bank, gave testimony that he had had a meeting with the Governor of the Central Bank, who had asked his opinion of a guarantee that was being canvassed by other banks. Do you have any knowledge, either within your own personal domain within Ulster Bank or, indeed, the industry generally, that this was the case in June or early summer 2008?

Mr. Cormac McCarthy: No, Senator, not at all.

Senator Marc MacSharry: Did you ever speak to Brian Lenihan?

Mr. Cormac McCarthy: I did, Senator, yes.

Senator Marc MacSharry: In the context of the guarantee or any of these matters?

Mr. Cormac McCarthy: Yes. The Minister was, as it happened, on the day of the guarantee, he had a ... we were launching a ... it was a customer event in Ulster Bank in George’s Quay, and Minister Lenihan was due to come to launch that, and he turned up, which was somewhat surprising, given the events of the evening before. And I did have a conversation with him before that event started about the guarantee and the impact on Ulster Bank, and, you know, he

listened, as he did, and, you know, he heard what I had to say. So that was the ... that was the first time I'd actually met him, and-----

Senator Marc MacSharry: Did he say anything?

Mr. Cormac McCarthy: He listened to what I had to say, and-----

Senator Marc MacSharry: What did you have to say?

Mr. Cormac McCarthy: I explained to him what the impact was on Ulster Bank, that, you know, we were systemic in ... we believed ourselves to be systemic in that we had branches and business relationships across the country, and that already we had seen the impact of this, even though it was early in the day, of deposits leaving us to go to the competition. So the message I was giving was that this was having a significant impact on us and, by implication, it would have an impact on our customers.

Senator Marc MacSharry: So at what point after that then were you offered participation in the guarantee?

Mr. Cormac McCarthy: We spoke to the Minister and his staff in the Department of Finance a number of times over the coming month. You may recall on 13 October, as it happened, Royal Bank of Scotland, along with other banks in the United Kingdom, were bailed out by the UK Government, so our immediate stress was resolved by that. But we still were experiencing, you know, challenges around deposit ... about deposit losses, so we worked with the Department of Finance over a period of months to try to see if we could avail of the benefit of the guarantee. And, sometime in October we got to a point where the requirements that the guarantee would have had for the group, not just Ulster Bank, RBS as a whole, would have meant it was impossible for us to join the guarantee. So we declined the opportunity.

Senator Marc MacSharry: Without the intervention of the Bank of England, would Ulster Bank have required the support of the guarantee here, or not?

Mr. Cormac McCarthy: I think, ultimately, Ulster Bank's fate in that regard was tied up with RBS's fate, and circumstances prevailed with the UK Government to offer assistance in liquidity terms to Ulster Bank, so the question didn't arise, Senator.

Senator Marc MacSharry: Were you aware ... this is my last question and thank you for your forbearance, Chair ... were you aware of the position of Anglo or Irish Nationwide in advance of 29 September?

Mr. Cormac McCarthy: I wasn't, Senator. But, you know, I once ... there had been liquidity stresses in the system, but when Lehman's collapsed it clearly was exacerbating. Hence my calls to the regulator to try and assess if there was ... you know, if there were matters afoot or if there was something I needed to know, etc., and to reassure the regulator that Ulster Bank was conscious of its obligations. But I was unaware of those two institutions' situations.

Senator Marc MacSharry: Okay, thanks.

Chairman: Okay, thank you very much. With that said, I now propose that we break until 4.25 p.m. The witness is reminded that once he begins giving evidence, he should not confer with any person other than his legal team in relation to his evidence on matters that have been discussed before this committee. With that in mind, I now suspend the meeting until 4.25 p.m. and remind the witness that he is still under oath until we resume. Is that agreed? Agreed.

Sitting suspended at 4.10 p.m. and resumed at 4.30 p.m.

Chairman: I'm now proposing that we go back into public session to continue with our engagement with Mr. Cormac McCarthy from Ulster Bank, this afternoon. Is that agreed? Agreed. And, in doing so, if I can invite Senator Michael McD'Arcy please. Michael ... Senator D'Arcy. We're more informal in the afternoon, I'm afraid. Senator D'Arcy, you have ten minutes.

Senator Michael D'Arcy: First time I've ever been called "McD'Arcy". Thank you, Chairman, Mr. McCarthy. Thank you for coming in. In terms of the Government guarantee ... and you're out of banking now for a number of years and you've the benefit of hindsight and the benefit of where we've come from to where we are today, Mr. McCarthy. Do you think the bank guarantee was a good idea?

Mr. Cormac McCarthy: Again, Senator, I've ... I wasn't there. I wasn't party to the conversations-----

Senator Michael D'Arcy: No, but you ... you were a national banker and you would have-----

Mr. Cormac McCarthy: I didn't have ... I can ... I have explained the impact it had on the institution that I ran. I suppose, the best I can say is that in the circumstances, I can understand why a decision like that would have been made, but I say that without the benefit of all knowledge of what happened that evening. So, therefore, you know, the value of my opinion must be questionable, but, you know, it had a significant impact on Ulster Bank, and that was my focus and my concentration, but my lack of insight into the circumstances, as I've explained, leading up to that point and what happened on that evening, leave me compromised in my ability to give an answer to that that would be meaningful, I think.

Senator Michael D'Arcy: Okay and, I suppose, the same question in relation to NAMA, the establishment of NAMA?

Mr. Cormac McCarthy: Again, Ulster Bank was not involved in the set up of NAMA. It didn't participate in the stress test. It didn't participate in NAMA. It had a significant impact on Ulster Bank, given that it was the mark in the market. So, in a market that wasn't moving at all, it was the only valuation methodology available, so it had an impact. Again, in the circumstances, I have some understanding of why one would do what was done but, again, I was not party to the discussions or the debate. We did have some conversations with NAMA about ... in the early days, about participation or, given that NAMA was the only vehicle that was acquiring assets at the time, as to whether we could participate, but it was ultimately for the guaranteed banks and not for us.

Senator Michael D'Arcy: In terms of the numbers from the national Exchequer from the British Government for RBS, £46 billion was provided for RBS. Ulster Bank, the figure I had was €14.3 billion, you said €14.9 billion, but it was in that territory.

Ulster Bank's ratio of RBS was, you know, the figures I have '07, 3%, '08, 2%, '09, 3%, '10, 3%. It seems like a very large quantity of the funds that went into RBS found their way into Ulster Bank and yet Ulster Bank was a very small sector of RBS. Could you explain that please?

Mr. Cormac McCarthy: Yes, it's a fair question Senator. The first thing to say is that the funds that were injected into RBS had no ... Ulster Bank was not part of that decision,

so when the British Government injected its capital into RBS in the first half of 2008, Ulster Bank was not a factor in that decision. So the Ulster Bank losses that occurred subsequently were supported by the ongoing business of Royal Bank of Scotland. There is no doubt that it was a significant cheque. There is no doubt it was a significant amount, but it is not, so I don't understate that at all. But it is difficult to make comparators with the Irish banks, for example, simply because Ulster Bank had no international business, it had no share capital in terms of third-party shareholders. It did not participate in NAMA, so it's...it's only time will tell what the ultimate cheque from RBS will have been. As I said in my statement ... as I said earlier on, in terms of provisions, which is what drove the capital, Ulster Bank wrote back €1.5 billion of provisions in the year end-2014. And I expect more will be written back, so the ultimate cost to Royal Bank of Scotland of the Ulster Bank support will only be known in time. But it is not an insignificant sum, Senator.

Senator Michael D'Arcy: One third of the overall moneys from the national Exchequer of the UK that went into RBS found their way into Ulster Bank.

Mr. Cormac McCarthy: Well, the money that went into RBS in 2008, went in to support the challenges RBS had in its global banking business. Ulster Bank in 2008, its results and its performance in 2009 were not part of that decision, so in making the decision to invest in RBS at the time, the Ulster Bank situation was not germane at the time. Subsequently RBS injected money as it traded through the following years into... into Ulster Bank.

Senator Michael D'Arcy: Okay, and can I read a quotation to you please, "For all those who say investment banking is this evil thing, as a terrible activity which lost all the money, the most money that RBS lost, the least wise decisions, were property lending in the UK and Ireland, of which Ireland was worst of all." That came from Mr. Stephen Hester, RBS boss. Do you think that is fair?

Chairman: When was that said?

Senator Michael D'Arcy: February 2012.

Mr. Cormac McCarthy: I don't ... I have no.... I don't recall or have seen that statement. I mean I reported to Stephen Hester for a while before I left the bank. I make no ... at the end of the day, Royal Bank of Scotland lost a lot of money through Ulster Bank and the losses in Ulster Bank were significant. But we were subjected to a situation where we had no.... we had no fall-back on the Irish Government. We had no access or insight into NAMA. We had to make provisions on a worst-case basis, only time will tell what the outcome was. But I have said already that I acknowledge that we made bad decisions and we made mistakes but I would, I would suggest that notwithstanding the significance of the numbers, comparability is very difficult still and it will take time before the ultimate cost. But ultimately, Ulster Bank had no international businesses to sell, it had no independent share capital to fall back on as other banks did. So only time will tell, I believe Senator.

Senator Michael D'Arcy: Can I ask, Mr. McCarthy, the 100% loan to value of mortgages, they were available from First Active prior to Ulster Bank making them available?

Mr. Cormac McCarthy: That is correct Senator, yes.

Senator Michael D'Arcy: Was there an international dimension or did you take the provision of 100% mortgages from another jurisdiction? When did the idea come up initially? I'm not talking about the First Active, was that on your watch in First Active or was it before that?

Mr. Cormac McCarthy: There had been a practice generally in the market of 100% mortgages for professionals, it wasn't uncommon. It was a small part of the market, but typically people who had... you know, very high incomes and had...you know, clear visibility of income. So it wasn't... it wasn't a unique product, but it wasn't available to first-time buyers. So what we did was, we made it available to first-time buyers, that was the change. And that happened on my watch, Senator yes.

Senator Michael D'Arcy: And did you take it from an international ... or from some other jurisdiction and say this could work here?

Mr. Cormac McCarthy: No it was available in the United Kingdom so we had insight as most mortgage providers in Ireland had, into the UK market so the product was available in the United Kingdom as well but that wasn't the driver. I mean it was, it was our own experience and market circumstances that lead us to offer the product.

Senator Michael D'Arcy: Okay. The terms, the loans that were offered and the terms offered to borrowers which were outside the normal commercial terms that were available from your institution made during your period as CEO. Can you identify why this happened or how it was allowed happen? The exceptions rather than the rule.

Mr. Cormac McCarthy: Exceptions had always been part of the norm and as I said earlier on, there were portfolio management limits. The typical mortgage was arranged around a standard model but every mortgage was individually negotiated so there would have been latitude allowed but that was only at the centre, so typically the tolerances were 10% loan-to-value and 10% debt service ratio. And by and large those were adhered to. I have acknowledged that in some circumstances we did let standards slip but by and large we were satisfied that the exceptions were within portfolio management limit tolerances and that they were justifiable. The experience of the Ulster Bank mortgage portfolio as it has worked through the cycle has been not particularly different to the rest of the market so there's no particular skew that I'm aware of in the Ulster Bank mortgage portfolio versus the rest of the market. So the exceptions were not the norm but exceptions were a factor of the industry for some time beforehand, they didn't arise subsequent to 2004.

Senator Michael D'Arcy: Can I just bring to your attention just a follow on, document UBI, Vol. 2. And it's a report from the Financial Regulator June '06 and attached to the report is page, go to page 13. And the letter that's attached to this shows ... the letter is page 3 but there is an appendix attached on page 13. And I think it's out of 61 files inspected 46 had some form of an exception deficiency and under files descriptions, no valuation, no evidence of cost of renovation being financed, no evidence of remaining terms of leasehold, no evidence of cost of reconstruction work being financed, no evidence of site ownership for a new build. I mean these are ... I'm not allowed make a judgment Chairman ...

Chairman: You are a professional politician.

Senator Michael D'Arcy: But these are surprising. That out of 61, 46 had deficiencies of this nature. Could you explain that to the committee please?

Mr. Cormac McCarthy: Unfortunately Senator I haven't been able to find the reply to this letter. However I'm satisfied it was replied to because I've seen-----

Senator Michael D'Arcy: Can we just forget the reply, explain the appendix there with the likes of "Value of loan repayments included in DSR calculation not clear", "No evidence

to support recalculation of DSR”, income, “No details of income, P60, payslips.” I mean these would suggest that there is an enormous deficiency in the documentation required for a loan.

Mr. Cormac McCarthy: All I can say Senator is I don’t believe that to be the case. As I described earlier the process the regulator had for these reviews was to do their review and do their work and then submit the letter. Typically as I said earlier we would rather they had discussed these with us at the point of the investigation because I believe most of these as has been seen by subsequent reviews, are capable of being answered. So to the best of my knowledge all of these were answered to the regulator’s satisfaction because there is no record that I have of follow up, Ulster Bank can’t locate the answer but unfortunately I don’t have the benefit of the answer to this which would address all of these on the basis of the regulator. As I said earlier on, the *modus operandi* was to come in, take the files and do the work and then leave and write the report. So we would have been able, because mortgage files are quite detailed they can be quite significant.

Senator Michael D’Arcy: Just to finish. You have had sight of this document?

Mr. Cormac McCarthy: I have had sight of this document yes.

Senator Michael D’Arcy: Can I just, No. 37 - “Use of terms ‘nixers’ in branch assessment and the use of income arising from ‘nixers’ in accessing a mortgage application.”

Mr. Cormac McCarthy: Again, Senator, I don’t have the benefit of the answer other than to say that if ... to the best of my knowledge and belief, all of these matters were addressed and answered. If that were not ... and that is recorded in the board minutes ... but if that were not the case then the regulator would have had the right of recourse to come back to us and express its dissatisfaction and escalate it. That did not happen, but, unfortunately, I don’t have the answer to this particular letter. But I think the circumstances of how the work was done and how the letters were written to us are relevant in understanding this.

Chairman: Okay, thank you. Deputy Pearse Doherty. Deputy you have ten minutes.

Deputy Pearse Doherty: Go raibh maith agat, a Chathaoirligh, agus fáilte roimh an t-Uasal McCarthy chuig an coiste fiosrúcháin. Can I begin by just asking you ... just in your opening statement on page 6 you say the Financial Regulator also set real estate caps at 250% of the capital base. You go on to say “In July 2007 the Financial Regulator agreed to a cap of 500%.” Can I ask you, Mr. McCarthy, did the regulator ever confirm to Ulster Bank that it approved ... it had approved or consented to the increase in Ulster Bank’s sector limit of 500%, as opposed to simply not objecting to it?

Mr. Cormac McCarthy: We would... there ... I will find... if I can find the appropriate documentation, Senator, I’ll provide it but we would not have done something like that without regulatory approval. The regulator would have had to approve that.

Deputy Pearse Doherty: So the regulator approved-----

Mr. Cormac McCarthy: Correct.

Deputy Pearse Doherty: From your ... that would have been in the form of a letter, a communiqué, would it?

Mr. Cormac McCarthy: I would think so, Deputy, but we would never have done something like that. There was an ongoing dialogue with the regulator on this topic, so we would not

have been able to do that without regulatory consent.

Deputy Pearse Doherty: Would you be able to furnish ... could you furnish the committee ... is it possible-----

Mr. Cormac McCarthy: If that can be done, I'd be happy to do so.

Deputy Pearse Doherty: Okay. I appreciate that.

In March 2008 ... on 15 March on the RTE "Marian Finucane Show", a developer by the name of Mr. Dunne spoke on the radio show. And the contents of that interview made its way into a *Sunday Tribune* article by Justine McCarthy and I want to just refer to what was referenced there. It talked about Mr. Dunne was at the time in Thailand with his wife and young son in late July 2005, with just seven days to secure financing before signing the purchase contract for Ballsbridge. This is the quote: "I phoned up a very good friend of mine, Richie Boucher. He's now deputy head of Bank of Ireland," Dunne remembered. "And, after about Wednesday, Richie said, 'Seán,' he said, 'if I was trying to borrow the money you're trying to borrow, I wouldn't stay in Thailand. I'd come back to Dublin.' So I thought that was good advice, even though I wanted to stay in Thailand with my wife and son." Dunne goes on to say that he flew back immediately, landing in Dublin on Thursday night and this is the quote: "I went straight from the plane to a meeting. I spoke to Bank of Ireland. I spoke to Irish Nationwide and Paul McDonnell in Ulster Bank," he said ... and then, "That Friday night, at nine o'clock, Ulster Bank walked through the door of my office and ... they produced the letter for the full purchase price. The contract was signed the following Wednesday." Is this typical of how Ulster Bank provided loans in excess of a quarter of a billion euro?

Mr. Cormac McCarthy: Deputy, unfortunately, I can't comment on that particular situation, for both confidentiality and legal reasons. So I have to say I cannot respond to that. Forgive me but-----

Deputy Pearse Doherty: No, that's fair enough and I won't press you on that particular issue. But forgetting ... parking Mr. Dunne's comments on RTE radio to one side, have you known, in your time as head of the bank, a situation where an approval of a loan of in excess of €100 million would be turned over in a number of days.

Mr. Cormac McCarthy: As I ... as we've described in our ... in my submission, and the documentation I submitted to the inquiry, we had a very rigorous credit process, so any loan of such would have had to go to the Royal Bank of Scotland credit committee. We had no capability within Ulster Bank to do that. If that ... so, therefore, there was a process involved, that something like that would have had to go to a local credit committee, and then an RBS credit committee would have had to be convened, and that RBS credit committee would then have to sit, listen to the credit and then give an opinion or delay it. So there was a *modus operandi*.

Deputy Pearse Doherty: And would that all happen before a letter of approval, in principle, would be given to a borrower?

Mr. Cormac McCarthy: Absolutely, absolutely.

Deputy Pearse Doherty: And in your time ... so am I taking from your answer in relation to the procedures they had to go through that you are unaware, during your time as head of the bank, of a loan in excess of €100 million being turned around in a matter of days.

Mr. Cormac McCarthy: I mean, sometimes I wouldn't have been involved in loans of that case. So if, for example, the credit committees were lined up appropriately or due to meet, it's possible that the process could work that way, but the process had to work. My expectation, given as a former chair of RBS credit committees with the difficulty there was in convening those kind of committees, that it would've taken more than a couple of days to get that organised.

Deputy Pearse Doherty: And, again from your experience, as head of the bank, would it be ... are you familiar with situations where bank officials would go after hours to developers' offices or homes to provide them with letters of offers?

Mr. Cormac McCarthy: I'm not particularly familiar with that, Deputy. I can't say that it didn't happen, but I'm not particularly familiar with that as-----

Deputy Pearse Doherty: Do you have any knowledge of it ever happening?

Mr. Cormac McCarthy: To the best of recollection, Deputy, I can't say that I recall it happening. No, it stands out of the ... out of the norm. Normally what would happen is there would be a postal or there would be a meeting or you would go to people's offices. But outside of hours in homes is ... strikes me as being unusual and not normal practice.

Deputy Pearse Doherty: Okay. Can I ask you, in relation to the ... and I'm referring to book of evidence, UBI - B2, page 28, and this is in relation to the inspection of commercial property lending exposures which was carried out by the Financial Regulator between 4 and 14 December 2007 and its General Findings - Medium Priority. The quote is:

The inspector's noted from the minutes of the RBS Group Credit Committee held on [the] 14 May 2007 that in relation to a €90 m[illion] facility being discussed for [blacked out customer's name], "*The relationship team said they did not know exactly what the €70 m[illion] equity release would be used for*", but that they were ... aware that [the blacked out customer's name], had tendered for two significant projects.

Was ... what was the bank's policy in relation to obtaining information on the purpose of a potential equity release?

Mr. Cormac McCarthy: Well, we would've had to have full details. So, in that particular case, because again I have cited the reply to that letter which has been submitted to the inquiry, the facility would've been granted subject to there being a referral of the ultimate drawdown. So it wasn't a case that there was a wallet or envelope available, irrespective of what the credit was. So when the ultimate drawdown would've come to the bank, there would've had to be an appropriate authority and review that that particular amount was relevant and appropriate and would've had to have been approved. So what this was a facility ... a general facility approval, that again, would've had to go through the process subsequently based on the information that would've been provided on the individual date.

Deputy Pearse Doherty: Okay. The same inspector's report quotes minutes of the board meeting on 26 September 2007. It's on page 27 of the same book of evidence and it reads and I quote:

[The] *Chair noted that the bank was not in a position where it had a full understanding of [blacked out customer's name's] liquidity. It was ... strongly emphasised that the bank needed information as to how [the customer] will generate cash and what its wider strategy*

is, as well as gaining further insight into the local strategy in relation to the build up of assets around [the blanked out customer's name and] the bank was now heavily exposed to this group and uncertain at this stage whether c. [€]500 million was the right number to be basing our appetite.

Can I ask you, given those board minutes, what was the problems, if any, with the credit review process in Ulster Bank?

Mr. Cormac McCarthy: I'm sorry, Deputy, I'm just trying to find this on my screen. Can you just remind me of-----

Deputy Pearse Doherty: It's on page 27 and it's the inspector's report about how the bank was heavily exposed and uncertain at this stage whether half a billion euro was the right number to be basing their appetite on.

Mr. Cormac McCarthy: Again, Deputy, I have the advantage of the response in my hand and I'm satisfied that the response back to the inquiry ... to the letter, was to satisfy them, that due process had been observed by the credit committee in this regard. So it had been referred back to credit committee and dealt with on that basis, so the point was responded to in full.

Deputy Pearse Doherty: Yes, but that's fine in terms of that there was a response issue. But this your ... this is your board minutes, Mr. McCarthy, and the board is actually saying that the bank wasn't in a position where it had full understanding of the customer's liquidity, that the bank needed information as to how the customer would generate cash, and this is a customer that belongs to a group that had half a billion euro exposure to your bank.

Mr. Cormac McCarthy: The response that I have, firstly, it's not a board minute; it's a credit committee minute so there is a difference but I don't want to split hairs, but it's a credit committee minute. The response that I have that's been submitted to the inquiry went back and said that full cash flow detail and analysis had been prepared in that particular case. So again, Deputy, this is part of the issue with ... again, if the inspectors from the Central Bank or the regulator had sat down with the team after completing their review and had that conversation, I believe that matter would have been resolved. But it was the nature of the process that meant this came back and then we had to respond. So I'm satisfied that the response dealt with the matter in that the credit committee did get cash flow information, did get full sight, and was deeply familiar with the details of the case.

Deputy Pearse Doherty: At another-----

Chairman: Final question now, Deputy.

Deputy Pearse Doherty: Yes, final question. At another meeting on 14 May 2007 - it's on the same page as the book of evidence, it was noted and I quote "the bank lacked a real understanding of the wider group liquidity, and we were unable to explain the inherent structural risk." And again, this isn't ... this is not the same minute that I referred to earlier on. This is a number of months earlier, your bank failed ... were unable to explain the inherent structural risk and lacked a real understanding of the wider group liquidity.

Mr. Cormac McCarthy: And again, Deputy, with the benefit of the response in front of me, I'm satisfied that we responded in that regard and dealt with the matter. So-----

Deputy Pearse Doherty: Could you satisfy this committee?

Mr. Cormac McCarthy: I'm happy the response has gone in to the committee, so it's part of the papers in the inquiry, so that has gone in.

Deputy Pearse Doherty: But the question isn't ... the question is is how could your committee be recording the fact that Ulster Bank lacked a real understanding of the wider group's liquidity, were unable to explain the inherent structural risk of loans that you issued to customers?

Mr. Cormac McCarthy: That was an independent committee. And I, from what I have seen, the individuals in Ulster Bank went back and satisfied the committee of those matters, so that shows that was good process and good questioning. I accept, as I've said all along, that we got things wrong, but in this particular case I'm satisfied that we responded to the query that they'd sent, that the regulator raised.

Deputy Pearse Doherty: Okay.

Mr. Cormac McCarthy: But, Senator - sorry, Deputy, we didn't ... we made mistakes.

Chairman: Just the date of the response, can you get the date of the response there, Mr. McCarthy, please?

Mr. Cormac McCarthy: Sorry, Chairman?

Chairman: The date of the response.

Mr. Cormac McCarthy: The date of the response was 22 July 2008.

Chairman: Okay. Thank you very much.

Mr. McCarthy, I just want to deal with the issue of remuneration there just for a moment, and refer to core document UBI - B5. There is in that, there is a description of remuneration schemes in period 2001 to 2008, and there's also a list of top ten bonus payments and share option awards for each of First Active and Ulster Bank for the period of 2001 to 2008. In specific, I want to draw reference there to page 9, and if I could maybe put the question first to you that the salary bonus and pension plans offered to the senior executives of Ulster Bank were significant, and on reflection, do you believe that they were justified and appropriate for an Irish financial institution?

Mr. Cormac McCarthy: Well certainly I would agree they were significant, but they were competitive. So, salaries and remuneration, remuneration generally was bench marked and there was significant comparability and oversight from Royal Bank of Scotland, not just Ulster Bank. So at any point in time our salaries were independently benchmarked and found to be competitive. Certainly with the benefit of hindsight, Chairman, yes there was an excessive element to things, yes.

Chairman: Bearing in mind the confidentiality factors there, you see redacted with regard to customers' information, but there is two employees have caught my eye: employee 14 and employee 15. In the year 2001, employee 14 and 15 received a bonus package of €65,000 and €45,000 respectively, and in 2003 their bonus packages went up in approximately on average €250,000 each.

Mr. Cormac McCarthy: Yes, Chairman?

Chairman: How ... was that reflective of the, as Deputy, or Senator MacSharry there indicated earlier, the sales culture that was growing in the bank, and the grow fast approach, and coming back to the earlier presentation of gaining market share where employees were being heavily incentivised to extend the bank's lending?

Mr. Cormac McCarthy: I don't believe that was the driver. For a start, employee 14 and 15 in that year would've been First Active, and then in the subsequent year would have been Ulster Bank so it would've been much bigger business that those were reflective of. And the ... so, I mean both of those salaries would've been subject to RBS oversight, and one of them would have been subject to Royal Bank of Scotland remuneration committee oversight.

Chairman: Yes.

Mr. Cormac McCarthy: So everybody had ... there was ... there was a ... in the same way as I described it for the business as a whole, there were ... there was a balanced scorecard of objectives, so, profitability, customer satisfaction, staff satisfaction, so there were multiple factors that drove remuneration and incentives.

Chairman: So, in average terms, there is a fivefold increase in the bonus payments paid out to these two individuals over a three-year period. Would that be normal or would it be an exception?

Mr. Cormac McCarthy: Well, I think firstly, the fact of a much bigger institution came into play, so you go from the First Active business, which is much smaller, to the combined First Active and Ulster Bank, so there's a scaling factor in that too. And then there was general growth in the market and benchmarking. I mean, one of those would be mine, and I never had any input into my remuneration; I never had any input into my incentive scheme. The Royal Bank of Scotland remuneration committee, in latter stages, prior to that, the First Active remuneration committee would have decided on my remuneration.

Chairman: And was there any risk associated or not, with this?

Mr. Cormac McCarthy: In balanced scorecard terms, risk, under ... risk was just a constant in the business so again, nothing we did or could do could be done without paying attention to, and observing, the risk parameters that were in place.

Chairman: Okay, but given your current position where you take a bet, you put odds on, and there's a gain and there's a loss. In the situation here, was there ever a factor built in with regard to remuneration, that if somebody got something wrong that the remuneration was claimed back?

Mr. Cormac McCarthy: There was no claw-back in general market terms in those days. Claw-back is a norm now, but there was no claw-back in place in those days and clearly that wasn't right.

Chairman: Okay, so just to get it on the record, there was no penalty in Ulster Bank if risk was found to actually be adverse and it impacted upon the bank?

Mr. Cormac McCarthy: Subsequent to receipt of a bonus, no, there was no claw-back. I'd imagine, Chairman, that there would have been more significant employment consequences to that extent, so one's job would be at risk, so ... I should say nobody ever set out to do anything on the basis of incentives in remuneration, that generally my experience had been, that was not

a driver of people's performance particularly.

Chairman: Okay, but in terms of motivation of people, the ... if there is no penalty for taking risk, is one likely or less likely to be more riskful?

Mr. Cormac McCarthy: Certainly, Chairman, it never crossed ... it never crossed my mind to do anything on the basis of ignoring risk. I think that remuneration structures subsequent to this have taken on board the claw-back matter. But at that point in time in the industry, there was no claw-back, there was no penalty, subsequently or at the time. Risk was a given and accepted and you didn't break ... you didn't break the protocols and the policies.

Chairman: But in a bookmakers, you take out odds on the risk and your ... your odds are made out then by the level of the risk. In this case, there is reward for taking risk and there is no penalty for getting risk wrong.

Mr. Cormac McCarthy: I think, Chairman, at the time, as I said, risk was a given. I think there is ... there was no claw-back, as such, which is now in place. So remuneration schemes in the industry have claw-back as a standard, and deferral as a standard. I think the other ... the other thing that wasn't in place at the time was deferral. So most bonus schemes that exist in financial services at the moment have a defer element so that you don't get your full bonus at the end of the year, it's deferred over a number of years. That allows one to take account of the risk issue as things emerge in time, as well as claw-back of bonus.

Chairman: So, on reflection of this, do you believe that this was good or bad practice in terms of the bank making decisions?

Mr. Cormac McCarthy: All I can say, in my own case and the experience of the people I worked with, Chairman, nobody ever set out to do anything, to take risk for granted, risk was a given. That said, I accept that with the benefit of hindsight and looking at it now, the structure of some of these schemes and the quantum of these schemes was excessive.

Chairman: Okay, thank you. Deputy Eoghan Murphy. Deputy, ten minutes.

Deputy Eoghan Murphy: Thank you, Chairman. Mr. McCarthy, I just want to pick up where Deputy Doherty left off, if I may, and that's the letter from the regulator from 12 March 2008, and the reference document is UBI - B2, page 24. It took three months to reply to the concerns that Deputy Doherty already examined with you. Would that be an average length of reply or is there a delay there?

Mr. Cormac McCarthy: Well it was ... it was definitely too long, Deputy, so I accept that. The principal reason for the delay would have been, as I explained earlier, the nature of the engagement, which would have been to come into the institution, to do the work and then leave and then send us the letter and thus, there would have been a significant amount of work to be done to get all the papers back together again, to look at them, to make sure that all the answers were ready. So that would have taken an amount of time. As to whether the length of time here was appropriate or not, on the face of it it seems to be lengthy, but I can understand the amount of time it takes to do these things properly, because we took our responsibility seriously in this regard.

Deputy Eoghan Murphy: I think you said earlier that matters could have been dealt with during the review with the regulator.

Mr. Cormac McCarthy: Correct, I believe so, yes.

Deputy Eoghan Murphy: If you could just help me then with ... on page 24, in the letter from the regulator, the first bullet says:

Following a request by the inspection team to meet with the relationship managers at [the bank, at Ulster Bank] our inspection team was advised by senior management that this may not be appropriate. In this regard, I would be obliged if you advise all staff of their obligations under Section 17 A 3 (e) of the Central Bank Act, 1971 as amended”.

Can you explain that bullet to me?

Mr. Cormac McCarthy: Yes, it’s not ... I can give you what the answer was in the letter we responded and we did explain and the answer is that we noted their comments and confirmed that all staff were aware of their obligations. That’s not satisfactory, there is no reason why I would want restricted access to be given to anybody in the institution. So at the time, if the regulator had raised an issue with me or my senior staff about access to people, I would have dealt with it at the time, so-----

Deputy Eoghan Murphy: Is that not a case of the regulator trying to meet with senior staff and them refusing to meet with the regulator?

Mr. Cormac McCarthy: That would have been people who were further down in the organisation, so this would have been about meeting relationship managers who handled client relations. It was not about meeting people further up the organisation. So what the letter seems to be saying is that Central Bank inspection team or the regulatory inspection team had asked to meet relationship managers who dealt individually with clients and for whatever reason that was denied----

Deputy Eoghan Murphy: I mean the regulator wouldn’t be contacting them directly, they would be going through their managers-----

Mr. Cormac McCarthy: Of course ... I would suspect so, yes.

Deputy Eoghan Murphy: So would that mean senior staff would then deny the opportunity for the regulator to meet with those relationship managers?

Mr. Cormac McCarthy: Unfortunately, Deputy, I don’t know. All I can say is that I would never had a problem with the regulator speaking to relationship managers and on foot of the letter, we went back to the regulator and, as requested, said to them that we had explained to our people what their responsibilities were in this regard. But if the regulator had come to me or to my senior executives at the time and raised this issue, I believe that there would not have been a problem, so I don’t understand how the matter arose. If it had been brought up at the time, I believe it would have been dealt with appropriately in allowing access and subsequently we responded to the regulator to say that “Yes, we were conscious of our obligations and had told our people what they were”.

Deputy Eoghan Murphy: If we take then the incidence of the interaction, the exchange of letters over this inspection process by the Financial Regulator and some of the comments that you’ve made in terms of your interaction with them being periodic or there being no regular dialogue, could you characterise then your bank’s relationship with the regulator in that period when you were CEO, 2004 up to 2008?

Mr. Cormac McCarthy: As I've said earlier, it was respectful and appropriate, we respected the regulator, we regarded our obligations as being, you know, as being serious. We sought to behave and observe all the appropriate protocols, we took inspections seriously. The relationship was characterised, I think we've submitted something like 300 pieces of correspondence for the relevant period to the inquiry, so there was a fair degree of interaction, but typically it was situational and thematic. There was little enough, kind of broad-based discussion, you know, I would have met the chairman of the Central ... the Governor of the Central Bank and the chief executive of the regulator probably annually for a general discussion, but typically the engagement was around situational matters, inspections, industry-thematic things. I mean, 60% to 70% of the engagement was around consumer matters not prudential matters, so typically what you're seeing in the flow of documents would have been not unusual in that there would have been an inspection or review, a thematic issue came up, a customer issue or a fee issue or something like that, so a lot of the dialogue and engagement was to that end.

Deputy Eoghan Murphy: Would you ever discuss the Financial Regulator or your relationship with the Financial Regulator with your parent bank, with RBS, would that-----

Mr. Cormac McCarthy: Yes, indeed and our parent bank would have met with the regulator when they visited, so for example, the head of regulatory risk or regulatory risk in Royal Bank of Scotland would have met with the regulator. Senior management from Royal Bank of Scotland would have, as a matter of courtesy, if they were visiting Dublin would have met the regulator, say, on an annual basis, so the chief executive of Royal Bank of Scotland Group would have met the Governor of the Central Bank or the chief executive of the regulator on, say, an annual basis when visiting Dublin.

Deputy Eoghan Murphy: And would letters like these been brought to their attention?

Mr. Cormac McCarthy: To the attention of?

Deputy Eoghan Murphy: Of RBS.

Mr. Cormac McCarthy: I can't recall - the process would have been the group policy committees, that RBS members sat on, would have sight of these. There were independent directors on our boards, so it was agreed that they would have oversight and in some cases the board of Ulster Bank Limited would have regulatory conversations and issues brought to it and there were Royal Bank of Scotland members on that, so but to the extent a detailed matter like this would have been escalated right up to the top of RBS, I'm not sure, Deputy.

Deputy Eoghan Murphy: And when you talk about receiving a non-objection, you know, you introduce a new product into the market, or a new policy-----

Mr. Cormac McCarthy: Yes.

Deputy Eoghan Murphy: -----there's a non-objection; is that the same as approval?

Mr. Cormac McCarthy: Yes, I suppose so, Deputy, in that if the regulator had said to us, "Don't do this" and had brought their ... you know, as has been seen subsequently, you know, had brought themselves to bear on us, we were respectful enough. Now, in fairness, we would have had a discussion about it, but, ultimately, if the regulator told us not to do something, we wouldn't have done it. For example, the 250% limit, we did not breach that limit, so we were conscious of our obligations and respectful of the regulator. So, you know, non-objection is tacit agreement, but if the regulator told us not to do something, we wouldn't have done it.

NEXUS PHASE

Deputy Eoghan Murphy: And what about being proactive in your approach with the regulator, ever going into them prior to September 2008, with a concern, say, over a particular product or, for example, an accounting standard, IAS 39?

Mr. Cormac McCarthy: On the latter point, Deputy, the accounting standards were the accounting standards. They were a given and they were accepted and then there was a huge amount of work went into it. We would have had a lot of engagement with the regulator over stress testing, so on a macro-prudential side of things, there was regular stress testing which was done and so that would have been quite an important series of engagement. When Basel II and ICAAP came in, we would have had a lot of engagement with the regulator in that regard and, in terms of products, as I said, we would have notified the regulator of the introduction of the 100% mortgage. But that was the general flow of things.

Deputy Eoghan Murphy: Okay, thank you.

Chairman: Thank you very much, Deputy, and moving on, Deputy John Paul Phelan. Deputy, ten minutes.

Deputy John Paul Phelan: Thank you, Chair, and welcome Mr. McCarthy.

Mr. Cormac McCarthy: Thank you.

Deputy John Paul Phelan: I want to ask you firstly in relation to the relationship between Ulster Bank in the Republic and your parent company. Did the ability, and it was touched on by previous speakers, to borrow from your parent company, did it allow you to expand your loan book at a faster rate than if you were relying on funding from other, third party funding sources?

Mr. Cormac McCarthy: I don't ... I don't believe so, Deputy, on the basis that there was a risk framework to our lending and funding and lending were separate, so treasury and capital risk were one part of the engine and credit and risk were another part, so to the extent that we had credit policies and approval policies, we couldn't breach those, even if we had the money, but, that said, having access to liquidity is not unhelpful, particularly from a cost perspective. If you can access relatively cheap liquidity, it does enhance your capability to be competitive.

Deputy John Paul Phelan: Okay. Can I ask ... changing subject slightly, I was struck by some of your answers earlier. Were you personally invested in the property market in your time in First Active, or in your time as chief executive of Ulster Bank, outside of your own residence, we'll say?

Mr. Cormac McCarthy: I did, Deputy, yes.

Deputy John Paul Phelan: Significantly?

Mr. Cormac McCarthy: I wouldn't ... for pension planning purposes, Deputy, yes, but significant is a judgment call. I did invest in property outside my home, yes.

Deputy John Paul Phelan: Okay. In Ireland or overseas?

Mr. Cormac McCarthy: In Ireland and overseas.

Deputy John Paul Phelan: Okay. Can I ask in relation to the 100% mortgages issue, which previous speakers have touched on in questioning to you and you've pointed out that other products existed in other financial institutions at the time prior to the marketing initiative

that Ulster Bank undertook, a direct quote from last week, Mr. Goggin, former chief executive of Bank of Ireland, I want to specifically quote what he said. He said that, “The pioneers of 100% mortgages was Ulster Bank, through First Active, and we actually, when the concept of providing 100% mortgages was first raised at a group risk policy committee, my recollection is it was declined and by the time we came to providing 100% mortgages, we were very much a reluctant follower.” Do you believe that Ulster Bank ... or that analysis, that Ulster Bank effectively were the drivers because there was a significant marketing effort made for this particular product?

Mr. Cormac McCarthy: We certainly did ... we put it on the counter, for want of a better phrase. The product ... I’m satisfied that the product already existed and was being accessed and delivered by others. Our policies were such that we couldn’t offer it, other than to professionals, so to do it, arguably properly, we had to go through a process and approve it and put it on the shelf. So, yes, we did launch the product in a public way, so ... but to that end, it didn’t make significant difference to our market share in time, so ... and the total amount that we lent as a percentage of our portfolio amounted to some 4%, so it wasn’t a significant part of our business, as it turned out.

Deputy John Paul Phelan: 4%. What would it have been, sorry, originally under ... before it was marketed as a product at first-time buyers, what percentage would it have been originally?

Mr. Cormac McCarthy: It would have been less than 1%, Deputy.

Deputy John Paul Phelan: So 4% was still a huge increase on where it was?

Mr. Cormac McCarthy: I don’t gainsay that, no, in fairness. I’ve accepted we made a mistake.

Deputy John Paul Phelan: What would 4% have been figures-wise, do you know?

Mr. Cormac McCarthy: As I said in my opening statement, approximately €1 billion of lending over three or four years.

Deputy John Paul Phelan: Okay. I want to refer briefly to the site in Dublin 4, the hotel site which has been referenced by previous speakers in their questioning. Ulster Bank was the major funder. I think it was ... the purchase cost of the site was in the region of €380 million. Where you sit or stand now, what do you think of the decision that was made in 2005 to fund that particular investment?

Mr. Cormac McCarthy: I’m sorry, Deputy, with respect, I can’t, I can’t answer that question, because it’s ... there’s a matter, firstly, of customer confidentiality, and there’s a legal matter there.

Chairman: Okay.

Mr. Cormac McCarthy: So, Chairman, I can’t answer that question, if that’s okay.

Chairman: That’s agreed.

Mr. Cormac McCarthy: Sorry, Deputy.

Deputy John Paul Phelan: Can I ask just for clarification on what is the legal ... I’m asking for his opinion now on that particular investment. It’s the most renowned property investment

that happened at the height of the boom. I don't ... I'm not looking for personal details of why the decision was made at the time, but can I just get some clarification on-----

Chairman: Well if the ... I just need to check on the witness, if you're saying that this is a matter of some proceedings at the moment; is that what you're saying?

Mr. Cormac McCarthy: I believe-----

Chairman: Or is it commercial sensitivity?

Mr. Cormac McCarthy: I believe that it is extremely commercially sensitive, Chairman, so I would prefer ... I would prefer not to answer the question. I believe it is extremely sensitive. That has been, Chairman, that has been ... in preparing for this I was conscious that this matter may arise, and I took some advice, as you'd expect, and my best advice is that I should not-----

Chairman: Okay, all right, that's fine.

Deputy John Paul Phelan: Okay, well look-----

Mr. Cormac McCarthy: I apologise, Deputy, but-----

Deputy John Paul Phelan: I won't ... I won't ... I won't pursue it, but it is, you know, I just wanted to put on record, it's probably the most significant property investment that happened at that particular juncture. Can I ask you, Mr. McCarthy, did you ever seek to have Ulster Bank loans transferred into the National Asset Management Agency provisions when it was established?

Mr. Cormac McCarthy: Yes, Deputy, as I said in response to, I think it was Senator D'Arcy's question, we did engage with NAMA in its early stages to see if there was any possibility of us selling assets to NAMA. NAMA was the only buyer of assets in the market at the time. There was no liquidity available from anything else, so it would have been reasonable for us to try to do that. As it turned out, those conversations didn't last very long, because it was the guaranteed banks that were involved in NAMA, and nobody else. So nothing came of very early stage conversations.

Deputy John Paul Phelan: Okay. I want to again refer to a line of questioning that previous questioners have referred to, which is the sectoral limits, the 250% limit that was increased to 500%. We've had evidence from previous witnesses, most notably Mr. Gleeson, among others, who have observed that these sectoral limits, as set out by the regulator at the time, were guidelines more than limits. I just wanted to ask in relation to your activities in Ulster Bank, did you see them merely as guidelines or were they hard and fast limits which you tried to adhere to?

Mr. Cormac McCarthy: We believed that to be a limit, and we adhered to it. Hence the capital planning exercise we did around our Northern Irish bank and our Republic of Ireland banks, so we believed that to be a limit, and we observed the limit.

Deputy John Paul Phelan: You didn't breach it at any-----?

Mr. Cormac McCarthy: No, we didn't breach it, no.

Deputy John Paul Phelan: Okay. My final question, again, I can't remember who asked

you the question earlier about your personal view on the guarantee, and I'm conscious of the fact you mentioned that you had a meeting with Mr. Lenihan on the day after the guarantee, but you didn't answer the question with relation to your own view as to the guarantee. Can you ... are you in a position to give the committee an insight into what was happening in Ulster Bank at that particular juncture?

Mr. Cormac McCarthy: I've tried to do that in my statement, Deputy, and, to that extent, I'm sorry if you feel I haven't answered the question. It's difficult for me to give an opinion on something that I had no involvement in and wasn't anywhere near the action, for want of a better phrase. So literally I heard about it the following morning, so all my insight is based on subsequent to that. What I've said is I can try to understand what the circumstances were at the time, but nothing beyond that. As I've said in my statement and subsequently ... it had significant ... it had a significant impact on Ulster Bank in terms of deposit outflows. And, indeed, on Royal Bank of Scotland because money was not just flowing out of Ulster Bank in Ireland. Money was flowing out of high street banks in the United Kingdom into Irish banks in the United Kingdom as well ... because they all had operations in the United Kingdom. So collaterally, at that point in time, it wasn't just an issue for Ulster Bank, it was a broader issue. In many ways the UK banking system ... and ultimately the UK banking system had a bailout on 13 October which ... was not long after the Irish Government guarantee. So the impact ... the impact on Ulster Bank was immediate and significant.

Deputy John Paul Phelan: What were your superiors in Royal Bank of Scotland ... can you give us any insight into what they were saying to you at the time in relation to the impact of the guarantee ... or was ... are you at liberty to divulge that?

Mr. Cormac McCarthy: I am, Deputy. They encouraged us to try and join the guarantee. So the view at the time of my superiors in Royal Bank of Scotland was that, given we were a systemic bank in the Irish market ... and that the guarantee was arguably afforded for systemic institutions ... that it would be in our best interest and in the interests of the RBS group to try and avail of the guarantee, given that enormous stresses at the time in the UK banking system and in Royal Bank of Scotland. So ... the idea that one of your subsidiaries, a systemic bank in, say, Ireland could avail of a guarantee to prevent the outflow of deposits ... not to do anything else but to prevent it ... was obviously attractive. So my superiors would have encouraged me to try and participate in the guarantee.

Deputy John Paul Phelan: And did you-----

Chairman: Final question now, Deputy.

Deputy John Paul Phelan: -----or any other employees of Ulster Bank have subsequent meetings with Minister Lenihan or others ... officials of his Department about ... about pursuing that?

Mr. Cormac McCarthy: Yes, Deputy. We had a number of meetings during the course of October in an effort to try to reach an accommodation or a situation where we could avail of the guarantee. We submitted quite a number of documents, board meetings in the main and added papers ... that Ulster Bank board meetings where this discussion took place. And, as I said, ultimately, we made our best effort but it wasn't possible for us to avail of the guarantee in time. So some time, you know, in late October, we ... we ceased and desisted from trying to do that. That said, at the same time ... you know ... the bailout of the UK banking system had brought some measure of stability, although we were still challenged. And we still would have liked to

get into the guarantee ... it just was not possible for us to do so.

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

Deputy Kieran O'Donnell: Just to follow up on that, Mr. McCarthy ... and welcome. In terms of your interaction with the Minister for Finance ... who did you actually meet at Government level in terms of looking to be ... to form part of the guarantee ... to join the guarantee?

Mr. Cormac McCarthy: We would have met the Minister ... and my chairman and I would have had meetings with the Minister and, as I recall it, with the Attorney General at the time as well because there were significant legal matters associated with it. We would have met with the Secretary General of the Department of Finance and we would have met with the assistant secretary general of the Department of Finance as well. They would have been the main dialogue we would have had. Obviously, I was in contact with the Governor of the Central Bank and with the chief executive of the regulator at the same time ... so there was-----

Deputy Kieran O'Donnell: Mr. Neary.

Mr. Cormac McCarthy: Mr. Neary and Mr. Hurley-----

Deputy Kieran O'Donnell: Fine -----

Mr. Cormac McCarthy: -----yes, So there would have been a series of dialogues between my chairman, Sean Dorgan at the time, and myself and-----

Deputy Kieran O'Donnell: How often did you meet?

Mr. Cormac McCarthy: I can't, I can't recall. There would have been ... with the Minister, there would have been no more than one or two meetings with his ...with his Department of Finance officials ... where most of the work was being done ... there would have been a number of meetings. But there would also have been a lot of, you know, telephone conversations and e-mail exchanges-----

Deputy Kieran O'Donnell: And that was over the month of October.

Mr. Cormac McCarthy: Over the month of October, yes.

Deputy Kieran O'Donnell: What was the issue that gave rise ... that you couldn't join the guarantee?

Mr. Cormac McCarthy: Ultimately, it would have required Royal Bank of Scotland to guarantee, effectively, Ulster Bank, which was the same difference as being in the guarantee, if you know what I'm saying. So ... the ... the way the guarantee was structured would have required Royal Bank of Scotland to effectively guarantee Ulster Bank and the Financial Services Authority in the UK, who was the regulator of Royal Bank of Scotland, saw that as being akin to essentially providing a UK state guarantee to Ulster Bank, which was a separately regulated and rated entity. And there were other matters. There were operational issues about appointments of directors. As you'll recall, the Government at the time insisted on appointing directors to the boards of the banks. That would have been challenging in governance terms ... although RBS could have got there with that ... but it was principally around the fact that RBS would have had to provide a guarantee for Ulster Bank ... which had ... would have had the same effect as the Government guarantee at the time.

Deputy Kieran O'Donnell: And did the UK regulator ... was of the opinion that was not acceptable, is that correct?

Mr. Cormac McCarthy: No. We just got to a point where ultimately, it was just not possible for us to do it. We understood where the Irish Government were. We had our own position. Our regulators were in a certain position and it just wasn't possible. I think as well, Deputy, the passage of time ... in that month ... I mean, a lot happened in that month ... the passage of time-----

Deputy Kieran O'Donnell: In October 2008.

Mr. Cormac McCarthy: In October 2008, with, you know, with the bailout of the UK banking system, added some measure of stability to the Royal Bank of Scotland situation and, collaterally, to our situation. So, you know, within a month the ... not the urgency of the issue, it was still a pretty stressed time, things had settled to a degree.

Deputy Kieran O'Donnell: And was there an outflow ... did the guarantee being put in place in Ireland, did it have an impact on your deposit base in Ulster Bank in Ireland?

Mr. Cormac McCarthy: Very significant. Within a period of weeks there were billions of wholesale customer deposits and a degree of retail deposits flowed out of the institution, yes. It was-----

Deputy Kieran O'Donnell: Did it put, did it put Ulster Bank Ireland under financial pressure?

Mr. Cormac McCarthy: We had to get an increase in the inter-group limit that we had from Royal Bank of Scotland. So we would have had a funding limit approved by the Financial Services Authority that ... which would have governed the amount of money that Royal Bank of Scotland could lend to Ulster Bank, so as soon as the guarantee came in we had to get that increased because the only place at the time we could get funding that we'd lost was from Royal Bank of Scotland-----

Deputy Kieran O'Donnell: And was that ... was that a function of the UK regulator?

Mr. Cormac McCarthy: It was function of Royal Bank of Scotland and the UK regulator, who were also our regulator in Ulster Bank in Northern Ireland-----

Deputy Kieran O'Donnell: How big of an increase was that, how big of an increase was that?

Mr. Cormac McCarthy: A number of billions, Deputy.

Deputy Kieran O'Donnell: So, we'll say in total, what level of billions would have flowed out in that month?

Mr. Cormac McCarthy: A number of billions, so it would have been of the order of €2 billion to €3 billion.

Deputy Kieran O'Donnell: Okay, and what would your deposit base have been at that time?

Mr. Cormac McCarthy: As I recall our deposit base was of the order of €20 billion to €25 billion which was-----

Deputy Kieran O'Donnell: It was significant.

Mr. Cormac McCarthy: It was very significant. Yes, Deputy, very significant.

Deputy Kieran O'Donnell: Can I just make a point? How much, between directly and indirectly, how much of UK taxpayers' money has been put in to Ulster Bank in Ireland?

Mr. Cormac McCarthy: I think ... I've been asked that question already, it's ... on the face of it, the capital that Ulster Bank got from Royal Bank of Scotland was of the order of €14 billion to €15 billion. That was ... that came from Royal Bank of Scotland. The capital that ... and I have no wish to be ... to get into semantics on this, but it's not unimportant. The capital injection that was made into Royal Bank of Scotland in 2008 had nothing ... little or nothing to do with Ulster Bank. So that money was in to deal with Ulster Bank, sorry with Royal Bank of Scotland-----

Deputy Kieran O'Donnell: But in essence, if Ulster Bank had been a stand-alone Irish bank, you would be looking at potentially up to €14 billion of Irish taxpayers' money being invested in Ulster Bank.

Mr. Cormac McCarthy: It's impossible to make that comparison, Deputy. The reason for that is Ulster Bank is not ... was not a quoted public company so, therefore, we had no capital base or no foreign businesses to sell, as some of the Irish businesses did, to generate capital. Our capital buffer at the start was less than it was, so if you look at the capital that was injected into the Irish banks, versus the provisions they made, there's a substantial difference. Ulster Bank's capital versus provisions is essentially one-for-one. We had no access to NAMA, so we had to make provisions on the basis of the lowest point in the market. I have no wish, Deputy, to underestimate the significance of this loan-----

Deputy Kieran O'Donnell: I suppose the question I'd ask is if NAMA was an option, would Ulster Bank be in a healthier position today?

Mr. Cormac McCarthy: I think Ulster Bank is, as it stands, in a reasonably, as I understand it, healthy position. So Royal Bank of Scotland has committed to the future of Ulster Bank in Ireland and the business is trading and lending so my understanding is that right now Ulster Bank is ... is, is operating in Ireland-----

Deputy Kieran O'Donnell: But if NAMA had of been an option, you would have taken it?

Mr. Cormac McCarthy: It's very hard to say Deputy, the circumstances were so different and ... and comparisons are almost impossible to make.

Deputy Kieran O'Donnell: Can I move on to the whole issue on the loans? At what level did you have to seek approval from Royal Bank of Scotland, at which level did they kick in, in terms of loan approvals in terms of Ulster Bank?

Mr. Cormac McCarthy: It varied depending on credit grades, so typically what you have in any particular loan is-----

Deputy Kieran O'Donnell: An average, an average.

Mr. Cormac McCarthy: Anything, typically €30 million to €50 million, above that had to go to Royal Bank of Scotland credit committee.

Deputy Kieran O'Donnell: So if you were typically putting a loan, of the order of the loan that's been mentioned in terms of the Ballsbridge site which was well in excess of €300 million, what type ... in a typical loan, what type of due diligence would be done? Would you give loans on the basis of land ... on the basis of land and development that would be subject to planning permission being applied for and obtained, as distinct from giving the loan without ... without planning permission? What would the normal due diligence you would have done?

Mr. Cormac McCarthy: Every situation would have been different Deputy, for obvious reasons, so, depending on the particular instance, there would be different levels of due diligence or various requirements, so every loan was different. But at that particular level you're talking about, that would have to have gone to an independent Royal Bank of Scotland credit committee, and as we have submitted in the papers to the inquiry there was a significant degree of due diligence required for credits of that level across the Royal Bank of Scotland group, and there would have been a significant amount of information provided to the credit committees. As Deputy Doherty's questions have arisen *vis.* what the regulators asked us of, there was quite a degree of independent oversight.

Chairman: You've a few minutes, Deputy.

Deputy Kieran O'Donnell: Yes, and, typically, in terms of the ... did you have any internal controls about the percentage of the loan book in terms of land and development that would be in any one particular loan?

Mr. Cormac McCarthy: We had. There were large exposure caps, yes, across the Royal Bank of Scotland group. So those large exposure caps had to be governed and run through RBS policies as well. So anything between €300 million to €500 million on a group basis required what was known as advances committee. So there were caps on individual and collective exposures.

Deputy Kieran O'Donnell: Well, can I make ... in 2005, what would have been your level of, we'll say, a land and property development loans issued in that particular year, roughly?

Mr. Cormac McCarthy: I don't have that information immediately to hand, Deputy. I can provide it.

Deputy Kieran O'Donnell: Well, you were ... you were CEO over those years. Typically, what were you lending per annum?

Mr. Cormac McCarthy: I think the evidence shows that the lending per annum - let me get my numbers here to hand - was typically of the order of maybe ten ... across the whole group, maybe about ten ... about €10 billion.

Deputy Kieran O'Donnell: No, I'm talking purely Ulster Bank Ireland, Ulster Bank Ireland.

Mr. Cormac McCarthy: It would have been ... Ulster Bank Ireland Limited, a couple of billion, Deputy.

Deputy Kieran O'Donnell: So, typically, what? €2 billion?

Mr. Cormac McCarthy: Probably, but I'd have to come back and correct that figure.

Chairman: Okay, one minute, Deputy.

Deputy Kieran O'Donnell: So you'd be talking that 15% of your entire loans issued in 2015 ... in 2005 went to the Ballsbridge site, which had ... appears to have had no planning permission in place. How would that have arisen? How would that satisfy due diligence requirements?

Mr. Cormac McCarthy: Again, Chairman, I'm sorry, I just do not want ... if it's ... I do understand the question, Deputy. I cannot talk about that particular-----

Chairman: Okay, you'll need to move on from that question.

Deputy Kieran O'Donnell: Well, it's the process I'm more interested in. I'm not talking about ... but the process, that you have a loan here making up 15% of the entire loan book issued, the land development in 2005, a site with no planning permission. So the question I'm asking, what due diligence process would you have gone through when you're saying it would have been heavy due diligence? How would these two particular issues have got through that due diligence process?

Mr. Cormac McCarthy: In any individual case, there would be significant documentation and due diligence done for any large case that we would have lent ... we would have lent. They were the standards and requirements of the credit committee process, so we would have had to have appropriate independent valuations-----

Deputy Kieran O'Donnell: And you would have made a recommendation to the RBS board ... this particular ... if it went to the RBS board, you would have been making recommendation that this loan would be granted?

Chairman: Okay, that's it.

Mr. Cormac McCarthy: No, if ... if anything ... on any large case ... no case would be brought from Ulster Bank to Royal Bank of Scotland credit committee without a local approval. It would have had to go-----

Deputy Kieran O'Donnell: Correct.

Mr. Cormac McCarthy: -----through the local approval process first. It's not ... it would be impossible for a rejection at local level to get taken to Royal Bank of Scotland credit committee, Deputy.

Chairman: Okay, thank you, Mr. ... Deputy, and thank you, Mr. McCarthy. Deputy Michael McGrath. Deputy, ten minutes.

Deputy Michael McGrath: Yes, thank you very much, Chair. You're very welcome, Mr. McCarthy. Can I just clear up one thing with you? And that is in the immediate aftermath of the announcement of the guarantee, you said you met Minister Lenihan the following day. Was that on the Tuesday, the 30th?

Mr. Cormac McCarthy: That's correct, Deputy, yes.

Deputy Michael McGrath: Yes, okay. And just the day after that again, Minister Lenihan, in the Dáil, in response to a number of Deputies when the Credit Institutions (Financial Support) Bill 2008 was being discussed, a number of Deputies raised the impact of the guarantee on non-Irish banks, including Ulster Bank. The leader of the Opposition, Enda Kenny, raised it as well, and Minister Lenihan said on that day in the Dáil, "I understand one of the institutions,

namely, Ulster Bank has made an application to the Government [to join the guarantee].” Was ... is that the case at that stage?

Mr. Cormac McCarthy: That would have been the case, so we would have ... we would have either written or verbally requested to join the guarantee, and that was part of the process I discussed with Deputy Phelan, where we-----

Deputy Michael McGrath: Yes.

Mr. Cormac McCarthy: -----went by ... we went through a process of discussion and communication with the Department of Finance on that matter. So, yes, we would have written in, I'd ... we would have written in to say, “We would like to avail of the guarantee.”

Deputy Michael McGrath: On 30 September?

Mr. Cormac McCarthy: Probably, likely. It was ... a lot happened on that day, so-----

Deputy Michael McGrath: Sure.

Mr. Cormac McCarthy: -----logically, we would have written either that evening or the following morning.

Deputy Michael McGrath: Okay. And were you lobbying politically as a bank? Were you making representations to politicians to be included in the guarantee?

Mr. Cormac McCarthy: We made it known through our normal channels that we had challenges in this regard and that we would like to avail of the guarantee, yes.

Deputy Michael McGrath: Okay. And were there any contacts that you're aware of between the Chancellor of the Exchequer, for example, in the UK - I know they hadn't bailed out your bank at that stage - but between them, for example, and the Irish Government in that 24-48 hour period?

Mr. Cormac McCarthy: I have heard it said that there were contacts, but I have no personal evidence of that, so it was said at the time that the Chancellor of the Exchequer had contacted the Minister, but I have no personal evidence of that.

Deputy Michael McGrath: Okay, but we can take it that the bank sought to be added to the guarantee as soon as it became aware of the guarantee as such. So on the 30th or perhaps on 1 October.

Mr. Cormac McCarthy: That is correct Deputy, yes.

Deputy Michael McGrath: Okay. And just to pick up on Deputy O'Donnell's questioning about the direct impact and the immediate impact it had and in terms of your... your deposit base and you make reference to 8 October, the UK Government announced £500 billion bank rescue package and then five days later, the bailout of RBS and Lloyds Bank. Did it ease somewhat after 8 October? What was the critical period, was it a week, ten days, two weeks, of significant outflows of funds?

Mr. Cormac McCarthy: It was two weeks in particular Deputy, when most of the, for want of a better phrase, damage was done. And it kind of settled, post the UK bailout, but we didn't... recovering the position was very challenging. So the money that went did not repatriate itself to Ulster Bank as a result of the UK bailout, that money took an awful lot longer to come back.

So we were still at a deficit compared to where we were, on say 29 September.

Deputy Michael McGrath: There is a reference as well in your statement that around this time, when the guarantee had been issued by the Government, “certain of our Irish bank competitors persuaded a significant number of our depositors to move their money from [Ulster Bank Group] to avail of the suggested greater security provided by the Guarantee.” Do you want to elaborate on that?

Mr. Cormac McCarthy: Yes, pretty quickly after the guarantee was announced there was predatory behaviour on the part of certain institutions. People in certain institutions contacting customers to the effect that, you know, “Bring your money in here, there is a State guarantee, it is much safer.” So that behaviour, and in fact that behaviour became public knowledge. So there were some... I certainly believe there were some media reports to that effect.

Deputy Michael McGrath: Who was doing that?

Mr. Cormac McCarthy: There were a number of institutions. So that definitely happened, we were aware of that from customer contact.

Deputy Michael McGrath: In the Republic?

Mr. Cormac McCarthy: In the Republic and outside the Republic. Elsewhere, I think I explained, elsewhere ... earlier on, that this was not confined to the Republic of Ireland because the guarantee embraced the international divisions of the Irish banks, therefore those, perversely at the time, the Irish Government guarantee was the best guarantee in the world for a period of... a short period of time. Therefore money, internationally would have moved into Irish banks, because the system was very stressed at the time. That would... we would have seen that in the United Kingdom.

Deputy Michael McGrath: And what were they targeting? Was it corporate deposits?

Mr. Cormac McCarthy: It was principally wholesale and corporate, because they were significant... they were of size. So if you were aware that a customer had a large amount of cash, and because you had a knowledge of a customer, then it would be... you know, it is easier to get that than a whole load of small deposits. So that was the behaviour at the time.

It didn't last very long, the regulator stepped in very quickly and the instruction was issued. I believe the Minister may have said something at the time that the guarantee was not to be used as a means of acquiring deposits. The guarantee was meant to be protecting your existing base and not as a means to go and take deposits from other institutions.

Deputy Michael McGrath: And did Ulster Bank feel that the guarantee was being abused?

Mr. Cormac McCarthy: At the time for... in certain occasions, that was how it felt Deputy, yes. Because we did not believe that the purpose of the guarantee was to be used as a marketing tool to harvest deposits. We believed that it was a protection mechanism and it was being used as a marketing tool to harvest deposits.

Deputy Michael McGrath: And how serious did the situation become for Ulster Bank before the UK bailout was announced?

Mr. Cormac McCarthy: Well, as I said earlier, we had to increase and get permission to increase the intergroup line that we had from RBS by a number of billions. So we had to get

support from Royal Bank of Scotland and collaterally from the Financial Services Authority who would have had to approve that intergroup line. And that was forthcoming, so RBS were, you know as good as their word and stood up to it.

Deputy Michael McGrath: As you mentioned earlier, Ulster Bank didn't participate in NAMA, so can you advise what happened to the property and development loan book within Ulster Bank?

Mr. Cormac McCarthy: Well...you know I left... I left the bank in April-May of 2011, so a lot happened after I left.

Deputy Michael McGrath: Yes.

Mr. Cormac McCarthy: But up to the time I left, given that there was no activity in the market at all, all we could do was mark to what the NAMA marks were. So we basically benchmarked our portfolio to what the best knowledge we had of what NAMA was valuing portfolios at. That was a very crude exercise-----

Deputy Michael McGrath: So, you wrote them down, is it?

Mr. Cormac McCarthy: We wrote them down. So we took significant provisions in 2009 and 2010 in particular, when the NAMA haircuts as they're called came in. So that was the only time in a completely illiquid market that we had any reference point. Subsequent to that, the market deteriorated further so after NAMA did its marks, the market went deeper and Ulster Bank had to mark further to, again, an illiquid and lower point in the cycle. In addition to that, RBS set up its own resolution vehicle and a number of Ulster Bank assets were transferred to that vehicle and so, to the question I was asked earlier about capital, RBS itself made a number of decisions around portfolio management that affected the quantum of capital that was injected into Ulster Bank, so therefore you have a situation where you have no comparability with what was going on between NAMA and the Irish banks and the Irish Government and capital and what was happening in Ulster Bank and Royal Bank of Scotland, in terms of capital and provisioning. And it will only be clear in time what the real comparability is, if at all Deputy.

Deputy Michael McGrath: But while you were there, that loan book was left within the bank and provided for in accordance with market value and the accounting standards.

Mr. Cormac McCarthy: Correct Deputy, yes. Now that's from a statutory perspective, the resolution, the way the resolution worked in Royal Bank of Scotland is the management of a chunk of those assets was taken out of Ulster Bank and managed by a separate unit within RBS.

Deputy Michael McGrath: Yes, a bad bank.

Mr. Cormac McCarthy: Correct. But in terms of governance and statutory accounting, those loans and they still are on the balance sheet of the Ulster Bank Group.

Deputy Michael McGrath: Okay. Can I just ask about the loan-to-deposit ratio in Ulster Bank Group, which peaked at 211%, as I understand, in 2007? Many commentators would say anything north of 120% is not a comfortable position to be in. How did the loan-to-deposit ratio go so high for Ulster Bank during your time?

Mr. Cormac McCarthy: I'm not sure that at the end of 2007 it was that high Deputy. I've seen a page in these documents that is an extract from a set of Ulster Bank Ireland accounts that actually, there were some errors in that 2007, which were subsequently corrected, so the

loan-to-deposit ratio was closer to 130% to 140% at the time in reality. That deteriorated subsequently and did get to the order of the 200% level simply because of the stresses that happened in the liquidity markets. So Ulster Bank's loan-to-deposit ratio, in common with many others, deteriorated through the course of 2008 to the extent that it did reach levels close to 200% but that wasn't the case at the end of 2007.

Deputy Michael McGrath: My final question, just on the 100% mortgages, did you go beyond 100% in some cases and provide funding for doing up the house and a car loan and buying furniture?

Mr. Cormac McCarthy: No Deputy, we were very strict on that policy.

Deputy Michael McGrath: Never more than 100% of the purchase price of the property?

Mr. Cormac McCarthy: To the very best of my knowledge Deputy, that was the case. We restricted the product and there were very clear rules on it. So to the very best of my knowledge Deputy, no.

Chairman: Deputy Higgins, Deputy you have ten minutes.

Deputy Joe Higgins: Mr. McCarthy, in your opening statement that you presented in written form to the inquiry on page 4 you say in 2003, that Ulster Bank contributed €350 million profit to the Royal Bank of Scotland and then you contrast that with €1 billion profits in Allied Irish Banks and €1.17 billion at Bank of Ireland. And then you say, "On this basis the enlarged [Ulster Bank] appeared to be punching well below its weight and to have a clear opportunity to challenge the 'dominance' of AIB and [Bank of Ireland]". So, as you became chief executive officer in January 2004, was your main motivation to catch up, profit-wise, with AIB and Bank of Ireland?

Mr. Cormac McCarthy: I think Deputy ultimately yes, but it's not as simple as that, in that the route to profit is through multiple channels so as a universal bank, we would have been looking at things like market share of current accounts, market share of mortgage lending, market share of business accounting so it would have been a broad base but ultimately, income or profitability is what defines success at the top.

Deputy Joe Higgins: Yes. But you then go on and give information in your statement in relation to loans to customers between 2004 and 2007 and Ulster Bank, which you were in charge of, extended a loan increase of 172% for the four years. Now, Patrick Honohan, the Governor of the Central Bank, writing in the *Economic and Social Review* of summer 2009, said and I quote, "A very simple warning sign used by most regulators to identify a bank exposed to increased risk is rapid balance sheet growth. An annual real growth rate of 20% is often taken as the trigger." We had evidence here from Mr. Bill Black, a veteran regulator from the United States, of a similar nature. I know balance sheet growth is not exactly identical to bank lending, but there is a close correlation. So, should you have known that the rapid increase in lending, much of it for property, could have led to serious risks which is what happened?

Mr. Cormac McCarthy: I think Deputy, with hindsight, that is what happened and it is what we got wrong. We lent too much to the property sector and were overexposed. At the time, in the context of what I said at the outset, we believed that we would be taking market share so that growing from a lower base, one could grow by a greater percentage because one would be taking market share. Therefore, we were comforted by that to a degree, in terms of why would we grow more than the market, and the second point was our incorrect assumption

about continued economic growth. The backdrop to what we were doing was, No. 1, we can grow by more than the other guys because we are smaller and can take market share. It didn't transpire that way. Secondly, all of the economic indicators to the backdrop of what we were doing were extremely positive.

Deputy Joe Higgins: Mr. Honohan goes on to talk about that that growth amount that he said contained risk was triggered by a number of banks. He concluded that this was a very obvious and public danger sign, not only to these two banks which he referred to, not Ulster here, but because of the potentially destabilising effect of reckless competition on the entire sector. You yourself, Mr. McCarthy, summed up as follows, "Despite Ulster Bank Group's significant growth during this period [that is 2004 to 2007] it is probably fair to say that the Bank's competitive position at the end of this period was, in reality, no different to that which it found itself in at the start." Could I ask you, would it be fair to sum up the situation in this way or not, that you all engaged in vicious competition, you all massively overextended in terms of property loans, you created a huge bubble and crash that devastated countless lives around Ireland, and apart from short-term profits which you had in a few years, you all finished up in mutually assured destruction? Would that be fair or not as a summation of what happened between you?

Mr. Cormac McCarthy: I have acknowledged that we made mistakes and we got our assumptions wrong. At the time everything we did, we did in good faith. I certainly did not make any decision on the basis of feeling that it was reckless. We did it with an environment that was positive. We did it with a, in my own institution, with an infrastructure of one of the largest banks in the world around us that made us feel that we were doing things in a proper way. It was very competitive, there is no doubt about that. The market was extremely competitive and that has been characterised by everybody, and we did get it wrong. As to whether I would characterise it as vicious, reckless, I don't believe that is the case because that is not how it felt at the time.

Deputy Joe Higgins: Mr. McCarthy, can I move on to the Jury's Berkeley Court situation? When did RBS Bank board agree to fund that project?

Mr. Cormac McCarthy: I am very sorry about this Deputy, but as I have explained earlier on to the Chairman-----

Chairman: The fear of legalities have been expressed so unless you have a different approach to this, Deputy Higgins, we will move on to the next question.

Deputy Joe Higgins: Chair, can I remind everybody that Dáil Éireann dictated that the subject matter of the inquiry should be to inquire into the reasons Ireland experiences systemic banking crisis, including the political, economic, social, cultural, financial and behavioural factors and policies which impacted on or contributed to the crisis, by investigating relevant matters relating to banking systems and practices. I would say Chairman, that I am trying to explore banking systems and practices in relation to property loans.

Chairman: I am trying to assist the inquiry just like yourself Deputy, and every member has the facility to engage with a legal team here, before they engage in a line of questioning with the witness. I am not too sure if you raised this matter or not with the legal team. But if you had, you would have been informed of the specific customer matters in this regard are not engageable ... and there are other matters such as NAMA ... there are particular aspects of NAMA legislation that make it prohibitive to discuss these matters in this inquiry as well. But you can get an extensive legal briefing after this meeting as to why this ground is not coverable

by your line of questioning.

Deputy Joe Higgins: Well, can we know ... can we know, for example, who delivered the letter to Mr. Dunne on the Friday evening of that July?

Mr. Cormac McCarthy: I'm very sorry, Chairman, I would like to help the Deputy but I feel I cannot discuss this matter-----

Deputy Joe Higgins: I don't think that compromises anybody. We have Mr. Dunne saying that the bank of Ulster ... the Ulster Bank came to his office on Friday night with a letter for ... covering the deal. Do we ... can you tell me who delivered the letter?

Chairman: Again-----

Mr. Cormac McCarthy: Again, Ulster Bank has never commented on this matter publicly, Chairman, so I feel ... I would like ... I'm here to help the inquiry, Chairman. I would be very keen to help in whatever way I can, I don't like not answering questions, but I feel-----

Deputy Joe Higgins: But how does it prejudice in any way ... to answer that question, Mr.-----

Mr. Cormac McCarthy: I'm sorry, Deputy, there's a customer confidentiality issue here for starters, so that's-----

Deputy Joe Higgins: I'm talking about an employee of the bank.

Mr. Cormac McCarthy: That relates to a customer. And the second point is, that there are legal matters affecting this particular matter that I-----

Chairman: And as a general rule ... and I'll facilitate you with some time here, Deputy Higgins, because this engagement has kind of maybe brought us outside to your time allocation is for all members - and every member is aware of this - that if ... and the facilities available to all members prior to any, sort of, specific question that they might be engaged with ... there is the interaction with the inquiry investigation team that can be availed of and there is the process of engagement with the committee's legal team as well. And there is also, just in terms of due process and procedures, of due notification to witnesses before they come in before the inquiry, in this regard as well. So ... to maybe avoid situations like this, I would just, on a general note, ask members to avail these processes so we don't end up in a repetitive situation of a question being asked that has legal difficulties in this regard. So Deputy Higgins, I'll afford another two minutes ... two or three minutes.

Deputy Joe Higgins: Well, Chairman, I think it's highly unsatisfactory, frankly. And Mr. McCarthy, you know, you might be familiar with the fact that, you know, a journalist in *The New York Times*, writing in 2005, by coincidence, said something to the effect that Dublin had become known of something of the wild west of European finance. I'm trying to tease out the banking practices that led to this crisis. I'm not getting very far but, you know if ... would it be fair or unfair to push what he says ... what happened to a caricature of the town banker rushing the saloon door to get to the biggest rancher before other bankers get to them. Is ... doesn't it conjure a picture of really frenetic activity among banks to gain and win a major project, or not?

Mr. Cormac McCarthy: I think, in an effort to be helpful, Deputy, what I'd say is, it was very competitive, yes, the market was extremely competitive, and that was characterised across the piece, so it was a very competitive market. As to whether the language that's been used *in*

extremis is how it felt at the time ... that's not how it felt. At the time, we felt that whilst it was competitive, the economic backdrop and the economic story in a European and Irish context was extremely positive. Again, the population was growing ... economic growth, we had full employment, there was a deficit in housing, there was a need for housing, so across the piece the view was that the economic backdrop was very sound and the forecasts were good. But I would completely agree, it was a very competitive marketplace, but at the time, it did not feel the way that you have characterised it. And that's all I can say ... that's how I felt at the time and how the business felt at the time. Certainly, it was competitive but the backdrop was very positive.

Deputy Joe Higgins: Well, I was putting it to you as ... that it might be caricatured as such or not.

Chairman: Final question.

Deputy Joe Higgins: Final, final question? I had a little bit of time out there while you were clarifying the legal position.

Chairman: You did and we stopped the clock as well. But I'm going to give you a bit of time, Deputy.

Deputy Joe Higgins: Yes, okay. Maybe two last questions now, very quickly.

Mr. McCarthy, you weren't able to give us a precise figure in relation to how much of the bailout to Royal Bank of Scotland would've been accounted for by the crash in the Republic of Ireland and the losses. But could I ask you, would you understand if the British taxpayers felt quite aggrieved that activities by a bank headquartered in Britain, should be bailed out by them, for activities in Ireland?

Mr. Cormac McCarthy: In principle, Deputy, yes. And in my opening statement, I've expressed my regret and my, you know, effectively how I feel about it. I have said that I'm sorry for what happened. But in principle I agree with you; I would say that it's not as simple as that, and I've no wish to get into semantics. It is a significant sum of money, but the RBS bailout and capital injection from the UK Government, Ulster Bank was not a factor in that when it happened in 2008.

Deputy Joe Higgins: Last question so, Chairman.

Chairman: Thank you very much, Deputy.

Deputy Joe Higgins: Can I ask you, Mr. McCarthy, if you are employee No. 14?

Mr. Cormac McCarthy: I believe I am, Deputy, yes.

Deputy Joe Higgins: Yes, in the thing. So, a question in two parts, which I'll ask at the one time for, that No. 1, your written statement and your colleague's written statements to come, the verbal one might be different, as happened today, there is no acceptance of responsibility whatsoever for any part in the property bubble and the banking disaster. Today, you did put it in, and you expressed regret. Did you do that as an afterthought? That's part A and part B, there were very, very high levels of remuneration for you in bonus terms, Mr. McCarthy, including €1.1 million in 2008, which was the year when the whole thing tanked. Do you think that that might sound extraordinary to the ordinary person out there or not?

Mr. Cormac McCarthy: I'll, I'll take both of your questions, Deputy. The first one is in

submitting my statement, my written statement originally, I was trying to address the particular lines of inquiry in factual basis and it had always been my intention to make an opening statement and express regret because that's how I feel and that's how I felt. That's why I said what I said at the outset. So there was no afterthought; in any event, I've always felt this way and I expressed that today. So, my apologies if that creates any confusion but what I said at the outset was heartfelt and I reiterate that point. It was not an afterthought. As regards the €1.1 million, just to clarify and again yes, it was excessive. But that payment in 2008 was in respect of 2007. I received no incentive bonus for 2008, it's just the way it's presented. But to your question, it certainly, with the benefit of hindsight, it was excessive.

Chairman: Thank you very much. Just before I go to the wrap-up, if I can maybe just ask you, Mr. McCarthy, did you ever invest in a property transaction that was actually financed by Ulster Bank?

Mr. Cormac McCarthy: No, Chairman, I didn't.

Chairman: Okay, thank you.

So we'll go to the ... move to wrap up. So, Senator Barrett, you have five minutes and then Deputy McGrath, sorry, Senator O'Keeffe, my apologies.

Senator Sean D. Barrett: Thank you, Chairman, and ... the link with the Royal Bank of Scotland, you know, which had to be bailed out for £46 billion and in 2008 lost £24.1 billion, the largest annual loss in UK corporate history, that was unfortunate for Ireland that that kind of a bank was also trading here, wasn't it?

Mr. Cormac McCarthy: I, I really can't comment on the particular Royal Bank of Scotland Group circumstances. The matters that led to the bailout of the Royal Bank of Scotland were unrelated to Ulster Bank at the time. So, I, I unfortunately I'm not in position to comment on that, Senator.

Senator Sean D. Barrett: Mr. Goodwin's pension was reduced from £550,000 to £342,500 in 2009. Were those kind of pensions paid in Ireland?

Chairman: Now we are moving outside the terms of reference now Senator as well, this is the Republic of Ireland investigation that ends at the end of 2013.

Senator Sean D. Barrett: The reduction of the pension by 38%, did something similar happen to executives in the Ulster Bank?

Mr. Cormac McCarthy: The ... I'm a member of the ... deferred member of the Ulster Bank pension scheme and it's a different scheme to the one that, the one that was the case in Royal Bank of Scotland. It was a pre-existing scheme.

Senator Sean D. Barrett: Were there any reductions?

Mr. Cormac McCarthy: My pension, Senator, is a private matter. It doesn't vest until I'm 60. So there's been no disclosure of my pension.

Senator Sean D. Barrett: Were there any pay reductions?

Mr. Cormac McCarthy: There have been significant changes in banking subsequent to 2008, and I left the bank in 2011, so up to that point in time, I received no bonus or incentive

subsequent to 2007 and I had no pay increases between 2007 and when I left in 2011.

Senator Sean D. Barrett: Could I draw attention to the letters from the regulator, UBI - B2, pages 26 afterwards. You were saying to Senator O’Keeffe that lots of banks got these kinds of letters, but I have to point out for the record that there are two recommendations which are general findings and there are five more which are specific to Ulster Bank. In fact, they’re called on page 26 Ulster Bank IL -”Specific Findings”. So, in fact, we don’t know that other banks got the majority of that report on them, dated March 2008, isn’t that right?

Mr. Cormac McCarthy: Sorry, just for clarity, Senator, the letters that I referred to as being generic were the 2003 letters that Senator O’Keeffe referred to. This particular letter was entirely specific to ... to Ulster Bank. It was a 2003 and perhaps the 2004 ... the letters, Chairman, that I received last night, that were generic industry letters with specific items for Ulster Bank. This particular letter relates to a specific inspection of Ulster Bank, and to the best ... I’m not aware of this letter or a version of it, going to other banks. I would say though that it would have been the norm that there would have been thematic inspections and reviews of other financial institutions.

Senator Sean D. Barrett: You say on page 10 of your statement there was no apparent deterioration of the performance of the Ulster Bank group loan portfolio, but £14.9 million sterling had to be put into that, was ... so that was the deterioration that took place.

Mr. Cormac McCarthy: I mean, your numbers are correct, but at the time of the guarantee, as has been well discussed, the view abroad was that there was a liquidity, not a solvency issue, and that was where people were focused. So at the time of the guarantee ... and, indeed, our financial statements for 2008, and the subsequent work that took place in 2008 seemed to indicate, that what existed was a liquidity, not a solvency issue. Ulster Bank was no different in that regard than any other Irish bank. Events subsequently transpired differently.

Senator Sean D. Barrett: The numbers you have on page 4, and discussed with Deputy Higgins, your advance is growing at 172% over four years, or second only to Anglo at 265% over four years, which was a major ingredient in the property bubble.

Mr. Cormac McCarthy: That’s a very big difference in percentage terms, Senator.

Senator Sean D. Barrett: You come in No. 2.

Mr. Cormac McCarthy: There is some ... there are some currency effect in that as well, but yes, we grew. I accept that we grew too much and we lent too much money to the property sector, I accept that.

Senator Sean D. Barrett: Now, you spoke earlier ... my final question, on branch banking, but on page 7 of your statement it says: “Ulster Bank branches held no lending authority and everything was transferred to Credit”, with a capital C. Now, you were defending the local branch bank manager earlier, but it looks like, by what you said on page 7, that the powers were being transferred away.

Mr. Cormac McCarthy: That had been the case for many years before I took over as chief executive of Ulster Bank. That was the standard process in Ulster Bank before my arrival, that lending authorities were confined to the centre.

Senator Sean D. Barrett: On HERMES to model property, there is no financial sector in

HERMES, the ESRI economic model.

Mr. Cormac McCarthy: I accept that we used ... you know, what John FitzGerald did, and I know he's given witness to this inquiry, was we ... we used the property price corrections and the employment correction numbers to input into our model, so we used those factors as the appropriate inputs into our stress testing.

Senator Sean D. Barrett: Thank you. Thanks Chairman.

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

Senator Susan O'Keeffe: Thank you, Chair. Mr. McCarthy, in relation to ... particularly in relation to property, but in general, did you think that, at the time as ... when you were a member of the board, that there was sufficient level of discussion and challenge at the board about concentration risks at both sector and borrower level that you were facing? Did you feel that it was a good robust board?

Mr. Cormac McCarthy: I did, Senator. There was quite a degree of conversation. A number of our non-executive directors would have raised property concentrations at various points along the continuum. We had various reports to the board at a variety of times from either internal management or third parties around the economy, and I think what the board did was accepted management's representations around the quality of the portfolio and the analysis that came behind that, which was significant, and also accepted the economic ... the general economic environment and expectations for growth that were there, but, yes, to the credit of the non-executive directors in the Ulster Bank board, it was a board that, you know ... it met regularly, and there was good debate, and there was good challenge. And I think that's been evidenced by some of the papers we referred to earlier where some of the non-executives were challenging what was going on in the business, so I think the evidence reflects that, Senator.

Senator Susan O'Keeffe: Given your evidence today, Mr. McCarthy, would you say that you were broadly satisfied with the bank's behaviour over the years that we've discussed?

Mr. Cormac McCarthy: Clearly, you know, I've said, Senator, that I greatly regret the mistakes we made and the assumptions we made. I'm sorry that that happened and the impact that that's had. At the time, all I can say is, that it felt ... that we had appropriate structures, we'd appropriate oversight ... being part of a very large international and globally respected institution gave us comfort that there was second-guessing and testing of what we were doing. So, at the time, all I can say, Senator, is it felt appropriate.

Senator Susan O'Keeffe: As you watched the ... you know, the sort of crash develop and as developers became ... you know, their loans and their situation became more apparent ... and some of them in the public domain at the time ... was it the case that Ulster Bank discovered that some of the people they you'd be doing business with, particularly lending money to, did you find that they had been borrowing money from other banks and other financial institutions that you didn't know about when you lent your money to them?

Mr. Cormac McCarthy: In most-----

Senator Susan O'Keeffe: And, if so, to what extent did that happen?

Mr. Cormac McCarthy: In most cases, we had reasonable insight into ... particularly with our larger connections ... into what they were doing elsewhere, they gave us that evidence, so,

yes, we had good insight. We didn't have validated detail in some cases, we made some mistakes in terms of checking that but, by and large, we had good insight into the cross-connections of our larger customers, yes.

Senator Susan O'Keeffe: Now, when you say good insight, do you mean that you ... you know, does that mean all of those loans were okay? Were you caught? Did people not give you information? Were there moments when, as I said, when you saw it unwinding that you realised certain people had used other vehicles, other consortium, other companies, other structures to not tell you about things or was it all just absolutely fine?

Mr. Cormac McCarthy: No, I don't believe that we were misled by any customers. I don't believe that anything I saw after the event led me to think that the majority of our customers had been, you know, duplicitous or misleading with us in any way-----

Senator Susan O'Keeffe: Well, I wasn't suggesting actually a majority. I was just trying to find out were there any.

Mr. Cormac McCarthy: To the best of my knowledge, Senator, most of what transpired after the fact we had awareness of in advance. So we would have been aware of cross-connections and we would have been aware of other banking relationships. So a lot of our customers had a long and successful history with Ulster Bank, so we would have had good insight into what they were doing. We didn't have full documentation sometimes but we had very good insight into our relationships.

Senator Susan O'Keeffe: You mentioned your own property interests for ... I believe you said, for pension purposes. Did you enjoy favourable loan terms from Ulster Bank for any of that property or did you borrow from any other financial institutions or both?

Mr. Cormac McCarthy: I only borrowed from Ulster Bank for my personal residence, everything else I invested in ... I don't need to go there but for what it's worth, was all in cash.

Senator Susan O'Keeffe: It was all in cash. Okay. Other bankers have said that they ... and I know you weren't there the night of the guarantee and I'm not asking you, but they said they were surprised that all six banks were covered rather than four. What went through your head when you realised all six were covered?

Mr. Cormac McCarthy: I suppose my immediate reaction was what it meant for Ulster Bank, so I didn't have the luxury of spending much time on 30 October thinking about the whys and wherefores and who and what. My concern was what this meant for Ulster Bank and how we could deal with it, so, you know, again-----

Senator Susan O'Keeffe: Yes, but surely in the day after or the week ... you know ... I mean you must have given some thought, no?

Mr. Cormac McCarthy: You know, again, the difficulty with this, Senator, is I wasn't party to the conversations ... I wasn't party ... I didn't have any insight. I didn't have any insight at all, Senator, so it's very difficult for me to say. I mean, my immediate reaction was one of significant surprise on the day.

Senator Susan O'Keeffe: Okay. Just finally, I just notice and I just ... you might clarify that some of the passages in your statement here are repeated in your colleagues' statements and I just wondered why that might be.

NEXUS PHASE

Mr. Cormac McCarthy: I didn't confer with my colleagues ... with my former colleagues in preparation for this. None of us work with Ulster Bank any more, so I didn't confer with them. I've seen their statements, they were circulated to me by the inquiry, so-----

Senator Susan O'Keeffe: Yes, but there are passages that are pretty verbatim in each of your statements.

Mr. Cormac McCarthy: We would've had a very similar experience and I assume that ... I had significant briefing and input from Ulster Bank, so, you know, fortunately RBS-Ulster Bank have been very accommodating in briefing me for this and I got a lot of briefing papers. My assumption is that the briefing papers that I received were circulated to my colleagues as well and I took extracts from some of those briefing papers in preparing my witness statement. My only assumption is that my colleagues did the same ... my former colleagues did the same thing.

Senator Susan O'Keeffe: Thank you.

Chairman: Thank you very much. Just one final question to you, Mr. McCarthy. In ... and correct me if I'm wrong in this regard, but a repetitive theme in your responses to a number of questions - most recently to Deputy Higgins - with regard to the crisis period was that it seemed right at the time, it felt to be the right approach and so on and kind of commentary of a similar regard, would that be fair enough?

Mr. Cormac McCarthy: I suppose, just to be clear, Chairman, the crisis period I consider to be sort of 2008 on. Prior to that was a ... let's just say it was the economic growth period. That period felt, you know, very competitive, but it felt that the circumstances were supportive of that at the time.

Chairman: Yes, but would you be acknowledging that the seeds of the crisis were actually in the pre-2007 period?

Mr. Cormac McCarthy: Indeed, Chairman, I would agree with that, yes.

Chairman: Okay. In addiction models, there's a term called euphoric recollection and what euphoric recollection is when somebody is in danger of falling off the wagon and to engage in behaviours that were damaging to them in the past, that they recall their addiction in positive terms, euphorically, hence the term euphoric recall. Is there a danger in Ulster Bank, to your mind, or in the banking sector at large, that the type of mindset that was there, back before 2007, could be engaged in, in terms of euphoric recall again?

Mr. Cormac McCarthy: I'm not familiar with the particular context that you describe, but I think what has happened in Ireland has been so searing in the public consciousness and the impact it's had on people in the banking sector, I certainly don't think in my lifetime that we're likely to see anything emerge again. History tells us that cycles repeat themselves and that history tells us that people always believe that they've learned from history and therefore they're destined never to repeat it and that may be the ultimate flaw. But I would say that, as regards the particular circumstances of what happened in Ireland in the banking sector, for the very ... for the foreseeable future, Chairman, I do not see any risk of that occurring.

Chairman: Okay, thank you. Is there anything first you'd ... or anything you'd like to add before we complete this evening's session, Mr. McCarthy?

Mr. Cormac McCarthy: No, thank you for listening to me, Chairman.

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Chairman: Okay, with that said, I'd like to thank you, Mr. McCarthy, for your participation here this afternoon and for your engagement with the inquiry. I now propose that you be excused and I also propose that the committee will suspend until 6.45 p.m. and return in private session at that time. Is that agreed? Agreed.

Sitting suspended at 6.12 p.m. The joint committee resumed in private session at 6.45 p.m. and adjourned at 8.15 p.m. until 10.30 a.m. on Thursday, 7 May 2015.