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AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉIREACHTA

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Dé Céadaoin, 27 Bealtaine 2015

Wednesday, 27 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.

Chairman: Sure.

Ms Mary Burke: -----start parsing it, I think staff in the Central ... or in Dame Street, let's use that term so as I don't have to start doing sides, would have felt that the Governor was the senior executive in the building. But, that being said, you know, I have come up through a long ... a long time in a central bank where we still call the Governor "Governor", so that would have been my feeling, as opposed to wondering whether or not, in law, he had powers over me, if you follow me.

Chairman: Okay, thank you very much for that. Is there anything else? Sorry?

Deputy Pearse Doherty: Just, sorry, because it may come up later on, just to clarify with the witness here. It was just on the question of stress testing and devising stress tests. I just looked through the core documents. You did have responsibility in relation to domestic mortgages and stress tests, isn't that correct?

Ms Mary Burke: Yes, but that was a different form of stress testing. That was the stress testing ... I can't remember who asked me the question earlier?

Deputy Pearse Doherty: I asked you the question.

Ms Mary Burke: Sorry, I beg your pardon. Yes, there was a guidance we had imposed on mortgage lenders that in the case of individual applications for mortgages they should stress test them for a 2% increase in interest rate and assess whether or not the applicant was in a position to afford that. That was implemented by the prudential department. It is now actually housed on the consumer side, in the context of affordability, and it is built into our consumer protection code.

Chairman: Thank you very much. Is there anything you would like to add before we bring matters to a conclusion, Ms Burke?

Ms Mary Burke: No, I'm fine, thank you, Deputy.

Chairman: Okay. With that said, I'd now like to thank you for your participation with the inquiry today, Ms Burke, and for your engagement with the inquiry, and to now formally excuse you and in doing so, propose that we would break until 5 p.m. Is that agreed? Oh sorry, I need five ... we need a bit of extra time for the switch-over. Okay, what time do you need? 5.15 p.m. Well, I'm saying 5.10 p.m. for 5.15 p.m., okay, is that agreed? Agreed. Okay, thank you.

Sitting suspended at 4.50 p.m. and resumed at 5.23 p.m.

Central Bank-Financial Regulator - Mr. Con Horan

Chairman: Okay, so I now propose that the committee go back into public session; is that agreed? And we'll now deal with session 3 of our hearings today with Mr. Con Honan ... Horan, Central Bank of Ireland IFSRA, and the Committee of Inquiry into the Banking Crisis now resuming in public session and can I ask members and those in the public Gallery to ensure that their mobile devices are switched off? This afternoon, we will continue our hearings with witnesses from the Central Bank of Ireland Financial Regulator. At our next session, we will hear from Mr. Con Horan, the senior official from the Central Bank of Ireland IFSRA.

Mr. Con Horan joined the Central Bank in 1979, where he held a number of roles. In 2003, he became head of banking supervision at the Financial Regulator and was appointed as prudential director in February 2006. Mr. Horan was appointed in February 2011 to the position of special adviser to the head of financial supervision, Matthew Elderfield. He was since seconded to the European Banking Authority in April 2011. Mr. Horan, you're very welcome before the committee this evening.

Before I hear from the witness, I wish to advise Mr. Horan that, by virtue of section 17(2)(*l*) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect to 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, the utmost caution should be taken not to prejudice those proceedings. In addition, there are particular obligations of professional secrecy on officers of the Central Bank in respect of confidential information they have come across in the course of their duties. This stems from European and Irish law, including section 33AK of the Central Bank Act 1942. The banking inquiry also has the obligations of professional secrecy in terms of some of the information which has been provided to it by the Central Bank. These obligations have been taken into account by the committee and will affect the questions asked and the answers which can be lawfully given in today's proceedings. In particular, it will mean that some information can be dealt with on a summary or aggregate basis, such that individual institutions will not be identifiable.

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 screens here in the committee room. For those sitting in the Gallery, these documents will be displayed on the screen to your left and right. Members of the public and journalists are reminded that these documents are confidential and they should not publish any of the documents so displayed. The witness has been directed to attend the meeting of the Joint Committee of Inquiry into the Banking Crisis. You have been furnished with booklets of core documents. These are before the committee, which will be relied on in question and form part of the evidence of the inquiry. So I now ask the clerk to administer the oath.

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

Mr. Con Horan, former Prudential Director, Financial Regulator.

Chairman: Thank you again, Mr. Horan. And if I could invite you to make your opening remarks this evening please.

Mr. Con Horan: Chairman, members of the committee, thank you for hearing my evidence today. It provides me with the opportunity to assist the inquiry in its work into what has been the most catastrophic, financial and economic crisis in the history of the state. The crisis has left many indelible marks, the system of oversight of the Irish banking sector clearly failed. The lessons learned from these events, as well as those in European banking over the recent years, have and will continue to drive major changes so as to avoid a repeat of what occurred. Commentators have implied that I personally did nothing to prevent the problems of 2008. Nothing could be further than the truth. Four years have passed since the report of the commission of investigation. Accordingly, I very much welcome this opportunity to have my voice heard and communicate the actions I took in seeking to avert the collapse.

When the Governor of the Central Bank, Professor Honohan, spoke to you in January this year, he advised that the people who took corrective action had been vilified in the media. He was speaking about my situation. When the commission of investigation report spoke about the lack of professional scepticism in the Financial Regulator, it also identified that there were exceptions at the level of the regulatory authority. I believe that exception was me. I can, however, assure the inquiry that this does not alleviate the sense of deep regret I feel, as a member of the senior management team in a registered authority that was not more intrusive and did not prevent the collapse of the financial system.

Before going into the events leading up to the crisis, it is important to distinguish between the roles of the Financial Regulator and the Central Bank. Briefly, the Financial Regulator was primarily responsible for supervising the safety and soundness of individual banks and their compliance with prudential requirements. The Central Bank, on the other hand, monitors stability of the overall banking system and the threats to the financial system. The Central Bank's views of market ... of the market inform the Financial Regulator in its supervision of the banks. The Financial Regulator in turn, contributes to the analysis of the stability of the overall system by communicating what it was observing in individual institutions.

I joined the Financial Regulator in mid-2003 as head of banking supervision. I reported to Mr. Patrick Neary, who was the prudential director. In this role I was not a member of the senior management team and only occasionally attended meetings of the authority. I was required to implement the strategic principles-based approach to regulation adopted by the authority prior to my appointment. As it would be expected, I acted at all times within the structure and the approach set down by the authority.

However, I believe the records demonstrate that I continually pushed the boundaries seeking to make the regulations of banks more intrusive and assertive. During this time, I proposed interventions in the property market to address high-risk mortgages. I proposed the imposition of formal corporate governance requirements on banks, including specific proposals to address the most difficult cases. I advocated for the establishment of a dedicated unit of specialists to pursue administrative sanctions. I also took on the role of head of banking supervision at a time when the international approach to the regulation of banks was undergoing the most radical change in decades. The Basel II accord was published in 2004, it was designed by central banks and regulators from major countries in the world. It established the key prudential ratios the banks needed to comply with and how these ratios should be calculated. The approach containing the accord was, in effect, the continuation of the deregulation of the industry which had been happening for more than a decade. While not fully responsible for the crisis, it provided poor incentives and moved supervision towards a greater recognition of banks' own methods for managing risk and calculating capital. The system of regulation supervision contained in this accord has proven to be grossly deficient and I will revert to this point. While I cannot be specific as to the dates, I believe it was around the end of 2004 or early 2005 that I grew increasingly concerned about the way property-based lending was developing in Ireland. My concerns were supported by my research of international banking crises and, in particular, what had happened in Scandinavia in the 1990s. In mid-2005, I made a written proposal to increase the bank's capital requirements on high loan-to-value mortgages. This sought to put more capital aside in the event of a downturn and to establish a standard in the market for prudent lending. However, the proposal was not accepted. My understanding was that senior management in the

Financial Regulator and the Central Bank had considered the matter but did not believe the action was necessary. Macro-prudential analysis on mortgage growth conducted around this time suggested that the developments could be explained by economic fundamentals.

In 2006, Mr. Patrick Neary became the CEO, following the retirement of Dr. Liam O'Reilly, and I was appointed prudential director. *The Irish Times* quoted in an article as follows "Shortly after Neary became the regulator's chief executive in 2006, Con Horan, who replaced him as prudential director, knocked on his door and warned that something had to be done to restrain property speculators as house prices reached new highs on spiralling land values and the market was awash with 100 per cent mortgage offers." Reflecting these concerns, my first week as prudential director, I presented proposals to the authority for capital measures to address high loan-to-value lending ... mortgage lending. This was the first time in almost a decade of an exceptional property market that the regulatory intervention was instigated. Prior to this, moral suasion was the tool used to try to persuade banks to rein in the practices. Therefore, the taking of direct action represented a significant change and met with internal resistance. There was concern that such action would jeopardise the stability of the Irish financial system. There were concerns that such intervention was inconsistent with principles-based supervision. However, it was approved, after what Governor Honohan has described as long and agonised debate.

I wish to point out that I took these actions immediately on my appointment because it was imperative to signal to the banking industry that the approach of property-based lending was changing under the new senior management regime. The speed and level of consultation in the introduction of the measures led to me being rebuked by the statutory financial services consultative industry panel. The panel considered the lack of consultation with its members in the preparation of the measures as regrettable and retrogressive. The chairman of the panel wrote to me reflecting those concerns.

Later in 2006, I followed up these mortgage measures with the introduction of the most stringent capital requirements in Europe for speculative commercial property lending and additional requirements for buy-to-let mortgages. There was also resistance to these measures. Clearly the majority view at the time was that the property market was going to have a soft landing as interest rates increased. There was fear about the message that regulatory intervention would communicate in terms of the property market in Ireland and how it might affect the competitiveness of the banking system. It is important to point out that a public consultation undertaken on the introduction of the measures did not produce support for these regulatory actions. The responses received to the consultation were largely critical, with the banks and their representative body expressing the belief that such action was unwarranted and raised the prospect of international investors reacting negatively to the Irish market. It took a lot of persuasion and a number of board meetings to get agreement on these actions.

I would highlight that had the actions been the catalyst for a sharp correction, as many had feared, it would have raised very serious consequences. However, I did not leave matters there. In July 2007, revised prudential stress testing guidelines were issued to credit institutions to address loosening underwriting standards. In effect, my first ten months as prudential director were spent pursuing this agenda of change, culminating in the most stringent regulatory regime in Europe for the key areas of property risk. Initiating such changes met a lot of internal and external resistance and an absence of public support.

The following slides demonstrate how the market slowed after the measures were introduced. Okay, I'll be very brief on this. The first slide deals with residential mortgage lending, and I just really tried to show the sequence of events, that in February 2006 I was appointed prudential director. I immediately proposed the change and the new rule was introduced on 1 May 2006. I think the committee can see that thereafter there's a very clear and consistent decrease in the level of mortgage lending.

And if I can have the other slide please? This relates to non-mortgage credit, and again it's from October 2005, and again just appointed prudential director February 2006; I proposed the measures in around September '06 with the capital requirements directive coming in. The measures came into effect on the 31 December 2006, and again I think you can see in general how the mortgage market, or the non-mortgage credit, went thereafter.

In all my research and in making my recommendations I was conscious of the views of external contrarians and used their arguments to support the positions I was putting forward. However, I was also conscious of other views as it would have been entirely wrong and counterproductive to ignore what the domestic mainstream authorities including the ESRI and the Department of Finance were saying. You must also remember that private sector professionals such as rating agencies, stockbrokers, investment managers and analysts were broadly supportive of the way markets were performing. The IMF has also acknowledged that it provided few clear warnings about the risks and vulnerabilities associated with the impending crisis. From its on-site reviews, it was supportive of the approach of supervision that was being taken. In 2006 it proposed that the prudential director should be appointed to the authority so the position would be on a par with the consumer director.

Other international bodies such as the OECD were also supportive of the macroeconomic analysis of the domestic Irish authorities. And the ECB, with its financial stability mandate, was not advocating macroprudential action. It was positive towards the strength of the EU banking sector prior to the crisis. It is of some comfort to me that the Basel II accord and the capital requirements directive which provided the foundation of the regulatory regime in Ireland have in recent years been acknowledged to be grossly deficient. In addition to permitting grossly excessive levels of leverage, Basel II encourage pro-cyclicality, failed to provide for systemic risks and allowed banks to operate on extremely low levels of capital, resulting in buffers that were far too low prior to the collapse. The weakness of the regime has now been identified by many authoritative sources, including parliamentary committees in other jurisdictions. The process of correcting the deficiencies has been ongoing since 2008, but even now, seven years on, the reforms are not complete.

To conclude, I wish to repeat that as a member of the senior management team in the Financial Regulator from 2006, I deeply regret and I'm sorry that the system of supervision did not prevent the collapse in the banking system. I do hope the inquiry will recognise that I took risks to address key problems by introducing stricter regulations in a difficult environment of groupthink. It was of course my duty as prudential director to do so. While the ten years as prudential director I saw the introduction of some of the most stringent capital and liquidity rules in Europe, regrettably, however, these measures were too late and were not sufficient to reverse the excesses of the previous decade and save the financial system when the global financial crisis struck.

Thank you for your attention, members. Can I also add one additional point if I can, Chairman? I do want to correct a point on my earlier statement ... just a brief correction on page 4 ... the third paragraph down under macroprudential supervision. There is a reference there to the IFSRA board, that reference ... the IFSRA should be removed it should just be the board. It's the Central Bank board I was referring to there.

Chairman: Thank you for the clarification, Mr. Horan, and thank you for your opening statement. I now invite first lead questioner, Senator MacSharry. You have 15 minutes.

Senator Marc MacSharry: Thanks very much and welcome, Mr. Horan, and thanks for being here. In your written statement you mention your proposals for regulatory intervention were put forward in 2006. You also say that concerns at the Central Bank senior management levels about the impact, the potential impact of it. And it also mentions the desire to temper what was perceived as the appetite for heavy intervention, that's a quote from page 4 of the statement. Your proposal for regulatory intervention was met with significant concerns, you say, from the senior management of the Central Bank. Was this level of intervention, in your operation as a financial regulator, normal?

Mr. Con Horan: It's hard, Deputy, to say normally, because literally this was my first week as prudential director. It didn't happen frequently. It was an event that occurred right at the start of my term as prudential director, and wouldn't have been frequent thereafter.

Senator Marc MacSharry: Yes, okay. You mentioned also in your statement a formal proposal in August 2005 to introduce measures to address high loan-to-values ... "the proposal met resistance from senior management of the Central Bank and was shelved". Subsequent to your appointment as prudential director, you implemented the same proposal, which then met with a rebuke by the chairman of the FSICP, as you mentioned there again in your oral statement as well. Can you explain the nature of this resistance to your proposal by the senior management of the Central Bank?

Mr. Con Horan: Well, in relation to the August '05 measure, I made a proposal in mid-August 2005 to increase the capital on high loan-to-value mortgages. I did that directly up my own reporting line at the time to the prudential director, and ... who took to bring it forward and address it. And the feedback I got at that time ... I tried to set out a fairly good argument in terms of why we should take measures at that point in time, but the feedback that I got was that the matter had been considered by senior management in the Financial Regulator, and the Central Bank, and the view was that the measures were not necessary at that time.

Senator Marc MacSharry: So it was a timing thing, as opposed to a "Look, we're not going there".

Mr. Con Horan: Well, that was ... it was kind of "We don't need to go there at this point in time". There was other macroeconomic analysis conducted around the same time, which was suggesting that the mortgage market, the growth in the mortgage market, was being driven by economic fundamentals, so ... that seemed to be the background as to why it was not accepted at that point.

Senator Marc MacSharry: And did that go ... was that a decision by your direct line director, as you say, the prudential director at that time, or did it go to the board, or Governor----

Mr. Con Horan: My understood that it went to the senior managers in the financial ... the chief executive level in the Financial Regulator and the Central Bank.

Senator Marc MacSharry: The seventh floor we were hearing about earlier, is that where all those guys hang out?

Mr. Con Horan: That would have been, yes, that would have been the seventh floor at the time.

Senator Marc MacSharry: Okay ... we're not allowed use names, are we, Chairman?

Chairman: Well, I always advise members to speak to legals before they get into specifics but-----

Senator Marc MacSharry: Yes, well, we might go back-----

Chairman: -----so I'll ask you to err on the side of caution, if you haven't spoken to legals.

Senator Marc MacSharry: Can you comment on the solvency protection measures in force, and taken before and during the crisis, and the stress-testing exercises carried out with the financial institutions?

Mr. Con Horan: Just to be clear, Deputy, you're talking about the 2006 stress tests?

Senator Marc MacSharry: Yes.

Mr. Con Horan: Well-----

Senator Marc MacSharry: And other solvency protection measures which were in place or in force?

Mr. Con Horan: So, there was a stress test conducted in 2006, which was in conjunction with the IMF, who were carrying out their FSAP visit. It was a normal round of stress testing, albeit with the IMF involved. And the outcome of that process was that the belief was that in an adverse scenario, the banking system was going to still hold up strong. I would say around the same time, obviously, Deputy, the ... I was also proposing the measures towards September '06 to increase the capital requirements on the commercial real estate lending activity. So that was also another solvency measure that was being put in place to try to address the problems at the time.

Senator Marc MacSharry: And, I mean, what was the regulator's view on the deterioration of properties' values and what implications did that have on the assessments in terms of stress tests? Did that come into it, the fact that property values were declining from, kind of, late 2006?

Mr. Con Horan: Well, I think the stress tests were actually conducted a little bit before there was decline.

Senator Marc MacSharry: Were there no further ones, no?

Mr. Con Horan: There may have been a further stress test in 2008, but I can't be sure of that.

Senator Marc MacSharry: Yes, well, what's your involvement with them then? Had you have an involvement with the stress tests?

Mr. Con Horan: Yes, we would have had an involvement. They were primarily run by the Central Bank, but we would have been involved in feeding in information from the bank, from the individual banking sector.

Senator Marc MacSharry: And would the concerns that you had to the extent that you were, you know, raising corporate governance provisions and raising loan-to-value issues and so on up to that date ... I mean, were you happy that these assessments could be accurate, on the basis that your suggestions had been rebuked by your own definition?

Mr. Con Horan: Well, just to get the sequencing right: in 2005, the measures I proposed had not been accepted for increasing the capital on high loan-to-value mortgages. In 2006, February 2006, they were accepted. And towards the end of 2006, when the capital requirements directive was coming in we implemented another set of additional requirements on commercial real estate and ended speculative commercial real estate lending, which in effect gave us the most stringent capital regime in Europe for that type of activity. So, that was all being conducted around the time of the stress tests, but the stress tests were generally coming out in 2006 as broadly positive in terms of the capacity of the banks to deal with a downturn.

Senator Marc MacSharry: We had been listening earlier to Mary Burke's testimony, and she spoke about resources particularly and said that requests for resources were endorsed by you as her line director, as prudential director, but rebuked higher up. Would you be in a position to outline for us who was responsible for refusing that request and why, in your view, that took place?

Mr. Con Horan: I'll give you my recollection of the sequence of events around 2006. If I recall ... I'm not sure there was a request for additional resources in 2006, I may be wrong here, but one of the problems that was faced in 2006 was we had a huge number of vacancies in the organisation and the organisation was not capable of filling those vacancies. So I don't think there was a request to the senior ... to the budget and remuneration committee in 2006. There may ... there would have been one in 2007, which was a large request for, I think, over 70 staff and I think we got 25 in that particular situation. I may have my dates there wrong, Deputy, in terms, but-----

Senator Marc MacSharry: And is that specific to the bank supervisory department?

Mr. Con Horan: No, sorry, that would have been across the board. So, I mean, I would have been-----

Senator Marc MacSharry: No, no, I'm interested specifically in BSD, I think ye call it?

Mr. Con Horan: BSD, yes.

Senator Marc MacSharry: Or that's what it was referred to earlier on. So, Ms Burke was telling us how, and she had ... gave quite a vivid description of a chaotic scenario where people couldn't effectively do their job, that there were difficulties even in carrying out the requirements on the capital requirements directive of the banks and so on. So, in that context, she had made a ... what she said was a number of requests, certainly one of which was endorsed by you, in her own words, but that these were refused.

Mr. Con Horan: Yes.

Senator Marc MacSharry: And I'm anxious to know who refuses them?

Mr. Con Horan: Okay-----

Senator Marc MacSharry: May 2008, I think, specifically we're talking to ... talking about. Thanks.

Mr. Con Horan: Right, thank you. Well, certainly, yes, Deputy, I mean, I had come ... I had been head of banking supervision, so I had a particular sympathy for that department in terms of its resourcing, and was supportive of the additional staff in it. One of the problems that was faced ... I mean, the process worked in whereby each individual department put forward their requests for resources and then that proposal was made into the budget and remuneration committee of the bank. My recollection is that the budget and remuneration committee did not fully endorse the request from management for the additional staff, for a number of reasons. I think they felt that the ... there could be savings gained from some of our work. I think there was a broad belief that, from a technology perspective, we were very weak and we needed to improve in that area, to be more efficient and cost-effective.

Senator Marc MacSharry: And was that consistent with your concerns generally in terms of the level of lending that was going on in banks at that stage? Of course we've had ... we'd have had the Northern Rock situation and so on that-----

Mr. Con Horan: Yes, well, I mean, I would say, Deputy ... I'll repeat: I was very supportive of the banking supervision, and-----

Senator Marc MacSharry: Yes?

Mr. Con Horan: -----to the extent that I could push for additional resources for that area, it would have been an area I certainly would have pushed for.

Senator Marc MacSharry: So, is it your testimony that you did all you could to secure the staff but the budgeting committee said no?

Mr. Con Horan: Yes, there was ... we didn't get the resource ... we didn't get the full request that we looked for, yes.

Senator Marc MacSharry: Okay, all right, that's fine, well then we can bring that question on to tomorrow then. Can I ask, from 2003 to 2008, when you had obviously a very, very serious increase in commercial lending throughout the country, and you had very regular breaches in what you might describe as prudential regulation, that there was no enforcement actions taken against any institution in that period? Why is that?

Mr. Con Horan: I think it's useful just to kind of recall the approach and the strategy that was employed by the Financial Regulator. And I would say, Deputy, and I'm not trying to avoid the question, I wasn't a member of the board here, so some of these issues would have been dealt with within the board. My understanding-----

Senator Marc MacSharry: But ... and I'm not holding you responsible, or anything. I'm merely asking.

Mr. Con Horan: No, no. I'm just trying to explain-----

Senator Marc MacSharry: You were the manager, or the head of the bank supervisory department for 2003 to 2006, and then you were the head ... the prudential director.

Mr. Con Horan: Right. Yes.

Senator Marc MacSharry: Isn't that correct?

Mr. Con Horan: Yes.

Senator Marc MacSharry: So, in that context. So I'm not ... you're not answering ... you're not answering for everybody here, just give me your view. Why was there no enforcement in that period?

Mr. Con Horan: I'll give you two key reasons. First of all, the system of administrative sanctions did not come in until July 2005, and at that point the authority had made the decision that the resources for administrative sanctions were to be primarily deployed towards consumer protection issues.

Senator Marc MacSharry: Could you just clarify one thing for me there, just for people watching at home? Is that ... when we say consumer things, is that things like overcharging on credit cards, and that type of thing, or-----

Mr. Con Horan: Yes.

Senator Marc MacSharry: As opposed to a bank transferring-----

Mr. Con Horan: As opposed to capital insolvency and liquidity.

Senator Marc MacSharry: -----€6 billion from one to another, for example?

Mr. Con Horan: Yes.

Senator Marc MacSharry: Yes. Okay, okay. That's great, thanks.

Mr. Con Horan: So the regulator had been set up in 2003. It had been set up, and my understanding was left the regulation of the ... prudential regulation was a key factor in the decision to leave supervision within the Central Bank structure. And the approach to supervision at that time was one of dialogue and interactive engagement. It was not an enforcement driven approach. And that approach was deemed to be suitable because there was a long record of safety within the banking system and it was also suitable to the development of the International Financial Services Centre.

Senator Marc MacSharry: But on the other hand, were you not concerned to the extent that as soon as a new boss took over you were at his door to say "I'm concerned, you know, I want to implement this, that and the other", as we've outlined earlier in 2005. And then you actually did implement them yourself in 2006. I mean, was that not against a backdrop that far from being safe, this was a situation that had a culture of regulatory breach?

Mr. Con Horan: Yes. I think just to get again the sequencing right. I think, again, I provided some documents to the inquiry. In advance, in 2004, I was making the case that we were structuring the organisation in the wrong way in that we hadn't set up dedicated inspection units to pursue administrative sanctions. I think that's a matter of record and I was very much in favour of setting up dedicated units at that time. And in preparation for moving ahead I had proposed corporate governance requirements in May 2005 to be imposed as a requirement on the licence of banks to enable us to take administrative sanctions, actions, against the banks, and some of the more difficult cases I was dealing with.

Senator Marc MacSharry: Okay. In the period after 2006, then, you've got your stuff in place. How is it that there was no enforcement in the period 2006 to 2008?

Mr. Con Horan: Again I think we hadn't set up a dedicated inspection area.

Senator Marc MacSharry: So, though we had the rules but just not the enforcement, was that-----

Mr. Con Horan: Yes. It wasn't an enforcement driven approach to regulation.

Senator Marc MacSharry: Okay. I put it to your colleague earlier on, and I used a somewhat unfortunate football analogy, so I'll adjust it slightly for you today and say is it a case that the principles-based regulation that was being employed by yourselves at the time, when it came to prudential regulation was a bit like a football match and the FAI with no referees?

Mr. Con Horan: I think it's probably fair to say there were actions taken against the banks but not in the administrative sanctions area.

Senator Marc MacSharry: So can you give me an example of one without one breach and one enforcement sanction without naming the bank or the individual involved?

Mr. Con Horan: I think the best ... there is examples given in Governor Honohan's report, I think, where on one occasion and with a particularly difficult institution, in 2004, and I think again in early 2008, we increased the solvency ratio on the bank from - I won't give the numbers - but we increased it by 1%, which was a pretty significant, and I think Governor Honohan called it a noteworthy intervention. So there were things that you could do, even though in 2004 we didn't have administrative sanctions powers, there were actions that we could take to penalise poor behaviour in banks and that, I think, is an example that would have had a significant impact on the institution. The institution involved appealed that but-----

Senator Marc MacSharry: But materially, what would that have meant to the institution, just again for us lay people?

Mr. Con Horan: Well, it sent a signal to them in terms of ... they needed to keep additional capital aside, so that they wouldn't have had as much capital available for additional lending. So the level of regulatory capital they had to keep was increased which kind of reduced the buffer that they had for other activities. And there were other things that could be done at that stage including sending in, you know, consultants to carry out work, etc., which was often very expensive and not something that the banks enjoyed. I think in another case we reduced the level of joint venture activity they could get involved in. So there were some measures within the structure that could be used but, as I say, that was in advance of the administrative sanctions regime which didn't come in ... I just make the point again ... I think until July 2005 and the guidelines were only issued in October 2005. So that explains a lot of that earlier period, I think.

Senator Marc MacSharry: Okay, thanks.

Chairman: Thank you very much. Just to clarify two issues there on Senator MacSharry's questioning to you, there was two items: there was your comment on page 4 of your witness statement about your proposals for regulatory intervention being put forward in 2006 and then later in page 6 of your statement about holding contrarian views to the groupthink on property lending and so forth. And you elaborated to some extent on those two questions, Mr. Horan. But maybe what I'd like you to do now is elaborate on the influence or the role of the Central Bank in terms of how they responded separately from that of the regulator's office.

Mr. Con Horan: Just to be clear again, Deputy, in particular in relation to those issues?

Chairman: Yes.

Mr. Con Horan: Well, I think, in both those cases ... so in 2005 when I made the initial proposals-----

Chairman: Yes.

Mr. Con Horan: -----I can't give you much insight into what went on from the Central Bank's perspective. I understood there was discussions between the Central Bank and the Financial Regulator at the time and the view was the measures were not necessary. In 2006, I understood that the chief executive had had a discussion with senior Central Bank officials who believed there's a potential for these-----

Chairman: Chief executive is the Governor now or the regulator?

Mr. Con Horan: Sorry, of the Financial Regulator ... had spoken to senior Central Bank officials and the view was that, taking these actions at that time, had the potential to bring the market down and there was concern ... real concerns from a stability perspective that these interventions would cause a problem.

Chairman: Can you ... I want to kind of segregate those two, if you don't mind. You've given us a kind of ... a very understandable position as to what you saw the regulator's role was but can you tell us what the positioning of the Central Bank was on these matters?

Mr. Con Horan: Well, so that ... I understood there was resistance at official level-----

Chairman: Central Bank level or the regulator?

Mr. Con Horan: The Central Bank level.

Chairman: Okay.

Mr. Con Horan: There were concerns that the measures would create instability in the market. But the reality was we decided to hold our ground on that and we went ahead and I believe the Governor gave his support to those measures at that time. So, there was concerns at official level ... at senior official level but in the end when the measures ... it took a number of meetings to get the measures through and in the intervening period, the Governor supported the measures.

Chairman: So you're saying both ... the Governor was both aware, cognisant and was in line with the measures and the position by the regulator?

Mr. Con Horan: Yes, I mean these measures, Chairman, were, you know, considered to be issues that impacted on overall financial stability-----

Chairman: Yes, indeed-----

Mr. Con Horan: -----and, therefore, we had to get the Governor's agreement to take those actions.

Chairman: Okay, thank you. Deputy Murphy.

Deputy Eoghan Murphy: Thank you, Chairman. Thank you, Mr. Horan, you're very welcome. I just want to move forward to 2007, if I may. You were a member of the domestic standing group?

Mr. Con Horan: Yes.

Deputy Eoghan Murphy: Okay. Were there any deficiencies in the DSG's operating model?

Mr. Con Horan: I think in early 2007 I wouldn't call it there were deficiencies in the model. It had only been set up in 2006 under EU legislation, this type of structure. So, I think, certainly for much of the time it was beginning to find its role and understand what its role was. It probably wasn't as proactive in retrospect, given what occurred subsequently, but it was trying to find its feet in terms of preparations for crises and running crisis simulation exercises, etc.

Deputy Eoghan Murphy: Why was the NTMA brought in in 2008?

Mr. Con Horan: So the NTMA became involved, I think, around September 2008, at the peak of the crisis. So they would not have been involved in-----

Deputy Eoghan Murphy: It was late 2008, sorry, when they came in it was-----

Mr. Con Horan: Yes-----

Deputy Eoghan Murphy: Is that what you were saying, it was late 2008-----

Mr. Con Horan: Yes, around September 2008. And that would have been at the peak of the crisis when a number of issues had ... specific issues had occurred. They weren't involved before that to best to my recollection in the, kind of, early days of the domestic standing group.

Deputy Eoghan Murphy: Would their absence up until that point be seen as a deficiency, do you think, in terms of the membership?

Mr. Con Horan: I didn't believe so because, you know, a lot of what we were doing in the domestic standing group at that stage was just understanding what was going on in Europe, preparing documents, etc., within the three authorities - the Department of Finance, the Central Bank and the Financial Regulator - in terms of how well that group would operate in a crisis situation.

Deputy Eoghan Murphy: And was there any agency missing from the DSG?

Mr. Con Horan: To the best of my knowledge, Deputy, the DSG construction in Ireland at that time was similar to that that operated in other European jurisdictions. So I am not aware that there were additional parties elsewhere.

Deputy Eoghan Murphy: You said that the level of contacts, interaction between both yourself and the Central Bank with the Department of Finance increased as a result of the establishment of the DSG. So did it increase to what would be seen as a normal level of activity or a heightened level of activity?

Mr. Con Horan: I think as the crisis evolved ... so early 2007, there would have been, let's say, ongoing regular contact. Post-9 August 2007, after the ECB's intervention, it became more frequent and regular at that stage.

Deputy Eoghan Murphy: But prior to the establishment of the DSG, in your opinion, would have the interaction between Financial Regulator and the Department of Finance been sufficient?

Mr. Con Horan: To the extent that we needed to engage with the Department of Finance, we did so on a bilateral basis. It was often around the introduction of legislation, etc. We wouldn't have been actively involved pre the 2007 in discussions on regulatory issues at that point.

Deputy Eoghan Murphy: Okay. The simulation exercise that was conducted at the end of December, or, sorry, at the end of 2007 in December ... were you involved in that simulation exercise?

Mr. Con Horan: I believe I was, yes.

Deputy Eoghan Murphy: Okay. I'm just wondering, how close to reality are these exercises? I mean, do the observations that are made in the simulation, do they translate to the real world?

Mr. Con Horan: In reality, no. Being absolutely frank, I've been involved in these at a European level and I've been involved in them at a domestic level. And they are largely simulations around a small group of facts that are conducted over an afternoon or a full day with papers prepared and people able to read documents in advance of that. So, the reality is they do ... you do learn lessons and you do pick up issues in relation to how it would happen in reality, but, in effect, having experienced crises in Ireland and in Europe in recent years, the reality is always an awful lot more complicated and different.

Deputy Eoghan Murphy: One lesson learned by the Financial Regulator was that the ... there was insufficient contact between the regulator and the Department of Finance and the Central Bank's feedback was that finance was out of the picture. So was that in the exercise or does that reflect the reality?

Mr. Con Horan: My recollection is that was that the exercise in that the simulation of the financial information in that exercise took a lot longer than expected in terms of the Central Bank and the Financial Regulator pulling together information. And the Department of Finance were not involved until very late in that process. So that was one of our lessons from that exercise.

Deputy Eoghan Murphy: In Mr. Hurley's evidence, when discussing the stress testing exercises, he said that "One of the conclusions was that there was too quick a movement to a guarantee in the context of the stress test''. Do you remember that?

Mr. Con Horan: I can't recall that specifically from those tests, no.

Deputy Eoghan Murphy: Okay. Do you recall the 2005 crisis simulation exercise? You were working in banking supervision at the time.

Mr. Con Horan: Yes, again I'm aware they were on, Deputy, but I couldn't be sure that I recall the specifics of that in 2005.

Deputy Eoghan Murphy: Because one of the observations from that exercise was that there was a lack of clarity about the supervisory regime and the nature of information that would be available in a real crisis. That was following the exercise in 2005. Do you recall that at the time?

Mr. Con Horan: I think that ... I can't say I specifically recall it from the ... but that would have been pretty consistent with the type of issues that happened in simulation exercises.

Deputy Eoghan Murphy: And would they have been acted upon?

Mr. Con Horan: Well ... I mean, we would have done some preparation out of that in terms of trying to be more prepared in terms of deposit guarantee ... deposits and information that may have come up, but I can't put my hand on specifics from the exercise.

Deputy Eoghan Murphy: But did that sentiment remain true into 2008 when the actual crisis emerged, that there was a lack of clarity about the supervisory regime and the nature of information that would be available in a real crisis?

Mr. Con Horan: Well, by two thousand ... by 2008 we obviously had experienced the crisis and, you know, there was ... clearly the information you needed at hand when matters started to evolve was not sufficient. There was clearly a lot of work needed to be done to gather information. But I would say that's pretty consistent across the board and was a feature in an awful lot of jurisdictions - that the information you needed immediately was not at hand.

Deputy Eoghan Murphy: Sure, but the observation that was made from the exercise here in Ireland in 2005 still stood when the crisis emerged in 2008?

Mr. Con Horan: I think that it's fair to say that that's correct ... that the nature of the crisis can ... the nature of a simulation exercise can never fully reflect what actually happens in a crisis, and every crisis is different so you'll always have a desire or a need for additional information than that which is on stream.

Deputy Eoghan Murphy: Of course. No, I think my point related to the feedback that was given after the exercise and then whether or not it was acted upon. But if we can look at the scoping paper that was prepared by the Department of Finance at the end of 2007 - were you involved in the preparation of that scoping paper? It looked at possible powers to be given to the Minister for Finance to guarantee the banks, to liquidate a bank ... it talked about a possible guarantee for all liabilities in the Irish financial system.

Mr. Con Horan: I don't recall that I was involved in the paper.

Deputy Eoghan Murphy: It came up with our discussions with Mr. Hurley. So when we look at the preparation or the agreement in early 2008, that legislation would be drafted to empower the Minister to guarantee the banks and nationalise financial institutions - do you recall that, those discussions?

Mr. Con Horan: I don't think I was actively involved in it at that point in time. I became a lot more involved in the legislation around September 2008. So I think the outline of the legislation had been prepared at that stage, and then as events unfolded from very early in September, that was probably our key focus was getting the legislation prepared for a nationalisation.

Deputy Eoghan Murphy: Okay.

Mr. Con Horan: Yes.

Deputy Eoghan Murphy: With Mr. Hurley we discussed as well the green jersey agenda where ... the Financial Regulator and the Central Bank Governor went to financial institutions and asked them to provide each other with funding support in order to maintain financial stability, given what was happening in international markets. Were you kept informed of this agenda, this action?

Mr. Con Horan: I would have been aware ... yes I would have been aware that banks-----

Deputy Eoghan Murphy: At the time?

Mr. Con Horan: Yes at the time, yes.

Deputy Eoghan Murphy: Okay. And in your view was this agenda designed to support any particular institution?

Mr. Con Horan: No. Certainly in the early stages it was international markets had frozen. We were aware that this was happening in other jurisdictions as well and it happened right across the board where interbank lending reverted to national borders and that continued for a considerable length of time afterwards. So it was relatively consistent with what was going on, that lending began. And people were probably more familiar anyway with some of the local operations.

Deputy Eoghan Murphy: And given what was happening in relation to the work of the domestic standing group in early 2008, and the approaches being made at the time by the Central Bank and the Financial Regulator, do you think that, looking back now, that the Government should have intervened in the banking system in March 2008, or closely after?

Mr. Con Horan: It wouldn't be clear to me what the intervention would have been at that stage that would have made a significant difference. You know, at that stage I think certainly liquidity was running short. I think it might have been better if the ECB or someone had announced measures in terms of providing additional liquidity to the system at that stage, as they did in 2011-'12. But it's not clear to me, when you put your question, what that measure would have been around March 2008.

Deputy Eoghan Murphy: Prior to that, prior to the share difficulty that one institution ran into in March 2008, the domestic standing group was already talking about possibly guaranteeing all liabilities in Irish banks. It was already looking at legislation to potentially nationalise a bank, liquidate one. So these concerns would have been there at the time, before then we had this extraordinary event in March 2008.

Mr. Con Horan: Yes, so, so, you know, at that time, I mean, I would say from 2007, I mean, there were lots of issues being talked about in terms of how we might oil the wheels of the system and remove some of the liquidity stresses were ... that were there, and there was contingency planning going on at that time in terms of what might happen.

Deputy Eoghan Murphy: Okay, let's move on to ... then, to July 2008. There was a domestic standing group meeting, and it's on page 124 and 125 of the booklet. The core booklet, Vol. 2.

Mr. Con Horan: Vol. 2. Sorry, Deputy, the page again, sorry?

Deputy Eoghan Murphy: Page 124. So you represented the Financial Regulator at this meeting?

Mr. Con Horan: Yes.

Deputy Eoghan Murphy: And if we just go down to the ... the bottom paragraph, there's a discussion held concerning the increase risk of a general loss of confidence in Irish banks, and the international viewpoint provided at the meeting is that the banks will see significant loan losses and would need to raise significant capital, and would be disadvantaged in doing so on account of the delay in going to the markets. Do you remember who expressed that view?

Mr. Con Horan: Sorry, sorry, I'm actually struggling to find the reference. It's Vol. 2, page 124?

Deputy Eoghan Murphy: Vol. 2.

Mr. Con Horan: And it's the ... the domestic standing group of 8 July?

Deputy Eoghan Murphy: That's correct, yes, and it's the paragraph at the bottom of the page, the large paragraph.

Mr. Con Horan: Of the ... of the first page, long-term investors?

Deputy Eoghan Murphy: Yes.

Mr. Con Horan: Yes, sorry.

Deputy Eoghan Murphy: And there's ... an international review of the-----

Mr. Con Horan: Sorry-----

Deputy Eoghan Murphy: An international viewpoint is provided, sorry, at the meeting, about risks ... significant capital risks facing the banks and potential for significant loan losses.

Mr. Con Horan: Yes.

Deputy Eoghan Murphy: Do you remember that discussion?

Mr. Con Horan: I, I can't say I remember it specifically, but I remember those type of discussions, yes.

Deputy Eoghan Murphy: Okay, but, you know, who might be providing the international viewpoint at that meeting?

Mr. Con Horan: It may have been the Central Bank through the ECB's ... their ECB contacts. It may have been some information we would have been picking up from the banking sector, but I couldn't say exactly what the source of that was.

Deputy Eoghan Murphy: Okay. Can we just drop down, just to the final sentence, because that states that the Financial Regulator "reported a detailed line-by-line examination of its loan book by one of the major Irish banks which highlighted that even allowing for 'worst-case' loan losses, profitability would remain strong". You made that point.

Mr. Con Horan: Yes, yes.

Deputy Eoghan Murphy: Okay. Is it possible to identify which institution you had-----

Chairman: No, I would advise not to. There's no need to.

Deputy Eoghan Murphy: Okay, well, I mean, how did that information come to you and did you verify it?

Mr. Con Horan: So ... so that would have been part of the ongoing engagement at the time with ... with the institutions to see how they felt about their books in terms of what was ... was going on and the type of ... so they would have been doing their own analysis and contingency planning. I don't think that we went in to check that at that time, in July 2008, but it would have also been the case that around that time, rating agencies, etc., were looking at the Irish institutions and, you know, in most cases, I think, affirming their ratings in terms of their strength and their capacity to ride out the problems. So, there would have been a ... a view at that time, I think, even from international rating agencies, that the Irish banks were able to ride out the problems at the time.

Deputy Eoghan Murphy: And, so ... sorry, were you then expressing that view depending on what the rating agencies were saying?

Mr. Con Horan: No, I think really what we were doing there is just giving feedback that we were getting at a time of heightened crisis, so we were ... we were well into the crisis at this stage. It would have been the feedback from the institutions in terms of their observations and their belief, in relation to their book.

Deputy Eoghan Murphy: Okay, but not feedback-----

Chairman: Last question, Deputy Murphy.

Deputy Eoghan Murphy: Thank you, Chair. Not feedback that you, as Financial Regulator, would have verified before bringing it to the domestic standing group, to overrule a point made by someone else as to the international viewpoint on significant loan losses, potentially, in the Irish banks?

Mr. Con Horan: Yes, I mean, the nature of the domestic standing group was, you know, it was a forum for clearing views that we were picking up through our various contacts. And it was an open forum for engagement, so the Central Bank would bring information that it would pick up, say, from the ECB, we would bring information that we were picking up, the Department of Finance would bring in information. It wasn't an effort to overrule, it was just feeding into the system of what we understood at the time.

Deputy Eoghan Murphy: So, it wasn't a decision?

Chairman: Sorry, Deputy, I'm going have to bring you in ... 'cause I have stuff to come back to here. I'll bring you back in the wrap-up.

Deputy Eoghan Murphy: Thank you, Chair.

Chairman: I just want to stay with the domestic standing group but I want to come back to the nationalisation, or the, the ... in spring 2008, the Minister was proposing the legislation with regard to a financial institution. Now, in questioning, Deputy Murphy, you spoke about the events, but what was the analysis behind that, where ... what was the *raison d'être*, where was that coming from?

Mr. Con Horan: I mean, there were very serious issues around March 2008. I think ... the famous St. Patrick's Day massacre, I think, it was known. So it was clear that there were institutions under significant pressure at that time and, I think, one of the contingencies that was being considered was preparing legislation in the event of it being necessary.

Chairman: Okay. And was that discussed at the domestic standing group meetings?

Mr. Con Horan: It may have been. I haven't seen reference to it in the documents that I've seen, but it's the sort of thing definitely ... you know, I would've expected would've been broached in that forum.

Chairman: To be more specific, was it prominent ... was it a prominent item of discussion at the standing group meetings?

Mr. Con Horan: I don't recall that it was prominent item. You know, at that stage we were in the depths of a fairly significant crisis so a lot of contingencies would've been floated at that point in time. I don't remember it being the predominant issue that we were considering.

Chairman: Okay. Just ... on earlier comments as well ... reports ... comments from known reports were quite agreeable that in the measure ... that the measures taken, you were talking about the measures for 2006 ... specifically the measures you were talking about today, such as increased weightings and high LTVs, loans and later on speculative commercial loans ... that these may have been too little too late. Ms Burke, in her engagement with the committee this evening, said really that after 2006 it ... any measure or any number of staff may have not actually been possible to actually avert the crisis. So could I put it to you or maybe ask you, Mr. Horan, that the measures taken maybe were showing the right way, but why was not more done to alert the banks more strongly and were you satisfied with the relativity moderate measures that were being taken?

Mr. Con Horan: Well, I would make the point that I had tried, in 2005, to begin this process and I think, you know, the process of intervening in the market was going to be very important in terms of the signal it sent to the banks because there had been an approach over the years ... and, Chairman, I'd go back into the ... my view is the bubble commenced in the mid-'90s and there were letters going out requesting banks to control their lending, etc., but the rates continued to grow. My view was that we needed to do more than that and directly intervene with some capital measures to show we were willing to act. That's what I proposed in 2005. I think it would've been better if it had been introduced then. I think it would've been even better maybe if it was introduced earlier. But my concerns formed in early 2005-late 2004 and those concerns were based on my reading of what happened in the Scandinavian economies when ... researching that, they were saying that their growth rates were above 20% and that was indicative of problems. In Ireland we were growing higher than 20% - 25%-30% - and that's what was causing me concern and that's why I believed we needed intervention.

Chairman: When did you join the domestic standing group, Mr. Horan?

Mr. Con Horan: I think the domestic standing group was established in 2006, to the best of my knowledge, so I probably was in there from the commencement of that process.

Chairman: And were you bringing these concerns to the attention of the domestic standing group?

Mr. Con Horan: Well, I mean, obviously ... yes, because the measures were successfully introduced. From February 2006 onwards we began the process of intervening in the market. So it would have been very clear and we would've communicated that to all parties. People like the IMF supported those measures, etc., and the DSG would have known that we were proposing additional measures in September 2006. I had made it known to the industry in May 2006, which was three months after my appointment, that we were going to look at the commercial real estate sector at that point. So I was trying to send out a very clear signal that the process and the approach was changing.

Chairman: And with regard to the contrarian views that you have stated to the committee this morning, how were the domestic standing group receptive to those? Were they listening to them, acting upon them or were they just considered contrarian?

Mr. Con Horan: Well, from 2006 I don't recall there was any objections from the domestic standing group because the measures were actually introduced. It wasn't that we had to pre-clear them, etc. We did speak to the Department of Finance in 2006 to advise them of the proposals in February. I don't recall that they objected to them. They did question why they felt they were necessary, but nobody ... once the measures were agreed by the authority, there wasn't objections to them.

Chairman: Okay. And just to finalise on this, I just want to return to the stress tests just for a moment. Were the stress tests from the banking supervisory teams ... or, sorry, were the stress tests moved from the banking supervisory teams to the Central Bank?

Mr. Con Horan: What happened in, I suspect around 2005 ... prior to 2005, the 2004 stress test was ... again, they would always have been led by the Central Bank because they were largely economically-driven exercises. We would have been actively involved with them at that time. With the introduction of Basel, we hadn't got the resources to spend a lot of time on the stress-testing exercises, so we provided direct access to the economic people to our data so that they could extract information and then we were available to help. Our role was less at that time in the stress-testing exercise but we were still making ourselves available to assist.

Chairman: So who in the Central Bank was responsible then for the collection of the analysis and the analysis stress testing?

Mr. Con Horan: I think it would have been the ... either the financial stability or the monetary policy people. Probably the financial stability people were in the lead on those stress-testing exercises.

Chairman: And who had responsibility for developing the model when it moved there?

Mr. Con Horan: Again, modelling would have been primarily done at the econometric level, so that would've been Central Bank's. So, the Central Bank was really, I would say, the driver on the stress tests and we were assisting them in that.

Chairman: And who checked the responses from the banks?

Mr. Con Horan: Again, I couldn't be sure who it was but I believe it was probably going to be a combination of economists from the Central Bank and from the financial stability area, with input probably from the banking supervision department.

Chairman: Well, are you able to confirm this afternoon that the responses were checked?

Mr. Con Horan: I'm not in a position ... I'm ... I mean, my assumption is that the process ran through and I've never heard that ... that the information was not checked.

Chairman: But, to your knowledge, do you know they were checked?

Mr. Con Horan: I wouldn't have been directly involved so I can't say that they were checked. But I would say, Chairman, I mean, in 2006 the IMF were directly involved in that exercise as well.

Chairman: Okay, tell us more about that. Tell us more about that.

Mr. Con Horan: Well, the 2006 stress test was carried out in conjunction with the financial services assessment programme that the IMF were conducting on Ireland in 2006, so the previous ... so the financial services assessment process was essentially where the IMF came into a jurisdiction and looked at the approaches and the methods of supervision, engaged with the banks, etc., to find out was the system suitable in terms of protecting financial stability. As part of that exercise, they did the stress testing. They also analysed the system of supervision and they were directly involved in the process as well, so ... and they would have issued their report and commented in the financial services action plan assessment of Ireland. So, quite frankly, I'd no reason to believe that that ... that that wasn't conducted in a diligent way because, if I recall correctly, the IMF actually said that there was a richer level of information in 2006 than there had been previously, primarily because banks were developing their own risk models under the Basel process.

Chairman: Okay.

Mr. Con Horan: So the information available to them at that time, my recollection is that it was better than it had been on the previous exercise.

Chairman: Thank you. Deputy Joe Higgins.

Deputy Joe Higgins: Mr. Horan, in September 2008, were you involved in any discussions in the Central Bank, or regulator, in relation to the potential insolvency of any financial institutions?

Mr. Con Horan: I would have been engaged in discussions in September 2008 about, yes, all the financial institutions and their solvency positions.

Deputy Joe Higgins: There was reference this morning about a high-level meeting on 26 September, where the Taoiseach, the Minister for Finance, the Governor of the Central Bank and others attended, and there is a question comes out of that as to whether two particular institutions were insolvent at that time. Were you aware of any of that discussion?

Mr. Con Horan: I don't recall. The reference I have is 26 September meeting-----

Deputy Joe Higgins: No, you don't need to refer to it-----

Mr. Con Horan: Okay, so not-----

Deputy Joe Higgins: -----just take my word for it.

Mr. Con Horan: Yes. So I'm looking at DOF 028-----

Deputy Joe Higgins: No, no you don't need to, Mr. Horan. I am just saying that, as a matter of fact, we have evidence of a high-level meeting and there is questions arising form the minutes of that as to whether two particular institutions were insolvent or not at that time. I'm just asking you if you were aware of that discussion?

Mr. Con Horan: I can't say I'm aware of the specific discussion. I am aware that some of the banks ... there was more concern about some banks than there were of others, in general, at that time.

Deputy Joe Higgins: Did you have a view on 29 September as to whether any of the banks were insolvent with the advantage of the position you had?

Mr. Con Horan: I didn't believe they were insolvent at that stage. At that point, we had an exercise being undertaken by external consultants to go through the individual banks and analyse their financial situation. And I think we probably were awaiting their response at that point in time.

Deputy Joe Higgins: Okay. Mr. Horan, following the legislation of 2003 in relation to the Central Bank and the Financial Regulator, the memorandum of understanding between the Central Bank and the regulator dealt with the responsibilities of both sectors, if you will. Do you think there was clarity on which ... what was the responsibilities of the Central Bank, on the one hand, and the regulator, on the other?

Mr. Con Horan: I believe there was clarity. I think I ... it was one of the first points I tried to address in my opening statement. I think the memorandum of understanding, if I recall correctly, the headings on it were the Central Bank had responsibility for financial stability. And the Financial Regulator heading is the Financial Regulator's contribution to financial stability. So the Central Bank was in lead on financial stability issues, and the Financial Regulator fed into that via the information it had from individual institutions.

Deputy Joe Higgins: So, would you believe or not that the board of the Central Bank, therefore, retained a serious responsibility in relation to financial stability arising from what the regulator was in charge of?

Mr. Con Horan: Yes.

Deputy Joe Higgins: And, are you aware that that's a direct contradiction of what the former Governor of the Central Bank told the inquiry?

Mr. Con Horan: Well ... I ... certainly, again, I go from the memorandum of understanding and my practices in there. I think the headings in the memorandum of understanding are very clear. One is responsible for the financial stability and one is responsible for contributing to it, so I think that it is clear. I would add, for instance, that the financial stability department was located within the Central Bank; it wasn't within the Financial Regulator. And I think that's pretty indicative of where the primary responsibility lay.

Deputy Joe Higgins: Okay. Was it significant that six or seven members of the financial authority board were also members, and, in fact, constituted a majority of members, of the Central Bank board?

Mr. Con Horan: Absolutely, I mean ... and this was ... I mean the information coming from the Financial Regulator and the purpose ... my understanding of the ... I wasn't on the Central Bank board ... my purpose of ... my understanding of the purpose of those ... that cross-membership, was to ensure that the board of the Central Bank had prudential information to assist it in its role. And it was my understanding that prudential information, the prudential pack, etc., was given to the board of the Central Bank to assist it in its role.

Deputy Joe Higgins: That was your understanding?

Mr. Con Horan: Well ... I know the prudential pack in the chief executive's reports were brought to the board of the Central Bank.

Deputy Joe Higgins: Okay. Can I refer you then quickly to your statement ... written statement, page 4. And in reference to why so-called principles-based regulation and you refer to the IMF calling it light-touch regulation, why that was the case ... and you make reference to:

> The ... Board was, however, concerned about generating instability and the risks attaching to shrill warnings. It also had concerns about the impact that regulatory intervention might have on the competitiveness of Irish banks.

This is to answer the question as ... as to why it was light-touch or principles-based regulation. And then you refer on footnote 11.12 to three sets of board minutes: July 2006, June 2006 and October 2007. What's that reference to? Where does shrill warnings-----

Chairman: I need to allow some time to reply as well because you're going to run out of time with your questions, so if we could maybe move to the question so I could allow Mr. Horan ... so I'll give you a few moments to wrap-----

Mr. Con Horan: Yes. So-----

Chairman: -----no, I ... just allow Deputy Higgins to wrap up the question and then I'll bring you in, Mr. Horan.

Deputy Joe Higgins: Yes. In other words, this concern that regulatory intervention might damage competitiveness, might perhaps affect the IFSC, which was a subject of discussion with Mary Burke ... is it that those minutes that you have footnoted here refer to that?

Mr. Con Horan: Yes, I think they give ... they give some examples of where the board ... for instance, when the Basel II measures were being proposed in mid-2006, I think one of the references at that stage was, you know, if you're going to do this, you need to be conscious of the competitiveness of the Irish banking system. So that was the sort of concerns that were being expressed at that time about the regulatory interventions.

Deputy Joe Higgins: Okay. So the prudential information that was getting through to the board on a regular basis, which you said-----

Chairman: I'm going to have to wrap you up here quickly now with a question-----

Deputy Joe Higgins: Yes, I am-----

Chairman: -----because you're way over time.

Deputy Joe Higgins: Notwithstanding that, we still had this type of concern on the board about people who might be raising red flags about dangers in lending, etc.

Mr. Con Horan: Well, I think there was a concern about the property market, you know, in that some of these ... and this was the argument that was being put to me, that some of these arguments ... this type of intervention could attract negative international interest in Ireland and, you know, we had to be very careful with that, and there were ... there are issues for the competitiveness of the Irish banking system as well. So, you know, they were reflected then, I think, in those minutes.

Deputy Joe Higgins: Okay. Yes.

Chairman: Senator Barrett.

Senator Sean D. Barrett: Thank you, Chairman, and welcome. Do you believe that there were effective instruments available to deal with excessive credit growth and sector risk concentration?

Mr. Con Horan: In terms of credit growth, I think the instruments ... and I hope the chart that I showed, showed that when we actually did intervene, there was definitely a change in market behaviour. I'm not saying it was entirely responsible for it. There were also interest rates, etc., that were effective at the time but if you look at mortgages, for instance, the speed of decline on the Irish growth rates was quicker than any European country after we introduced the measures. In relation to sectoral concentrations, clearly they would have been beneficial, but I think, again, I'd make the point that at a European level, issues like central ... sectoral concentrations were not part of the Basel process. While the Basel process did have specific limits on individual exposures, it didn't have anything on the sectoral front.

Senator Sean D. Barrett: But doesn't that bring to one of our problems, Mr. Horan, that our banks seemed to do nothing else except invest in property at some stage? The remainder of the loan book was shrinking as a percentage of the total at a very rapid rate.

Mr. Con Horan: Yes.

Senator Sean D. Barrett: So we needed them-----

Mr. Con Horan: Well, I think, just again, without getting into the technicalities of it too much, the rule and ... you know, was where you had an exposure that had a common predominant risk factor ... and the issue and the arguments that the bank made - and I would say, Senator, that this preceded the establishment of the Financial Regulator - was that if you had a hotel ... funding a hotel in Sligo and an apartment block in London or an office block in New York, they were not subject to the same common predominant risk factor, and that was the argument that banks were putting forward in terms of that they weren't exposed and weren't breaching the limits *per se*.

Senator Sean D. Barrett: You said that the measures, on page 7 of your paper, that the measures were the most stringent capital regime in Europe, but the downfall was also the most adverse. How did the most stringent rules produce the worst outcome?

Mr. Con Horan: I think, very simply, that they were too late.

Senator Sean D. Barrett: I see, yes. The opposition to the CRD requirements from within the industry, could you tell us something about that?

Mr. Con Horan: Well, yes, I mean, the process was we went to public consultation, I think, around September 2006. So we'd gone through our internal processes internally, and we went to consultation and received back in the responses. And, certainly, the representative body of the banks believed very strongly that the measures were unwarranted, that they risked bringing negative attention to Ireland and jeopardising the property market. And that view was also reflected in the comments of the individual banks, so they were clearly not happy because we were at least 50% more than most other jurisdictions, all other jurisdictions, and, in many cases, the level of capital being demanded in Ireland was three times the European level.

Senator Sean D. Barrett: Your statement on page 11, does that contradict that or does it apply to all banks? What you say that banks were woefully under capitalised and what would they need to do to bring themselves up to the capitalisation of Google, say, for example?

Mr. Con Horan: Well, the comment I have there is a quote from the chairman of the Financial Stability Board, who has a broad remit obviously across banking across the world. And I think this is one of the key problems that we faced was that simply the Basel accord completely underestimated the amount of capital that banks needed to have. If you compare 2007 with now, banks are holding probably in the region, to use his numbers, seven times more capital than they were at that time. If you can imagine the Irish banking system in 2007 or 2008 having seven times more capital at that point than it did, then the situation was obviously entirely different. So that's, that's the scale of the weaknesses in the Basel process from my perspective.

Senator Sean D. Barrett: How much more capital did they need, double it?

Mr. Con Horan: They would have at least required double, and maybe triple, yes.

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

Chairman: Thank you very much. Senator Susan O'Keefe.

Senator Susan O'Keeffe: Thanks, Chair. Mr. Horan, on page 11 of your statement you say from a supervisory perspective these two issues are considered to be very closely related as liquidity issues in banks can quickly give rise to solvency problems and *vice versa*. I mean, in the context of this, every time we raise the word "solvency", everybody runs off into the distance, but when we talk about liquidity, we're all fine. So, you're putting them right beside each other there. So can you just tell us whether or not in those conversations about liquidity at the time, was solvency also being discussed? Or were you alone in this consideration?

Mr. Con Horan: No, no, I mean, I think the issues of solvency and liquidity are very closely related in banking. If a bank has not got sufficient, to put it at its most simple, cash to do its day-to-day business, the assets it hold will, you know, will not be sufficient to enable it and it may have to dispose of assets, etc., impacting on its solvency. Equally, if a bank has not got enough capital and enough solvency, then the markets won't lend it liquidity on a day. So the two things are very closely related. A bank that runs out of liquidity will probably fail; a bank that has not got enough capital will probably struggle to get liquidity from the market.

Senator Susan O'Keeffe: So at the time as it closed in through July, August, September, and it was clear that there were serious liquidity issues with many of the banks, and some more acutely than others, is it fair to ask then whether discussions that were being had with all levels, among all different groups of people, yourself included, I'm sure, were also considering the solvency of those institutions and whether they were ... that was at stake?

Mr. Con Horan: Yes. Again, just to be clear, I'd say the dominant issue at the time was the liquidity issue. We had literally had the crisis from August '07 and there was a struggle almost on a daily basis to make sure the banks had sufficient liquidity and they were putting in place the proper measures. That was definitely the dominant discussion. But equally important in that discussion was, you know, their audited accounts, etc., coming out, their own views, you know, of the ... their management statements, etc., were they sufficiently capitalised? And at that ... certainly '07, etc., I don't think there was any problems being mentioned at that time. All their rating agencies were holding them up very strongly in terms of their capital and their international ratings.

Senator Susan O'Keeffe: Given you'd had ... there was a liquidity crisis which, as you say yourself, roughly started around August '07 had now been running for a year ... I mean, does the length and depth of a crisis of that kind not escalate the fear of insolvency? I mean a liquidity crisis of a week you might say, "yes, yes that's fine", but this is a year?

Mr. Con Horan: Yes. I mean, I think that's a fair comment, I mean ... as the Chairman pointed out, even in March 2008, you know, contingency planning was going on in case a bank ran into a solvency problem. So, you know, clearly ... I think the macroeconomic view that I was getting at that time was that the Irish economy was still relatively robust, commercial property sector was still holding up, vacancy rates, etc., were still good so there wasn't huge concern ... sorry, there was concern, but there was also belief that the overall economic situation was still enough that we weren't seeing solvency problems.

Senator Susan O'Keeffe: We heard evidence earlier from Ms Burke about meetings that took place on the seventh floor, to use that expression, between senior executives from banks and senior executives within the Financial Regulator and Central Bank, I think. Were you ever party to those meetings, do you know what that's about, that these were meetings that were not minuted and were not discussed then, by and large, with the banking supervision department?

Mr. Con Horan: I mean, depending on the time here, you know, if it was September 2008-----

Senator Susan O'Keeffe: No no, we're talking about earlier than that, she was talking about a period before that, 2006, '07, '08.

Mr. Con Horan: I had worked in banking supervision up to 2006, so I was conscious of the situation where, at times, chief executives came in and met the senior executives and the banking supervision people wouldn't have been involved. I certainly would have tried to the extent, you know, to make sure that that didn't happen and, I'm not saying it happened on every occasion, but certainly, I mean, I wouldn't have been having meetings with banks without understanding the banking supervision position, and I certainly would have been meeting with the people in banking supervision on a very frequent basis, weekly, and more often than that.

Senator Susan O'Keeffe: Okay. I think you said earlier that when you tried to introduce those measures about increasing capital for high loan-to-value mortgages in 2005-----

Mr. Con Horan: Yes.

Senator Susan O'Keeffe: -----you said you encountered the difficulty, environment of groupthink, I think was the expression that you used.

Mr. Con Horan: I don't think I used that, I think that's maybe from the report, but I don't think I used that expression.

Senator Susan O'Keeffe: All right, okay. Was there, I mean, you said I introduced measures in a "difficult environment of groupthink", I'm sorry, was that the only thing that was going on there, do you think, it was just groupthink, or was there other resistance to change, and if so, what might that resistance have looked like?

Mr. Con Horan: I think groupthink is a fair description of it; I think there was a view that, the predominant view was that interest rates were going to rise, therefore, the market would naturally calm itself down and as an organisation, no further intervention was required, and in fact it was concern that interventions such as regulatory interventions may in fact disrupt the market and may send out the wrong signals internationally. Personally, I didn't subscribe to that; I believed it was appropriate that we would intervene, and I think one of the important things I tried to achieve in 2006 was to establish the principle, very early in my term as prudential director, that intervening in the market didn't necessarily mean we were going to have horrendous problems. And I think that was one of the benefits of the intervention in early 2006.

Senator Susan O'Keeffe: Just finally, were you disappointed in 2005 when your attempts to intervene, if you like, were turned down?

Mr. Con Horan: I was-----

Senator Susan O'Keeffe: Or frustrated.

Mr. Con Horan: I was. Obviously, I had put a lot of effort into a paper and a lot of research into debt levels, international practices, etc., what was going on in other jurisdictions, so I tried to put out a fairly balanced and logical argument as to why we should begin the intervention at that point in time. There were other views that it wasn't necessary, and ... it didn't happen.

Senator Susan O'Keeffe: And they prevailed.

Mr. Con Horan: They prevailed at that point, yes.

Chairman: Listen, I'm aware that members are, nearly ten hours ago they came into the committee room this morning, but I would just remind them like that there ... that we do have to complete a line of questioning this evening, before we get through, because that's going to be quite extensive, if the line of questioning isn't followed up, as disciplined as we would usually do it. I appreciate it myself, I've been here since 9.30 this morning myself, like other members, and that can maybe create its own attention issues. Okay. Deputy Doherty, six minutes.

Deputy Pearse Doherty: Thanks a million, I think the same question that I've been given has been dealt with adequately, and if not, I'll take direction from the Chair. Can I ask you, Mr. Horan, in relation to a discussion we were having at this committee with another witness in relation to a letter that you signed in March 2008, to a financial institution, which talked about ... an institution having no access to ECB monetary operations, not having access to wholesale markets for funding in recent months, and were relying on retail and corporate deposits initiatives for liquidity? This was in, as I said, 2008. Would that not be a very serious issue if there was ... if it was an institution obviously ... there was, given your letter, of that nature, and what was the response by the office at that time?

Mr. Con Horan: I don't think I have the ... I don't think I've seen the letter in my pack. I may have missed it, but I don't think it's in my pack. But, I mean, I can maybe imagine who the institution, or one of two institutions that it would have been. I mean, clearly that would have been a concern about access to liquidity but that was not unique to one institution. I mean, the markets in March 2008 had gone very, very bad. There was severe shortages and concern at that stage right across the board. So, you know, I talked about the St. Patrick's Day massacre, that was a really difficult time, and markets were going extremely frightened at that point.

Deputy Pearse Doherty: And that fact that they would be shut out from ECB monetary operations and from the interbank market for a number of months, would that be more than just-----

Mr. Con Horan: Yes.

Deputy Pearse Doherty: -----you know, the liquidity pressures that were being felt across the financial sector at the time?

Mr. Con Horan: Yes, I mean, certainly, I mean, at that time access to ECB financing was extremely important, and, you know, a lot of our work around that time was making sure that banks had sufficient collateral in hand to gain more ECB funding. So the fact that somebody was out of that at that point in time, I can't recall the specific, but would have certainly added to the problems.

Deputy Pearse Doherty: Okay. Mr. Horan, I want to refer to the core document booklet, Vol. 2, page 134. It's a short reference anyway, but the document references the fact that towards the end of 2007, Irish banks had already lost between 30% and 50% of their value since the start of the year and that this was due to the exposure of Irish banks to the Irish property market. Would you agree or disagree with this analysis at the time that the banks' exposure to property and the knowledge within the investor circle was having a negative effect on the share price?

Mr. Con Horan: Yes.

Deputy Pearse Doherty: Yes. Was the perception of the Irish financial sector's overexposure to commercial and residential property a correct or incorrect perception, in your view?

Mr. Con Horan: I think clearly, as it has turned out, it was a correct view at the time, yes.

Deputy Pearse Doherty: And can we say or not that by the end of 2007, it was common knowledge in investor circles that the Irish financial sector was overexposed to commercial and residential property, and that this knowledge of the overexposure risk was being reflected in the share price?

Mr. Con Horan: I think that certainly would have been one of the issues that was reflected in the share price. I mean, I think there were a number, there would be a number of drivers to that point in time, such as the liquidity strains, the size of the Irish banks, etc., they weren't able to compete in the same way as major globally systemically important banks would. So being a small jurisdiction with small banks would also have played on the pressures, but I'm not taking from your point in terms of the property market; it was the issue that was relevant and would have been commented on at the time.

Deputy Pearse Doherty: Is it your view or not that, given that the share price had dropped significantly, as was said between 30% and 50% in the end of 2007, that the markets had already made up their minds in relation to certain financial institutions in this State?

Mr. Con Horan: I wouldn't ... I wouldn't agree with that. I wouldn't fully agree with that. I mean, I think it's fair to say that right across the board at that stage, internationally, banking share prices were under huge pressure. I mean, we'd already had the ECB intervention on 9 August, and they were not ... that was not related to Irish banks, that was related to the banks in another jurisdiction who'd run into liquidity problems. So, you know, there was a lot of problems across the market. This was the feature of the Irish market. There were different features in other markets in terms of exposure to US securitisations, etc. Clearly, the US banks were in serious trouble at that stage as well. Northern Rock, one of the-----

Deputy Pearse Doherty: Yes.

Mr. Con Horan: -----UK banks, had already collapsed. So there was a lot going on.

Deputy Pearse Doherty: Mr. Horan, finally, before I run out of time, you mentioned about being vilified in the media. You mention in your opening statement that you believe you are a contrarian voice, and you've added evidence to the committee in relation to back up those assertions. In relation to being vilified in the media, can I ask you, because the Irish public would be very aware of your involvement in the Anglo tapes, your voice appearing on the Anglo tapes.

Mr. Con Horan: Yes.

Deputy Pearse Doherty: And-----

Chairman: You'll have to be careful now, Deputy.

Deputy Pearse Doherty: I will and I'll take direction, and if Mr. Horan doesn't want to go down this direction-----

Mr. Con Horan: No. I'm more than happy to.

Deputy Pearse Doherty: Yes. The question I had to ask you was in relation to the sanctions, but it was being dealt with by Mr. MacSharry. But, the question then is if the Central Bank isn't given administrative sanctions - and I believe that the recording in the Anglo tapes was you suggesting to executives in Anglo, or senior bankers in Anglo, or a senior banker in Anglo, to act ethically, and to not kill the golden goose of the bank. And not to suggest that there was any unethical behaviour, but the comments that are in the public domain, and not to kill the golden goose of the guarantee. But there was subsequent recordings, which shows a bit of laughter and jousting and-----

Chairman: Sorry, Deputy I'm going to have to pull you back because-----

Deputy Pearse Doherty: Okay.

Chairman: -----we, we're right on the edge now, right on the edge, really. So, you're out of time.

Mr. Con Horan: It's a topic I'd like to deal with.

Chairman: I'm not ... yes, I wouldn't even ... I don't even want to know what your inner thoughts are on this one, Mr. Horan, okay?

So I just want to return to one issue there. Why were the stress tests not effective in predicting the bank's failures?

Mr. Con Horan: I think the most obvious reason is that the scenarios that were developed were adverse. You know, the adverse scenarios that developed in no way reflected the events that occurred in 2008. And quite frankly, if you had put those scenarios out in 2006 nobody would believe them. I mean, we have to recall that this was the period that the economists had coined as the great moderation. This was a period of stable interest rates, stable inflation, stable banking that had been going on for a decade. What actually happened in 2008 was simply not on the radar screen. If you had tested for that, the scenario that occurred if you had tested for it, I suspect would have shown failures of the banks, but I just think the scenario was not contemplated.

Chairman: Okay. Thank you. Deputy Phelan.

Deputy John Paul Phelan: Thank you, Chairman. Good afternoon, Mr. Horan.

Mr. Con Horan: Deputy.

Deputy John Paul Phelan: I just have a couple of questions. Firstly, I want to ask you to outline for the inquiry was there any internal guidance system or manual in operation as to how the regulator would handle breaches of principles or other regulatory breaches?

Mr. Con Horan: In 2005 there was preparations made for the administrative sanctions regime at that time, yes.

Deputy John Paul Phelan: And what was the format like? Was it general guidance, or-----

Mr. Con Horan: At two levels. So there was the general guidance coming from the authority at that stage was ... literally the administrative sanctions was coming on stream, and taking over a year to get developed and develop the systems. What each department was asked to do at that stage was to go through all the legislation that applied to their particular area and try and rank the issues in terms of actions where sanctions might be contemplated. But at that point, as I said earlier I think, was that the decision of the authority at that stage was we would focus on the consumer issues. The chief executive would prepare a plan as to how eventually things would be rolled out, but the prudential was not given the same prominence at that point.

Deputy John Paul Phelan: So there wasn't really a formal document or-----

Mr. Con Horan: There would have been. So there would have been board papers showing the approach with administrative sanctions, I think around May 2005. And then there would have been guidance coming from the legal people in terms of ... and an expectation as to what the ... what each department had to do.

Deputy John Paul Phelan: Okay. I want to turn to your statement on the issue of corporate governance and proposals that you made in 2005, and I want to quote directly again, and you referenced it I think in some of the previous answers that you've given. You state:

> In May 2005, I proposed to the Authority a corporate governance regime for banks and building societies. This proposal was to impose a formal condition on the licences of all credit institutions, thereby laying a strong foundation for the taking of enforcement actions under the administrative sanction regime that was being developed at the time.

If you could briefly maybe elaborate a little bit more on that particular proposal, and also elaborate as to why you believe that it didn't come to fruition?

Mr. Con Horan: Yes. I mean, the origin of the proposal was ... well, one, I thought it was the proper thing to do in terms of the principles-based approach to regulation, corporate governance was at the core of what we needed to do. And there was no real articulation of what the best practices were and I thought it was appropriate to put in a floor or a standard of corporate governance. I think the second point ... the second driver for me was that there were significant challenges with particular institutions in terms of their corporate governance and I wanted to put in measures that would enable administrative sanctions to be taken in the future against those particular ... circumstances. It was around May 2005 I made the proposal and administrative sanctions were literally coming on stream very soon after that. I did go the authority, I think, on two occasions that year with this particular paper. There was consultations with the industry in between but I think I've set out there my understanding of the ... the view was that the markets ... the institutions were overburdened with regulatory burden at that stage. The financial services action plan had just been going on a for a long time ... we had come out ... statements had been made that we weren't going to overburden the industry with additional rules at that point in time and it was just seen as a step too far, I think, is my opinion as to why it wasn't accepted.

Deputy John Paul Phelan: All right, thank you.

Chairman: Okay, thank you very much. Just in following up to Deputy Phelan's question there with regard to internal guidance manuals and how to handle breaches of principles and other regulatory matters, you said that preparations were made in 2005, Mr. Horan, yes?

Mr. Con Horan: On administrative sanctions?

Chairman: Yes.

Mr. Con Horan: Yes.

Chairman: Okay. Did you not also say that there was one in place when you left in 2008? That there was similar type of-----

Mr. Con Horan: Procedures?

Chairman: Yes.

Mr. Con Horan: Well, to the best of my knowledge, the same procedures applied across the board. I don't think there was a change that I can recall.

Chairman: Okay, all right. Thank you. Next questioner, Deputy Michael McGrath.

Deputy Michael McGrath: Thank you, Chair. You're very welcome, Mr. Horan.

Mr. Con Horan: Thank you, Deputy.

Deputy Michael McGrath: Can I start by asking did you judge the IMF country reports and OECD reports as an important information instrument to aid in banking regulation and banking supervision and financial stability issues?

Mr. Con Horan: Absolutely, particularly ... I mean, the IMF was, you know, it's a hugely influential organisation in the context of supervision and the approach that's been taken. And, being honest with you, I, you know, I took great comfort from the fact that they had seen significant improvements in 2006 in the regulatory regime and the fact that they were recommending that the prudential director would be put on the board of the authority. I think ... so that was important and clearly the OECD's views on the market were also vitally important and influenced a lot of people.

Deputy Michael McGrath: Thank you. There may be a view that the approach of principles-based regulation arose from the new structure in 2003 but you state in your opening statement "The core strategy of IFSRA was a 'principles-based' approach. It was a continuation of the approach to supervision, previously adopted by the Central Bank." So, can you clarify, in your view, since when - in Ireland - was there a principles-based approach to regulation of banks?

Mr. Con Horan: Certainly, from my experience of looking ... when I went into banking supervision in 2003, that had been the way, I'd say, for the previous decade.

Deputy Michael McGrath: Okay and the origin of it ... the ultimate origin of it?

Mr. Con Horan: I-----

Deputy Michael McGrath: Legislation, European guidance?

Mr. Con Horan: I think it was probably practice in a lot of jurisdictions at that time. I mean----

Deputy Michael McGrath: Established practice?

Mr. Con Horan: Established practice, not only in Ireland but elsewhere. I don't think we would have been out of sync with the rest of Europe, etc., at that point in time.

Deputy Michael McGrath: Okay. In your opening remarks - and I don't believe it's in the witness statement - but you made reference to an *Irish Times* article which cited an instance of you knocking on the door of Mr. Neary when you became prudential director and highlighting concerns and looking for action. You quoted it, presumably from the perspective that it's accurate, so can you tell us in your own words what happened in that instance?

Mr. Con Horan: Yes. I mean ... maybe they're not my words but they're a media interpretation of it and, again, I can't tell you the exact origins of that but-----

Deputy Michael McGrath: Sure.

Mr. Con Horan: Yes ... I mean ... when I became ... just to briefly recap again, I clearly made my proposals in 2005 for the increase in capital when I was head of banking supervision. I hadn't got it through. When I became prudential director, I spoke to the chief executive to say that this was the issue that I felt was the biggest risk we were facing in banking supervision and I really felt that we needed to do something to intervene into the market at that point in time because I ... I'd looked at other international cases and that was the driving force behind my desire to commence action immediately. And I spoke to him because I would have needed his support.

Deputy Michael McGrath: And just to clarify, you felt that it was the most important issue and that issue being higher capital charges for high loan-to-value mortgages?

Mr. Con Horan: Well, yes, I ... the market and the way the market was going ... the levels of growth in the market, I was not comfortable with. The immediate issue that we needed to deal with I felt was the residential ... the high loan-to-value ratio loan, but in the paper I put forward in February 2006, I also signalled to the authority at that stage that we were going to look at the commercial property sector as well.

Deputy Michael McGrath: Okay.

Mr. Con Horan: So it was a general approach and a desire to, kind of, intervene in the market and start taking action.

Deputy Michael McGrath: Okay. And apart from that paper which originated in August 2005, which at the time was rebuffed - it wasn't adopted at that point - are there other examples of measures you proposed during your time as head of banking supervision which you wanted to have implemented but which weren't implemented?

Mr. Con Horan: I think that ... I mean, I think that at the end of 2004, I would have been arguing for the establishment of specialist units to pursue administrative sanctions. I didn't believe at the time the way we were structured was correct. I didn't believe it was really feasible for accountants and people who were trying to understand the Basel process to also convert themselves into people who could take sanctions cases maybe up as far as the High Court. I believe that was a specialist area and I argued for that in writing and I think that's one of the areas that we maybe looking back ... I think when the new regulator, when the new environment was established, we have now two enforcement departments and I think that's probably the right way of approaching that-----

Deputy Michael McGrath: Okay, did you take specific measures on concentration risk, on the risk of the banks lending too much to one sector? Did you propose and initiate specific measures on that concentration, key concentration risk-----

Mr. Con Horan: Yes, I didn't ... I mean, I certainly would have considered it-----

Deputy Michael McGrath: Okay.

Mr. Con Horan: -----and I would have considered it as an option of what were my options in 2006? Quite frankly, the whole European thing had moved away from sectoral concentrations.

Deputy Michael McGrath: Sure.

Mr. Con Horan: It was not part of what was happening under the, kind of, best practices at a European level. And, quite frankly, IFSC entities, etc., and a number of businesses that were in place, it would have been extremely difficult to unravel it at that stage. So I did consider the option-----

Deputy Michael McGrath: Okay-----

Mr. Con Horan: -----but I didn't consider it feasible. But the capital was the better way-----

Deputy Michael McGrath: Finally, finally, Chair, if I may. And Senator MacSharry raised this but, can you just be as specific as possible on that May 2008 request by Ms Burke for additional staff resources. Where did that hit a roadblock?

Mr. Con Horan: If I recall on it I-----

Deputy Michael McGrath: Yes-----

Mr. Con Horan: -----I can't be ... I shouldn't be held to this but-----

Deputy Michael McGrath: She said she had your support-----

Mr. Con Horan: Yes, I mean, I had a ... I had ... because I had worked there, I had a particular sympathy for-----

Deputy Michael McGrath: Yes-----

Mr. Con Horan: -----for banking supervision. My recollection is that there were discussions within the budget and remuneration committee where we were ... where there were some sympathy towards the case that was being made by the management for additional resources-----

Deputy Michael McGrath: Okay.

Mr. Con Horan: -----but we were sent back to look at kind of, areas for savings, etc., so there was some push back at that particular point of time.

Deputy Michael McGrath: Who ... who was on that committee at that time? You were ... were you a member?

Mr. Con Horan: I would have ... I would have appeared before the budget and remuneration committee but I couldn't tell you the membership.

Deputy Michael McGrath: Or the chairperson?

Mr. Con Horan: I ... I can't remember exactly who it was. I can certainly find out and ... more than happy to give it to you.

Deputy Michael McGrath: I think that would be helpful.

Chairman: Thank you very much, Mr. Horan. Deputy O'Donnell.

Deputy Kieran O'Donnell: Thanks, Chairman. Welcome, Mr. Horan. Do you feel that the level of European macroeconomic and prudential supervision was adequate in the years between '03 and '07?

Mr. Con Horan: The European ... no. I mean, the answer is "No". It was a transitional period. Obviously '04, the Basel Accord was published. It moved a lot more flexibility to the banks in terms of how they did things rather than to the supervisory authorities. That was the forerunner to the capital requirements directive which began to be put in place then. I think ... I don't think anyone will doubt that that was not a robust system and I think the fact that I made there - that seven years on we're still correcting those errors in the regulatory regime and trying to improve and strengthen it, is testament to how poor it was at the time.

Deputy Kieran O'Donnell: Just on a quick note - on the night of the guarantee were you in any way consulted by your superiors?

Mr. Con Horan: On the night of the guarantee I was in Dame Street and my role was to provide information if the principals needed it in the course of their discussions. It wasn't just me, sorry, we kept a team of people there to do it. My recollection is I don't think we got any inquiries that night for additional information.

Deputy Kieran O'Donnell: So you weren't consulted as such-----

Mr. Con Horan: I certainly wasn't consulted on the decision. No.

Deputy Kieran O'Donnell: Can I just quickly - the stress-testing regime that was in operation, do you believe or not that the stress testing, proper stress testing, fell between two stools in terms of the regulator was in charge of in terms of mortgage, we'll say, stress testing, and, we'll say, the Central Bank took over stress testing from 2006 on. So did that process make for good stress testing? Did it compromise stress testing?

Mr. Con Horan: I disagree a little bit Deputy in terms of ... my recollection is the Central Bank was always in the lead on the stress-testing front because it was a matter of macroeconomic modelling, etc.

Deputy Kieran O'Donnell: But wasn't there a changeover in 2006?

Mr. Con Horan: No, I mean I think they still would have worked together, there would have been less involvement from the prudential side around that time-----

Deputy Kieran O'Donnell: We were told by Mary Burke when she was in that the stress testing up to 2006 was carried out by the Financial Regulator and that the Central Bank stepped in and, under questioning from my colleague, Deputy Phelan, she did agree that, in terms of stress testing of the banks in terms of mortgage lending - residential mortgage lending we'll say - that the supervision department in the regulator would look for a 2% stress testing above the interest rate they are being charged. So the question I am asking is - and you have made reference previously - could you explain why the Central Bank took over? And it does seem unusual that-----

Chairman: Could you just ask the question to afford some time for a response?

Mr. Con Horan: Sorry, just for clarity, I think there's two forms of stress testing that we're talking about here-----

Deputy Kieran O'Donnell: I'm talking about ... the main one I want is prudential stress testing of the balance sheets of the banks.

Mr. Con Horan: That was run by the ... the Central Bank would have been the driver of that stress testing in 2004-2006, in conjunction with the Financial Regulator.

Deputy Kieran O'Donnell: And prior to 2004?

Mr. Con Horan: I believe it was ... because it's macroeconomic modelling, my recollection is that form of stress testing has always resided in the financial stability side of the house. The stress testing you're talking about was a prudential measure, sorry the additional ... is a prudential measure that we opposed in 2007 to ensure that individual mortgages were stress tested because there was concerns that that wasn't happening in the market at the time.

Deputy Kieran O'Donnell: Okay. Can I ... did you in your role as director of prudential, were you on the seventh floor of the building in Dame Street at that time?

Mr. Con Horan: I was, from 2006, yes.

Deputy Kieran O'Donnell: Your colleague, Mary Burke, in her witness statement spoke about the disconnect between the seventh floor and the staff and she said that in a lot of cases that senior banking executives had director contact with senior executives without the knowledge of the supervisory staff. And she said that she tried to rectify that in October '06 but she said it had little or ... it was at it's most it had little or any impact-----

Chairman: Could you clarify the point you're making?

Deputy Kieran O'Donnell: I suppose the point I'm making is, is that she stated that it led to undermining the work of the supervision department and more particularly the banks took advantage of it in terms of regulation.

Chairman: Just be mindful now that the transcripts aren't up online yet so people might be making an abridged version of it. If it's not coming out as a statement it's coming out as testimony this afternoon I would be inclined-----

Deputy Kieran O'Donnell: Well, I'm trying to be in the time limit.

Chairman: I know that but quoting can be difficult if you don't have the exact words in front of you. I can give you a bit of flexibility in that area, Deputy.

Mr. Con Horan: Yes, I have ... I have the gist of the ... I mean, I had worked in banking supervision for a number of years, you know, as I said earlier on. I was conscious of making sure that that engagement continued and that we wouldn't have that disconnect. I would've met with banking supervision at the very least on a weekly basis and, I would have thought, in 2006, possibly on a daily basis, because I had been the previous head of the department-----

Deputy Kieran O'Donnell: And when you were previous head of the department, did you look for additional resources yourself?

Mr. Con Horan: Yes, we would have had our annual requests for resources.

Deputy Kieran O'Donnell: Do you believe you were understaffed?

Mr. Con Horan: Yes, we were very tightly staffed at the time. It was a huge ... I mean, not only had we ... I think, again, I've given evidence to say that in 2003 one of the big problems we ... we faced was that, with the establishment of the regulator, a lot of the staff in banking supervision were moved to other areas just because we were taking on additional functions. So we lost a lot of the staff and, I think, what I identified in 2004 was that the key risk that we had was developing expertise in basic supervision and we put a lot of effort, etc., into training and getting staff up and running. After that we had to get numbers and it was a very difficult time in terms of ... the Basel accord was coming on stream, needed mathematicians, etc., for some of the complexity around this ... it was very difficult to compete in that market.

Deputy Kieran O'Donnell: Well, I suppose, to finish with, do you believe-----

Chairman: Last question, Deputy.

Deputy Kieran O'Donnell: Yes. Do you believe that you had a lack of the necessary skill base, both in terms of the quality of personnel, in terms of their experience and their ... and their qualifications, and the quantity of personnel, to properly supervise the banks or was the tail wagging the dog?

Mr. Con Horan: No, I think with ... with the Basel accord coming through we ... we definitely struggled with the skillsets and being able to recruit them from the market. You know, I know that our head of Basel left just before the accord because it was ... you know, there was better opportunities in ... in the sector. So that was a constant problem of retaining the skills and being ... being honest with you, even now I'd say, looking back, we probably needed some additional skills that we hadn't got at that time that we didn't really think about. We were kind of prudentially focused in terms of the Basel accord but I think regulators are better ... better ... more efficient now with the credit experts and market experts and treasury experts - the people who've actually traded in the markets. So, I would say, yes, the construction and the ... the way you would set up a department now would be different, I think, to 2003 and '4.

Chairman: Thank you very much. Senator Michael D'Arcy. Senator.

Senator Michael D'Arcy: Thank you, Chairman. Mr. Horan, thank you for coming. In the DSG reports there's a lot of mention of ... this is the quotation "highlighting the inherent strengths of the Irish financial system and economy". Was the frequency of this particular stance not a cause of concern by members of the group?

Mr. Con Horan: So, in terms of the DSG, around 2007-----

Senator Michael D'Arcy: Yes.

Mr. Con Horan: -----I mean, the ... the view ... the macroeconomic view at that stage was that the economy was still in good ... good shape or at least should come through it. The GDP-

GNP was going to continue to grow and the macroeconomic view was that even the commercial property sector, etc., was holding up despite the problems elsewhere. I'm not an economist myself so I have to rely on the economists to give me that sort of information, but that was ... that was their analysis around that period of time.

Senator Michael D'Arcy: Can I ... can I ask you ... if you go to booklet ... Vol. 2 of your booklets, Mr. Horan, please, page 136. I believe this is 33AK redacted, so it won't be coming up on the screen. At the bottom of ... of page 136, the "International investor views and the share price of Irish banks have continued to fall". Am I allowed read this, Chairman, and exclude names of banks?

Chairman: Yes, just be general in the institutions, okay?

Senator Michael D'Arcy: Yes, okay.

> Irish bank share prices have continued to fall and have lost between 30% and 50% of their value since start of ['07]. Notwithstanding the posting of good results by [a bank] ... its share price fell by 6% that day, at one point falling 8%, perilously close to the 9% figure at which trading in a share is temporarily suspended. The decrease in value of Irish bank shares has been greater than in other countries. There is a general discount in the value of Irish banks as there is a perception internationally that they are exposed to property market - reinforced in a 7 November report from [another institution] setting out a negative perspective in the Irish banking sector because of property exposures.

Now that was in a report to the DSG, of which you are a member, I believe.

Mr. Con Horan: Yes.

Senator Michael D'Arcy: Can I ask you, which was the bigger difficulty? Was it a bigger difficulty that financial broker firms had decided that the Irish banks were in serious trouble because of their loan book or the liquidity crisis? Which came first? Which was the biggest problem?

Mr. Con Horan: It is very difficult for me to answer in terms of what the international investors' perspective was at that time.

Senator Michael D'Arcy: You were the banking supervisor.

Mr. Con Horan: I accept that but I would have had my own perspective. My own perspective at the time would have been it was largely liquidity driven but as I mentioned earlier on, liquidity and solvency are two fairly closely related issues. So to the extent that the international market was extremely nervous at the time and was wondering where it would invest its money, clearly one of the issues of concern to them would have been ... sorry, the major issue of concern to them would have been property, the Irish banks' exposure to property.

Senator Michael D'Arcy: Which was the biggest issue? I suppose what I am saying is the liquidity crisis ... this is almost a year, it is ten months before the guarantee. The liquidity crisis, while there was contingency planning for events, this was the November 7th report from a major player in the international markets stating quite clearly a negative perspective on the Irish banking sector because of property exposures, almost a year before it, before the guarantee. Which was the bigger issue? There was liquidity for other institutions at this stage. What I am trying to ask is, had the international brokers decided that the Irish banks were in trouble at this stage, as early as this and as a result of the losses, 30% to 50% of their share value in ten, 11-month period? Did one lead to the other?

Mr. Con Horan: I would disagree with what you said, that the banks were getting liquidity. November 2007 was a very difficult time in terms of ... they may have been rolling over liquidity but it would have been extremely short term, so that was a very difficult liquidity period in the run up to the year end. I won't, I can't overstate that. That was a huge issue.

Senator Michael D'Arcy: But it was available, liquidity was available.

Mr. Con Horan: It was available at very short tenures and lines were being cut probably at that stage as well, because everyone was being careful coming to the year end. Additionally, on top of that what was the big issue they were looking at in the Irish institutions was they were exposed to the property market so I'm not taking from your ... that was the issue that was added on top of that to cause the concern and walk away and sell shares.

Senator Michael D'Arcy: Were they more exposed than anybody else?

Mr. Con Horan: I think some of the analysis around that time I recall on sectoral concentrations was that the Irish market was less concentrated than some in the property and more than others that we were in. In 2007 I think there was a financial stability report which said we were around the average, there were certainly countries more exposed and countries less exposed.

Chairman: Last question, Senator.

Senator Michael D'Arcy: Can I just conclude then, there was a financial stability report in November '07, which stated that the Irish citizens were indebted, now the most indebted people in Europe, up to 248% of GNP and they also stated the difficulty in relation to the CRE sector. Again, the coincidence of the FSR report, this report that you had sight of and a further ten months down the line. Did the banks' balance sheet exposure lead to the liquidity crisis?

Mr. Con Horan: I think that for me, the liquidity crisis was an international crisis from August 2007.

Senator Michael D'Arcy: Was ours worse than anywhere else?

Mr. Con Horan: It is difficult for me to say but I know other jurisdictions we were talking to were under severe pressure at that point in time as well. I mean, the US market clearly had had-----

Senator Michael D'Arcy: Just to finish-----

Mr. Con Horan: -----a horrendous time at that stage.

Senator Michael D'Arcy: -----was ours worse than anywhere else?

Mr. Con Horan: In terms of liquidity?

Senator Michael D'Arcy: In terms of liquidity.

Mr. Con Horan: My guess is not, but I wouldn't have had access to what was going on in other banks. But, internationally, banks were struggling hugely around that time and it wasn't a uniquely Irish issue in November 2007.

Senator Michael D'Arcy: Ours wasn't?

Chairman: Okay, thank you.

Senator Michael D'Arcy: Okay.

Chairman: I just want to wrap up now, just with a couple of matters and I just want to come back to just an earlier question, I think it was with Senator Barrett you had, Mr. Horan, and it was to do with the issues of excessive credit growth and particularly sector risk concentration. And I'll go on to a question in regard to the auditors later, but I think this kind of is an auditing related question anyway. Were there clear guidelines about the different sector definitions issued by the banking supervisors and, for instance, in property; everything seemed to be in the property basket, whether it was a buy-to-let, a mortgage for oneself, a residential mortgage, or somebody was developing a big shopping centre?

Mr. Con Horan: So, you're absolutely correct. I mean, it was categorised under "Property" depending on, you know ... that was the allocation, so people were put into buckets at that stage. The reality was, underneath that, then there were all sorts of different risk exposures and I'll go back to my earlier comment about what was the common predominant risk factor. A property in, I think, Sligo was the example I used, versus one in London, are not subject to the same common ... at least they wouldn't have been pre-crisis, common predominant risk factor. So it did require an analysis of the book to see where the exposures were at that time.

Chairman: I'm trying to establish were there guidelines actually sent out by you and your sector that provided clear definitions and different definitions by banking supervisors?

Mr. Con Horan: Yes, the answer to that is "No", Chairman. Quite frankly, I don't believe it's possible, even now, with the new regime, I'm not aware of anybody who has that sort of capacity to delineate the entire economic sector into buckets that automatically are ... so that's the way it is under-----

Chairman: Okay. So, by your own statement, because it wasn't actually set out, was it potentially then possible that the interpretation of sectoral concentrations, that that was really left to the banks who could interpret those concentration levels subjectively?

Mr. Con Horan: Well, I think the approach, as I recall it, was to the extent that banks were over those limits, there was a process of engagement went through to just see where their exposures were. So, if the book was split between the UK and Ireland and the US, you might say, "That's diversified enough". If it was one in development land, another in-----

Chairman: Yes.

Mr. Con Horan: -----investment property, etc. ... so, I'd make the point that, even under the current international practice-----

Chairman: Yes.

Mr. Con Horan: -----the approach is a case-by-case analysis of the banks. The banks must make their own adjudication on their sectoral concentrations. They must put aside capital for that and the regulators must always ... to see are they comfortable with it, but I don't believe internationally there's anybody has a structure that they just apply for sectoral concentrations.

Chairman: But in continuous testimony here, and even in your own engagement this afternoon, it wasn't banks investing in start-up companies, it wasn't banks investing in IT, it wasn't banks investing in dotcoms or tulips or anything else like this, it was banks putting shed loads of money into the construction sector in one manifestation or another. So, in your opinion, should clear guidelines have been issued by the Financial Regulator to get this area defined, because it was very much a holistic interpretation? Should clearer definition lines have been there?

Mr. Con Horan: I mean, I think the ... I think it would have been extremely difficult to have a clear definition around that. I mean, I'm not taking from the fact that, clearly, the sectoral concentration and the exposure to the property market is the kernel of the problem we had. Predefining that, I think, would have been difficult without banks being able to ... and, I think, Governor Honohan has acknowledged this in his report, that this sort of structure was too easily evaded and, quite frankly, if you did it, it would have impacted significantly on the IFSC, etc. As I say, internationally I don't believe anybody has that structure currently.

Chairman: Okay. I'm just going to move on. In your statement, its in your opening statement there, it's in the very last line of it actually or the last paragraph of it, Mr. Horan. You say that "Audits and other forms of analysis undertaken failed to identify the looming issues that emerged in 2008 and 2009." And just giving our earlier conversation, can you explain why you think this was the case?

Mr. Con Horan: So the last line of-----

Chairman: In your statement you suggest ... its in the very last line of your statement:

> The solvency of credit institutions was an issue of concern throughout the crisis. It was vitally important to the management of the crisis and was, therefore, subject to ongoing consideration within the CBFSAI. The various audits and other forms of analysis undertaken at that time were suggesting that the banks were meeting their solvency obligations.

So, in that regard, we had auditors in here last ... they didn't pick up the crisis that was coming down the tracks. In fact, all the banks that they were auditing, each and every one of them, were on record as saying that it came as a huge surprise to them. None of them saw it.

Mr. Con Horan: Yes.

Chairman: And I'm assuming that the ... was the crash ... well, I won't assume I'll ask ... I'll ask you the question, was the collapse of every bank in the Irish State in one way or another a surprise to you?

Mr. Con Horan: Yes. Yes. Certainly in September 2008 I didn't imagine that we were facing that.

Chairman: So can you explain why that is the case?

Mr. Con Horan: Yes, I mean you're absolutely right in your analysis. I think auditors were going in and ... and let's bear in mind in 2008 auditors were sending in larger teams than normal to do additional analysis of the individual banks, didn't see what was happening. Rating agencies right up to mid 2008 were commenting on, going back to your earlier point, that the banks were reasonably well diversified to be able to handle the problems.

Chairman: Yes. Yes.

Mr. Con Horan: My own view is that the scale of the deterioration post-Lehmans in September 2008, was on a scale that none of us imagined was going to happen. And when you have massive withdrawals of liquidity out of the entire global banking sector, all asset values dropped far more significantly than you could ever have imagined before.

Chairman: Okay. I'm aware of the rating agencies and all the rest of it. But, kind of, in analogist terms, they're living down the road. You were in the house. You weren't living next door, you were meeting with these institutions. You were engaging with them on a day-to-day basis. You weren't abstractly removed or you weren't, kind of, taking a macro overview from a distance. You know that somebody up the road everything looks okay because there's a reasonably new car outside the door, the children are going out to school every morning. You were inside in the house.

Mr. Con Horan: I absolutely was. But let me just put some perspective on that, you know. The directors of the individual banks where primary responsibility lay, were even closer to those institutions. The risk managers in those institutions with you know large staffs, etc., the internal audit functions, they didn't see those problems coming ... or certainly they didn't come to us to identify that there were problems. So those who are actually ... yes, we had a perspective and we saw what was going on across the board, but that perspective is always going to rely, to some extent, on the institutions and the control systems that they have. It's always going to rely, to some extent, on the audits and what's being produced from there. And I can only go on those facts as presented to me and the facts at that stage, together with the macroeconomic analysis, was that it wasn't as significant as it clearly turned out to be.

Chairman: Senator MacSharry, wrap up please.

Senator Marc MacSharry: Great, yes thanks. Just two quick ones. In October 2008, did you watch Mr. Neary on "Prime Time"? That was the one where he extolled------

Mr. Con Horan: Actually, I don't think I did I think we were in ... in the office at that stage.

Senator Marc MacSharry: Okay. So you never saw it back or-----

Mr. Con Horan: I may have seen it. I may have seen parts of it in various programmes but I don't think I ever looked at the whole thing.

Senator Marc MacSharry: Around the time like or-----

Mr. Con Horan: I honestly don't know. I mean-----

Senator Marc MacSharry: You were aware ... were you aware or not of his-----

Mr. Con Horan: Oh no, certainly no. I was aware ... I was in the office when-----

Senator Marc MacSharry: -----extolling the solidity of the capitalisation of the banks?

Mr. Con Horan: No. I was aware before he went so I'm not saying I wasn't aware that he was heading to do the interview.

Senator Marc MacSharry: Yes, but just the content of it. It's, I suppose, a quite famous ... the content was very much that the banks were very, very well capitalised. "The best in Europe," I think was the quote on the night. Were you aware of that content at the time?

Mr. Con Horan: I was aware of the general ... the general-----

Senator Marc MacSharry: October 2008.

Mr. Con Horan: -----message that was there. Yes.

Senator Marc MacSharry: And what would have been your view at the time?

Mr. Con Horan: My view was that we were in an extremely difficult situation.

Senator Marc MacSharry: Did you agree with it?

Mr. Con Horan: I think in terms of the capital of the banks, I don't think that we were the highest in Europe that I'm aware of, but we believed at that stage that the banks were capitalised or at their solvency ratios. They were clearly, though, under enormous pressure, and it was a very difficult message at that point in time in terms of how you presented that message without exacerbating the problems that were already there. So, again, I can't look at the ... I actually don't believe that I've looked at the actual wording, but it was a very difficult and challenging time to get the message-----

Senator Marc MacSharry: But you wouldn't use "The best in Europe" as ... in your own words?

Mr. Con Horan: I don't believe at that stage that we were the best in Europe.

Senator Marc MacSharry: Okay.

Mr. Con Horan: My recollection ... I ... I ... I-----

Senator Marc MacSharry: And just------

Mr. Con Horan: We ... we ... we probably would have been perceived, though, as having high capital ratios at that stage.

Senator Marc MacSharry: Was Mr. Neary your line manager from 2003 on? Did you report directly to him?

Mr. Con Horan: Yes.

Senator Marc MacSharry: So he was the director of prudential when you were manager or head-----

Mr. Con Horan: Correct.

Senator Marc MacSharry: -----of bank supervision and then he became CEO and, presumably, you reported to him then.

Mr. Con Horan: Correct.

Senator Marc MacSharry: Okay. Did he rebuke your advances in terms of the regulatory improvements that you sought to make?

Mr. Con Horan: No. I mean, in 2006 ... when the measures were introduced in 2006-----

Senator Marc MacSharry: But before that, as head of banking supervision.

Mr. Con Horan: My understanding was in 2005 when I made those proposals that he was broadly supportive of them but when he got into negotiations at a higher level, he hadn't been able to get it across the line.

Senator Marc MacSharry: So to the extent that you can judge, he was supportive but he came back with the message that, "Look, this isn't working."

Mr. Con Horan: Yes. And-----

Senator Marc MacSharry: Okay.

Mr. Con Horan: -----you know, in 2006 when we went, he was supportive of those measures at that time.

Senator Marc MacSharry: And then in his new role and your new role, he was supportive of what you sought to introduce.

Mr. Con Horan: He was supportive ... yes, certainly, in 2006. I mean, I think he might have been a little bit less aggressive than I was in mid-2006, but I think by ... come September he had come on board in terms of that we needed to tackle the-----

Senator Marc MacSharry: And very finally, do you recall that when the remuneration and budgeting committee were considering the approaches which you felt were justified, having been in the position yourself, for more staff for bank supervision, do you recall was Mr. Neary involved in that decision?

Mr. Con Horan: Yes, he would have been involved in those discussions.

Senator Marc MacSharry: Okay.

Mr. Con Horan: Yes. He would have led the side from dealing with the directors, yes.

Senator Marc MacSharry: Okay. Thanks, Chairman.

Chairman: Okay. Deputy Murphy.

Deputy Eoghan Murphy: Thank you, Chairman. And thank you, Mr. Horan. I just ... to conclude, I want to look at one document, if I may, and it's in Vol. 2 of your booklet, page 127.

Mr. Con Horan: Yes.

Deputy Eoghan Murphy: This is a meeting on 26 September, so it's the Friday before the guarantee. And at this meeting, three representatives from Merrill Lynch are making a presentation to five others, including the Minister, and including yourself.

Mr. Con Horan: Yes.

Deputy Eoghan Murphy: Is this the domestic standing group meeting?

Mr. Con Horan: I would say not. The domestic standing group didn't stay in, you know, clear format. At this stage of the crisis, there was a lot of meetings literally going on all day long, but the main players were there from the domestic standing group.

Deputy Eoghan Murphy: This meeting continued on the Sunday, the day before the night of the guarantee. Were you at the meeting on the Sunday?

Mr. Con Horan: I was, yes.

Deputy Eoghan Murphy: You were. Okay. And just on the second last paragraph on that page, it says, "On a blanket guarantee for all banks - ML felt could be a mistake and hit national rating and allow poorer banks to continue." What was the reaction to that? And was there any discussion at that point in time about partial guarantee, either for five banks or for four banks?

Mr. Con Horan: I don't recall that there was. I think ... my recollection - and it's a long time ago at a very difficult time - is that that was their initial reaction. So they were putting out their views at that stage to the attendees in terms of what the various options and what their perspective was, and we continued in that discussion the following morning.

Deputy Eoghan Murphy: Okay. And when that discussion continued, the possibility of a five-bank or a four-bank guarantee, was that discussion held, given what was stated there at that meeting on a blanket guarantee?

Mr. Con Horan: I don't recall ... I don't recall that issue being discussed. I can't be clear but I would not have thought so.

Deputy Eoghan Murphy: Okay. You would not have thought so.

Mr. Con Horan: I wouldn't have thought so, but, again, I ... I ... I'm ... being honest with you, I cannot actually remember the meetings themselves, so what happened ... I remember there was a meeting in the NTMA the following morning, that Merrill Lynch came in and gave their views, if I recall correctly, on what they'd seen in individual banks. So there was an elaboration on the work they were doing but, to the best of my knowledge, we didn't get into specifics on guarantees and things like that.

Deputy Eoghan Murphy: Do you remember then if Merrill Lynch, at that follow-up meeting, was sticking to the warnings against a blanket guarantee?

Mr. Con Horan: I don't ... I genuinely couldn't say that to you. I don't remember the meeting well enough, I just have a recollection of the meeting.

Deputy Eoghan Murphy: Okay, and just as a final question then. So, you don't participate in the follow-up meetings on a Monday and a Monday evening in terms of being in the room, as you were then, so have you briefed Mr. Neary in the interim as to what is happening? And do you ... did you brief him with the recommendation?

Mr. Con Horan: I mean, I've no doubt I would've briefed internally in the bank, both Mr. Neary, the Governor and other people in terms of what was going on. These were clearly important meetings at the time. My role would have been to participate in them, because I had knowledge of the banks, and then report in to the principals in terms of what was being discussed.

Deputy Eoghan Murphy: With a recommendation ... would you brief with the recommendation as to a view?

Mr. Con Horan: I'd say ... I mean, I suspect, my view is I would have given an outline of what was discussed in the meeting at that point in time.

Deputy Eoghan Murphy: Okay, and you didn't keep a minute yourself of this ... of these meetings?

Mr. Con Horan: I ... I don't think I did at that stage. I mean, meetings were happening literally every minute of every day around that time and, you know, we were working 18 hours or longer every single day at that point in time. So, yes, you know, there would have been somebody ... I mean obviously there were people keeping note of the meetings at that point.

Deputy Eoghan Murphy: Okay, thank you very much.

Chairman: Okay, I just want to wrap up with just getting an overview ... maybe ... situation from you, Mr. Horan, in regards to the IFSRA's view of liquidity situation of the Irish banks. And ask you did you get any sense of urgency or concern from the banks as regards their funding or liquidity positions in the three months immediately prior to the issuance of the guarantee?

Mr. Con Horan: Yes, they would've been ... the banks still would have been struggling at that stage, so the ... my recollection is early in the year things were very difficult. My recollection is then around May the markets began to improve and then, June, July, things start to deteriorate again.

Chairman: I just want to take you ... this won't be displayed, but it's Vol. 1, page 93.

Mr. Con Horan: That's core documents Con Horan?

Chairman: Yes, indeed. And it's a letter from the regulator's office to a financial institution. And in that correspondence ... are you familiar with it?

Mr. Con Horan: 92 or 93?

Chairman: It's page ... it's actually 97 and 98 in my document here ... it's the ... sorry, I'll just put it up for you there now. Page 97 in the core document.

Mr. Con Horan: Yes.

Chairman: 93, so I might've mis-referenced that there. Are you familiar with that correspondence, are you?

Mr. Con Horan: I've seen it as part of the correspondence, yes.

Chairman: Were you familiar with that correspondence at the time of its issuance or there ... or some time afterwards?

Mr. Con Horan: I don't recall it, no, no.

Chairman: When would you have seen this correspondence for the first time?

Mr. Con Horan: I think, when I saw the core documents.

Chairman: Okay, was the contents of that correspondence at any time discussed at any meeting that you were in attendance to?

Mr. Con Horan: It didn't ring a bell to me when I saw it. I thought it was an example ... of what ... so, the specific letter, I'm not sure that I saw it. It certainly didn't ring any bells for me at all.

Chairman: Looking at it now and given that we were speaking about the three months before the guarantee that there was a liquidity crisis ... that there were liquidity issues in the sector, was this indicating ... or did this have potential to indicate that it was more than once ... in fact it was over a year beforehand, that there were significant liquidity matters that were on the radar of the regulator's office at the time?

Mr. Con Horan: So, just that I'm right, this is the letter 28 September 2007?

Chairman: Yes, yes.

Mr. Con Horan: My reading of that letter was that we had just introduced, in July 2007, new liquidity requirements for the banks. So there was a whole set of liquidity requirements came into effect, I think it was 1 July 2007. When I read this, my view was that this was teething issues with the reporting system around that at the time. It was a new set of regulations and this was ... problems with the reporting to the regulator at that time.

Chairman: Are you describing this as a teething problem?

Mr. Con Horan: Again, I'm just trying to ... when I read it, my view was that this was just, yes, the initial ... it probably would have been the first return that came in after the new requirements came in. So there was reporting problems in it.

Chairman: I know, but you can have difficulties with new legislation, new measures come in, because people have to get up to speed and all the rest of it, which are kind of teething issues. Are you saying that this is a teething issue, and it's not a liquidity issue?

Mr. Con Horan: My reading of the first three bullet points is that the ... there were some, we had noticed some errors ... that there was manual interventions needed in the reports, and they needed extra resources to generate proper reports. And we were just advising them at that stage was that the liquidity requirements were statutory requirements that had been imposed as a condition of their licence. So it doesn't read to me that it was indicative of stresses in that bank's book at that time.

Chairman: Finally, just to ask you, Mr. Horan, by means of closing comments, I give you the opportunity to close this evening's engagement. In your opinion, what steps could have been taken to avert a crisis, and what would it have been, and at what time would you have made those interventions?

Mr. Con Horan: I mean, I've obviously thought about this quite a lot over the years. My view, looking back on it now, is that from the early ... from the mid-1990s right up to 2001, 2002, the market was very active at that stage, the lending was very high, and that continued obviously into 2003 to 2006. My view is probably at that stage, at the earlier stages, before the system became dependent, almost, on the property market, that the interventions, maybe regulatory interventions, from an earlier stage would have curtailed it, and we should have had some targets in our mind as to what was acceptable levels of growth right throughout the period. So, I think it was a ten-year property bubble, and I think it's ... we left it too late in terms of the intervention.

Chairman: Thank you. So with that said, I'd like to thank you, Mr. Horan, for your participation today, and for your engagement with the inquiry, and now to formally excuse you, and to propose that the meeting is adjourned until 9.30 a.m. on Thursday, 28 May. Is that agreed? Thank you.

The joint committee adjourned at 7.43 p.m. until 9.30 a.m. on Thursday, 28 May 2015.