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AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉI-REACHTA

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Déardaoin, 28 Bealtaine 2015

Thursday, 28 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.

Nexus Phase

Central Bank-Financial Regulator - Mr. Patrick Neary

Chairman: As we have a quorum, I'm calling the meeting into public session. Is that agreed? As we have a quorum, the Committee of Inquiry into the Banking Crisis is now in public session and can I ask members and those in the public Gallery to ensure that their mobile devices are switched off. Today's session 1 is a public hearing with Mr. Patrick Neary, former CEO of the Irish Financial Services Regulatory Authority and in doing so, I would like to welcome everyone to the 30th public hearing of the Joint Committee of Inquiry into the Banking Crisis. Today, we continue our hearing with senior figures from the Central Bank and Financial Regulator who had key roles during the crisis and before.

This morning and this afternoon, we will hear from Mr. Patrick Neary, former CEO of the Irish Financial Services Regulatory Authority. In this morning's session, we will focus on the period of Mr. Neary's tenure up to October 2007, while the afternoon session will focus on developments in the period from November 2007 to January 2009.

Patrick Neary joined the Central Bank in 1971 and, in 2003, was appointed prudential director of ISRA; in 2006, we appointed chief executive of the IFSRA, a position he held until his retirement in January 2009. Mr. Neary, you are very welcome before the inquiry this morning.

Mr. Patrick Neary: Thank you, Chairman.

Chairman: Before hearing from the witness, I wish to advise the witness that by virtue of section 17(2)(*l*) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to this committee. If you 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're 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 and IFSRA 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 bank inquiry also has 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 effect the questions asked and the answers that 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, only 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 the screens here in the committee room. For those sitting in the Gallery, these documents will be displayed on the screens to your left and right and members of the public and journalists are reminded that these documents are confidential and they should not publish any of the documents so displayed. The witness has been directed to attend this meeting of the Joint Committee of Inquiry into the Banking Crisis. You have been furnished with booklets of the core documents. These are before the committee, will be relied on in questioning and form part of the evidence of the inquiry. So, if I can now ask the clerk to administer the oath to Mr. Neary.

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

Mr. Patrick Neary, former Financial Regulator.

Chairman: Thank you, Mr. Neary, and if I can now invite you to make your opening remarks to the committee, please?

Mr. Patrick Neary: Thank you very much, Chairman. I have an abbreviated version of the statement that I provided some weeks ago and I don't believe the ... either yourself or the members have it. So, good morning again, Chairman, and members of the committee. As the chairman has introduced me, I'm Patrick Neary. I held the position of prudential director of the Irish Financial Services Regulatory Authority from 1 May 2003 until 31 January 2006, after which I was appointed to the position of chief executive from 1 February 2006 until 31 January 2009. Before I begin my statement, I would like to say that, with hindsight, the supervisory measures taken by the authority, which I will be outlining in this statement, were not sufficient to meet the challenges posed by the crisis and the recession that emerged. I am deeply sorry about that.

I'd like to describe the various regulatory actions and initiatives taken by the authority over the period up to end-2008 such as higher capital requirements, new liquidity requirements, new requirements for impaired loans, new fitness and probity tests, new consumer protection requirements for impaired loans, better regulation policy and oversight by the IMF and the OECD.

I will begin with the regime of prudential supervision. The Central Bank Act 1971 first established the prudential supervision of banks in Ireland. The primary purpose of prudential supervision is to safeguard, as far as possible, depositors in banks. In fact, no prudential supervision of any entity involved in lending is required if that entity doesn't also take deposits. The approach to supervision by the authority derived from EU banking supervision legal requirements. The authority's approach, in the same way as that of other countries' banking supervisors, was subject to ongoing best practice review and external assessment by international bodies such as the IMF and the OECD. These agencies benchmarked in detail the authority against a framework of principles entitled the Basel Core Principles for Effective Banking Supervision. The conclusions of all these assessments by these independent expert bodies in relation to the authority were very favourable, such as would indicate that the approach of the authority was at least as good, if not better than other authorities reviewed by those agencies. The five key constituents of the Basel core principles, which are fundamental to the prudential supervision of banks, are referred to as the CAMEL principles; which is an acronym of capital adequacy, asset quality, management and earnings and liquidity.

A bank's capital is the ultimate protector of depositors and there are international rules setting minimum requirements for all banks which have been enshrined into EU and Irish law. It provides the cushion to absorb losses that arise in the loans made by a bank. EU law requires that an EU bank must hold a level of capital to a value of at least 8% of the value of its risk assets. I would like to make the following observations. All loans made by a bank have a risk weighting attached to them to determine its total risk assets. Loans to EU governments attract a 0% weight, meaning, under EU law, a bank has to hold no capital whatsoever in respect of these loans. Put differently, it is assumed by the law that these loans will not default and this practice continues today. Loans to other EU banks with a maturity of less than one year attract a 20% weight, which may go some way to explaining the attraction to EU and international banks of funding the activities of Irish banks during the boom period. Recognising that the EU legal requirements were minimum standards, the authority required the Irish banks to hold capital within a range of 8.5% to 11% of risk-weighted assets.

On 1 January 2007, the capital requirements directive, commonly known as Basel II, came into effect. This directive afforded supervisory authorities some discretion to tailor capital requirements to reflect national circumstances. Using this discretion, the authority introduced a more stringent capital regime for property transactions to counter the growing exposure of Irish banks to the property sector. I am not aware of any other instance where an EU banking supervisor imposed tougher requirements on their banks than the basic minimum requirements of Basel II. At the requirement of the authority, the Irish banks were subject to much higher capital requirements than the EU demanded, for instance, Basel II assigned a risk weighting of 35% for residential mortgages, irrespective of the loan to value of those mortgages. The authority set a 75% weighting for such loans by Irish banks having a loan-to-value ratio in excess of 75%. For residential investment mortgages, Basel II also assigned a risk weighting of 35%. The authority made the entire loan subject to a weighting of 75%. Basel II allowed a 50% risk weighting for secured commercial real estate; the authority required 100%. Basel II applied a 100% weighting to speculative real estate loans; the authority demanded 150%.

Staying with residential property, the authority's decisions reflected the economic and growth forecasts from the Central Bank, which it was obliged to follow. These predicted a soft landing and if that prediction had been fulfilled, there wouldn't have been a banking crisis. In mid-2007, the authority introduced a number of additional supervisory requirements on the banks as a response to the strong appetite for credit for residential property purpose: stress testing of individual mortgage applications to gauge repayment ability at a level 2.75% above the ECB rate; introducing the consumer protection code with measures to address aggressive lending including suitability; a ban on pre-approved credit and obligations to engage early with customers in arrears; eleven separate press campaigns were carried out in relation to debt as well as numerous interviews and published articles. I have to stress that these were the minimum standards expected of banks. The authority did not run the banks and these minimum standards did not excuse the boards from their duties to set appropriate policies.

In July 2005, well before the crisis in financial markets began to take hold, the authority imposed new conditions on the licences of the Irish banks in relation to credit risk management policies and procedures which required each bank to have specified arrangements in place to monitor and control credit risk, with particular focus on impairments and provisions. Each bank was obliged to comply with international financial reporting standards and was obliged to advise the authority of deterioration in the credit quality of its loans. These reports formed part of the quarterly statutory returns submitted by each bank to the authority and never indicated deterioration in loan quality.

In line with Basel supervisory best practice and corporate governance codes, the authority required that all appointments to the board of a bank and any of its subsidiaries should be subject to its approval. This was to ensure that all directors of a bank, both executive and non-executive, and later, heads of all business critical functions, should be fit and proper persons with the necessary competence and experience in banking to contribute to the proper running of the bank. A final framework was introduced by the authority in January 2007 and applied to all new appointments from that date. Existing persons were “grandfathered” under the new arrangements.

In January 2007, the authority imposed new liquidity rules by way of conditions on the licences of the Irish banks. This made Ireland a leader in Europe in introducing a forward-looking system of liquidity management. Ireland was the only EU country to have updated its liquidity requirements in advance of the liquidity crisis. The reporting frequency was increased from monthly to weekly reporting in August 2007 to coincide with the onset of the international liquidity crunch. In relation to all of the foregoing, I should mention that the OECD, in its Economic Survey of Ireland 2008, commented that the authority had introduced the new consumer code to limit the scope for predatory lending practices and introduced a forward-looking liquidity regime just before the international financial market turmoil struck.

Just a few words, Chairman, about regulatory strategy. The authority adopted a principles-led approach to supervision from its inception in 2003, which essentially placed boards and management of banks at the centre of responsibility for the prudent conduct of business. The authority was legally obliged, at least three months before the beginning of each year, to prepare a strategic plan and submit this plan to the Minister for Finance. The plan had to specify the objectives of the authority for the financial year concerned, the nature and scope of the activities to be undertaken and the strategies for achieving these objectives. This principles-led approach to supervision was followed by all EU countries. The strategy also set down the objectives of the authority. One of its objectives was that its regulatory approach would facilitate innovation and competitiveness. It is clear that both of these elements played an important part in the increased availability of credit in Ireland in the years before the crisis, through a combination of more banks entering the market and more innovative types of lending products being developed.

In January 2004, a White Paper entitled Regulating Better was issued by Government to improve national competitiveness. The paper called for wider consultation and more regulatory impact assessment on any new regulations. This illustrates the context in which all supervisory initiatives of the authority required extensive consultation with a wide range of what are termed stakeholders - Government Departments, representative bodies and the industry and consumer panels, for example. Detailed regulatory impact analysis was extensive. In fact, the authority also put in place an arrangement with industry, called the stakeholder protocol, which enshrined time commitments by the authority to respond to industry requests for regulatory approvals, issuance of the findings of inspection reports, etc. I can understand that initiatives such as this formed a perception of the authority as a can-do entity, willing to prioritise industry demands rather than appearing more detached and discerning. This is something which I believe, in hindsight, both myself and the authority got wrong.

The growth in private sector credit arose mainly from the appetite for property acquisition and associated construction activity. This expansion in these areas was due to a number of factors, including strong economic growth, an increase in the level of household formation, very low interest rates, lower personal tax rates, a vast range of tax incentives for property investment, the desire of Irish people for property ownership, a feel-good element generated by increasing property values which quickly seasoned loan-to-value ratios, and all supported by readily available bank loans.

A further, and extremely important, factor was the consistent pattern of very positive economic commentary in relation to the performance and prospects for the economy and the property market from the Economic and Social Research Institute, the Central Bank and the Department of Finance. In formulating its strategy, the authority always took full account of the output of these authoritative sources which predicted that the Irish economy would continue to show growth above the EU average and that the property market would experience a soft landing. The authority relied on the Central Bank, which maintained an economic services division with 86 staff, including a dedicated financial stability department, to monitor and assess the overall health of the financial system. Had these predictions held, there wouldn't have been a bailout.

Questions have rightly been asked in relation to number, skillset and experience of resources devoted to the supervision of banks. As mentioned in the Honohan report, staff numbers in the banking supervision department increased marginally from 44 at end 2005 to 48 at end 2008, and were allocated in teams to supervise portfolios of banks. Apart from considerable day-to-day contact with their respective banks, staff in banking supervision carried out over 50 inspections of banks between 2003 and 2008.

The authority had approved higher staff. However, the HR department of the Central Bank, which performed recruitment activities on behalf of the authority, experienced difficulty in attracting persons with banking experience to the department. This reflected constraints on salary levels available to public servants and very strong salary competition for such persons in a market operating at a high level of economic activity. I agree with the conclusion in the Honohan report that the authority did not have the mix of skills necessary for a more intrusive style of supervision. The difficulty in attracting new staff with good experience in banking, and the rapid pace of evolution of the new regulatory directives which had to be implemented, stretched existing staff to the limit, to both engage in ongoing supervision work, while at the same time having to maintain training programmes for newer staff transferring in from other departments in the authority. There is little doubt that staff were stretched more thinly in banking supervision, and thus the capacity to foresee and react to the unfolding crisis was made more difficult.

In July 2007 an MOU was put in place between the Central Bank, the authority and the Department of Finance to establish a committee called the domestic standing group to help in the management of financial stability issues and to prepare to handle the financial crisis. Frequent and regular meetings of the group were held, and a number of work streams emerged dealing with emergency liquidity, deposit protection, draft legislation, as well as the updating of a manual to be used in the event of a crisis. As the crisis deepened the Department of Finance retained consultants to assist in preparations to nationalise a bank or a building society, and work to determine to what extent there may have been a need for further capital injections to meet market expectations. I see no reason to call the adequacy of the DSG process into question. Its operations meant that many issues that could arise in a crisis were identified and examined, and several initiatives relating to emergency liquidity arrangements, draft bank legislation, and capitalisation of banks were undertaken.

I will now address the bank guarantee decision. On the evening of 29 September 2008 I accompanied the chairman of the authority to a meeting at the Department of the Taoiseach. The meeting seemed to have only recently begun when we arrived and was in the process of discussing the serious liquidity position of Anglo, and what facilities could be made available to it to help it survive until the weekend. Mention was also made of the fact that the two larger banks had sought a guarantee for the deposit holders from the Government earlier that afternoon. The chairman and I advised the meeting, in relation to the solvency position of each bank, from the point of view of the authority. We advised the meeting that on the basis of the information available to the authority, all banks were in compliance with their required capital ratios, were in a position to meet their obligations on a going concern basis, but liquidity was becoming a critical issue for them, especially Anglo.

Both the chairman and I left this meeting after about an hour. We were asked by the Secretary General of the Department of Finance to remain on in the offices of the Department in case our presence was required later. We rejoined the meeting some hours later, possibly around 11 o'clock. On our way back to the meeting room we were met by the Governor of the Central Bank who indicated that the discussions that had occurred since we had left the meeting had narrowed things down to two options, either nationalisation of Anglo coupled with a guarantee of the five remaining banks, or a guarantee of all the banks. He suggested to us that our view was likely to be sought in relation to these options. When we rejoined the meeting, the chairman and I raised a concern about whether there would be confusion in the minds of the market practitioners in the following morning as to who was or was not guaranteed, and that making a distinction between nationalised banks and guaranteed banks ran the risk of being misinterpreted by the markets. We raised a concern that this would neither encourage the inflow of liquidity that would be expected to occur, nor would it stem outflows of deposits. Questions would undoubtedly arise whether the nationalised bank was stronger or weaker than the guaranteed bank and in that situation, all banks would risk being adversely affected. The chairman and I expressed the view that if a guarantee was going to be put in place, we would be inclined to favour it being extended to cover the depositors in all banks concerned in the same manner. Some two weeks earlier, confusion had arisen in relation to the increase in the deposit guarantee scheme limit to €100,000, especially as regards whose deposits it covered and the eligibility criteria. The effects of the guarantee were evident immediately, the daily liquidity reports being submitted by the banks to the Central Bank showed inflows of both market and retail resources and an end to the pattern of outflows which had been occurring prior to the guarantee. The guarantee was viewed positively by market commentators and was seen as addressing satisfactory the concerns of depositors and thus the funding and liquidity difficulties that had been affecting the banks.

So just in summary, Chairman, in this brief statement I have set out for you the authority's approach to prudential supervision of banks, as well as the various initiatives taken by it to strengthen its oversight of banks such as the higher capital requirements liquidity, impaired loans, fitness and probity, consumer code and the influence of the White Papers on regulatory policy. I also acknowledge, Chairman, with the benefit of hindsight, that the supervisory measures introduced by the authority were not sufficient to meet the challenges posed by the crisis and the recession that emerged and I regret that very deeply, Chairman. So thank you, Chairman, and members of the committee for your attention.

Chairman: Thank you for your opening statement, Mr. Neary, and just to remind the ... so that we get the structure of today's proceedings under way, this morning's session will be focusing on the period of Mr. Neary's tenure up to October 2007, while the afternoon session will focus on developments in the period of November 2007 to January 2009, which we will be dealing with this afternoon with you Mr. Neary. Mr. Neary, can I maybe just get two matters out of the way before we commence the full line of questioning? In Mr. Hurley's evidence to the inquiry last week on 21 May 2, Mr. Hurley said "the Financial Regulator was established with its own responsibility and its own independence", "the Financial Regulator was accountable to its own board, it was not accountable to the Governor of the Central Bank". Can I ask you is this accurate, were you independent and were you accountable to the Governor or the board or the Central Bank or anyone else?

Mr. Patrick Neary: Yes Chairman, I think you could consider that the authority was independent, it had its own ... the authority was the authority, it consisted of ten people, including the chief executive, we had our own chairman and we had responsibility under the law for the micro-prudential supervision of institutions. The Central Bank, on the other ... the structure that was put in place meant that the authority had to use the services of the Central Bank, for activities such as HR and IT and economic services. They were called central services, we shared those but the reporting line for those was into the Central Bank, into the board of the Central Bank. When it came to ... when it came to systemic risk, if you will, or yes, I suppose, call it as systemic risk or financial stability, that was clearly in our view the responsibility of the Central Bank. We were obliged to contribute to financial stability, in the Financial Regulator, by doing our job which was trying to maintain the financial soundness of the individual entities.

Chairman: Mr. Neary, in my opening comments today I said that this is the 30th hearing of the banking inquiry. We have had a number of witnesses that have come to us during that period. I would like to quote some of them to you. Professor William Black told the inquiry on 5 February that extreme growth itself is something that should not be allowed by a regulator. We have centuries of experience to tell us this is true and then he went on to say, "The Irish crisis was one of the most easily preventable crises by either competent bankers or competent regulators." On 21 January, Mr. Klaus Regling told the inquiry:

> There was this light-touch approach to supervision, not very intrusive, not very assertive and therefore also imposing penalties just did not happen. The rules which existed were applied very loosely.

Professor Alan Ahearne, appearing before the committee on 4 March, said:

> They [meaning the regulator] had a certain interpretation of principle-based regulation which meant that they really just looked at whether the banks had certain governance systems in place, including having an audit committee. They put a lot of trust in the senior management of the banks. That is the very opposite of intrusive, proper regulation and so the implementation of regulation failed dismally.

On 11 October ... of February ... or sorry, 11 February, Professor John FitzGerald said:

> The build-up of the bubble could have been prevented by appropriate fiscal policy or by appropriate prudential action by the Central Bank and the regulator, or both. Either one of these policy instruments, if appropriately deployed, could probably on its own have prevented the disaster. Both together would have prevented [the] disaster.

And then, when Professor Honohan came before us, discussing his report and where he wrote about the options available to the Financial Regulator on moral suasion, in questions at the inquiry on 15 January, he said:

> Moral suasion is useful but is not enough if the regulated entity will not heed ... indication. Moral suasion has nothing to do with morality. It has to do with non-legally binding requests whereby one says, "Please stop doing this, please stop doing that" and if the banks know what is good for them, they say, "Okay, let's behave differently". However, if they do not respond, it has to be followed up with enforcement, strict directives and rules. It in not principles versus rules, [it is] principles and rules.

Mr. Neary, the finger of responsibility would seem to be directly pointed at the office of the regulator in those accounts to the inquiry. Would you care to comment?

Mr. Patrick Neary: Thank you very much, Chairman. Yes, I think you've set out a number of things there but, at the core of this, is the option chosen by the authority in relation to the way it carried out its business and it shows a principles-led regulatory approach. Now, that meant that it was a combination of the statutory requirements, some of which I outlined already and we'll just go through them again: capital, proper capital, liquidity; making sure there were proper provisions made for bad debts, ensuring that there was fit and proper management in place etc. etc., we've gone through all of those but they were ... they're the key indicators of prudential soundness, capital and liquidity especially. On top of that, the authority chose to build, if you like, a further layer of principles, which was directed at each bank and the directors of each bank and what they were obliged to do and I think actually it's set out there in the core documents, I'm sure we'll come to them later on.

Now, I suppose that recognised ... the concept, I think, behind that in the mind of the authority was that, first of all, you had very ... should ... we had experienced directors in the banks that had been with them for a long time. The banks had built up serious resources. I mean, for example, in earlier testimony by one of the banks, they told the committee that they had 200 people in the risk management unit alone. I mean, compared to our resources, that was a lot of people. So, there was trust and reliance placed on the boards and management of the banks to conduct their affairs prudently and properly. That was part of the model of supervision that was put in place by the authority and that clearly failed. Now, I mean, it does stretch credibility, and there's no denying it, that what we were faced here with was a pretty straightforward, you know, lending crisis. I mean, banks, I believe, with hindsight, should have known what they were doing. They should have been able to, you know, grant loans and make sure they had them properly secured and make sure they were being repaid. I mean, that's the very least you would expect them to do and I think that's what the principles-led approach to supervision expected. And, you know, as part of our quality assurance process then, we had our reviews and our inspections which tried to assess the processes and the procedures they had put in place, the banks, to assess ... to monitor risk, control risk and make sure it was reported into the boards and that it defined and controlled the risk appetite.

Chairman: Thank you. I'm going to move on to Senator D'Arcy. Senator D'Arcy, you've 25 minutes.

Senator Michael D'Arcy: Thank you, Chairman. Mr. Neary, you're very welcome.

Mr. Patrick Neary: Good morning, Senator.

Senator Michael D'Arcy: Mr. Neary, given the extraordinary losses by Irish banks and financial institutions, did the Financial Regulator's office fail the people of Ireland?

Mr. Patrick Neary: The system of regulation that was put in place by the ... by the authority failed. There is no denying that, it's a fact. In its defence, I would say it was the same system that was used throughout Europe and it is clear now that that whole system, throughout Europe, also failed. Now, you have to put it in the context as well of the CRD or the Basel II structure. I mean, the way in which that was evolving was to, if you like, rubber stamp the whole approach ... principles-led regulatory approach going forward in Europe, whereby further responsibility was being transferred away from regulators to the boards and management of banks. They could determine their own capital requirements, they could determine the add-ons for other risks, like operational risk and concentration risk and things like that. And, it was ... it was grounded on ... on the premise - and this came from the Commission and it came after lots of consultation - that the capital requirements in Europe were too high, it was adding to the costs of financial services in Europe and that a way should be found to let banks have more say in the way they structure their businesses. And that was ... that's the philosophy that was behind our principles-led supervision, and it clearly failed. There is no denying that.

Senator Michael D'Arcy: Can I ask you, in your opening statement, where you outline where the Financial Regulator's office required higher ratios than were requested ... if we required higher ratios, how then was our crash so much worse than any other financial jurisdiction in Europe?

Mr. Patrick Neary: Well, it seems to me that there were characteristics in the Irish economy at that time that weren't present at the same extent in other European jurisdictions. And I think we outlined some of those, where there was incredible demand in the economy, there was a growth, there was a lot of household formation, there seemed to be great appetite for property and it could be funded easily in a very low-cost and very liquid international market for funds.

Senator Michael D'Arcy: In your response to the Chairman you said that the Financial Regulator's office, and this is your quote, were responsible for "financial soundness" of individual institutions.

Mr. Patrick Neary: Okay.

Senator Michael D'Arcy: And in the ... in the years '01 to '08, in evidence on a number of occasions, the figures that we have quoted to witnesses in relation to the growth of AIB was 30% year-on-year increase, compound, Bank of Ireland, 29% year-on-year increase, compound, Anglo had a similar rate of growth. Why wasn't action taken to slow down the growth of the property bubble earlier, especially in the commercial real estate sector?

Mr. Patrick Neary: Well, I think you have to bear in mind a few things. What were ... what were ... what was the environment like at the time? You had an economy which was growing, you had incredible demand for residential property which was serviced by property developers and builders. It ... there was no sense whatsoever that there was any likelihood of an increase in defaults or an increase in loan impairments. I mean, we were monitoring that very carefully. And, for almost a decade, the question of a bad debt in a bank was unheard of. Now, that's the reality. We have to ... I suppose, banking supervision people are mainly accountants. We have to take the facts as they're presented to us. We assess and look at the composition of the capital. We look at the composition of the loan book from the point of view of looking for impairments and default. And those just were not happening. So, I mean, the growth within the economy and I think we're straying into .. excuse me ... Senator ... excuse me ... I think we're straying into a financial stability area and this is ... I think, fits comfortably where the Central Bank had a mandate to assess those risks that were out there and to alert the Financial Regulator to the threat posed by those risks.

Senator Michael D'Arcy: Sorry. Can you just clarify that for me, Mr. Neary, please? You're saying that your role was the financial soundness of the institution. But you felt - the regulator's office, not you individually - that the growth rate was too high. It wasn't for you to tell, or raise the matter with, the Central Bank. It was a matter, via guidance of section 33D, that they raise it with you. Is that what you're-----

Mr. Patrick Neary: No I wouldn't ... I wouldn't want to ... to kind of get in for a tit for tat here. I mean, there was constant dialogue going on.

Senator Michael D'Arcy: If you could clarify that, please, because-----

Mr. Patrick Neary: Yes...No, it's a fair point. There-----

Chairman: Before you clarify that though, Mr. Neary, I'm getting reports of phone interference, so can I ask members to turn off their phones and to put them ... even if ... if they're not the questioner, if they're in proximity to the questioner, they're interfering with the microphone and broadcast as it's actually happening, so please have your phones on safe mode, please. Do not be using them while other people are asking questions. Sorry, Mr. Neary. Back to yourself.

Mr. Patrick Neary: Okay, Chairman. Now ... sorry ... now, I could ... I wouldn't see a tit-for-tat exchange going on between ourselves and the Central Bank and any fighting over responsibilities. I mean, we worked very closely with the Central Bank, and these discussions would have ... there was an internal committee called the financial stability committee.

Senator Michael D'Arcy: Yes.

Mr. Patrick Neary: Now, I mean, I know you're ... you ... you kind of began there in the year 2000-2001. That was long before the regulator was established. Now, in fairness, there was continuity of sorts from the Central Bank to the regulator. But we did have the financial stability committee and, you know, these issues were discussed and thrashed out there. But from the point of view of an individual institution, from our point of view, if we saw growth, right, which would indicate, certainly, that it might put pressure on capital, it might put pressure on funding, it might put pressure on impairments, I mean, we satisfied ourselves that there was adequate capital in place. There seemed to be no problem with the Irish banks raising new capital in the markets, and they all secured very high ratings, nor was there any problem with them raising funds in the market. I mean, the Irish banks were a minnow in the European financial markets. I mean, there was never any kind of concern that the financial markets would dry up and not be able to provide liquidity to the Irish banks as needed. Now ... but it is a warning sign, and I think it is a warning sign that, from a financial stability viewpoint, if you see all the banks, collectively, expanding their balance sheets at a great rate, you start to worry.

Senator Michael D'Arcy: Can I put it to you, Mr. Neary ... we've had AIB, Bank of Ireland and Ulster Bank in, and they've all made the point that while they had access to their own data of their ... people who they had lent money to, to particular developers, and to a particular sector. One of the things that they did not have access to was the consolidated data, that that was a matter for your ... for the Financial Regulator. And you had access to the information, which clearly showed, in particular, the commercial real estate sector was massively over-linked. And what I'm saying to you is: why did you not use the powers that were available to you? The question I'm asking you, to cool that sector, to slow it down ... did you see the evidence from Mr. Dan McLaughlin?

Mr. Patrick Neary: No, I didn't actually. No, I missed that-----

Senator Michael D'Arcy: You didn't. Mr. McLaughlin made the point about Anglo Irish Bank, a mono-line bank. The figures that were given were 82% commercial real estate sector, 1% residential, 17% corporate lending. And that bank had nothing to do ... had 1% residential, and yet that bank cost the taxpayers of this State €30 billion or thereabouts. What I'm asking you, Mr. Neary, is why, with the information that was available to you, sector specific, you had the powers to call ... to request the information on the top number of exposures per bank. You could have cross-referenced that to see that the ... that some developers were cross-securitised, cross-collateralised with other institutions ... the institutions did not have that information available.

Chairman: A question, please, Senator.

Senator Michael D'Arcy: Why did you not request that information? Why did you not impact upon that sector?

Mr. Patrick Neary: Okay. I mean, there's no doubt that if you look at any bank anywhere, you're going to find lumpy ... lumpy exposures in its balance sheet. You're going to have a kind of ... a size ... you're going to have some large exposure, so you'd expect that in every single bank. Now, there is a large exposures directive and .... it's law, so we all have to abide by that, and that permitted a bank to lend 25% of its own funds - in other words, a quarter of its capital - to any one individual. That is the law. They're permitted to do that, and, in fact, they can have ... if you add up all the 25s ... there's an upper limit of 800%. So, essentially, they could have had 32 or 33 loans of that size in their balance sheet and be within the law. I mean, that is a reality of it. So let's not lose sight of that. Now it's not ... I would never see it as the job of a regulator to tell a bank or a customer, you know, about their relationship. I mean, a large customer is entitled to go into their bank, make their case; you expect the bank to assess the business proposition and the security and decide if they want to grant that loan or not. That's not the business of the regulator, to ... to dictate to banks on their customers whether or not they can borrow or lend money. I mean, that is a commercial transaction between mature borrowers and lenders that they have to decide for themselves but it's a very important point, I think, that we, we, we-----

Chairman: -----now, Senator.

Senator Michael D'Arcy: Is it not your role as regulator to ensure that the sector is stable, and if the numbers had gone beyond the limits, which they did on a number of occasions?

Mr. Patrick Neary: No, I ... I ... I don't agree with you ... I don't agree with you, Senator, that the numbers went past their limits. I'm not aware of any bank where the large exposure limit of 25% of-----

Senator Michael D'Arcy: What about the commercial real estate sector? As a general.

Mr. Patrick Neary: You're talking about the sectoral concentration limit?

Senator Michael D'Arcy: Yes.

Mr. Patrick Neary: Okay, that, that brings us to a different dimension. There was a requirement, as set out in, I think, in the licensing supervision requirements of 1995. And there was a requirement set out there that banks should not have exposures ... I recall, it's 200% to a sector with a ... to sectors with a common predominant risk.

Chairman: 250%?

Senator Michael D'Arcy: 250%?

Mr. Patrick Neary: 250%. That's right, with a common predominant risk factor. Now, it was a guideline, and it was a useful one, and ... it was ... it was ... I suppose an indicator to, to banks what, you know, a prudent limit on this might look like. But there was ... there was a lot of trouble with the interpretation of that particular concentration limit. I think it was very easy to game it, because there was a lot of discretion about, well, what's a common predominant risk? And, I mean, everything was lumped into that. You had ... you could have a land bank, you could have, you know, a-----

Senator Michael D'Arcy: Is that not the role of the Financial Regulator's office to be clear on what was, ... was that not your role?

Mr. Patrick Neary: Yes. No, and I agree with you. Like, with hindsight, when I look back on that, I mean, I think there was an opportunity there for us to do something on that. And rather than let the thing fall into abeyance-----

Senator Michael D'Arcy: Did you take the opportunity?

Mr. Patrick Neary: No, we didn't take that opportunity but I think the reason for that may have been, No. 1, we had the difficulties with the interpretation, right? But like I say, we could have probably drilled down on that and picked out a few sectors, like we did subsequently in relation to speculative property development when we put on the higher capital weighting. I think we could have done that; we should have done that, and there was no reason why we shouldn't have done it. But-----

Chairman: We are moving up on to ten minutes so.

Senator Michael D'Arcy: Mr. Neary, can I move on please?

Mr. Patrick Neary: Can I just to add-----

Chairman: I'll just allow him a bit of time then I'll bring you back to your questions. Mr. Neary.

Mr. Patrick Neary: Just to add, Chairman, on that point that within the Basel II, there was an arrangement, let's call it an arrangement, whereby sectoral concentration risk would be picked up, and sectoral concentration risk would be picked up in terms of Basel would ... would demand more capital for a portfolio that had more concentration. So that may have been the reason, you know, as well why, I think, the thing fell into abeyance, was that it was going to be picked up by Basel.

Senator Michael D'Arcy: Can I ask, Mr. Neary, in relation to the FSR reports, you participated in the FSR reports?

Mr. Patrick Neary: Yes, the FSR reports were driven by the economists in the Central Bank. I mean, we didn't-----

Senator Michael D'Arcy: You participated?

Mr. Patrick Neary: I did. I participated in the discussions, some of the discussions at the preparatory phase on the financial stability committee. And also as a member of the authority we used to have a joint meeting with the board of the Central Bank to discuss the content of the FSRs.

Senator Michael D'Arcy: Yes, I want to raise the issue of personal indebtedness within banking. In 1995, the percentage of personal indebtedness to the GDP of the nation was 71%; in 2006, it was 192%, according to the FSR reports; in 2007, the predicted figure, according to the FSR report, was 248% of GNP. The original figures I quoted were GDP. What was going to be the outcome, Mr. Neary, when a downturn came, for people when they were indebted to that extent? When a downturn was going to occur, how were people going to be able to pay their bills?

Mr. Patrick Neary: I'm not an economist, and that's not a defence, and, you know, it certainly would suggest to me that ... it raises a question about people able to meet their indebtedness, in general, but bank loans are, you know, done on an individual basis, and if we are talking about ... people's ability to service their, their commitments for residential mortgages and that, you're looking at them on an individual basis. I mean, this would be a sign. I would expect that people who are, you know, trained and proficient in, in assessing, you know, economic threats would have raised an alarm about, but in some strange way, this transmitted into a message from the Central Bank that, notwithstanding all of these issues, that we were going to have a soft landing.

Senator Michael D'Arcy: But, Mr. Neary, are you aware of the many people who are before the courts at the moment as a result of the failure to control their personal indebtedness?

Mr. Patrick Neary: I most certainly am, and I ... I regret that very much, there is no doubt, but the system did fail, and that the warnings from the Central Bank, that came out in the area of financial stability were certainly not strong enough. Now, having said all that, I mean, just to defend the position of the Financial Regulator, not to defend it but to explain it, Senator, I mean, we ... we had a heightened awareness in relation to the level of residential mortgage growth, and, in fairness to some of my colleagues, and they were here yesterday, I think, they did outline some of the initiatives that were taken, and, you know, that were put forward by, by the former prudential director in relation to mortgage credit. And also, on ... the authority took action on the consumer protection side, expecting banks to ... to carry out what they called a stress test to make sure that there was affordability at two and a half, 2.75% above the ECB rate, etc. So we were doing our bit, in that sense, at an individual bank level, but ... you know, I take your point here that what was coming out in the FSR, despite all of these indicators, wasn't strong enough.

Senator Michael D'Arcy: One of the statutory objectives of the Financial Regulator was the promotion of the financial services industry in Ireland. Did the objective affect the prudential role in the Financial Regulator?

Mr. Patrick Neary: I don't think so, Senator, because a great part of the prudential role was enshrined in the EU legal requirements, like the capital and the liquidity, the large exposures, all of that, so we applied the very same level of legal requirements to the entities operating, let's say, in the IFSC as we did to the domestic banks, and so it would be hard to see how that might have been a factor.

Senator Michael D'Arcy: In terms of the usage of the powers that were available to you-----

Chairman: We'll come back to that. Maybe, Mr. Neary, if I could ask you, whilst we're on the issue of the Financial Regulator, how much of your time as Financial Regulator was spent promoting Ireland's financial services sector? It's very much part of the same question Senator D'Arcy was asking you there.

Mr. Patrick Neary: How much of our time? The promotion more or less took the form of public speaking engagements and that. That's kind of how it was really put into practice. I mean, on the ground, I think the relationship would be broadly the same but, you know, I'm certainly conscious of the fact that we would have been trying to project Ireland ... and this was in line with the stakeholder protocol, which I ... which I mentioned in my opening statement, that the authority wanted to be seen as a kind of a user-friendly, can-do kind of organisation, and, therefore, you know, be seen as, you know, to be a regulator in a location which was kind of friendly to financial services.

Chairman: Was there a potential or was there potential for conflict in that regard, Mr. Neary, that we were inviting in overseas financial institutions into the Irish market and, at the same time, in need to robustly monitor and regulate the existing services in the country?

Mr. Patrick Neary: Yes, I mean, I ... it was an uncomfortable situation for the authority to be in. I think it was a shame that that ... particular piece of legislation, that particular requirement was inserted in the legislation and I believe it has been taken out now. There is an inconsistency between being a regulator and, you know, also being seen as very receptive.

Chairman: Because that objective was removed by the Central Bank reform Act in 2010, and is it or was it your view that this change ... do you have a view on this change in the statutory remit of the office? Do you think that was a good or a bad thing?

Mr. Patrick Neary: I think it was a good idea, Chairman, yes.

Chairman: Back to yourself, Senator.

Senator Michael D'Arcy: The sanctions, Mr. Neary, that were available to you ... you'll allow me that time, Chairman, I take it?

Chairman: Well, I will, indeed. If we get through the questions, we will, indeed.

Senator Michael D'Arcy: The sanctions that were available to you, Mr. Neary, in terms of dealing with financial institutions, did you use those sanctions or did you use your powers? Did ... what I'm talking about are quantitative controls ... did you ever use quantitative controls in relation to sanctioning a bank who had gone beyond particular sector limits?

Mr. Patrick Neary: No, because the sector limit ... the ... we spoke about it there a few minutes ago. I mean, there's two, there's two elements in the sector limits. There's first of all the large exposures directive, which we dealt with, the 25% and the 800%; I don't believe that any bank ever breached those, so the situation didn't arise.

Senator Michael D'Arcy: What about the control limits?

Mr. Patrick Neary: The sectoral concentration limit was a guideline. It was never ... it was never ... we got powers for administrative sanctions in the 2003 Act. And that meant that, you know, these requirements would have had to be codified and then you would monitor any breach of the codified arrangements, and that would be ... could be called a ... I think the term was a "prescribed breach", and you could take action and sanction that.

Senator Michael D'Arcy: Did you-----?

Mr. Patrick Neary: That didn't, that didn't-----

Senator Michael D'Arcy: It never happened?

Mr. Patrick Neary: No, that didn't happen. And the reason it didn't happen was that because of pressures, I think, around the time, excuse me, in banking supervision, because of simply work pressures and other priorities like the implementation of Basel II ... the authority decided that we had to prioritise that, and that in relation to the sanctions of prudential matters that the ... it was, I suppose, they saw it as the less pressing of the two priorities, and they said that the existing relationship, line relationship, between bank supervision people and their counterparties in the banks would take care of those compliance issues or control issues, if they arose.

Senator Michael D'Arcy: Mr. Neary, in your opening statement, under the term "Regulatory Strategy", you state:

> The strategy also set down the objectives of the authority. One of its objectives was that its regulatory approach would facilitate innovation and competitiveness.

You subsequently discussed the White Paper entitled Regulating Better, issued by Government, and you state: "I [can] understand [that] initiatives such as this formed a perception of the authority as a 'can do' entity, willing to prioritise industry demands rather than appearing more detached and discerning." Can I put it to you, Mr. Neary, some might suggest that what the Financial Regulator's office promoted was reckless behaviour by banks? Is that fair?

Mr. Patrick Neary: Oh, I think that would be ... that would be a very unfortunate conclusion, and I don't think I could agree with that. Because at the core of the ... of the ... of the authority was, you know, a very strong mission, and a very strong commitment to maintain the soundness of each individual institution in order to protect the depositors. I mean, that was our mandate. But, I mean, taking that as being in place and working, there was also then the idea, you know, that the ... I suppose the authority placed itself, unfortunately, I believe, in a situation where it could be viewed as a sort of a service provider rather than a detached, strong regulator, it ... this element, this element developed, I think-----

Senator Michael D'Arcy: Are you saying you weren't a detached, strong regulator, or you were?

Mr. Patrick Neary: No, this is about perception, right? That this ... this stakeholder protocol that the authority signed up to, where it would deliver ... where it would deliver responses within a particular time, I think, created a perception that the authority wasn't a strong, detached regulator.

Senator Michael D'Arcy: In hindsight, Mr. Neary-----

Chairman: Final question, Senator.

Senator Michael D'Arcy: With hindsight, Mr. Neary, the shareholder value in the banks, €29 billion lost; €35 billion to €40 billion share ... or funds from the State of this Republic injected; another €20 billion from the UK injected into banking sector in Ireland. Should you have been a strong, detached regulator?

Mr. Patrick Neary: The style of regulation, Senator, that the authority-----

Senator Michael D'Arcy: With hindsight, with hindsight?

Mr. Patrick Neary: Oh yes. Yes, yes, yes, yes.

Senator Michael D'Arcy: Should you have been?

Mr. Patrick Neary: No, but ... but I think ... I think, you know, very few people would dispute that the style of regulation that the authority adopted did not address the situation that pertained in Ireland during the period before the crisis. And I think very few people would dispute that a far more intrusive form of regulation was required. And, I mean, you can see what is happening throughout Europe now, that everything has changed; the complete regulatory structure in Europe has changed.

Senator Michael D'Arcy: My final question-----

Chairman: No, Senator, you-----

Senator Michael D'Arcy: No, Chairman, you took some of my time, Chairman.

Chairman: No, Senator, I took some of your questions actually. That's what I done.

Senator Michael D'Arcy: You took some of my time, please. If you don't mind, Chairman, just very quickly.

Chairman: No, no, no, no, sorry, Mr. Neary-----

Senator Michael D'Arcy: My last question, Mr. Neary ... my last question to you, Mr. Neary-----

Chairman: Mr. Neary, come to the Chair, please. Sorry, Senator, I'll be bringing you back in, because you've time at the end of the session.

Deputy Michael McGrath: Thank you, Chair. You're very welcome, Mr. Neary. Do you believe that the banks lent too much money to the property and construction sector?

Mr. Patrick Neary: I do ... I do now, yes.

Deputy Michael McGrath: Do you accept that you had the power to impose lending limits through the concentration ratios applying to the banks?

Mr. Patrick Neary: Well, I think we had ... I think we had powers to intervene, maybe not necessarily through the sectoral concentration limit, but I think we did have the power to set ratios. And, you know, I would never try and defend ourselves by saying we didn't have the power. I think we could have interpreted our powers. I think, you know, if we ... if the authority was of the view that an intervention was necessary, we could have found a way. Now, admittedly, I mean, and the argument would probably be, in the authority, that, you know, those rules are ... were more focussed on the affairs of an individual bank, that if somebody was kind of out of line compared with all the others, well, this is how you'd intervene, that you'd, you know, use your powers to deal with one bank. But what was happening here was everybody was in the same boat, and, you know, it quickly, I think, this thing ... this thing moved ... shifted its boundary out of the micro area more into the macro area, and into the kind of financial stability dimension.

Deputy Michael McGrath: But, in essence, are you accepting that the Financial Regulator has the tools and the powers to put a brake on the extent of lending by the banks to property and construction?

Mr. Patrick Neary: I think there were tools available to us, and if we had sat down and worked them through and considered them in the context of needing to do something, we would have found a way. I wouldn't ... I wouldn't argue against you that there weren't tools available.

Deputy Michael McGrath: And, Mr. Neary, the Central Bank and regulator sent about 80,000 pages of documentation to the banking inquiry, which have been gone through forensically. And on the issue of the concentration limits, for example, extensive correspondence was available between the Financial Regulator and the banks. The concentration limits were breached in a number of cases, as you know. There are letters on file from the banks, essentially stating their case that they felt the risks were acceptable, and asking the regulator to go away. The summary that we have of the correspondence on sectoral limits: 2003, no conclusion in the documentation; 2004, no conclusion in the documentation; 2005, no conclusion in the documentation; 2006, no conclusion in the documentation. There seems to have been a distinct lack of follow-up by the Financial Regulator in dealing with that issue of the banks lending too much money to property and construction, despite you having the explicit and direct tools to do so.

Mr. Patrick Neary: Yes. I saw ... that's in the core documents and, you know, there was a lot of correspondence. I wouldn't have been aware that all of this correspondence was going on but that's beside the point. It was going on. Now, I think that serves to illustrate, I think, the difficulty that people had with the interpretation of the sectoral concentration limit, and that the arguments that were coming back and forth ... and, for example, I think in that correspondence, it illustrated, you know, some of the ways in which there was a way around the sectoral concentration limit. I mean, banks who had their head offices somewhere else and had subsidiaries here could quite easily transfer the risk out of this jurisdiction back to head office by an internal risk transfer mechanism and get around it-----

Deputy Michael McGrath: But the-----

Mr. Patrick Neary: Now, but it just illustrates, I suppose, the way in which mechanisms can be used to ... to, you know, to ... I don't know what word you'd use, but to kind of minimise the impact of the-----

Deputy Michael McGrath: But, Mr. Neary, the inability to reach a conclusion and to follow through on that, does that also illustrate a failure of regulation?

Mr. Patrick Neary: I think it does. I ... I think we ... I ... I have to say that we had an opportunity with that sectoral concentration limit. Rather than letting it fall into abeyance and get into all this back-and-forth correspondence, we had an opportunity at least to look at that limit. Now, it seemed to have been unworkable in the way it was expressed and the way in which it was interpreted but we could have at least, I think, taken the opportunity to ... to visit upon that guideline and to see was there ways in which we could segregate some of the riskier sectors out and put a limit on that. We did not do that and that ... that ... I regret that.

Deputy Michael McGrath: And on the broader issues, Mr. Neary, just to clarify: you aren't citing a lack of powers, as regulator-----

Mr. Patrick Neary: No, I ... I'm not.

Deputy Michael McGrath: -----as a reason for not dealing with the issues?

Mr. Patrick Neary: I'm not, Deputy, because I think that ... I think that, you know, when, when push came to shove, the regulator, if it had set that limit and had, you know, even ... powers or no powers, I think, you know, if it had really, really set a hard, well-defined limit, I think we would have been able to ... to, I think, bring some control onto the situation.

Deputy Michael McGrath: Okay. You, you state in your opening statement that "the supervisory measures introduced by the authority were not sufficient to meet the challenges posed by the crisis and the recession that emerged." Can I ask you, Mr. Neary, in hindsight what do you think are the most important things you should have done and would have done differently as CEO of the Financial Regulator?

Mr. Patrick Neary: I mean, I have to say that I was a practitioner of principles-led regulation. I bought into ... I bought into that. I think our ... our ... the authority, as well as regulatory authorities all over Europe, bought into that. And I think we had great expectations that a combination of the ... the legal requirements, both capital and so forth, plus responsible behaviour from boards and management, would contribute to a stable financial system. That clearly didn't happen. So, with the benefit of hindsight, and seeing what ... what has happened throughout Europe, it was, I think, necessary to have a far more intrusive regime of supervision where we ... we, I think, were tough and, you know, adjudicated much ... much ... much more rigorously on what was happening in the banks.

Deputy Michael McGrath: You said on page 9 of your witness statement "I do not think, even with the benefit of hindsight, that the authority, in the context of the time, would have assumed a different approach to supervision." People would regard that as a remarkable statement, Mr. Neary.

Mr. Patrick Neary: Yes, well, I was trying to set that in the context of the time, right? When principles-led regulation was ... was, if you like, the accepted practice throughout Europe. I mean, clearly that's not the case now. So I'd like to maybe correct that possible misinterpretation of what I meant.

Deputy Michael McGrath: What is the essential reason why no sanctions were imposed on banks, credit institutions, during your tenure?

Mr. Patrick Neary: In relation to the prudential ...the prudential area, I think it was a matter of conflicting priorities and resources. And the ... the ... and it's not ... it's not an excuse because it worked in other departments of the regulator. But the ... the administrative sanctions regime was quite a demanding structure to put in place because it had to be ... it had to, you know, be absolutely fair in all its proceedings and procedures and arrangements and it could have been contested all the way up, I think, to the court, at the end of the day. So it had to be very fair and it had to be very judicious and there had to rules and all the rest of it. So, it was a big job of work.

Deputy Michael McGrath: But it never happened, Mr. Neary.

Mr. Patrick Neary: Oh, it did happen ...it did happen in the ... in the ... across the regulator. It most certainly did and there was-----

Deputy Michael McGrath: No, in actual enforcement sanctions against the banks.

Mr. Patrick Neary: But not in ... not in the prudential area. We never got ... we never got that established properly because of the competing priorities coming from other work within banking supervision.

Deputy Michael McGrath: But, Mr. Neary, is that not like bringing a suspect before a criminal court and the court doesn't have the option of sending the person to prison. And they're released back onto the street and what will they do? They will reoffend because there's no sanction.

Mr. Patrick Neary: No, I'm just trying to explain what happened; I'm not trying to defend it or excuse it. Of course, when we had the ... the structure in place to put in the sanctions, of course they should have been ... they should have been put in. Now, the authority's view, though, was that there was a lot of merit in the ... continuing the ongoing arrangement and the contacts between the regulatory people and their counter-parties in the bank to deal with governance and compliance issues. That that was the right thing to do on the prudential side and that the focus of the administrative sanctions should be more towards compliance with the codified arrangements for consumer protection.

Deputy Michael McGrath: We had evidence yesterday from Mary Burke, who was the head of banking supervision from 2006. Under questioning she said "we were not able to pursue administrative sanctions cases because of a lack of resources." Is that accurate?

Mr. Patrick Neary: I ... I ... yes, I wouldn't disagree with that at the time that the resources in banking supervision were extremely thinly spread. And I think ... and, you know, I think that was why, I think, the authority, you know, was of the view that okay, park the administrative sanctions for the moment - the banking supervision on the prudential side - and let the ongoing relationships deal with that and let banking supervision concentrate on the implementation of Basel, which was a huge project. I can't ... I couldn't overstate how big that project was at the time.

Deputy Michael McGrath: The request for additional resources by Ms Burke in May 2008 was supported by her immediate superior, Mr. Con Horan, but was not ultimately implemented. Where did that fall down?

Mr. Patrick Neary: Yes. I have ... I've just a couple of little reminders here, because there's a ... you don't have a reference in your ... just, Deputy, there, in your core documents so that I can find it quickly?

Deputy Michael McGrath: No. It's in her own ... it's in her statement yesterday, Mr. Neary.

Mr. Patrick Neary: Oh, sorry. Yes. Because I think I had just made a few notes on that myself that might just help me. Just give me one second now, please.

Deputy Michael McGrath: No, it was yesterday's evidence.

Mr. Patrick Neary: No. But I ... I ... in anticipation of this issue maybe coming up I just jotted down a few notes to help my recollection but I just want to find them. If you just bear with me now for one second, please, Deputy.

Deputy Michael McGrath: Mr. Horan indicated that the issue went to the remuneration and budgeting committee---

Mr. Patrick Neary: It certainly did. That ... that is-----

Deputy Michael McGrath: ---of which you were a member?

Mr. Patrick Neary: Yes. That was the procedure ... that each year there was an extensive ... extensive budget process that we undertook. So, each department had to set out their budgets in detail and submit requirements for the resources and that. I mean, we got ... we shared our services with the Cental Bank in a lot of cases.

Deputy Michael McGrath: Do you remember this particular case, Mr. Neary?

Mr. Patrick Neary: Oh, I remember it. Yes, I do.

Deputy Michael McGrath: And what happened?

Mr. Patrick Neary: What happened was ... well, there's a process - I have to describe the process briefly - that each manager of the various departments made a submission in relation to the required resources and brought them all together and then it formed part of a presentation ... of a case to the budget and remuneration committee. And I would attend that committee and it would ... usually be accompanied by both the prudential director and the consumer director when we'd be meeting the committee on these matters because obviously they had to argue the case for their ... for their resources. That year we came up with a figure for new staff of ... I think it was 77 people -70 something anyway, it was in the 70s - across the entire organisation, okay? And, certainly, the head of banking supervision was looking ... I don't remember exactly how many she was looking for but she was looking for-----

Deputy Michael McGrath: Six.

Mr. Patrick Neary: -----for six. What happened was when we went up with the 77 to the budget and remuneration committee, I mean, they were kind of quite taken aback, I suppose, because, you know, this was a huge figure. It seemed to be inconsistent with our ... the strategy ... that process that we had gone through not too long before ... so, where had the figure come from? And there was a lot of argument and discussion. It was a combination of new work that we had got and also vacancies and pressure on existing staff. The long and short ... the long and short of it was that ... yes, sorry ... I'm sorry, I don't mean to use up your time. The long and short of it was that the authority approved 25 staff, right, and they gave me some discretion about how that staff should be allocated. Now, I think an extremely important fact in all of this is that the Central Bank ... the HR department of the Central Bank recruited all our staff for us and, to be fair to them, they used recruiting agencies, they put ads in the paper, they had stuff up on the web, we could not get people to come to work in the Central Bank. So much so, that every month during 2008, we had the deputy director general of the Central Bank who was responsible for providing recruitment services, coming and briefing the authority on his efforts.

Deputy Michael McGrath: Mr. Neary, whatever about the ability to actually recruit people, was the request for six additional staff by the head of banking supervision in May 2008 sanctioned or not?

Mr. Patrick Neary: It was sanctioned-----

Deputy Michael McGrath: Fully sanctioned?

Mr. Patrick Neary: It was sanctioned within the 25 people. I had that discretion and there was never any push back from the authority ... you know ... really, really ... they never said "No, you can't have resources."

Deputy Michael McGrath: Mr. Hurley's statement that any requests for additional resources by the Financial Regulator was never refused. Is that accurate?

Mr. Patrick Neary: Yes, I think that's accurate. But ... but Mr. Hurley ... the service that Mr. Hurley's people had to provide to us in that instance was to get the people for us and they weren't able to do that. So, the question, I think ... you know ... I can understand Mrs. Burke's frustration but it really wasn't anything to do with the authority not approving her six people. It was that you couldn't get them.

Deputy Michael McGrath: It was the ability to recruit.

Mr. Patrick Neary: Yes.

Deputy Michael McGrath: Okay, so do you believe that you fulfilled your duty under section 7 of the 2003 Act, where you as chief executive, had the same power as the board to appoint employees, as you considered necessary, for the effective performance and exercise of the functions and powers of the bank in each of its constituent parts?

Mr. Patrick Neary: Well, yes-----

Deputy Michael McGrath: Did you fulfil that duty?

Mr. Patrick Neary: -----in the sense that one can only use, you know, the extent of human endeavour to provide those resources and I think why that clause was put in there was that if there was identified a particular position in the regulator that might fall outside the norms for grading structures and all of that, that gave the chief executive power to recruit a person outside those structures. I think that's why it was put in there.

Deputy Michael McGrath: Mr. Neary, can I put to you some of the central conclusions of Professor Honohan in his official report on the regulatory approach? He said:

> It was and was perceived to be excessively deferential and accommodating, insufficiently challenging and not persistent enough. It meant not moving decisively and effectively enough against banks with governance issues. Corrective regulatory intervention was delayed and timid. There was a pattern of inconclusive engagement with regulated entities on prudential matters and a lack of decisive follow through.

Do you accept that?

Mr. Patrick Neary: Well, I think as a general assessment of principles-led supervision, it's very .. very hard to argue against it------

Deputy Michael McGrath: On a general assessment of principles-led supervision, Mr. Neary, it is an assessment of your application of regulation during your tenure; that's what it is.

Mr. Patrick Neary: I think we'll have to agree to differ on that, Deputy, because I think the authority took the view that the principles-led supervision regime was the appropriate one and it clearly did not deliver the desired outcomes. So, you know, in that sense, the conclusions in Professor's Honohan's report, I think, it condemns the system and-----

Deputy Michael McGrath: But, Mr. Neary, where in the principles-based regulation does it say that the regulator should not move "decisively and effectively ... against banks with governance issues"? Where does it say that the regulator should be "excessively deferential and accommodating", that the regulator should be "insufficiently challenging"? Where does it say the regulator should "not [be] persistent enough"? Where does it say that in the principles-based regulation?

Mr. Patrick Neary: That's ... that's a fair point. It doesn't say that and I thought in our earlier discussion or hoped in our earlier discussion that we clarified some of the challenges and the issues that we had to overcome and, you know ... and I think that the .... you know, I accept that the system of regulation, you know ... that, if you will, allowed those elements to develop?

Deputy Michael McGrath: Mr. Neary, how would you describe your professional relationship with the Governor of the Central Bank, John Hurley, during your time as CEO of the regulator?

Mr. Patrick Neary: I'd describe it as constructive and cordial.

Deputy Michael McGrath: In his report, Governor Honohan notes that pressure was exerted on the Financial Regulator. Can you comment on his view that the Financial Regulator acted in a deferential manner towards the Department of Finance in regard to proposed legislative changes and he cites compliance statements, fit and proper requirements, etc.? Can you characterise the relationship between the Financial Regulator and the Department of Finance?

Mr. Patrick Neary: Well, the main relationship with the Department of Finance, I think, was reflected in the DSG, the domestic standing group. That's where most of the contact would have happened. There was some contact on those matters that you mentioned ... there was contact with the Department of Finance in relation to the director's compliance statement to the best of my recollection.

Deputy Michael McGrath: Can I ask you about pressure from the industry, the banking industry, Mr. Neary? How extensive ... was there lobbying by the industry of you personally and your senior executives on the approach to regulation, on specific regulatory issues affecting certain institutions?

Mr. Patrick Neary: No, not affecting certain institutions. Most of the representation that would have come, would be by way, I think, of observations and discussions at the industry panel, which was the statutory consultative panel that was set up to represent the views of industry towards the regulator and they met, I think, every month and represented a broad spectrum ... I think it was every month, anyway, and represented the broad spectrum of interests and I had fairly regular meetings with the chairman of that. And they did comment extensively on the work of the regulator and they did, you know, set out certain areas where they would have expected the regulator to act

Deputy Michael McGrath: Can I put to you, Mr. Neary, some of the evidence from Mary Burke yesterday again on this issue? And I'm paraphrasing but she painted a picture of senior executives at the regulator's office meeting bank executives behind the backs of the employees of the regulator who were directly regulating those banks. She painted a picture of meetings on the seventh floor involving very senior people at the regulator with those bank executives which she said was a "cause of tension .. that, at its most benign, indicated a disconnect between banking supervision department and senior regulatory executives and it seemed to sap morale". Did that happen?

Mr. Patrick Neary: I don't know what period Mrs. Burke was referring to. In the last few months before the crisis, there were regular meetings held with banks and the Governor organised a lot of those ... he led the meetings and at short notice, I could have been asked to attend those meetings and I would. And in those circumstances, you know, I would have gone along and maybe not have notified anyone in the bank supervision department because I was called in at short notice but as a general rule, when banks were coming in on a prearranged visits to the regulator to deliver their annual results or whatever ... if I attended that meeting, I would certainly have been accompanied by the prudential director or somebody else and a briefing would be prepared. But they would be the regular kind of contacts but in the exceptional contacts that took place towards the end of 2008, you know, I think maybe Mrs. Burke has a point but I wouldn't consider that that would be ... there was no, if you like, practice set out to do that or to go behind her back, I think. I wouldn't accept that.

Deputy Michael McGrath: Mr. Neary, when did you first become aware of Seán Quinn's contracts for difference exposure in Anglo?

Mr. Patrick Neary: Can I talk about the client of a-----

Chairman: It was ... it was dealt with yesterday afternoon in the inquiry, so I can give you some guidance on that.

Mr. Patrick Neary: Yes, please, Chairman. Just-----

Chairman: In a general ... in a general matter you certainly can Mr. Neary.

Deputy Michael McGrath: In the context of what is in the public domain. For example, there is a book by Simon Carswell, *Anglo Republic*, which claims that some time around late September 2007, Mr. David Drumm met you at your office to tell you about Seán Quinn's investment in Anglo Irish Bank and the concerns that Anglo's board had about it. Did that happen, for example?

Mr. Patrick Neary: No. That ... there was a meeting, I had a meeting with David Drumm at some stage around September and David Drumm came to me and said did I know anything about CFDs, that he had a sense that there was some activity in CFDs and that he suggested there was rumours out there that Seán Quinn was active in the CFD market and he kind of said, ''Look, I'm not able to get any information, do you know anything?''. And we didn't at that time, other than the rumours that were circulating.

Deputy Michael McGrath: That was, that was in September 2007-----

Mr. Patrick Neary: That was in September 2007. Absolutely, yes.

Deputy Michael McGrath: And Seán Quinn's name was mentioned to you specifically by Mr. Drumm at that stage in the context, possibly, of holding contracts for difference in Anglo Irish Bank?

Mr. Patrick Neary: Possibly, I think as a suspect of Mr. Drumm, if I can put it that way that he, he was wondering, you know, was any truth in ... in Mr. Quinn holding CFDs, had I heard anything. He was coming down just ... and he came down on his own informally to kind of tease this out ... to see had I any insight about that.

Deputy Michael McGrath: And did you look into it further at that stage?

Mr. Patrick Neary: Yes, well, I tried to kind of make some inquiries you know in ... with colleagues that regulated the, the broker side of the house. But there was nothing other than the rumours around the place. Nobody had anything hard and fast about Mr. Quinn and his CFDs.

Deputy Michael McGrath: And when did you first establish facts?

Mr. Patrick Neary: The facts were established, I think it was a Good Friday, which is around 24 March 2008. Now I ... I haven't got the facts of this here in front of me but ... that ... and I am relying purely on memory, so I haven't got the dates precise. Yes, you'll have to excuse me-----

Deputy Michael McGrath: Was there a meeting between you and Mr. Quinn in January 2008?

Mr. Patrick Neary: There was, there was a meeting in January 2008 but he said that he had small CFD positions and I remember a phrase that stuck in my mind that he was, ‘’now long in financials’’, or something that he took. But he certainly didn’t give me any impression. And I didn’t feel and you know this ... this matter, you know, if he had CFDs, I mean, that’s a matter for Mr. Quinn. And he volunteered that he had some CFDs and that he had now gone long in financials. And I took him to mean, I took him to mean that whatever CFDs he had in financial stock, that he had converted it into a holding and shares.

Deputy Michael McGrath: And when you first learned of this issue-----

Chairman: Final question now-----

Deputy Michael McGrath: -----were you satisfied, Mr. Neary, that you took the adequate and appropriate steps to assess the significance of it and the possible impact that it might have on the stability of Anglo Irish Bank and the wider financial system?

Mr. Patrick Neary: Well, when we got ... when we got the full facts on ... on the 24th of ... on the Good Friday.

Deputy Michael McGrath: In the seven months from September 2007 to March 2008, did you take adequate steps to get to the bottom of the issue?

Mr. Patrick Neary: No, well, I had absolutely no information. The only thing that was out there was ... was ... was rumour. And I had ... no I didn’t.

Deputy Michael McGrath: You had the CEO of a bank at your door-----

Chairman: I’ll just give you a little bit more time on this, Deputy, but I’ll bring you back in at the end of questioning as well-----

Deputy Michael McGrath: I’m just making the point to Mr. Neary. You had the CEO of a bank in your office in September 2007 bringing this issue to your attention.

Mr. Patrick Neary: Well, it wasn’t ... it wasn’t quite as direct as that. He was ... he came into me and he was trying to see if there was any way we could establish or did I know anything. And he said he would continue his investigations and I said I would make my inquiries. And I certainly, I think, met or spoke to Mr. Drumm, I had contact with Mr. Drumm either by the phone or I had met him at some, some time and nothing had emerged on, on that to quantify it or to give any kind of credibility to the fact that there was a huge CFD position built up in Anglo.

Chairman: Thank you very much Deputy McGrath and I’ll be inviting you back in later again this session. There’s just a couple of matters I want to deal with before we take a break for coffee, Mr. Neary. And I’m just going to bring a document up on the screen there. It’s from the evidence book, Vol. 1 pages 43 to 50. Basically, it’s the memorandum of understanding that establishes the kind of ground rules between yourself and the Governor. So the memorandum of understanding between the Central Bank and the Financial Regulator dealt with the responsibilities of both the Central Bank and Financial Services Authority of Ireland and the Irish Financial Services Regulatory Authority. Could I maybe ask you, and it’s particularly on item three there, where there is very specific sort of rules of engagement. Was there clarity on what should be dealt with by the regulator-----

Mr. Patrick Neary: Yes-----

Chairman: -----and what should be dealt with by the bank?

Mr. Patrick Neary: Yes. The, the way where we saw it was our job was to contribute to financial stability. And I think this particular MOU was fairly clear that our job was micro, excuse me, micro-prudential supervision, that is, concentrating on the activities of each individual institution. And also, we worked closely with the Central Bank then through the financial stability committee because they had a mandate for financial stability and we contributed a lot of information, facts, figures, views through the financial stability to ... to help the Central Bank manage their responsibilities.

Chairman: The memorandum of understanding is not a section 33AK document. It's a document that's in the public domain as I understand it-----

Mr. Patrick Neary: Yes, yes-----

Chairman: -----so that its now clouding the Official secrecy's Act. People can go and read it-----

Mr. Patrick Neary: Oh, I know that yes.

Chairman: All right. So in that regard, was there any expectation that the Governor would invoke his rights under the MOU and intervene with the Financial Regulator and did that ever happen?

Mr. Patrick Neary: Oh, that ... that never happened. I think we had a very good working ... it never came to quoting the law at each other. I think there was very good co-operation from both sides and any request for information or data that we ever got from the financial stability committee was provided. The Governor and the director general of the bank got ... every single piece of information that went to the authority was given to them. And also, at the Central Bank board meeting, the minutes of the Financial Regulator were tabled for any of the members that wanted to take them. So there was ... there was no withholding of information if I put it like that, from the regulator to the Central Bank.

Chairman: The Roman ... the Roman numerical iii, there for example-----

Mr. Patrick Neary: Yes.

Chairman: -----the Central Bank would have had responsibility for the macro-prudential management of the country, stability and so forth. I ... would I be correct in saying and I'd say that this happened but just as an example, that the Governor of the Central Bank may have a macro concern and would then talk to the regulator that maybe some regulatory actions might deal with these ... might-----

Deputy Michael McGrath: Yes.

Chairman: Okay. Did that every happen?

Mr. Patrick Neary: No. That never happened.

Chairman: Okay. Should it have had happened?

Mr. Patrick Neary: Well, with the benefit of hindsight, and it depending on what assessments that were made by the financial stability people and you know, when we look back on it now and see the way the risks were building up ... and it may have ... possibly should have occurred to the ... to the Governor or the ... there maybe the advice to the Governor was given that maybe we should explore ways to tackle this. You know, and it's not ... it's not an unreasonable kind of a proposition to put forward that, you know, he might have said, ''Look we have a problem here, there's a big problem building up, is there any way we can deal with it?''. But that didn't happen.

Chairman: In earlier questions there with Senator D'Arcy, you were discussing the sanctions that were available to you. Senator D'Arcy mentioned some sanctions that were available or that were in your power. Could you maybe give us an example as to what you understood the sanctions were?

Mr. Patrick Neary: When you are talking about sanctions now, Chairman-----

Chairman: These that would have been the sanctions that would have been available to you to go into banks, to not give kind of, moral suasion or to say, ''Look, I'm a bit worried about this''. These are specific actions that you could have taken with banks to actually temperate or moderate particular actions that they were engaged in.

Mr. Patrick Neary: I think-----

Chairman: Could you give us an example of-----

Mr. Patrick Neary: Yes I could-----

Chairman: -----some of those powers that you would have had?

Mr. Patrick Neary: We had the power to impose directions. We had the power to set ratios. I suppose, they're the ... and impose conditions on licences. I suppose they are the three main ones, Chairman that I ... that I can recall right now.

Chairman: And were they invoked?

Mr. Patrick Neary: The conditions were invoked because the liquidity requirements and the impaired loans requirements were imposed on all banks by way of condition ... I can't recall any other instances where there were directions given. And in the ratios I suppose, the ratio ... those reflected the fact that the capital ratios, large exposures limits and that, were set I suppose, under the ratios power.

Chairman: In terms of the communications that were taking place between yourself and the Governor, his office, his board, your office, your board and all the rest, was the issues of sanctions and how sanctions would be discussed, and at any time did the Governor or the Central Bank and Financial Services Authority of Ireland influence your approach as to how you would invasively go in and direct banks or not?

Mr. Patrick Neary: No, no, I have no recollection of any ... of anything emerging along those lines.

Chairman: Were they saying "Go in" or "Don't go in" or did they not just comment upon it at all?

Mr. Patrick Neary: There was no comment upon it at all, no. I mean we got no direction or guidance or suggestion from the Central Bank that we should impose anything or do any ... the measures that I described in my opening statement were authority initiatives and-----

Chairman: I'm just trying to get an image in my head on this in that you either have something tightly on a leash or you're letting the leash off. What were they doing? Were they holding you back or were they saying "Get in there"?

Mr. Patrick Neary: No, they ... what they I think saw their job was, was to produce the financial stability report and, you know, that was meant to be a factor that we would take into account in setting our regulatory approach. And the financial stability report contained an assessment of the economic situation and where the risks were, and the conclusion was that we were in a ... we had a ... economy was still growing, that the outcome was going to be one of a soft landing and that there was no regulatory interventions mandated by them.

Chairman: We had a bit of imagery yesterday afternoon to call the seventh floor, where it seemed all the big decision-makers in ... over in Dame Street were residing. Were you on the seventh floor?

Mr. Patrick Neary: Yes.

Chairman: And was the Governor on the seventh floor?

Mr. Patrick Neary: Yes.

Chairman: And would you meet the Governor every day or would you meet him once a month?

Mr. Patrick Neary: I'd meet him quite frequently. By meeting, I mean it was informal-----

Chairman: You could be having a cup of coffee?

Mr. Patrick Neary: And have a chat, yes, absolutely.

Chairman: And would that be the daily sort of level of engagement that you would have had?

Mr. Patrick Neary: Well the formality of the engagement, no the formality of the engagement would happen around the board meetings.

Chairman: No but informally, I mean would you be meeting him in the corridor, would you be most likely see him once or twice a week?

Mr. Patrick Neary: I would see him regularly, yes I would.

Chairman: The issue of you going in and taking a very prescriptive and very outlined and detailed engagement with the financial institutions in this country in terms of cooling them down, that never took place formally or informally?

Mr. Patrick Neary: In discussions with the Governor?

Chairman: Yes.

Mr. Patrick Neary: No.

Chairman: Okay, thank you. I now propose that we go for a break and we'll return at 11.30

a.m. if that's agreed? Agreed. In doing so I wish to advise the witness that he ... once he begins giving evidence he should not confer with any person other than his legal team in relation to their evidence on matters that are being discussed before the committee. With that in mind I now suspend the meeting until 11.30 a.m. and I remind the witness that he is still under oath until we resume. Is that agreed? Agreed.

Sitting suspended at 11.13 a.m and resumed at 11.38 a.m.

Chairman: I call the committee back into public session. Is that agreed? And we'll continue our engagement with Mr. Neary this morning and the next questioner is Deputy Kieran O'Donnell. Deputy O'Donnell.

Deputy Kieran O'Donnell: Thanks very much, Chairman. Welcome, Mr. Neary. Mr. Neary, from 2003 to 2006, you held the position of prudential director of IFSRA, the Financial Regulator. When you became CEO of the Financial Regulator in '06, what was your guiding philosophy as to how the role should be performed in order to achieve all the objectives, goals of the Office of the Financial Regulator?

Mr. Patrick Neary: The guiding principles of the Financial Regulator was the principles-based system and the entire strategy of the authority derived from that. So the strategy was quite detailed and had a number of principles in it and it had deliverables specified for each department and derived from that were deliverables that were specified for myself and agreed with myself and the chairman. And they formed the basis of quarterly performance assessment by the authority of me, so every three months, I went to the authority and I had to present to them how we were ... how we were performing against the strategy and the deliverables that I had agreed with the authority as part of the strategy.

Deputy Kieran O'Donnell: And why ... you said earlier you bought into a principles-based regulation. Why did you buy into a principles-based regulation?

Mr. Patrick Neary: Well, I believed at the time, as did all members of the authority, that there was a resource within the financial system, like within the banks, that could be seen as an extension of our own resource. Like there was ... and I think we mentioned it already this morning, you know, there was a huge risk management resource in AIB and I thought we could sort of tap into that.

Deputy Kieran O'Donnell: Do you believe the banks should regulate themselves?

Mr. Patrick Neary: No, I didn't believe that but I believed the combination of the prescribed requirements in relation to capital and liquidity, combined with the risk management resources in the banks themselves, would ensure that the-----

Deputy Kieran O'Donnell: Did you rely on the banks for analysis of risk management? Did you rely on the banks for the analysis of risk management?

Mr. Patrick Neary: Yes, we did and that was-----

Deputy Kieran O'Donnell: Why?

Mr. Patrick Neary: -----that's why ... that's why ... because we believed that they were best placed to know their own business, to know the risks in their own business and that was consistent as well with the Basel II philosophy, that-----

Deputy Kieran O'Donnell: How ... how does that differ from saying to the banks ... you're basically saying the banks could regulate themselves for risk.

Mr. Patrick Neary: Well, they were given ... they certainly were given discretion and where we saw our role was to ... to ... assess the way in which they went about that and that was what our inspectors were doing when they went on site to try and satisfy themselves that these governance arrangements that you would expect to have been in place, were in place and were working.

Deputy Kieran O'Donnell: And what changes, if any, did you introduce to the model of regulation and the approach to enforcement?

Mr. Patrick Neary: Well, the enforcement ... as I've said, the enforcement derived from the provisions for administrative sanctions and that ... I think we discussed that already there a while ago, that the ... in relation to banking supervision, the introduction of the administrative sanction regime was deferred because of the prioritisation of the Basel II implementation.

Deputy Kieran O'Donnell: And the ... going back to the ... we'll say, the credit concentration limits, like, were you in any way concerned with the growth of the property and construction loans on the balance sheets of the banks, where you saw the major banks going up, in some cases up to four times of an increase in their ... the size of their ... the value of their loans between '03 and '08?

Mr. Patrick Neary: Yes, the growth ... it's an indicator that ... when you see strong growth in a balance sheet, it is an indicator that it's going to stretch the resources of the banks to manage that ... to manage that-----

Deputy Kieran O'Donnell: I'm talking about property. The sheer scale of the increase in property loans during your tenure, between ... you were ... you were director of prudential from '03 to '06 and you were Financial Regulator from '06 to '09. In that six-year period, the loans ... the property loans in the banks grew exponentially-----

Mr. Patrick Neary: Yes.

Deputy Kieran O'Donnell: -----between three and four times over that period.

Mr. Patrick Neary: Yes.

Deputy Kieran O'Donnell: Did that ... was that a source of concern to you?

Mr. Patrick Neary: Of course it was a source of concern and that's why ... that's why the authority reacted in the way it did, that it ... we introduced the new measures in relation to mortgages and also the higher risk weightings, as part of our implementation of Basel, to cover the couple of areas that we thought were higher risk, like the speculative land and-----

Deputy Kieran O'Donnell: Well, for instance-----

Mr. Patrick Neary: -----stuff like that.

Deputy Kieran O'Donnell: -----the credit concentration limits, where they could have up to 200% of their own funds for property in a specific area and then related up to 250%-----

Mr. Patrick Neary: Yes.

Deputy Kieran O'Donnell: -----the banks ... all the major banks consistently breached that over the years. Was there ... could you have imposed sanctions on the banks for breaching that?

Mr. Patrick Neary: I don't believe we could have imposed sanctions under the administrative sanctions regime but we certainly ... and we discussed this already this morning, I think we should have had a hard look-----

Deputy Kieran O'Donnell: No, no, I'm asking you a question. What could you have done? Surely you had something at your disposal. These limits were there and they were being consistently breached, in some cases, by the end of it, up to nearly 400%, rather than 250%. So, what tools ... sanctions did you have at your disposal in terms of breaches of these particular limits?

Mr. Patrick Neary: In relation specifically to the breaches of the limits, there was no legal or supervisory remedy that we could take for that thing specifically because the concentration limit was a guideline only and, therefore, it wasn't codified, it wasn't a legal requirement and it wasn't something that was covered by the administrative sanctions regime. So, the answer to that specific question, in a very, very ... to a ... in that very prescribed was, is no, there was nothing that we could actually do about that.

Deputy Kieran O'Donnell: At all?

Mr. Patrick Neary: At all. Now-----

Deputy Kieran O'Donnell: So ... so the banks were effectively ... it was the wild west. The banks could effectively breach the limits without fear of any consequence from the regulator.

Mr. Patrick Neary: The sectoral concentration-----

Deputy Kieran O'Donnell: Yes.

Mr. Patrick Neary: -----limit that we're talking about-----

Deputy Kieran O'Donnell: Yes.

Mr. Patrick Neary: -----yes.

Deputy Kieran O'Donnell: So, therefore, what controls were in place to stop the banks from growing their property portfolio concentration? I mean, this is what ... this is what caused the crash.

Mr. Patrick Neary: The ... the concentration on property was if ... or the exposures were ... there was a parallel system. First of all, there was the large exposure directive, which limited the size of individual loan exposures and the totality of those large exposures was limited in terms of capital. There was no breach of that. The other guideline ... it ... I mean, it was there but it was a guideline and there was no way of ensuring compliance but-----

Deputy Kieran O'Donnell: So, what could have been done at the time that you could have maybe gone to Government, or whatever, to ensure that you could have imposed sanctions to make sure these limits weren't breached?

Mr. Patrick Neary: I think we should ... we should have looked for an alternative approach. I think the sectoral concentration limit was allowed fall into abeyance too easily, and I accept that, and I regret that that-----

Deputy Kieran O'Donnell: Do you bear responsibility for that?

Mr. Patrick Neary: Of course. I'm-----

Deputy Kieran O'Donnell: So, why did you allow-----

Mr. Patrick Neary: I mean, as the chief executive of------

Deputy Kieran O'Donnell: -----why did you allow it to-----

Chairman: Allow a time to answer-----

Deputy Kieran O'Donnell: Sorry.

Chairman: -----and then I'll bring you back in.

Mr. Patrick Neary: No, as the chief executive of the Financial Regulator, I mean, I have to accept responsibility for that and I'm not ... in no way would I seek to throw that elsewhere. And I regret that and I've said that already this morning ... that I regret that we did not have a hard look at that sectoral limit and see was there an alterative way of dealing with the risk. And it would have been done-----

Deputy Kieran O'Donnell: But, Mr. Neary, that's fine, apologising, that's great, right, but this was left run unchecked for six years. Maybe one year may be unfortunate, two years would be careless but three and four and five and six-----

Chairman: Thank you now, Deputy, and don't create a value judgment or I'll have to overrule you, please.

Mr. Patrick Neary: No, no-----

Deputy Kieran O'Donnell: I'm quoting from Oscar Wilde, Chairman.

Chairman: You are indeed and it is indeed. It is indeed, and very appropriate in the week that's in it and all the rest of it but please don't compromise your line of questioning.

Mr. Patrick Neary: No, that's ... no, I don't-----

Deputy Kieran O'Donnell: I've one final question, Chairman.

Mr. Patrick Neary: I don't agree with you, Deputy, in the sense that ... and I keep ... I have to come back to Basel and, you know, there was a mechanism in Basel to address the sectoral concentration limit, whereby a factor was added on to the calculation-----

Deputy Kieran O'Donnell: -----do that?

Mr. Patrick Neary: Well, we did do that, we did do that, but the trouble is, and we all know now, everywhere across the globe, that Basel just wasn't ... it wasn't a very good directive and it didn't give us any-----

Chairman: Final question, Deputy-----

Deputy Kieran O'Donnell: Final question. Can I-----

Chairman: -----then I'll move on.

Deputy Kieran O'Donnell: Vol. 2, PNE, page 115. One of the banks described you as a "hopeless regulator". How do you respond to that, Mr. Neary?

Chairman: I might add now that the ... that that comment was subsequently withdrawn and added to so ... and it was dealt with an earlier engagement, Deputy - I think actually with yourself - and I think I ... I'm not too sure, whoever it was, but I did get that re-clarified and maybe Mr. Neary is aware of the re-clarification that was put on that as well, I'm not too sure.

Mr. Patrick Neary: I'm not but I have no comment to make on it, Chairman.

Chairman: You've no comment to make on it.

Mr. Patrick Neary: No.

Chairman: Okay.

Deputy Kieran O'Donnell: And ... well then, finally, your period as regulator, how would you define it, Mr. Neary?

Mr. Patrick Neary: Well, it was a period where I bought into a system of regulation that didn't work. The system failed and I regret that.

Chairman: Thank you very much, Deputy. Could I just ask one question, following Deputy O'Donnell's line of questioning with you, Mr. Neary, and that is, if the banks had lent €440 billion and the Irish economy was worth €160 billion, how do you think the banks had enough capital to withstand the property downturn?

Mr. Patrick Neary: Well, the capital is a function ... is a function of the risk assets. It's a mathematical calculation and also it's a function of the impaired loans and if you track back from 2008 back to 2002, you will find that there was practically a zero level of impairment. Now, I mean, the regulatory approach that's used and that was used during that period, it's a point ... it's a point-in-time approach, compared to a ... compared to an approach which is far more intrusive and is trying to look at economic values in the portfolio and that. Ours is an accounting approach and, the reality of it is, it takes account of the capital and the impairments which adjusts capital.

Chairman: Mr. Neary, the banks were four times the size of the Irish economy. Did that not send off a flag to you, in your office, and others in the regulation office and in the Central Bank?

Mr. Patrick Neary: Well, I think, the final part of your question touches on the issue. Within the regulator's office, we were looking at the compliance with the capital and the other ratios that we talked about already. We're now moving into the area of systemic risk and financial stability. The size and the risks for the sector as a whole were the responsibility of the Central Bank. There is no doubt about that and they would accept the responsibility for that. But, the warnings that were coming from the Central Bank certainly did not create a concern that actions needed to be taken. They were benign and the conclusion was that we had a soft landing and so were the commentaries from all the other bodies, including the OECD and the IMF.

Chairman: But Mr. Neary, what we know from your testimony this morning is that the measures to introduce higher risk ratings for residential mortgages came very late in 2008 and on commercial property loans into 2007. I mean, we have testimony here that consistently, and I think Mary Burke gave it yesterday afternoon and others did, that by 2006, the game was over. It didn't matter how many staff that she had in her office and so forth. So, why were your office so late in coming to the table when credit growth had soared in all the years since 2002, with a very short disruption in 2001 and 2002?

Mr. Patrick Neary: Well as, as I hoped I explained there earlier on, I suppose our focus was narrow. It was focused very much on the capital and focused very much on the ... on the level of impairments that were emerging. And we left the bigger picture to the Central Bank and it was within their analysis and their assessment which, I suppose, gave us comfort that we weren't in an extremely challenging position.

Chairman: During that time, Mr. Neary, were you masters of your own fate in making these decisions or were there external agencies saying to you, "The economy is booming, there's a lot of income coming in in these sectors, don't scare the horses or whatever"? Or were these decisions that you ... there were no decisions in regard to the matters I spoke about before 2006 and 2007. Were you in complete control at that time not to make those ... and not make those decisions at the same time?

Mr. Patrick Neary: In 2006 you're talking about?

Chairman: From 2001, 2002 onwards we saw this massive growth in lending-----

Mr. Patrick Neary: Yes, yes.

Chairman: -----resulting in four times the size of the Irish economy. There were interventions made in 2006 in the property sector and the commercial sector in 2007. So in the preceding years before that, action or inaction is a decision. So was it a decision not to actually engage during the pre-2006 period?

Mr. Patrick Neary: No, there was no decision taken at the authority-----

Chairman: So that's an action?

Mr. Patrick Neary: -----one way, one way or the other. Well, there was no proposal I suppose taken to the authority, Chairman, and I suppose no assessment that regulatory action was required because each individual bank was in compliance with their required ... with their mandated requirements.

Chairman: Deputy John Paul Phelan.

Deputy John Paul Phelan: Thank you, Chairman. Good morning Mr. Neary. I just wanted to ask you a couple of quick questions at the start. Was there any pressure brought to bear on you or on the regulator by the Department of Finance or the domestic standing group to maintain a more favourable view of Irish financial services and the banking sector in particular during your time in the regulator?

Mr. Patrick Neary: No I can't recall that, Deputy. Nothing springs to mind that would cause me to believe that that happened.

Deputy John Paul Phelan: And even in the context of the dual role of promotion of Ireland as destination for financial services or-----

Mr. Patrick Neary: No. No pressure. I wouldn't use the word "pressure". The Department of Finance never gave us any mandate or, you know, influenced their mandate in that. I think that was a voluntary thing in accordance with our, our legal mandate to ... in public engagements and that, to promote the attraction of Ireland as a location for financial services.

Deputy John Paul Phelan: Can I turn now to Vol. 2, page 27 of the core documents? And there's a heading there on page 27 at the bottom of the page called "Constructive Ambiguity". I'd like you to explain for the inquiry, what the term "constructive ambiguity" means ... meant, in relation to how it impacted on your role as Financial Regulator.

Mr. Patrick Neary: I think this, this is very much ... this constructive ... constructive ambiguity, I think, is a concept that's used very much by central banks and is traditionally associated with them. And is ... it's that ... you'd ... essentially, it means that you don't show your hand or declare your intentions, that you want to be seen to give every bit of help short of assistance, and maintain that kind of opaque position in relation to any actions you might take. That's my understanding of constructive ambiguity.

Deputy John Paul Phelan: Okay. Can you elaborate more on what you mean by opaque? Like-----

Mr. Patrick Neary: Well, by what I mean by opaque, I think Deputy, is that you literally don't show your hand. You don't kind of declare in advance what you might do or might not do in a particular set of circumstances.

Deputy John Paul Phelan: To the entities being regulated or to the-----

Mr. Patrick Neary: To the ... well, this is a-----

Deputy John Paul Phelan: -----public?

Mr. Patrick Neary: -----matter for central banks as to what action they might take, let's say, when the bank came under pressure. That they might, they might assume for example, that liquidity assistance might be available from a central bank and constructive ambiguity, I think that, that concept allowed the Central Bank to keep all those options at the table, on the table, without committing to any of them. That would be my interpretation of it.

Deputy John Paul Phelan: I want to put to you a number of quotes from evidence yesterday received from Mr. Horan, who is a former prudential director and head of banking supervision. I want to quote him directly, where he said that he had, "continually pushed the boundaries seeking to make the regulations of banks more intrusive and assertive". Is that how you recall his time in that particular role in the regulator?

Mr. Patrick Neary: Well, certainly I would give Mr. Horan a lot of credit for the ... some of the initiatives that ended up being taken by the authority. So-----

Deputy John Paul Phelan: Yes, he furthermore went on later in his evidence to state, "the end of 2004, I would have been arguing for the establishment of specialist units to pursue administrative sanctions". Do you recall that? And why, if so, did it not happen?

Mr. Patrick Neary: I don't recall that. And I think on that matter, that was the administrative sanctions, and I wasn't the chief executive at that time. I was the prudential director. The administrative sanctions were handled by a unit which reported into the chief executive at that time. Now its ... its quite likely, if Mr. Horan said so, that he made representations through that department into the CEO. But I can't recall that.

Deputy John Paul Phelan: Okay. Further in his evidence, he stated and I quote, "[...] my first week as prudential director, I presented proposals to the authority for capital measures to address high loan-to-value lending ... mortgage lending”. Do you remember that?

Mr. Patrick Neary: In August ... towards the end of August 2005, yes 2005, Mr. Horan presented a proposal to me where he wanted to introduce higher capital requirements for higher-value mortgages. That is true. And I accepted his arguments and I took them forward to the then chief executive and discussed with him and I proposed that perhaps we should take a paper to the authority to give effect to Mr. Horan’s proposal.

Deputy John Paul Phelan: He then went on to say that in May 2005, he proposed to the authority a corporate governance regime for banks and buildings societies. Do you recall that?

Mr. Patrick Neary: I don’t recall that.

Deputy John Paul Phelan: He said it was not accepted, and I’m going to quote him again, Chairman, directly, because, “the view was that the markets ... the institutions were overburdened with regulatory burden at [this] stage”.

Mr. Patrick Neary: I don’t recall that Deputy. Definitely not. I have no recollection of that happening and that’s surprising because I thought I would recall it. But no, I’ve no recollection of that.

Deputy John Paul Phelan: Okay, I want to turn than to the evidence that was given by, and it was referenced by Deputy McGrath earlier, Mary Burke yesterday, where she said the following quote:

> I think people felt undermined by the fact that you would see [a chief executive officer] of a bank in at reception. It was a bank you supervised and you would come to me and say “Do you know why they’re in?” and I would go “No, I have no idea.” I think that did undermine people.

Mr. Patrick Neary: Well-----

Deputy John Paul Phelan: Do you have any answer to that?

Mr. Patrick Neary: Well, its a pity that that perception ... that was formed. Just because somebody was in the reception from, a chief executive, doesn’t necessarily mean that he was coming in to meet me or Mr. Horan or ... it could be quite, quite-----

Deputy John Paul Phelan: The clear implication from her evidence yesterday was that they were meeting people above her in the regulator.

Mr. Patrick Neary: Okay.

Deputy John Paul Phelan: And she was the head of banking-----

Mr. Patrick Neary: Yes, sure.

Deputy John Paul Phelan: -----that particular section and that she didn’t know why they were there.

Mr. Patrick Neary: Well that’s-----

Deputy John Paul Phelan: And she felt undermined.

Mr. Patrick Neary: Yes and that's-----

Deputy John Paul Phelan: There's questions by Deputy Higgins-----

Chairman: The question is made Deputy. Mr. Neary?

Mr. Patrick Neary: Sorry Chair?

Chairman: No, I'm saying the question is made. You can respond please.

Mr. Patrick Neary: Okay. No, as I say, I regret that Mrs. Burke has that impression. I certainly can see how in the weeks and that ... as the crisis started to unfold and a lot of meetings were organised, mainly by the Governor, in relation to liquidity and ELA and things like that, and discussions with the banks, that at short notice, I could be asked to join those meetings and, literally, I ... because of that, wouldn't necessarily involve people from banking supervision. But other than that, I cannot think of any occasions where that would have happened. Now, there wouldn't have been that many meetings, I mean, where that could arise. But all I can say is, you know, I regret that that perception persisted in the organisation.

Deputy John Paul Phelan: Okay. Can I ask then, in reference to your ... your evidence earlier today where you spoke at length about the principles-led approach that existed in regulation at the time. And this morning, you said:

> Trust and reliance was placed on the bank boards; banks should have known. We believed that they were best placed to judge risk. There was trust put in the banks to run their affairs prudently.

If that was the case in terms of prudential matters rather than consumer matters, what was your job as regulator?

Mr. Patrick Neary: Well, our job as regulator was to set the ... the ... the capital ratios, the liquidity ratios, and to monitor those, to monitor the activities of the banks, which we tried to do on a principles-led basis where our focus was on compliance with process and compliance with internal policies, and in that sense, if you like, in co-operation with their internal resources to ensure as best we could that the banks were managed properly.

Deputy John Paul Phelan: You viewed your role as one of co-operation with the banks rather than regulating?

Mr. Patrick Neary: Well, you see, essentially ... yes, essentially, that's what that model of principles-led regulation left us with, that it had to be done in co-operation with the control elements in the banks who, you know, I ... I think the ... the argument would have been made that they were best placed to assess the risks and run their business in according ... in accordance with the risks.

Deputy John Paul Phelan: The perception of many people, though, would be that it was the regulator's job to regulate, not to place this amount of trust in the boards of banks.

Mr. Patrick Neary: Yes, the supervision of the activities of the banks was within that framework that I've just described, whereby there were certain legal requirements set out but the rest of the framework was an overview of the operation of controls and processes within the banks to manage risks.

Deputy John Paul Phelan: I have a brief final question. You said in relation to sectoral concentrations that it was a guideline - it was a useful one. That was your ... a direct quote from this morning. And then you furthermore went on later to say that it was allowed to fall into abeyance. We've had evidence from several banks, including Mr. McCarthy, the former chief executive of Ulster Bank, to say that these guidelines were honoured more in the breach than in the observance. Do you have an appreciation of the absolute anger that exists among the general public in terms of the €64 billion that was pumped into financial institutions, in terms of retired people whose pensions have been wiped out because share prices have plummeted-----

Chairman: This is your final question now, Deputy, not a speech.

Deputy John Paul Phelan: -----and the fact ... no, no, I'm just making the point that this guideline, which you state was useful, appears in the evidence that we've heard not to have had any use for the general public and for the shareholder in ... as well.

Mr. Patrick Neary: Let me respond to that, Deputy, and I ... I ... I mean, the point of your question is do I regret that, and I do. But now ... just ... I think it's important just to get a bit of balance into my response. I mean, there are two ... there are two cohorts of people involved here. There are the depositors in the banks and there are the shareholders in the banks. The shareholders, regrettably, they lost money. They owned the banks. It was their boards, their directors, that let them down. Their ... their ... the boards of the banks had the primary obligation to the shareholders in the banks. The primary obligation of the regulator was to the depositors of the banks, and thanks to the Government guarantee, the depositors' interests were saved. And I accept that our regulation of the banks did not prevent that happening.

Deputy John Paul Phelan: How was that guideline ... I just want to push that point.

Chairman: Last question now, Deputy.

Deputy John Paul Phelan: How was that guideline that you said was a useful one ... we've only had evidence that there was letters written by the regulator, and we've had evidence that the guideline was breached. Who was it useful for? That's the point.

Mr. Patrick Neary: Yes. I suppose, to elaborate on that, it was a guideline that, had we found a way to make it stick, would have been useful, but we didn't. We failed ... we failed to do that.

Chairman: Okay, I'll have to allow to respond, and you'll be back in again this afternoon, Deputy Phelan, because Mr. Neary is with us for the day. Our next questioner is Senator Sean Barrett. Senator, you've ten minutes.

Senator Sean D. Barrett: Thank you very much, Chairman, and welcome, Mr. Neary. The CAMEL that you described in your introduction, is that dispensed with now or is it still in operation, the CAMEL model of bank regulation?

Mr. Patrick Neary: I would ... I think that it would still be a core methodology because capital would be still at the centre of banking supervision. I think asset quality and earnings, liquidity, all of those factors would still remain at the centre of banking supervision, but I think the approach now is a far more rigorous and far more intrusive approach.

Senator Sean D. Barrett: Well, in that sense, would we replace the CAMEL by an Irish wolfhound who would look at things like loans-to-deposit, sectoral concentration, loan-to-value, and that principles-based regulation without a statutory basis and without sanctions does not work, and that this wolfhound would bark and bite as distinct from the five-level CAMEL, which has got us into this situation?

Mr. Patrick Neary: There is no doubt about it, Senator, and I couldn't disagree but that the principles-led system of regulation was flawed and it did not ... it did not ... it did not function well.

Senator Sean D. Barrett: You told my colleague, Senator D'Arcy, that it wasn't your job to tell a bank how to run itself. Could I put it to you that, because of the guarantee and the lender of last resort, it was your job, and that's the difference between banks and bicycle shops and dry cleaners?

Chairman: Maybe you need to rephrase that analogy there so Mr. Neary can come back to it. I'll allow a bit of time for that actually.

Senator Sean D. Barrett: Yes, thank you, Chairman. We don't have to bail out bicycle shops or dry cleaners; we do have to bail out banks, therefore, you should have said in response to Senator D'Arcy's question, you know, "You keep lending that much to property and you'll be calling upon me and my colleagues and the legislators in Leinster House for €64 billion."

Mr. Patrick Neary: Yes, again, Senator, I think there ... we have two elements here to deal with. We have, first of all, the individual institutions and the focus on the key indicators of those, which over the years did not suggest that there was any major fault lines appearing in the loan portfolios. There was no impairments or ... materialising. That's on the one hand, at the micro-level. I think then we step across into the wider context, the level at ... at system level, and that is where I think our colleagues in the Central Bank have to come into the equation. And, like I've already said, I think their analysis and assessment of the situation was overly benign.

Senator Sean D. Barrett: In the operation of regulation ... Chairman, could we go to Vol. 1 and page 104? And that relates to 2004, Financial Regulator letter to a director of a large financial institution. And just reading from here, Chairman.

> The letter refers to a meeting which took place in September 2003 and a follow up meeting in February 2004. A period of 9 months had elapsed between the two meetings, though the following serious concerns had been raised in the first letter:
>
> [And the serious concerns were]
>
> - the inadequacy of Internal Audit,
>
> - a substantial increase in the commercial loan book
>
> - lack of progress in the review of commercial loan files, [and]
>
> - failure to segregate "front" and back office functions in Treasury.

And then, "The letter does not indicate that any regulatory action had been taken as a result of the findings." So there's nine months between the two letters, and, presumably, an interval between the first letter and the ... the expression of the serious concerns, and nothing was happening. I have to put that proposition to you, Mr. Neary.

Mr. Patrick Neary: Yes. Thank you, Senator. In the case of that particular ... particular bank, the bank supervision department, at the end of that, if you like, exchange that I have just described, imposed an increase in the solvency ratio requirement of that institution and also got a firm of ... leading firm of accountants to carry out assessment of the commercial lending business of that particular entity.

Senator Sean D. Barrett: And the whole process took a year or so, was it?

Mr. Patrick Neary: Well, regrettably, that seems to be the case that that's ... that's the length of time that it took of toing and froing and back and forth, but because of the unsatisfactory nature of the response, the decision was taken to impose the increased capital requirement on that entity.

Senator Sean D. Barrett: Could I refer you to page 67 in the same volume if I may? This was when your office pointed out to Bank of Ireland that they exceeded the 200% limit in real estate, their response was, ''Bank of Ireland remains comfortable with the exposure in this category." Is that an acceptable response to a regulator in the public interest? It tells somebody, "You're breaching our practices", and he says, "I'm comfortable."

Mr. Patrick Neary: I just want to try and find it-----

Senator Sean D. Barrett: It's page 67.

Mr. Patrick Neary: My pagination seems to be ... sorry, Senator, different to yours. Vol. 3?

Senator Sean D. Barrett: Vol. 3, 19 May and page 67.

Mr. Patrick Neary: Sorry, I beg your pardon, sorry Senator. Thank you.

Senator Sean D. Barrett: And the remark about being comfortable is in the last paragraph.

Mr. Patrick Neary: I don't see ...

Senator Sean D. Barrett: Page 68. Last paragraph. Very last paragraph. I'll just read it out for him.

Mr. Patrick Neary: Okay sorry, yes. I don't see the word "comfortable", I'm just-----

Senator Sean D. Barrett: It's the second line in the last paragraph, "Bank of Ireland remains comfortable with the exposure in this category."

Chairman: Previous page. Bottom paragraph.

Mr. Patrick Neary: Okay.

Chairman: There Senator Barrett, "Bank of Ireland remains comfortable-----

Senator Sean D. Barrett: Yes.

Chairman: Read it again.

Senator Sean D. Barrett: I will indeed, thank you, Chairman. "Bank of Ireland remains comfortable with the exposure in this category." And it's the second line going into the third line in the last paragraph on that page 67. It's a letter to Mrs. Burke from the Bank of Ireland.

Mr. Patrick Neary: Yes. And it was in relation to a letter that Mrs. Burke had sent out to the sectoral concentration framework that was coming under Basel. Now, they admitted that they have exceeded the limit and, I think they also touch on this question of the predominant risk factor. But yes they did say they were comfortable, and they weren't challenged on that by all accounts.

Senator Sean D. Barrett: But was it your job to challenge them? That's-----

Mr. Patrick Neary: Well ... I mean, it was the job of the regulator, certainly, the authority, the staff to challenge statements like that as to how they could take comfort from it and give us a similar assurance. I don't see that any further correspondence mentioned here, but maybe it was followed up. I don't know.

Senator Sean D. Barrett: But, you know, as of that time they were comfortable even though you told them to comply. Was it appropriate that the financial institutions in the domestic market were regulated the same as those in the IFSC? And could you tell us your experience in your regulation in the IFSC?

Mr. Patrick Neary: Well I think it was the position of the authority that no distinction should be made between the approach to banks operating domestically and those in the IFSC. Because they have concern that a lesser regime that might apply to the international banks might be seen as in some way promoting the kind of the tax advantages of establishing in the IFSC, and in some way a less demanding regime on them, for that reason.

Senator Sean D. Barrett: Well did that rebound on Ireland afterwards because I think there's stories that two German banks, Depfa and Sachsen Landesbank, lost more and cost the German economy more even than the €64 billion here. I think €80 billion between those two. Did you come across them in your auditing?

Mr. Patrick Neary: Yes, I was aware that, I certainly remember that Depfa Bank was certainly one that was on the list. But the supervisory requirements that would have applied to Depfa would have been exactly the same as the requirements that applied to the domestic banks. There was no reduction in the oversight of Depfa.

Senator Sean D. Barrett: But why were the results so horrible?

Mr. Patrick Neary: Well I don't, I'm not sure that I can actually get into discussing the details of Depfa; but I suppose it's ... I suppose it's public utterances, because I think it was a public company. It would be generally known that most of Depfa's exposure were sovereign debt exposures, requiring very little levels of capitalisation. And I think they fell victim to the emerging difficulties in the international funding markets.

Senator Sean D. Barrett: Thank you, Chairman, and just as a final one. Could I direct you to page 53 on Vol. 1, if I may?

Mr. Patrick Neary: I have two volume ones, sorry Senator.

Senator Sean D. Barrett: Now this one on Vol. 1 says, "Report of the Implementation Advisory Group on the establishment of a Single Regulatory Authority." And it's dated 24 June 1999.

Chairman: Can you get it on the screen there for Mr. Neary if you're-----

Mr. Patrick Neary: I'm very slow, I'm not able to keep up with you with the-----

Chairman: Just take it from the screen, you don't need to be ... just take it from the screen.

Mr. Patrick Neary: Okay, yes.

Senator Sean D. Barrett: Now, what ... when it was proposed that regulations were to be done ... completely separately, it has, it's come up on the screen. Thank you, Chairman.

When it was proposed that regulations should be done completely separately, it was very strongly resisted by the Central Bank who say in the last paragraph there, if we had it separate ... and you would be, if you like, as the first Financial Regulator, out on your own as a separate institution, that would lead, "to loss of regulatory expertise; difficulty in establishing an international reputation [...]; and duplication of supervisory effort."

Isn't that exactly where we've ended up? That we didn't have the expertise, the international reputation was shredded and we're never sure what's the division of labour between you and the Central Bank under the, kind of, combined arrangements that resulted in the 2003 legislation.

Chairman: The context of that statement is 24 June 1999.

Senator Sean D. Barrett: It is indeed. This was not to have Mr. Neary completely separately from the Central bank, to include him in, and the case all these evils would result.

Chairman: The case is made let Mr. Neary proceed and then on to the next question

Mr. Patrick Neary: Which ... I suppose, if I understand you correctly, Senator, the question is did this structure that eventually emerged ... was that a factor in what happened? I don't think you can blame the structure for that, I think the approach that was adopted by the authority was inherited from the Central Bank which was a principles-led approach and continued in the same vein. And it's likely that if there was a separate agency that may have, that agency may have also done the same. I don't know that, I had no involvement whatsoever in any of these arguments and happened way before I was appointed any senior position in the regulator.

Senator Sean D. Barrett: Thank you, Mr. Neary, and thank you, Chairman, for your forbearance.

Chairman: Thank you. Senator Marc MacSharry. Senator?

Senator Marc MacSharry: Thank you very much, and thanks Mr. Neary. Can you tell me, as CEO who did you report to?

Mr. Patrick Neary: Well, my direct report was to the chairman of the authority. For the first few years while I was CEO that was Mr. Brian Patterson and subsequently Mr. Jim Farrell.

Senator Marc MacSharry: And was that an executive role or a non-executive role, the chairman?

Mr. Patrick Neary: That was a non-executive role although Mr. Patterson in the earlier years of the establishment of the regulatory authority, oversaw a lot of the bedding down of the authority and sort of the structured arrangements and the whole project. So while he wasn't an executive, he certainly was involved to a greater extent than say Mr. Farrell was later on.

Senator Marc MacSharry: Yesterday, Ms Burke mentioned that there was a kind of a clear instinct I think was the word she used among her colleagues that the senior official in the building was the Governor. Did you have any sense of responsibility to the Governor?

Mr. Patrick Neary: Well yes I suppose within the culture of the organisation the Governor would have been seen as, yes, he would have been seen as the patriarch of the organisation I think.

Senator Marc MacSharry: And as the patriarch, to use your word, of the organisation is that somebody that one would, for want of a better expression, genuflect to, or keep informed of all major developments?

Mr. Patrick Neary: Well, I think we would certainly keep the Governor informed of all major developments, yes.

Senator Marc MacSharry: And is it correct to say, we had some outline yesterday from Mr. Grimes of the Central Bank, that the board, or your authority, and the board of the Central Bank had dual membership to the tune of some six members that were the same. Is that correct?

Mr. Patrick Neary: That's right there were six members of the authority on the Central Bank board. That's right.

Senator Marc MacSharry: And earlier you were saying to, I think my colleague Deputy McGrath, that in the context of enforcement, that you monitored breaches, and if I'm quoting you correctly, of the codified arrangements on sectoral breaches but due to work pressures and other priorities such as Basel II, sanctions on prudential matters were less pressing. And that this style of regulation is what the authority adopted; so, you were saying that because of resources, that this limited the potential, perhaps, to enforce these matters. Who decided that, I mean, was there a proposal at the authority that, "Look, we're going to prioritise" or?

Mr. Patrick Neary: I think, well, specifically, to take up that point, when the administrative sanctions regime, which had gone to consultation, etc. was finalised and the final version was being brought to the authority, the issue was raised in relation to where, how we go about implementing this, and the issue was raised about the prioritisation of the resources in banking supervision which were very, very stretched, and we've talked about that already. And the authority, and I think it might be somewhere in the minutes of the authority, accepted that ... the code should, sorry, the sanctions should first of all focus on matters that were already in the code of conduct and directly on the protection of consumers-----

Senator Marc MacSharry: Consumer-related.

Mr. Patrick Neary: Absolutely, and that's to allow-----

Senator Marc MacSharry: So that's things like charging on credit cards and that type of thing.

Mr. Patrick Neary: All that, yes, and you know the way in which entities reacted and related to their customers and on the provision of services, on lending and credit cards and insurance and so on.

Senator Marc MacSharry: But sectoral breaches or unusual transactions, interbanks or anything like that, that wasn't of concern?

Mr. Patrick Neary: Well, of course it was of concern and, I mean, it was deferred, it wasn't just dismissed, it was ... the assumption was that, when the priorities that resources were directed to would have been addressed, that this matter would be revisited. That would have been my understanding of the situation-----

Senator Marc MacSharry: So there was, for want of a better expression, a to-do tray for, on the never-never, that at some stage in the future if resources were available, we might look at enforcing-----

Mr. Patrick Neary: No, the authority would be more demanding than that in relation to those matters, it would be something that would have been, you know, included in the strategy. It would not have been delivered and it would certainly be carried over for review again. So it-----

Senator Marc MacSharry: In that period then, 2003 to 2008, was there never ever any enforcement for regulatory reasons?

Mr. Patrick Neary: Because we didn't, we didn't have the administrative sanctions. I think they were introduced in the back half of 2005, they didn't-----

Senator Marc MacSharry: Before 2005, you could do what you like, was that the case?

Mr. Patrick Neary: Well, on the prudential side, you know, it was, it was essentially, nothing changed from 2005 into 2006 on the prudential side because the administrative sanctions didn't actually come into effect on the prudential side.

Senator Marc MacSharry: Right, so up to 2005, there were no sanctions available to you to check an institution who had breached, from a regulatory perspective, on the prudential side?

Mr. Patrick Neary: Under the administrative sanctions, that's right, yes.

Senator Marc MacSharry: Okay, so in post-2005 we had rules, and we had the game, but we had no referee.

Mr. Patrick Neary: No, you see, this was, this was one of the issues, that one of the things that had to be done as part of that job was to define the rules, because the administrative sanctions process was very detailed and had to comply with ... you know, best practice, best legal practice, so there was a concept known as the "prescribed contravention", I think that's the phrase, it's stuck in the back of my head and I think it's right. So that had to be, that had to be, first of all you had to define the behaviour, and then you had to see was that a prescribed contravention of that behaviour, whatever happened, and then you had to decide was there enough evidence to commence an inquiry, and then you had to have separate people doing the inquiry. It was very convoluted and a very, very complicated process.

Senator Marc MacSharry: Is it true to say or not, that because of the complexity of enforcement, you chose not to?

Mr. Patrick Neary: No, I ... I wouldn't think that's true at all, Senator. It was a resource matter, the complication we had to live with because the similar complications that, in fairness, would have arisen on the other side of the house, if I want to call the consumer side the other side of the house, for the purposes of this discussion, it would have arisen there as well. But they had a more straightforward, if you like, codified regime of requirements where it had to be constructed in the prudential side.

Senator Marc MacSharry: As the patriarch of the organisation, was the Governor of the Central Bank aware of this non-action?

Mr. Patrick Neary: I ... I don't think the Governor would have got involved in that.

Senator Marc MacSharry: I know he wouldn't have got involved in it, but would you ... you said earlier that you'd make him aware of all major issues, you know.

Mr. Patrick Neary: Yes, well-----

Senator Marc MacSharry: Would he have been aware of this?

Mr. Patrick Neary: Well, he would have been aware of it because-----

Senator Marc MacSharry: And would it have had his blessing?

Mr. Patrick Neary: Well, I suppose there's active awareness and passive awareness, and I want to be fair to the Governor in the sense that the Governor would have been made aware because he had ... he was given all the minutes of the authority meetings, so unreeling that, he would have seen what the authority had decided in relation to the regime that was to apply for administrative sanctions but was there active briefing of the Governor on this matter, I ... I don't believe there was.

Senator Marc MacSharry: Okay, so what we have is, post-2005, when we do have a clear set of rules and we do have a clear set of sanctions, you are saying that due to lack of resources, they were never enforced.

Mr. Patrick Neary: They ... they-----

Senator Marc MacSharry: The Governor would have been passively aware of this, as a minimum, and we assume from what you are saying, has not objected to this-----

Mr. Patrick Neary: Yes, that's right.

Senator Marc MacSharry: -----and this is all down to resources, but when the Governor was in with us he told us that no request for resources was ever turned down by the Department of Finance, as Deputy McGrath has been saying earlier on. So, what was the problem?

Mr. Patrick Neary: There were ... and I thought we covered this earlier on, but just to ... just to, kind of, revisit this again, the ... the resource needs of the regulator was a matter for the budget and remuneration committee of the regulator, that's where we made our case, and it was done in the context of setting the budget for the following year.

Senator Marc MacSharry: We understand that from earlier on, and the committee decided that they needed 70 staff, and there was a difficulty in recruiting staff, but we could have gone international, whatever else. I mean, was it never said to the Governor or to the Department of Finance or onward from that remuneration and budgeting committee "We need more resources, we need more money and whether you have to go to Australia to recruit them, we need to get them" or was it just "We don't have them, end of story, we won't enforce it and that's it."?

Mr. Patrick Neary: No, it wasn't a question of ... of money, it was a question of absolute difficulty in attracting the people. The money would have been set aside in the budget for the staff levels that were approved by the budget remuneration committee.

Senator Marc MacSharry: It wasn't a question of competitiveness on salaries, for example, was it?

Mr. Patrick Neary: Well, I believe it was ... I believe that was a huge factor because, at that time-----

Senator Marc MacSharry: I have a very short time, I've got the answer. Did ... can you say ... were the limits that you were imposing to say "Okay, well we can't pay any more than X so therefore-----

Mr. Patrick Neary: Yes-----

Senator Marc MacSharry: -----we can't attract Y"?

Mr. Patrick Neary: Yes, I mean, one of the ... one of the features of the construct that we had, with the two sides of the house, was we had to be very mindful of cohesion between two sides and not allow one side to get out of sync with the other in terms of salaries and to ... made sure that staff morale and all of that, career paths for people, were maintained. So it was endeavoured, as far as possible, to ... that people should, on both sides of the house, Central Bank and regulator, be on the, the same salary scales, which replicated those in the Civil Service; we're essentially the same as the Civil Service in terms of-----

Senator Marc MacSharry: And finally, a brief question. Mrs. Burke yesterday would have referred to, and this was touched on by both Deputy Phelan and Deputy McGrath, in the context of executives from banks regularly being in around the building, and they not knowing what they were there for. She also made reference to the fact that, in dealing with her duties in liaising with a bank, occasionally the bank personnel might say, "Look, I'll be talking to so-and-so about that on the seventh floor". Is this true, first of all, that there was this *ad hoc*, for want of a better expression, gazumping of the authority of people in bank supervision in favour of dealing with somebody on the seventh floor? And, if it was, would you feel that this was a healthy environment to promote within the organisation?

Mr. Patrick Neary: No, I do not accept that. I heard that exchange yesterday with Mrs. Burke. I have ... I can't recall any instance where I intervened to overturn a decision made by anybody down along the line.

Senator Marc MacSharry: Or your other colleagues at that level.

Mr. Patrick Neary: I can't speak for my other colleagues, I can only speak for myself.

Chairman: Okay. And speaking for yourself, Mr. Neary, at any time did consider redeploying staff from the consumer numbers if there was a difficulty in recruiting? I mean, I would assume that you would prioritise, "These are our big jobs, these are our smaller jobs"; did you ever consider redeployment?

Mr. Patrick Neary: The authority was, you know, quite insistent that if there was ... if there was flesh on the bones anywhere else that could be moved across, it should be done. Now, you have a question, the question arises that ... I mean, Mrs. Burke's area was a very complex area in terms of the move to Basel. This was becoming a very complex environment, and she required, you know, skills, a skill set that had kind of accounting or banking or, you know, that type of financial expertise. And it wasn't always necessary ... necessarily the case that there were people in other departments that could be easily transferred in to take up the running on what she wanted done.

Chairman: Mr. Neary, I just want to deal with issues relating to other agencies other than the Central Bank that you may have been engaging with, and explore your relationship between the Central Bank, the Financial Regulator, and the Department of Finance. So maybe just to get matters rolling in this regard, could you please describe the channel of communication between you and the Department of Finance during your tenure as CEO of the Financial Regulator; and how did this relationship then evolve; and how did you deal with the emerging material issues prior to the establishment of the domestic standing group in 2007? So I'm talking about the relationship with these agencies now, before the DSG was put in place?

Mr. Patrick Neary: I think what happened was, Chairman, that ... taking it from ... down from the top: the Secretary General of the Department of Finance was a member of the board of the Central Bank, so I think that was the ... that's the first level of relationship, and he would have had an access to all the data, materials that would have been put before the authority and that. So he would be kept very well informed. Then coming down there was relationships at various levels, depending - and it was a kind of an issue-driven relationship. It would depend of what the subject matter was. It could come to me; it could come to the head of banking supervision; it could go to any other head of function across the organisation, I think, really, depending what the issue was. There was no really formalised relationships in place, but we knew one another and we had a cordial constructive relationship with colleagues in the Department of Finance.

Chairman: There was no formal relationship with the Department of Finance?

Mr. Patrick Neary: No, what I mean by that is there isn't ... it wasn't prescribed that, you know, I would only deal with you, or you would only deal with somebody else. I mean, in the sense of day-to-day interaction, there was no prescribed route for going between ourselves and the Department of Finance.

Chairman: Just on the formal reporting in that regard, and I ... once again now I'm before 2007, can you outline the communication protocol that existed between the relevant parties prior to the setting up of the DSG? So had the Central Bank a relationship or a position or ... sorry, had the Department of Finance a relationship and a position that interfaced with the board of the Central Bank and your board?

Mr. Patrick Neary: They had ... the Secretary General of the Department of Finance was on the board of the Central Bank.

Chairman: Okay. So they were sitting informally with you and you were talking to them on a structured basis with minutes and everything else, yes?

Mr. Patrick Neary: Oh, at that level, yes, yes.

Chairman: Okay. The matters we discussed this morning, were any of those ever fed into the Department of Finance - the build-up in the banking sector becoming four times the size of the Irish economy, and all ... and the escalating issues, and then the decisions that you made in 2006 and 2007 in regard to the property sector and the commercial property sector?

Mr. Patrick Neary: Through ... well, I imagine that a lot of that exchange would have happened through the DSG, and I think there was a, you know, a fairly extensive exchange of information in that context. In the other ... in ... otherwise I think it's through the Secretary

General of the Department of Finance that those communications would have happened, and the Governor had frequent meetings with the Department of Finance, you know, independently of the Financial Regulator.

Chairman: Okay. Maybe you ... if I can maybe describe what the understanding of the domestic standing group was, and maybe you could maybe give us some clarity as to what the role of the domestic standing group; who was on it?

Mr. Patrick Neary: From the Central Bank was the head of economic services; from the regulator it was the prudential director; and from the Department of Finance I think it was ... I don't know what exactly the title is, it'd ... the deputy Secretary General, that level, I think it was.

Chairman: Okay, so these were the men in black that were to prepare us for a calamitous situation if it were ever to arrive. Was that the job?

Mr. Patrick Neary: Well, certainly that was within their mandate. Financial stability was the mandate of the DSG as well, with ... in the ... within the context of the three groups. It was formed for that purpose, to help ... to help sustain and maintain financial stability.

Chairman: Okay. Would I be correct in saying that these ... this group was put together with particular expertise, with a particular focus to give early sight, and early warning, and early preparation for any imminent crisis that might be coming down the lines financially?

Mr. Patrick Neary: Yes, I'd say they saw their role very much as early preparation.

Chairman: And you were a member of that group, were you?

Mr. Patrick Neary: No, I wasn't a member of that group, I-----

Chairman: It was the Governor was a ... was the Governor a member of that group?

Mr. Patrick Neary: No. The members were head of economic services, prudential director, and a senior man in finance.

Chairman: Should you have been a member of it?

Mr. Patrick Neary: Well, I think that if there was a matter that needed to be escalated to the Governor or myself, we could certainly have layered that particular group by attending it, yes.

Chairman: Okay.

Mr. Patrick Neary: But the reality was that this was the agreed level at which participation should happen.

Chairman: But the ... correct me if I'm wrong now, but the understanding of the domestic standing ... or the understanding of the *raison d'être* of the domestic standing group was to be the sort of No. 1 line of defence against an economic meltdown or crisis in this country, and you're saying this morning that neither the Financial Regulator's office, or the board, or the Governor of the Central Bank was actually a member of it. Would you see that as a deficiency in the structure?

Mr. Patrick Neary: No, I wouldn't necessarily, Chairman, because senior people were present on the group.

Chairman: And did they engage with you in your role as regulator?

Mr. Patrick Neary: I ... I ... my ... the prudential director was a member, and kept me fully briefed on what was going on in the DSG.

Chairman: Okay, so you wouldn't be familiar with the DSG. In that regard-----

Mr. Patrick Neary: Well, I'd be familiar with issues that would be arising in the DSG and some of the preparations and work that they were doing.

Chairman: Was there any deficiencies, to your mind, with your familiarity with the domestic standing group that may have contributed to the failure of it in identifying early signs of the crisis?

Mr. Patrick Neary: It's ... it's ... it's very difficult to actually look at it like that. Certainly, the DSG were very active in making preparations for a crisis and to have all the various preparations in place. Working back from that, I suppose they would have had a role ... should ... should ... should they, as part of their dialogue, feel that there was an impending issue, I think they would have had a role to alert people about that, yes.

Chairman: Mr. Neary, this country faced an economic financial meltdown, probably the biggest ... well, no question it may be the biggest crisis since the foundation of the State. This group had a role in operating as an early warning signal and as a strategy group to respond to any crisis. Did they do their job?

Mr. Patrick Neary: Well, to be fair to them, I think we have to look first of all at ourselves, and our system didn't work. We have to look at the Central Bank, and that system didn't work. And it's not ... wouldn't be ... I don't think it would be justified, if you like, to place that burden on the members of the domestic standing group when the institutions from which they came, if you will, didn't see and react in time to the crisis as it was unfolding.

Chairman: Senator Susan O'Keeffe.

Senator Susan O'Keeffe: Thanks, Chair. Mr. Neary, when risks were identified by the financial stability reports, what actions were taken, and who was accountable for them? Or was it a version of "passive awareness or active awareness", to use your own words?

Mr. Patrick Neary: I'm sorry, Senator, when ... when ... when-----

Senator Susan O'Keeffe: Risks were identified by the financial stability reports. What actions were taken, and who was accountable for them?

Mr. Patrick Neary: The ... the ... the financial stability committee and the financial stability department identified risks that would be factored in to make an assessment of the economic environment. At no stage were they ... were they ever given to predict the likelihood of these risks materialising or whatever. It formed, I think ... it fed into them forming a view as to what the most likely outcome for the ... for the economy was and, I think, we ... we were aware that the general consensus was a soft landing.

Senator Susan O'Keeffe: Mr. Goggin, when he came in here, gave evidence on ... and it's on page 19, but I'll just tell you roughly what he said. He said he had a meeting with you at which you both discussed 100% mortgages and the worries around them. And he said to you, he said "My reaction to him [that's you] was that he was wasting his time [talking about applying higher capital weightings to 100% mortgages]". He said "to be helpful, I suggested to him that he immediately ban the provision of mortgages of more than 90%. I told him ... I would come out and back him publicly. [And] The reaction I got was it wasn't the role of the regulator to interfere in the market. To which my response was, this is the very time the regulator should interfere in the market."

Mr. Patrick Neary: Can I talk about Bank of Ireland in my response, Chairman?

Chairman: You can certainly talk about this question.

Mr. Patrick Neary: It's okay to react to that?

Chairman: Yes, sure.

Mr. Patrick Neary: I mean, I don't share Mr. Goggin's recollections of that meeting. The meeting was that I went to Mr. Goggin to tell him that we were introducing the higher weighting on the mortgages. Mr. Goggin's own business ... at that stage we were aware that, you know, he was ... they were well out there leading the pack in the market for 100% mortgages. And I ... I certainly don't recall any strong argument from Mr. Goggin to have the ... the product withdrawn. But in relation to the product itself, it was ... it was made clear very early on - in the early days of the Financial Regulator - I think the day of the launch of the Financial Regulator's first annual report, this question was posed in the ... in the press conference or the public conference launching the report: what about 100% mortgages, are you going to ban them? And the then chief executive was quite emphatic that it was not the role of the regulator to be banning products; that it was in conflict with the ... the view of the regulator, that a full choice should be given to people and that the emphasis should be on the way in which they were sold to people rather than banning the choice.

Senator Susan O'Keeffe: When Ms Burke was here with us yesterday and she talked about those meetings on the seventh floor and you've given, you know, your account, but she did say, when I asked her if those meetings were minuted and the minutes shared with her, as head of banking supervision, she he said "I don't believe, I rarely if ever saw what one would call a minute. You might get feedback, particularly if there was an issue they wanted you to look at again". But there ... you know, she said there were no meetings, "The sheer number of those meetings I certainly wouldn't have been aware of what was discussed". Why were there no minutes at the very least, or were they, and she wasn't shared with them?

Mr. Patrick Neary: Yes, it depends, Senator, I think, on who was at the meeting. Generally speaking, somebody was keeping a record of the meeting so I'm surprised there mightn't be something on file. And, I think, if any issue ... pressing issue, would have arisen, I ... I can't understand why Mrs. Burke wouldn't be briefed.

Senator Susan O'Keeffe: She says that she was not. She said those meetings were happening and that there were no minutes that were ever shared. And you're saying that you don't know why that is?

Mr. Patrick Neary: No, I'm not saying that, Senator, what I'm saying is that it depends on who called the meeting and why. And a lot of these meetings descended, literally at the last minute.

Senator Susan O'Keeffe: No, she wasn't actually talking about that, Mr. Neary, she was saying that this was something that happened all along. She was ... she actually said she understood there were more meetings at the end but that in the ... in the lead-up to that time there were constant meetings. But you have ... your ... that's not your recollection, you've told us earlier.

Mr. Patrick Neary: Exactly.

Senator Susan O'Keeffe: In relation to the contracts for difference, if I could just take you back. Again ... and I'm not meaning to go into the detail of this, but it's about the minutes of meetings. You said, when you were giving evidence in relation to your meeting with Mr. Drumm, there were two meetings and, again, there were no minutes or no records of those meetings. And I'm just wondering why would there not have been. You explained that one of the meetings was of a personal nature, which was why there were no minutes. And I'm just wondering why a man at your level, a chief executive of the Financial Regulator's office, would not ... would not have minutes of a meeting.

Mr. Patrick Neary: As a general rule, minutes would be kept. On that particular ... it was more, I think, the way in which that particular meeting happened, that he dropped down to see me informally. It was a matter of just having a conversation about knowledge of CFDs. It was a very informal, general meeting and I didn't keep a minute.

Senator Susan O'Keeffe: But, Mr. Neary, it was clearly a very important meeting as it turned out.

Mr. Patrick Neary: As it turned out and I accept that.

Senator Susan O'Keeffe: So perhaps a minute of the meeting, no? You still didn't think it was important enough to keep a minute of?

Mr. Patrick Neary: No. No, I regret that I didn't keep a minute of the meeting.

Senator Susan O'Keeffe: Okay. Who in the Financial Regulator's office authorised the famous golf balls with the Financial Regulator's logo on them?

Mr. Patrick Neary: They ... there was-----

Senator Susan O'Keeffe: And why?

Mr. Patrick Neary: There was products ... there was products, I think, a suite of products purchased as promotion materials down in the ... down in the ... we had a consumer centre and there was ... there was some products purchased to be distributed down there. It was a mistake. There was a very small number of them purchased and it was discontinued very quickly.

Senator Susan O'Keeffe: But what was going through the mind of the ... of the regulator's office that it would be an appropriate thing to be out there with golf balls when in fact your job, as you've said yourself, was the micro-prudential soundness of the banks.

Mr. Patrick Neary: Absolutely.

Senator Susan O'Keeffe: What was going on?

Mr. Patrick Neary: Absolutely. That was a mistake. It was ... its was-----

Senator Susan O'Keeffe: By who, Mr. Neary? Who made the mistake?

Mr. Patrick Neary: Whoever ordered the golf balls.

Senator Susan O'Keeffe: Did you know about it?

Mr. Patrick Neary: Well, I became aware of it and that's when they were discontinued.

Senator Susan O'Keeffe: Right. So, you didn't know about them but you discontinued them?

Mr. Patrick Neary: I knew that the ... that the office ... this was the public office where people came in and there was things given out, there was packages of materials and promotional materials, which was, you know, at that stage golf balls were included in it. It must have been a package of things that were delivered. I really don't know much about it other than when it was unearthed, it was discontinued. And I regret that, it was ... it was ... it shouldn't have happened.

Senator Susan O'Keeffe: Mr. Neary, when you came in this morning you said to us that you regretted what had happened. You said the system failed, you said you'd bought into the principle-based regulation. You then laid out your own statement in which you talked about stress testing, White Papers, Central Bank forecasts, strategic plans, Basel, inspections, capital requirements to domestic standing group. I would have thought, Mr. Neary, that given the scale of what happened ... that in saying at the outset that you accepted responsibility and that you regretted it, that you would have then laid out all the things that had gone wrong and you would have given us the detail of the errors that had occurred, the mistakes that were made, you would have offered the documentation to show us the exact trail of activity and where it went wrong. That's not what you chose to do and I'm wondering why you did, if you like, try to offer us the good side of what you had done, rather than say, do you know what, we were wrong, and here's how we were wrong.

Mr. Patrick Neary: And when I came into the meeting this morning, I didn't hesitate to say that we got it wrong and I was wrong. And-----

Senator Susan O'Keeffe: Yes, but you spent 15 minutes telling us how you were right. You didn't-----

Chairman: I understand the main question you're pursuing, Senator, and I'll give you some time on that. So go on.

Mr. Patrick Neary: Okay, I mean, I'll accept that as an observation. That's all I can do, Senator. I wanted to set out the activities that the authority took. They ... no, I think it's important for balance-----

Senator Susan O'Keeffe: But we know what the authority did.

Chairman: Senator, Senator, I'll give you time-----

Senator Susan O'Keeffe: Thank you.

Chairman: -----because I want to come in here myself now.

Mr. Patrick Neary: No, I think, Senator, I think it's important. This, thankfully, is an opportunity for people within the regulator to advise the committee, if you like, of an alternative view of the regulator. We've heard ... one could argue we've heard a view from a particular cohort of people, who ... the regulated community so far. I think it's important for balance that the regulator should also try and give their sense of ... of what happened, the measures that they tried to take, albeit that they didn't work. But I think that's important for balance. That's why

I took the opportunity in my opening statement to set out those measures, to inform the committee and I think we now have a ... have an opportunity here today to discuss the ... the good things that we did and the bad things that we did or the things that we didn't do at all.

Chairman: Senator, I'll bring you back in because I need to reframe this for Mr. Neary so it's very, very clear. And to remind you you're under oath, you're here for questioning and that this inquiry has two things to do: one is to find out what went wrong, and secondly is to prevent it from happening again. What Senator O'Keeffe is asking you is that yes, there were a lot of actions taken by the ... by you and your office. The question is ... is that there were series of things that happened and we ended up in the biggest financial crisis that this country ever faced. For us to prevent that from happening in the future, we need to know what went wrong. And Senator O'Keeffe is asking you what went wrong and we need to hear it from you.

Senator Susan O'Keeffe: And what went wrong in the detail, Mr. Neary, because obviously that it is part of the problem? Lots of people have been surmising about might and might not have happened. You were central, you were there, as were your colleagues. And yet, we are still no clearer, after being here for two and a half hours or whatever, we are no ... really no clearer as to what the mistakes were that were made and what errors were made------

Chairman: The question has been made, Senator, so don't get overly prescriptive on it and it is made clear to Mr. Neary, now.

Mr. Patrick Neary: I'm sorry, Senator, if I may have taken you up the wrong way and I apologise for that. I believe that in setting out my statement today that I should emphasise some of the actions taken by the authority because I believe comprehensive studies have been taken ... have been carried out by Professor Honohan and Professor Nyberg and ... Watson and Regling ... in those reports, that clearly cover the failings of the principles-based system, the failings of the regulator. I mean, they are all set out for everybody to see and I felt that in my statement that I should just give the counter argument to those to get some balance into it. That's all. There is no ulterior motive and I'm sorry if you feel that, you know, I didn't give enough focus on the downside.

Senator Susan O'Keeffe: I appreciate that ... perhaps you might now in the remaining time that we do have, step us through the sorts of errors and mistakes because bearing in mind Mr. Honohan's report was anonymous-----

Chairman: Senator, the question was made and you are over time and it's very, very clear what's being asked of Mr. Neary, so if I can .... talk us through some of the errors.

Mr. Patrick Neary: Yes, I think ... we should ... I think the source for that response has to be the Honohan report. I think we adopted a principles-led based system of regulation that clearly failed. It wasn't intrusive enough. We didn't rigorously assess the controls and procedures and the risk assessments carried out by the banks over their business. We allowed a concentration ratio guideline to fall into abeyance and not to actively, I think, follow that up and implement it and ... in that regard, I think the style and the approach to supervision that we chose to follow at the authority level was not the right one but it was the same as the approach taken in all the other European countries and it was ... it was ... it got a ringing endorsement from objective ... objective agencies like the IMF and the OECD.

Chairman: Okay, Senator, you're back in again this afternoon.

Senator Susan O'Keeffe: Thank you.

Deputy Pearse Doherty: Go raibh maith agat, a Chathoirligh, agus fáilte roimh an tUasal Neary. I want to ask you in relation to ... just in relation to your actual principles-based approach and I put it to you and it could be suggested that not only did you implement and celebrate a principles-based approach but you went actually further than a principles-based approach because the rules that apply to that approach were not possible to be followed through, given all that we've heard early on in terms of resources. And I want to put this quote to you that you gave in a speech in 2006 at the Regulation 360 Conference "We feel a regulatory approach is good for business and that it is not overly rules-based and encourages good business practice by allowing each regulated financial service provider to determine for itself how best to abide by regulatory requirements." Does that not mean that you were allowing the banks to regulate themselves, given the fact that you had no ability to follow up on sanctions during your term?

Mr. Patrick Neary: Yes, I think that reflected the strategy of the authority, which was that reliance could be placed, and should be placed, on boards of management to run their businesses properly. So, yes, I think with hindsight what you're saying there, I would accept.

Deputy Pearse Doherty: Was there any other ... you say that this was celebrated internationally and so on. Was there any other European jurisdiction that had a principles-based approach but that could not follow up on sanctions when the principles were breached?

Mr. Patrick Neary: I'm not able to answer that. I wouldn't have that in any detail of what administrative sanctions regimes applied in other countries for prudential supervision. Certainly, I would be aware that for the consumer protection, especially in the UK, I think they had a pretty rigorous rule book and a sanctions regime affecting that but I don't know if they had it for the prudential supervision. So, I'm unable to answer that.

Deputy Pearse Doherty: So, would you be ... do you still stand over the statement that the type of approach here, which included that the rules that were set out, could not be followed through were the similar practice ... practised throughout Europe and internationally?

Mr. Patrick Neary: What I was referring to there, Deputy, was the ... how would I say ... the statutory requirements in relation to capital, in relation to liquidity, in relation to large exposures and so forth. That was the same and the running and the management of the risk management of the businesses was a matter for the boards and management, as I understood it in all other EU countries. Whether or not they were able to back that up with an administrative sanctions regime, I'm not sure of.

Deputy Pearse Doherty: The point I'm making, Mr. Neary, is that a principles-based approach have principles of which you developed nine principles, which were followed up by codes and by conditions that had to be fulfilled by the banks but you did have ... you had no power, whatsoever, during your tenure as CEO to follow them up because of the staff resources that you have. I'm putting to you that: is it the case that you were the only jurisdiction, to your knowledge, that was in that type of position ... that you had principles but nothing else, nothing to back it up?

Mr. Patrick Neary: No, I'm not able to answer that question. I don't know the answer to that question, Deputy.

Deputy Pearse Doherty: Okay. Can I ask you, your predecessor of the CEO of the Financial Regulator made a comment for the purpose of the internal review of the crisis simulation exercise in 2005. He said "That in a crisis [and this is summarised] ... that in a crisis scenario, there is a limit to the type of information that can be provided by a principles-based regulator". Can you comment on how ... on this and how this was reflected in the next exercise?

Mr. Patrick Neary: I don't know what he was referring to there and it depended, maybe, on the information that was being sought and the source of information for the regulator is ... derives from the potential returns that were received in and there was a suite of them ... there was balance sheets and also, there was supporting documentation in relation to bad debts and impairments and things like that. So, that would be the main source and then overlaid on top of that would be information that could be got at fairly short notice because of the relationships between the banking supervision people and the regulated entities. So, if there was an information request, it would be sent out and got in fairly quickly.

Deputy Pearse Doherty: Mr. Neary, I'd like to now discuss, if I may, loan concentration, not by sector but by borrower, and we know and the public are now becoming knowledgeable of these matters after the event as information started to trickle out, but you, in your capacity as CEO of the Financial Regulator, I assume, would have all of this information at hand-----

Chairman: At the time.

Deputy Pearse Doherty: -----at the time ... at the time. We know from the Nyberg report that the top 20 customers in Anglo Irish Bank at May 2008 had 50% of the Irish loan book, which was €41.7 billion at the time. Now that's 20 borrowers in that bank had 50% of the loan book, that's more ... there's more people in this room than had 50% of the loan book of Anglo Irish Bank. We know in terms of INBS that 25 customers represented 51% of the INBS commercial loan book. Were these levels of loan concentration by borrower a cause of concern to you personally, as Financial Regulator, and did you have that information?

Mr. Patrick Neary: That information would have been submitted to the banking supervision department every quarter. So, yes, that information would be available and would be circulated within the organisation but the point I was making earlier was that, from the point of view of the authority, all of those loans would have been in compliance with the large exposure directed, the legal requirements set out in that directive, so they were in compliance with the law------

Deputy Pearse Doherty: No ... okay-----

Mr. Patrick Neary: Just sorry, Deputy, to cut across you.

Deputy Pearse Doherty: Sorry.

Mr. Patrick Neary: The question as to whether or not they were a systemic threat, whether that level of concentration was a systemic threat, was something that, I think, was taken into account by the financial stability people in framing their view. They would have been aware of that concentration, they would have got that information, that information was widely available in the Central Bank.

Deputy Pearse Doherty: Right, Mr. Neary, you were the regulator or what people perceived as the regulator, the CEO ... you were fully aware, you're telling this committee, that half of the Irish loan book of Anglo Irish Bank resided in the hands of 20 of its customers. That 51% ... at the time ... at the time that 51% of the commercial loan book of INBS resided in the hands of 25 individuals. The question I am asking you is: what do you do in relation to that? And you have pointed out - and I've not made the suggestion that it was against the law - but can I make this point: that the directive that was transposed by the Central Bank allowed ... allowed you to put additional sanctions there or additional requirements, which you did do in terms of directors' loans and in terms of loans to shareholders but you didn't in relation to concentration to borrower. So can you answer the question: was this a concern to you that half of Anglo Irish Bank's loan book was in the hands of 20 individuals and what did you personally do as regulator?

Mr. Patrick Neary: Well, I think it's important that you have to take account of the fact that these loans were in compliance with the law. These loans had ... had those loans exhibited any impairment, it would have been our ... our job to make sure that proper provisions were made and charges were made against the capital in assessing the capital position of each of those banks and that would have been our primary focus. And in relation to whether or not that constituted a risk to the system, it was the focus of the Central Bank.

Deputy Pearse Doherty: Okay. Can I put to you that when the lawyer and academic, Bill Black, appeared before this committee, he was asked about these types of concentrations and he said and I'll quote:

> I have never seen a concentration that high at any financial institution of any size anywhere in the world at any time in history. It is absolutely - no question ... no ifs, ands or buts - utterly unsafe and unsound and I would [... I would] have begun efforts to stop it immediately. At those levels we would have been gearing up for receivership.

What is your views in relation to Bill Black's testimony to this committee?

Mr. Patrick Neary: Well, the reality of the situation is that the banker-customer relationship is a contractual relationship between two people - the borrower and the lender. It is up to the lender to make sure that when they are lending to a large borrower that they secure that borrowing, that they ensure there is capacity to repay it. That assessment is theirs. So when the loan is being negotiated and put on the books, there is no involvement by the Financial Regulator in that process. The involvement by the Financial Regulator arises in the ... in the event that such a loan becomes non-performing or is impaired to make sure that there is proper provisions made against it. We ... it ... it is inconceivable that the regulator can determine who or who doesn't get a credit from a bank as a customer of that bank.

Deputy Pearse Doherty: With respect, Mr. Neary, nobody is suggesting that you are saying the individual ... individual customers but let's be clear in this here: the transposition of the directive actually does exactly what you are arguing that you should not be able to do. It does put limits in relation to the type of loans that can be given by financial institutions in relation to their own resources to ... to large exposures. You had the power to increase those levels beyond what is ... what was in that directive. You didn't do that obviously, and you were completely aware that Anglo Irish Bank and Irish Nationwide were lending to a small number of cohorts at a huge amount of their loan book. The question I have to ask you again is: why did you do nothing, giving the risk to that institution of concentrating their loan book to a very small number of individuals, a power that was allowed to you by transposing the minimum requirements under the '95 EU directive?

Chairman: Thank you.

Mr. Patrick Neary: The ... the directive was ... was in ... imposed as ... as ... with the limits as set out in the directive. I think it was imposed in Ireland in the same way as it has been imposed anywhere else. And I don't believe that it has been changed since, that I think that directive is still in the books in its original format.

Deputy Pearse Doherty: Can I just say, and I ... I make this point. When the Central Bank issued their notice to the banks, you actually state in it while it was minimum requirements, you have increased the requirements for directors and shareholders. So I'm not sure if that was the same that happened right across Europe. But you had the ability to increase the requirements in relation to concentration of borrowers. Why did you not do it? Regardless of what other jurisdictions did, you now knew that we had two institutions that were heavily concentrated to 45 individuals. 20 in Anglo, half the loan ... Irish loan book and 25-----

Chairman: Allow Mr. Neary to respond.

Deputy Pearse Doherty: -----why did you do nothing?

Mr. Patrick Neary: Well, as I ... as I said, it is ... it is ... I can't conceive of a situation where the regulator would intervene in a relationship between the bank and the client that has a contractual relationship and it's prescribed by the law and if the law allows that relationship to develop, well, you have to live with that. And it is in the context of the performance of that loan and the way in which it's managed that the regulator gets involved.

Chairman: Can I ask you one question before I move this on to the next questioner, Mr. Neary. At any time was your office or the Central Bank's office concerned about these levels of concentrations ... were they a matter of concern for you?

Mr. Patrick Neary: Well, of course, Chairman. The fact that there was a huge concentration on property lending in its broadest context was a concern.

Chairman: Did those concerns ever find their way into the financial stability reports, or were they ever considered in the context of putting together the financial stability reports?

Mr. Patrick Neary: Well, I ... I take it that they were because this information was available in the context of preparing the financial stability reports.

Chairman: Okay, so, first question on that. Can you ... could you comment on where the accountability for instigating enforcement action lay for actions taken from the financial stability reports?

Mr. Patrick Neary: Sorry, Chairman, I didn't quite grasp-----

Chairman: I'll repeat it?

Mr. Patrick Neary: Yes.

Chairman: Could you comment on where the accountability for instigating enforcement action lay for actions taken from the financial stability report?

Mr. Patrick Neary: Well, it-----

Chairman: Where is the accountability for instigating those actions?

Mr. Patrick Neary: Well, I think that if the financial stability report had laid out actions that would ... that should be taken, I think that would require the Governor to draw that to the attention. if there was actions prescribed for the regulator, I think the Governor would advise the regulator that those actions should be taken.

Chairman: So the concerns that Deputy Doherty were talking about, they were ... there was a cognisance of them in the financial stability reports, yes?

Mr. Patrick Neary: I would have taken it to be the case that the financial stability report would include that type of data in the overall assessment of financial stability. Yes, Chairman.

Chairman: And, therefore, the financial stability reports could have recommended an action or an enforcement or a protocol or a legislative change, even, in this regard. And are we correct in hearing you this morning that it made no recommendation, suggestion, proposal or such-----

Mr. Patrick Neary: That is correct-----

Chairman: -----in that regard to those concentrations.

Mr. Patrick Neary: -----that is correct, Chairman, yes.

Chairman: Okay. Whose desk does that eventually come back to? You or the Governor's?

Mr. Patrick Neary: If it's a financial stability matter, it comes to the Governor.

Chairman: Okay. Was it a matter of financial stability?

Mr. Patrick Neary: Well, I believe it was because, as I said, at the ... at the level of the individual institution, there was full compliance with the requirements laid out by the regulator, which was the law relating to large exposures.

Chairman: Okay. Was it also a matter of going into each and every individual bank and, in this case, one specific bank that had massive loan concentrations and saying ''We need an action to ensure that this is pulled back and that it doesn't develop in other financial institutions as well''? Because we saw in other reports and evidence presented in this inquiry that while the concentration levels may or may not have been on the same par as Anglo, they looked like they were travelling in that direction eventually.

Mr. Patrick Neary: Well, I think what ... what would have occurred during the course of the ... of the inspections of those institutions would be attention ... attention would have been drawn to this issue and it made quite clear to the risk management people that these ... these loans would have to be very carefully managed.

Chairman: Okay, look, the information of large borrower concentration loans was known to the single ... the singe supervisory teams for single banks, yes?

Mr. Patrick Neary: Yes.

Chairman: Okay. But an analysis or an addition of all loans to specific large borrowers across different banks was apparently not done.

Mr. Patrick Neary: An aggregation would have been done. And I think it would have been pulled together into ... into a report, yes.

Chairman: To your knowledge, was it ever attempted to build a database of large borrowers with combined exposures across all the large banks?

Mr. Patrick Neary: I don't know how they handle the data down in banking supervision in relation-----

Chairman: To your knowledge.

Mr. Patrick Neary: No, not to my knowledge.

Chairman: Okay, thank you. Deputy Joe Higgins.

Deputy Joe Higgins: Mr. O'Neary, how would you describe ... background is that you were in banking supervision up to 2003. You became prudential director regulator in 2003 - a very senior position - and you were chief executive of the regulator in 2006. How would you describe your relationship with the banking institutions over that time?

Mr. Patrick Neary: I think it would ... it would have been constructive and professional to the extent that I would have any great personal dealings with any of the institutions.

Deputy Joe Higgins: And you referred in your opening to the need for trust, if I understood you correctly, between banks and regulator and you refer on a number of occasions that primary responsibility resided with the banks themselves for much of what they were doing. Mr. Neary, why should you trust the banks? I mean, you're a person more or less of my own generation. Do you not remember in 1984 the scandal of Insurance Corporation of Ireland, an affiliate of AIB, which cost the taxpayer hundreds of millions of pounds? Do you not remember the tribunal findings regarding Ansbacher and nefarious activities in that bank? Do you remember the bogus offshore accounts which the banks had to restitute the taxpayer to the tune of ... masses in any case? So, on what basis did you decide that these profit-seeking institutions would act like gentlemen or ladies?

Mr. Patrick Neary: The ... the position of the authority in relation to that was ... first of all, the ... the system was grounded in that trust and I ... you know, that, I accept that, that's what I said. Overlaid on that was the fitness and probity regime whereby an assessment was made of directors for their competence and also an adjudication made on their suitability for the job. And I think that went to the ... that went to the core of this trust, that you had competent, experienced people appointed to the boards and people were trustworthy.

Deputy Joe Higgins: But, Mr. Neary, financial institutions have manifestly betrayed any trust previously which you were well aware of. Mr. Neary, were you a regulator who may have done well in the staid world of Irish banking in the 1950s but were you totally at sea in the cutthroat world of the capitalist financial markets in 2005, for example, which *The New York Times* described Ireland as the "Wild West of European finance"? Were you out of your depth completely?

Mr. Patrick Neary: Well, I think the authority didn't see it like that. The authority had signed up to the principles-led regulation but ... and I have to keep coming back to this because the reality of it is that this system failed. So clearly ... we have to ... I have to recognise and accept that and it ... it can't be defended otherwise than it was a failure, the approach that we took.

Deputy Joe Higgins: Mr. Neary, Simon Carswell, a witness to the inquiry, in his opening statement, page 2, said "I ... characterise the relationship between ... the government, the banks and the financial supervisory authorities - as extremely cosy in the period leading up to the 2008 banking crash." Do you agree?

Mr. Patrick Neary: I really don't know what "extremely cosy" means. I mean, was there dialogue and a professional relationship with the banks? Certainly, at all levels in the regulator and in the banks, but I wouldn't go any further that ... to describe the relationship.

Deputy Joe Higgins: Mr. Neary, Deputy Shane Ross wrote a book called *The Bankers* and in it's prologue, 26 November 2008, page 1:

> The banking crisis was at fever pitch. The nation's finances were in peril but Ireland's banking elite were celebrating in a private room in a discreet hostelry near Dublin's Stephen's Green ... The bankers were ... careful not to be spotted as they entered and left. Any media story that the regulators were living it up with the bankers would have been dynamite. A view that the two groups were far too cosy was gaining credibility with the public by the day.

Chairman: Is this November '08, Deputy, yes?

Deputy Joe Higgins: Yes, 2008. Was it appropriate that such a close social relationship existed-----

Chairman: Will you make your point now because we're not going to go into the guarantee until this afternoon, but I understand where you're going generally with this one?

Deputy Joe Higgins: Yes, it's not in relation to the guarantee at all.

Chairman: I'm not going into the guarantee here now.

Deputy Joe Higgins: But was it appropriate that such a cosy relationship existed between the tops of the banks and the Financial Regulator?

Chairman: Could I just first of all ask the question? Do you accept that the event took place, Mr. Neary, and then we'll come back? I'm not going into the guarantee now.

Mr. Patrick Neary: I do, indeed. Yes I do, indeed, Chairman. What that event was about was the former chairman of the Financial Regulator, Mr. Patterson, had retired and in recognition of his retirement, there was a small function organised to, I suppose, to mark the occasion. It was organised by the IBF, which was the bankers' federation, and they issued invitations to people to attend the dinner to mark the occasion of Mr. Patterson's retirement.

Deputy Joe Higgins: But, Mr. Neary, I don't think you get my point really. I mean, you were the regulators, you were supposed to be the protectors of the ordinary people from what could be predatory practices by these profit-seeking financial institutions. In a sense you were, to use a figure of speech, the gamekeeper. Why would the poachers want to be toasting you?

Mr. Patrick Neary: Well ... I think it was a once-off event and, you know, with the benefit of hindsight, maybe it was misjudged, but I don't think that ... that impacted on the professionalism in the relationship between ourselves and the banks but the optics of it, with hindsight, were not good.

Deputy Joe Higgins: Okay, Mr. Neary, I'll move forward quickly. Mr. Bill Black, a former US regulator, referred to banks like Anglo Irish Bank growing like crazy based on property lending, turning out huge profits and then an inevitable disastrous crash. The loans and advances extended from 1998 to 2008 amounted as ... the growth of those was as follows: Bank of Ireland 325%, which is huge; AIB 330%, which is huge, and Anglo, 1,950%, which is mega.

Mr. Neary, I want to put these concrete figures to you. In 2002, Anglo Irish Bank had total loans out there of €13.3 billion; in 2003, those loans increased by €4 billion; 2004, by €7 billion; 2005, by €10 billion; 2006, by €16 billion; and 2007, by €17 billion. Mr. Neary, did you notice this, to use Black's terms, "crazy" level of growth, and that this was largely for speculation and development in construction projects?

Mr. Patrick Neary: Certainly, you couldn't ... you couldn't but notice the growth in all the banks during that time and, as I've said, in the context of an economy which was performing very well, but I think it's also important to bear in mind that during that time the level of impairments and defaults in the portfolios that were built up in the banks were negligible. So that while there was growth, it did not transmit itself into defaults or bad debts or impairments.

Deputy Joe Higgins: Mr. Horan yesterday spoke about his knowledge of the Scandinavian crisis of the '90s. Surely, you would have been aware of that and would have seen that here was lending-----

Chairman: Would you have been aware?

Deputy Joe Higgins: Would you have been aware of that and the lending of far more reckless character?

Mr. Patrick Neary: Well, every single crisis has different characteristics and certainly the growth in credit, a phenomenal growth in credit, is one. And that is why I think it's important to oversee the risk control environment in the banks and to keep a very close eye on impairments and we were doing that. But it was ... it is clear now, and I accept the argument, that that was not intrusive enough and that we should have taken more steps. And, as we discussed this morning in relation to the concentration ratio, we should have taken more steps to halt the progress of that loan growth.

Deputy Joe Higgins: Mr. Neary, Governor Honohan said in his evidence that the regulator, by not challenging in detail many aspects of the security underlying these huge loans, that the regulators did not realise just how vulnerable the lenders were to property price declines. And even when confronted with evidence that the banks had insufficient info, the regulators failed to grasp the scale of the potential exposure. Now, Mr. Neary, throughout the 2000s, this period we are talking about, the banks were showering loans like ticker tape-----

Chairman: Mind now, Joe. It's your final question as well.

Deputy Joe Higgins: -----for massive speculation in property. Every day in the newspapers, we had developers announcing prestige projects costing billions or hundreds of millions, clattering around the place in their helicopters. And every year from 1996 to 2006 the price of an ordinary home for a first-time buyer increased each year by the average industrial wage. Young people, in other words, were being pulverised by this and by 35 and 40-year mortgages. So, Mr. Neary, Ireland had obviously become a massive casino economy, fed by bondholders, by speculating and profiteering-----

Chairman: Can you move your speech to a question now, Deputy?

Deputy Joe Higgins: -----screwing young people to the wall. How could you not see this and be alarmed to the core? Because, you seemed to sleepwalk through this landscape.

Chairman: I heard that, leading now.

Deputy Joe Higgins: Is that true, or not or fair or not?

Chairman: Prejudgment there now, but Mr. Neary to respond please.

Mr. Patrick Neary: Well, I have to frame my response in terms of the ... the framework of supervision that the authority put in place and that was to monitor the capital position, the liquidity position, the bad debt position and the governance position of the banks. The authority never envisaged a role for, for the regulator in involving itself in individual loan assessments and loan contracts between banks and borrowers.

Deputy Joe Higgins: Mr. Neary-----

Chairman: Sorry, Deputy, you're out of time and the questioning is getting very loose there now.

Deputy Joe Higgins: Weren't ... weren't these rules not a blindfold that you couldn't see the obvious?

Chairman: Okay. Mr. Neary, I'm going to move on, please. Deputy Murphy.

Deputy Eoghan Murphy: Thank you, Chairman, and-----

Chairman: I'll bring you back this evening, Deputy Higgins.

Deputy Eoghan Murphy: -----thank you, Mr. Neary. There's just two areas I want to touch on, if I may, before we conclude this session. On page 11 of your opening statement you said that apart from considerable day-to-day contact with their respective banks, staff in banking supervision carried out over 50 inspections of banks between 2003 and 2008. Are you presenting this as a positive?

Mr. Patrick Neary: Well, I'm presenting it in the sense of what was achieved by very tight resources and unfortunately the relationship did not necessarily, I think, achieve a measurable outcome. I mean, the reality of it is that despite that level of oversight, intervention and engagement, we got to a ... to the unfortunate situation where we ... we found ourselves at the end of 2008.

Deputy Eoghan Murphy: Okay. In a report from the Comptroller and Auditor General in 2007, a special report on the Financial Regulator, he criticised the level of on-site inspections. So what did you do as a result of that criticism?

Mr. Patrick Neary: He certainly put ... put quite a range of findings in front of us. I think he did it on the basis of value for money and I think it was in that context that-----

Deputy Eoghan Murphy: I can give you the context, if I may. A central concern of the special report was that the inspection levels were low and that risk rating was used to ration resources rather than determine an appropriate regulatory stance for institutions.

Chairman: Is that in the core book there, Eoghan?

Deputy Eoghan Murphy: That's in the C&AG special report of 2009 and it's referencing the 2007 special report.

Chairman: Is it in the core documents?

Deputy Eoghan Murphy: It's not in the core documents but the regulator is ... is aware of the report.

Chairman: Okay, fair enough.

Mr. Patrick Neary: Yes. I can recall the value for money report that was done in 2007, and yes, the, the selection by the supervision staff for the inspections that they were to carry out I think derived from the internal risk rating programme that they had in banking supervision, which took in account of a wide range of factors. There was an annual review that they did. They had ... they had a well-established procedure in banking supervision for determining the inspections. But, I think his view was, you know, in terms of value for money, how they ... what outcomes were coming from the inspection, etc. I ... I only partially recall that, I'm not really-----

Deputy Eoghan Murphy: Well, he did say that the on-site inspections ... the level was low, and you just mentioned the ... the determination of how they'd carry out the inspections, the risk rating, and the C&AG criticised that as well in 1999 and in 2007, and what did you do about those criticisms?

Mr. Patrick Neary: What did he say in 2007 in relation to the risk rating?

Deputy Eoghan Murphy: He said that successive reports ... sorry, I don't have the C&AG's report in front of me, this is actually in the Honohan report on page 64.

Mr. Patrick Neary: Okay.

Deputy Eoghan Murphy: Successive reports of the C&AG have urged improvement in the methodology, and that being the system evaluating risk, using such factors as supervisory complexity, corporate governance, business and reputational risk, and so on, based on regular statistical reports provided by credit institutions on their activities and financial conditions. I suppose, Mr. Neary, my point is ... or my question is in relation to the criticisms coming from the C & AG, about the level of inspections and the, the methodology being used in carrying out those inspections to evaluate the risk being taken by the banks and what your response was, as Financial Regulator, to those reports.

Mr. Patrick Neary: I ... I can't recall the ... the outcome to that engagement with the C&AG. I can certainly confirm that the inspection took place and that there was engagement with him. The action plans that were put in place to address his concerns, I cannot recall them, Deputy.

Deputy Eoghan Murphy: You're saying those concerns were addressed?

Mr. Patrick Neary: I would expect so. I mean, the C&AG's recommendations would not be set aside.

Deputy Eoghan Murphy: In 2005, you had a three-person team responsible for both Bank of Ireland and Anglo Irish Bank, in terms of those inspections. Was that an adequate number of people?

Mr. Patrick Neary: Certainly, with hindsight, definitely not.

Deputy Eoghan Murphy: Okay, so, could you have known what was happening in the banks, in those two institutions, with those three people?

Mr. Patrick Neary: Well, it was a combination ... our source of data would be a combination of ... of a number of different sources from the prudential returns, from the engagement with the banks, from their annual accounts and so forth. In the context of a principles-led approach to supervision, and with the model whereby boards and management were expected to take charge of the risk management of the organisation, the answer to that is probably yes but, with hindsight, that was clearly not correct.

Deputy Eoghan Murphy: The answer is that, yes, that three-person team was sufficient for giving you a level of information on the banks?

Mr. Patrick Neary: In that context of, of principles-led regulation. Then ... because, on top of that there was a further resource that carried out the inspections. The ... the people that we're referring to there were the people that had the day-to-day relationship with ... with the bank and dealt with any ongoing issues or issues that came out of the inspection process. Those people then took ... took that on. Now, but clearly, I think, as ... as we moved through the decade, and as we got closer to Basel, it was clear that the resources were becoming much more thinly stretched and that's what prompted Mrs. Burke to look for the additional resources.

Deputy Eoghan Murphy: Okay, and I have to move on because my time is short. If I could look at just stress testing, if I may, Mr. Neary. The stress testing that was conducted in 2006, and there's a reference in core documents, Vol. 3, page 35.

Mr. Patrick Neary: Page 35.

Deputy Eoghan Murphy: Of Vol. 3.

Mr. Patrick Neary: Yes, okay.

Deputy Eoghan Murphy: The 2006 stress tests, were you involved in designing those stress tests?

Mr. Patrick Neary: No.

Chairman: It can't be displayed, just reference it. Okay?

Deputy Eoghan Murphy: Okay. The Financial Regulator wasn't involved in deciding the methodologies of the variables-----

Mr. Patrick Neary: No, I'm not ... I'm not saying the Financial Regulator wasn't involved in them. I ... I think we would have been informed, through the financial stability committee, of the stresses being used and the factors being used. It was this ... this functionality was discharged by the economists and the people in the financial stability area. So, I mean, you know, it would have taken account of any information we'd have provided from the bank supervision people.

Deputy Eoghan Murphy: Would you have been aware of the scenarios being put in the stress tests to the banks?

Mr. Patrick Neary: Well, I ... I was aware that they were supposed to be conservative and, you know, I trusted the process that the conservative stresses would be used. I ... I didn't get actively engaged in setting those parameters and I think that's a skillset that, I think, is more appropriate to the economics people.

Deputy Eoghan Murphy: Well just ... if you could help me clarify, because there was two scenarios put to the banks to test for. Shock scenario one was the extreme scenario and had a number of variables, and one was a decline in house prices by 40%, in the extreme scenario. Shock scenario two was the weak scenario and it had the same variables at different levels but the decline in house prices in the weak scenario was still 40%. Why would that variable be constant amongst both the extreme and the weak shock scenarios for the banks?

Mr. Patrick Neary: I'm not able to answer that question, but the only additional point I would make in, in responding to you, Deputy, is that, as far as I remember, in 2006, the stress test process was validated by the IMF, so it would have met their requirements.

Deputy Eoghan Murphy: Well, actually, the IMF, if I can find the document in front of me, the IMF ... the Central Bank was ... oversaw the stress test results, and the IMF did comment on them-----

Mr. Patrick Neary: Okay.

Deputy Eoghan Murphy: -----and the IMF said that they welcomed these results but observed that the long period of strong economic performance limits the ability to quantify the relationship between macroeconomic variables and credit risks. And was there a response from the Financial Regulator to the ... that comment, from the IMF?

Mr. Patrick Neary: I do not recall any response from the Financial Regulator. I think if there was a response, it was more likely to come from the financial stability people.

Deputy Eoghan Murphy: That was in the 2006 country report from the IMF and they did flag a concern with those stress tests that were conducted. But, just to come back to that point on the two shock scenarios, can you help us as to why in an extreme scenario and a weak scenario, in stress testing the bank's books, you would have a decline of property prices at 40% for both? Why would you do that?

Mr. Patrick Neary: I am not able to answer that question.

Deputy Eoghan Murphy: Could it have been that something was suspected as to the quality of the lending in relation to property?

Chairman: Allow the witness to answer.

Mr. Patrick Neary: I would not be able to answer that or to offer any opinion on that.

Deputy Eoghan Murphy: Why was it then, in the letters that were written to the banks to conduct this stress test, they asked for special attention to be given to the performance of property and consumer-related lending?

Mr. Patrick Neary: Well ,I would have thought that, because of the way in which the portfolios of the banks were expanding, that they had picked up on this in a financial stability department, which ties in with what we were saying earlier on. That this growth in the system is a financial stability ... a systemic risk matter and they must have picked up on that and wanted to have it addressed as part of the stress test. Now I am speculating.

Chairman: To qualify that, Mr. Neary. The operation of stress tests were not within your remit or job description or competency. Is that correct or incorrect?

Mr. Patrick Neary: That is correct.

Chairman: Okay. So what you are doing is giving an opinion or observation on that, not a direct account of it?

Mr. Patrick Neary: I am giving an opinion, yes. I am not able to give a direct account, Chairman.

Chairman: Deputy Murphy.

Deputy Eoghan Murphy: Thank you, Chair. It is on page 41 of Vol. 3. It is an e-mail. I won't say who it is from, but it is from someone in the Financial Regulator's office to one of the banks. It is talking about one of the questions that the IMF wants to look at in particular, when they come to meet the banks to look at the stress testing that they have done themselves. They want to know:

> ... how sensitive would specific provisions be to a large drop in house prices, given that the collateral behind the mortgage loan would have to be revalued. We realize that the current level of specific provisions is a very low percentage of the loan reflecting very low default rates.

So, just to summarise, this is the IMF coming into Dublin to meet with the banks following the stress tests that they have conducted, the parameters set by the Central Bank and the Financial Regulator. They, too, want a focus on a large drop in house prices and how resilient the banks would be to that. Why? How resilient the banks would be to a large drop in house prices. My question is, why?

Mr. Patrick Neary: I think there in your introduction, Deputy, if I understood you right, they saw that there was a significant increase in lending for house purchase and very, very low defaults, and I think as well as that at that time, with the increases in house prices, there would have been considerable seasoning in the value of the security and I can only presume again that the IMF wanted to test the resilience of the security and the resilience of the portfolio for downturn.

Deputy Eoghan Murphy: And the concerns that the IMF had-----

Chairman: Final question now, Deputy.

Deputy Eoghan Murphy: The concerns that the IMF had in spring 2006, did you have these concerns?

Mr. Patrick Neary: That exactly ties into the initiative that we took in 2006 to increase the risk rating on the higher LTV mortgages because we saw that that particular line of business was starting to grow significantly.

Chairman: Thank you. I want to move to wrap up by one final question and then it is Senator D'Arcy, Deputy McGrath and then we will break for lunch. It comes back to the breaches we were discussing earlier this morning. Mr. Neary, to put the question to you, at what point did the breaches become so endemic that it became a financial stability issue and become a Central Bank issue, which would then mean the Governor should have followed up or discussed new legislation or powers that might have been requested from the Minister or the Department of Finance?

Mr. Patrick Neary: When you are talking about the breaches, Chairman, are you going back to the sector concentration guidelines?

Chairman: Yes.

Mr. Patrick Neary: Well, you see, as we were talking about earlier on in this particular guideline, regrettably had fallen into abeyance and there were all kinds of ways of assuring compliance with it and determining the common predominant risk factor, etc. So I think that there was no evaluation, formal or structured evaluation I should say, carried out in relation to compliance with that limit. It had fallen into abeyance. So I think the matter that would have informed a financial stability assessment would be the growth in the loan portfolios of the banks, irrespective of the limit being in place.

Chairman: Senator D'Arcy.

Senator Michael D'Arcy: Thank you, Chairman. Mr. Neary, you said that the principles-based system failed. But there is no system without people. Did the people within the principles-based system fail?

Mr. Patrick Neary: I think that ... I do not know how to make that connect, you become a practitioner of a system. You see that at that particular time the system is in widespread use. It is also embedded in the proposals that are coming down the road from Basel, which actually devolves more autonomy if you will to the banks to determine their own capitalisation and their own internal controls. So I can see how people, myself included, believed that the principles-led regulation may have been suitable. We committed to making the system work but it did not work.

Senator Michael D'Arcy: You had powers that you chose not to use. We spoke about them earlier. Quantitative controls.

Chairman: Ask about the powers and then establish why didn't they use them.

Senator Michael D'Arcy: You had those powers that were unused. Was it a failure of the people within the system to choose not to use those powers?

Mr. Patrick Neary: No, I would not put it that way. It was a failure, I think, a misjudgment of the risk by people that did not propel people to take decisions to use the powers. I think if the assessment of the risk was judged to be a major threat I think that would have forced people to consider what actions. I can't see that people would ignore the need to take actions if we had adjudicated on the risk properly but we did not adjudicate on the risk properly, so therefore it was not a matter of people being involved in dereliction. It was people involved in misjudgment.

Senator Michael D'Arcy: Mr. Neary, did you fail in your role as the CEO of the Financial Regulator's office?

Mr. Patrick Neary: In that context, I signed up to the principles-led model of regulation. I believed in it.

Chairman: Allow him time to respond, Senator, and it is a bit of a leading question as well.

Mr. Patrick Neary: In the sense that the system did not deliver a desired outcome, it does not stand to any of us in the regulator, unfortunately ... leave us in a good position. All I can say in response to that is I believed in that system, I misjudged the risk and it resulted in the situation where we found ourselves at the end of the day. All I can do is express my regret for that and that is as far as I can go with that.

Senator Michael D'Arcy: Mr. Neary, were you up to the job?

Chairman: Sorry. You can talk about competencies and functions and all the rest but I am not going to be facilitating soundbite leading questions, Senator, okay?

Senator Michael D'Arcy: Can I ask, Mr. Neary, you said that the dinner that Deputy O'Toole brought up, that that was a once off.

Mr. Patrick Neary: Yes,as far as I remember.

Senator Michael D'Arcy: Were there any other dinners ran by the IBF banks AGMs that you attended?

Mr. Patrick Neary: I would have been required to attend a good few industry occasions. Certainly there was the funds industry, the insurance industry, the audit. There was a schedule that I would, with the agreement of the authority, that they would have expected me to attend. But that particular dinner was more of a personal matter for the retiring chairman and it was most unusual.

Senator Michael D'Arcy: When you say a good few, monthly?

Mr. Patrick Neary: No, I mean, these are public occasions where, for example, the Institute of Bankers have this annual ... where it would be addressed by the Minister, the financial services industry would have an annual dinner which would be addressed by people as well. It was those kind of functions where the regulator was sort of expected to attend and I think the authority expected that the regulator would be represented at those functions.

Chairman: Senator-----

Senator Michael D'Arcy: And, final question, Mr. Neary, do you believe the Irish banks lended recklessly?

Mr. Patrick Neary: It's ... well, they certainly misjudged their risk. I mean-----

Senator Michael D'Arcy: Recklessly?

Mr. Patrick Neary: Well, I-----

Chairman: Let the ... you can ask the question, Deputy-----

Senator Michael D'Arcy: Well, I did ask the question-----

Chairman: -----or Senator, yes-----

Senator Michael D'Arcy: -----but he answered a different question, Chairman.

Chairman: Yes, but no, but this is ... the witness answers the question.

Senator Michael D'Arcy: He ... he-----

Chairman: And I chair then to determine-----

Senator Michael D'Arcy: He posed a different question.

Chairman: -----whether the question's been answered or not. Mr. Neary.

Mr. Patrick Neary: I'm struggling with the word "reckless" because that's ... that seems to me to imply that a deliberate ... a deliberate effort was made to grant loans without any assessment of the risk, or perfection of the security, or any attempt to have regard to the shareholders' interests that we talked about already, or deposited ... deposits ... depositors' interests. I mean, if there was reckless lending, I mean, as I kind of outlined there, we're almost into the area of fraud and criminal behaviour. I mean, if we were to go down the road of describing something-----

Chairman: I'd ask you to be mindful now of your language there because that's a separate-----

Senator Michael D'Arcy: I didn't use those terms, Chair.

Chairman: Sorry, Senator, you're out of time.

Mr. Patrick Neary: I apologise, Chairman. I'm sorry.

Chairman: Yes, I'll just give you a ruling there because in my opening remarks I said there are matters that are before the courts-----

Mr. Patrick Neary: Of course.

Chairman: -----and all the rest of it, so I'll just pull you back on that.

Mr. Patrick Neary: But we ... we stray into that kind of an area, I think, when we start using words like "reckless". I'm not in a position ... I've no evidence-----

Chairman: It's not a matter for this inquiry, matters of a criminal ... or criminal matter are a matter for the courts, Mr. Neary. They're not a matter for this inquiry. Deputy McGrath.

Deputy Michael McGrath: Thank you, Chair. Mr. Neary, was there consensus at board level of the CBFSAI and the Financial Regulatory Authority about the regulatory approach with banks and was there ever any difference of opinion expressed between the two?

Mr. Patrick Neary: No, there wasn't.

Deputy Michael McGrath: Thank you. What role did the Financial Regulator play in the preparation of the financial stability report every year?

Mr. Patrick Neary: I would suppose we would be the providers of data and information in relation to the activities of the banks and their loan books, etc., so it would be very much contributing the information and, in that regard, the assessment, the analysis, the adjudication, was done by the economics people.

Deputy Michael McGrath: But was it a joint report, ultimately?

Mr. Patrick Neary: Yes, it was, in the sense that the final report and the message from the report was determined from a joint meeting of the authority and the Central Bank boards. The two boards came together to agree the message of the financial stability report.

Deputy Michael McGrath: So, Mr. Neary, when you described earlier on the Central

Bank's assessment in the financial stability report as being overly benign, should that be not "our assessment"?

Mr. Patrick Neary: In so far as ... yes, there would have been buy-in to that from the Financial Regulator. I think that's ... that's a reasonable observation to make there.

Deputy Michael McGrath: Just to be clear, Mr. Hurley, in his witness statement, stated "The Central Bank agreed the content of the Financial Stability Reports with the Financial Regulator." In the foreword, for example, of the 2007 report, he said "This Report reflects the joint views of the Bank and the Financial Regulator ..." Did you essentially sign off on the financial stability report every year?

Mr. Patrick Neary: Yes, the authority did that at a joint board meeting of the Central Bank board and the authority, yes.

Deputy Michael McGrath: Okay. Well, do you think in any sense that until now, in your evidence, you might have sought to deflect some of the responsibility in terms of the financial stability report entirely onto the Central Bank and not reflected the joint nature of that report, which is clearly evidenced in Mr. Hurley's statement and in the report themselves?

Mr. Patrick Neary: Sorry, Deputy, I had no intention of deflecting blame anywhere on anybody.

Deputy Michael McGrath: I'll give you an opportunity to express your view-----

Mr. Patrick Neary: Well-----

Deputy Michael McGrath: -----because earlier on you were referring, a number of times, to "their assessment" and "the Central Bank's assessment". The reports were clearly joint reports.

Mr. Patrick Neary: Well, I suppose it's maybe then ... it's to describe a process. What would have happened is that a final position would have been arrived at and that position ... that's where the financial stability people, from their research, would present a position and it would be taken on from there by the joint boards and they would discuss that position and see whether they could agree with that and endorse it. If they didn't agree with it, well then I imagine that it would have to go back and be reworked.

Deputy Michael McGrath: I suppose the key question that arises from that is: did you also miss the financial stability risk posed to the financial system by the lending practices of the banks?

Mr. Patrick Neary: Well, the ... the risks posed by the ... to the financial system by the practice of the bank ... by the banks was, I suppose, a combination of factors. First of all, it was the over-concentration on property lending, which, in the year 2009, was decimated by the fall in the values of property but, before that, the solvency, liquidity issues were also a contributory factor.

Deputy Michael McGrath: Yes, that's not a very direct answer, Mr. Neary. I mean, for example, the 2007 report, published in November '07, financial stability report, concluded ... the overall conclusion is that "The Irish financial system's shock-absorption capacity remains robust and the system is well-placed to cope with emerging issues", November 2007.

Mr. Patrick Neary: Yes.

Deputy Michael McGrath: You signed up to and, presumably, concurred with that conclusion. So, my question again is, along with the Central Bank, did the Financial Regulator miss the financial stability risks posed to the financial system by the lending practices of the banks?

Mr. Patrick Neary: Well, it certainly understated those risks, there's no doubt about that.

Deputy Michael McGrath: On the question of resources, was it open to you, as CEO, to reallocate your existing resources from, say, the prudential supervision side, where you had 210 people in 2007, to the banking supervision side, where you had 48 people in 2007?

Mr. Patrick Neary: Well, you see, each department ... each department was compartmentalised and every department would argue - hence the 77 people that we looked for in 2007 - that their resources were stretched. Take, for example, the insurance department where we had the reinsurance directive and the Solvency II directive to be implemented, which was broadly equivalent to Basel II. So, in circumstances like that, the ... those departments also had huge work demands on them and ... but I did have discretion that if there was a surplus in one area, to move to the other, but I just have to qualify that because it was a question of skillsets as well as available people.

Deputy Michael McGrath: Okay. Just to clarify one final point, Mr. Neary, and I think it's important from an evidential point of view, Mr. Horan's statement yesterday that he made formal proposals in August '05 for higher capital charges for high loan-to-value mortgages were not accepted as they were not considered by senior management in the CBFSAI to be necessary. Subsequently, they were implemented, in 2006, but can you just clarify, they were not accepted by whom?

Mr. Patrick Neary: They were accepted by me.

Deputy Michael McGrath: Okay.

Mr. Patrick Neary: I took it forward to the chief executive and I proposed that the ... proposed it should be taken to the authority because it was a very, very significant and well-argued proposal. I believe that the chief executive consulted with the then director general of the Central Bank to discuss the ... our proposal ... to discuss the issue and I believe that they came to the conclusion that interest rates were likely to increase and that we should wait and see-----

Deputy Michael McGrath: Okay.

Mr. Patrick Neary: -----would the increase in interest rates take the heat out of the market.

Deputy Michael McGrath: So, at that time, in the autumn of '05, those proposals didn't make it to the level of the board?

Mr. Patrick Neary: No, they did not get to the authority, to the best of my recollection. They were reactivated again in either January or February 2006.

Deputy Michael McGrath: February '06, yes.

Mr. Patrick Neary: Yes.

Deputy Michael McGrath: Yes. Thank you, Mr. Neary.

Chairman: Thank you very much, Mr. Neary. I'm now proposing that we will suspend for lunch. However, I'd just like to remind the committee that we have a small private session to deal with as ... before we go to lunch, to deal with some matters to deal with hearings that are coming up in the coming weeks. So, with that said, I propose that we suspend the public session now and, in doing so, remind the witness that, once he begins giving evidence, he should not confer with any person other than his legal team in relation to the evidence and matters that are being discussed before the committee. With that in mind, I now will ... propose to put the meeting into private session as soon the public Gallery has been cleared and that we would resume again at 3 p.m. and remind the witness that, during that time, that he's still under oath until we resume. Okay, is that agreed? 3 p.m.

The joint committee went into private session at 1.49 p.m., suspended at 2.11 p.m. and resumed in public session at 3.07 p.m.

Chairman: And the committee now is formally back in public session and can I ask members and those of the public Gallery to ensure that their mobile devices are switched off. In welcoming back, our witness today is Mr. Patrick Neary, former CEO of the Irish Financial Services Regulatory Authority. And, as I mentioned this morning, we were focusing on the period of Mr. Neary's tenure up to October 2007 and this afternoon's session will focus upon developments in the period from November 2007 to January 2009. And, if required, I may ... we may facilitate situations that are maybe still outstanding from this morning as well or questions that relate to that period of tenure. So with that said, if I can call on Deputy Doherty, please, to open this afternoon's questions. Deputy, you have 25 minutes.

Deputy Pearse Doherty: Go raibh maith agat, a Chathaoirligh. Mr. Neary, can I ask you to outline your knowledge on events and analysis that led to the initial drafting of legislation in the spring of 2008 to permit the Minister to nationalise a financial institution? And can you outline to us what advice, if any, did you give ... did the Financial Regulator offer in this regard?

Mr. Patrick Neary: As far as I recall, Deputy, there was ... in the ... in the domestic standing group, I think, at some stage in 2007, a scoping paper was prepared by the Department of Finance about tasks and a kind of a programme of work, as I recall it, for issues relating to financial stability and preparations that should be made. And it covered a range of topics, including having a look at a deposit protection scheme, legislation for nationalisation, etc., the tools that might be needed in the event that there was a crisis. And I think legislation for nationalisation was one of the things on the list, that was on the scoping paper. I think that was it now, as far as I can recall.

Deputy Pearse Doherty: And when was the legislation drafted?

Mr. Patrick Neary: I don't know for sure. I wasn't involved in the drafting of the legislation. The Department of Finance took on that role and they drafted it up. Now I never actually laid on eyes on it-----

Deputy Pearse Doherty: Okay.

Mr. Patrick Neary: -----I never actually seen it in the flesh, but I believe that there was legislation drafted up.

Deputy Pearse Doherty: And is your belief that it was for a building society, or a bank, or in which order did that legislation because they would differ?

Mr. Patrick Neary: I believe it was done for both. I think it was done for a bank because it was easier to do it for the bank and then adjust it for the building society, rather than doing the other way around. It's just a pragmatic thing, as far as I know, but-----

Deputy Pearse Doherty: Yes.

Mr. Patrick Neary: -----I wouldn't be sure about that now.

Deputy Pearse Doherty: Okay, that's fine. If you've never seen it, that's fine. Can you comment on the liquidity policies, the compliance monitoring, the procedures and protection measures in force, and actions taken before and during the crisis?

Mr. Patrick Neary: Yes, the authority introduced a new liquidity regime in 2007. I think ... at ... it may have taken effect from 1 July, around that time, whereas there was monthly reporting done ... that ... it set out ... it set out a kind of a schedule of cashflows whereby you set out the cash in, the cash out, and you had to maintain a net balance in various maturity ... various maturities from out to a week, and then a month, and so forth. That was more or less the kind of thinking. And initially when that started up it was reported every month, and then we changed that to weekly reporting as the difficulties in the financial markets started to emerge and ... I mean, in the closing days before the guarantee, the liquidity reports were coming in, I think, daily, and-----

Deputy Pearse Doherty: Okay.

Mr. Patrick Neary: -----perhaps even more frequently than intraday.

Deputy Pearse Doherty: And can you tell the committee, just in relation to any financial institution or building society with liquidity and/or solvency issues prior to 30 September 2008?

Mr. Patrick Neary: Yes, I mean, the ... everybody was experiencing difficulty with liquidity. The maturities were getting much shorter. It was very hard to get, I think, money ... anything ... certainly, a month would have been seen as very long money as we came closer to the guarantee time, so the term was getting very short. I think the focus on particular was in relation to Anglo. Anglo were the people that were experiencing the greatest challenges on the liquidity front.

Deputy Pearse Doherty: And we've had evidence before, and we've discussed this with Mr. Horan yesterday, that there was a financial institution that had no access to ECB monetary finances, no access to the markets, interbank markets, and were relying solely on deposits in the first quarter of 2008-----

Mr. Patrick Neary: Yes. Yes, that-----

Deputy Pearse Doherty: -----were you aware of that? And how serious or significant or otherwise was that?

Mr. Patrick Neary: What they hadn't put in place was an arrangement whereby the Central Bank could accept collateral. The collateral that they had to offer wasn't in a form, I think, that was acceptable for the ECB to allow the Central Bank to provide liquidity to it. That was my understanding, and I think there was historical reasons for that because most of the collateral that, I think, is acceptable to the ECB is essentially in the form of portfolios of mortgages, and there's a discount on those and they gave out the facilities on the back of that. Now, when ... that requires that every mortgage document, to the best of my understanding, has to have a consent that the mortgage can be transferred from the originator of the mortgage to somebody else. Hence the securitisation, and all this that goes on, is done with the consent of each individual mortgage.

As I understood it at the time, the documentation in Nationwide, the individual mortgage documentation that they had, didn't have that facility. So they couldn't be transferred. So, therefore, it rendered it ineligible for the ECB direct assistance. So they had to construct an arrangement with the Central Bank, an elaborate arrangement for ... to identify assets and construct an arrangement whereby the Central Bank could give them liquidity. And I don't think that was done at the time. It was recognising that issue and putting an arrangement in place for that particular institution, which was different to the others.

Deputy Pearse Doherty: Okay. And in relation to solvency issues prior to 30 September 2008, would you have any concerns personally in relation to solvency issues of any financial institution?

Mr. Patrick Neary: I didn't believe that any institution was insolvent on the date of the guarantee. Based on the information available to us, which ... I've talked about it before, came in from the returns. They came in from the institutions. And also we had had Pricewaterhouse in in a couple of the institutions and also there was another corporate finance house which was advising one of the institutions, had also looked over the portfolio. And based on all of those sources, there was no evidence that there was a solvency issue in any of the institutions on the night of the guarantee.

Deputy Pearse Doherty: Just explain this to us in terms of from your point of view as a regulator, what solvency means? The standard definition that people would be familiar with is liquidity ... or, liabilities exceeding assets. Is there a different interpretation of solvency when we're dealing with the Financial Regulator's office?

Mr. Patrick Neary: Well ... no, it ... first ... the big one is that your assets exceed your liabilities and the other one is that you're not able to meet your obligations as they fall due. I suppose, that's a ... you know, that's the kind of liquidity test but, I mean, they're interrelated.

Deputy Pearse Doherty: But what about regulatory solvency laid down under EU law where you had to have 8% of capital?

Mr. Patrick Neary: Yes ... yes, yes ... no, all institutions were in compliance with the 8% capital requirement. In fact, to the best of my recollection, Deputy, on the night of the guarantee, the ... if you were to calculate backwards from the risk assets in each of the banks, collectively the capital requirement was of the order of €33 billion and there was actually €36 billion in capital in the system. So there was some surplus capital in the system on that night.

Deputy Pearse Doherty: Okay, well, we'll come to that again. Can you explain the role of the Financial Regulator in the need to seek both sets of analysis of, one, the review loan books, and, two, capital adequacy? And, specifically, why was the analysis not performed under the remit of your office? This is the analysis that was carried out just at the time of the guarantee by Merrill Lynch and PwC.

Mr. Patrick Neary: Well, we engaged PwC to go in and conduct a root and branch assessment of the loan books in two of the banks initially, and then following on from that, in the rest of them, and they had a much bigger resource from us. They could go in and they could carry out that work promptly and quickly for us and validate what we believed to be the case.

Deputy Pearse Doherty: So this is the review that fed into the decision in terms of the guarantee?

Mr. Patrick Neary: Yes, the findings from that review were taken into account.

Deputy Pearse Doherty: And how long from reporting to requesting them to do this ... what period of time are we talking about?

Mr. Patrick Neary: I don't remember when they went in. It was early September, I think it was. They had a couple of weeks, I think, to do that work, and-----

Deputy Pearse Doherty: Okay.

Mr. Patrick Neary: -----they would have given us the preliminary kind of assessment as they went along.

Deputy Pearse Doherty: So my question to you, Mr. Neary, is ... like ... so we ... we paid ... you paid ... or, the State paid millions of euro to these outside agencies and gave them a number of days or a number of weeks, but it's a number of days between the middle of September to the end of September, to carry out a review in relation to the loan book and to capital adequacy for information that you, as Financial Regulator, had at your fingertips and was being reported to you on ... on some ... in some instances, on a daily basis, and in other instances, a weekly and quarterly basis. Why were you bypassed in relation to that?

Mr. Patrick Neary: No ... the authority decided to quality assure the information that we had, that it would be good to have another set of eyes to look at the information and to make sure that we came to the same consensus view.

Deputy Pearse Doherty: Mr. Neary, one of the themes that we're trying to explore in this investigation, this banking inquiry, is the relationships between different sectors, different individuals, bankers, developers, politicians, regulator, so on and so forth. Can I ask you in terms of your own social relationship ... or did you have a social relationship with senior bankers at the time when you were either the CEO of the Financial Regulator's office or prudential director when you were regulating those banks?

Mr. Patrick Neary: When I became CEO I had absolutely no social contact other than the grounds that we covered there this morning.

Deputy Pearse Doherty: Yes.

Mr. Patrick Neary: When I was prudential director, I think there may have been one occasion where I was in a group where I had social activity with a couple of the banks, and that was in a golfing society. But there was only one occasion that that happened, so there was ... it was part of a group, so it wasn't on a one-to-one basis.

Deputy Pearse Doherty: It has been reported in the media, and I'm sure you're aware. If you're not, you can inform me that ... and it stems from the FitzPatrick tapes that yourself, Mr. FitzPatrick and Willie McAteer had a golfing outing on three occasions, dinner and drinks, but nothing in relation to banking was discussed. Is that something that you're aware of and is that an accurate reflection of those events?

Mr. Patrick Neary: That goes back even further.

Deputy Pearse Doherty: Okay.

Mr. Patrick Neary: That goes back before I was the prudential director at all and that derived from, again, a ... in the golfing society context, that ... games ... a couple of games of golf were arranged, but that's well back in history at this stage.

Deputy Pearse Doherty: Okay. Is it appropriate, in your view, or not, for a prudential director to be in those social circumstances with senior bankers that you're supposedly or, not supposedly, but that you're regulating, you're responsible for regulating?

Mr. Patrick Neary: My engagement with those was always with the knowledge and the approval of my boss.

Deputy Pearse Doherty: But is it appropriate?

Mr. Patrick Neary: I ..., I think in ... in the light of what has happened in today's world it is certainly no longer appropriate.

Deputy Pearse Doherty: Okay. Can I ask you what was the Financial Reg-----

Chairman: To clarify, I will give you time, did you have a boss, Mr. Neary, or did you have a senior that you were accountable to or in the structure?

Mr. Patrick Neary: Well, when I was prudential director I had the ... the chief executive and, before that, I reported in to in the, I suppose, in Central Bank times in to the ... I forget what the title was but it was the assistant director general in charge of supervision.

Deputy Pearse Doherty: Just following on from that, so ... just you had the golf outing, I think it's mentioned that it was golf, dinner and drinks. Is that an accurate reflection of the type of social event we're talking about?

Mr. Patrick Neary: I think that's probably over-hyping it a little bit ... it was perhaps a cup of coffee and a sandwich, nothing more elaborate than that.

Deputy Pearse Doherty: Okay, and ... and in that ... in that instance you didn't talk about banking at all, you didn't talk about-----

Mr. Patrick Neary: No, no, these matters have no places in golfing societies or social events and that's the way I looked at it purely in that context.

Deputy Pearse Doherty: Yes, well, my own experience is different in terms of, you know, when you meet a politician or somebody interested in politics or meet a journalist, you'd ... you'd end up talking about industry and I know that with Mr. FitzPatrick is saying that the best knowledge is garnered at the 19th hole, but no discussion in terms of industry?

Mr. Patrick Neary: No and, I mean, that thing fizzled out because it was, as I say, a golfing society that just kind of ran out of steam around that time.

Deputy Pearse Doherty: And what time was that?

Mr. Patrick Neary: This was back in 2001 or 2001-2002. It was certainly before the Financial Regulator was established.

Deputy Pearse Doherty: Yes, but you mentioned that you were at one event where you were a prudential director.

Mr. Patrick Neary: Oh sorry, yes, I was, one event. Yes, I'm sorry, I thought you were going back to the other ones.

Deputy Pearse Doherty: No. And which ... what year was that?

Mr. Patrick Neary: That was probably 2003.

Deputy Pearse Doherty: 2003. What was the reaction of the Financial Regulator's office to the Northern Rock crisis in 2007?

Mr. Patrick Neary: Well, I ... I think it sent ... a certain kind of a chill down everybody's spine at that stage, and I think that's what kind of triggered a heightened ... heightened awareness of the need to put in place arrangements to deal with any possible issues that might arise in ... in the Irish financial system and that's when ... when the Department of Finance and the domestic standing group started to look at these various challenges that they started to address.

Deputy Pearse Doherty: And, outside of the domestic standing group, what did you do in terms of the funding model? Was Northern ... Northern Rock was ... there was a core issue there in terms of relying on wholesale markets and so on. What did you do as Financial Regulator, given the alarm bells that were ringing just across the water in terms of that kind of banking model?

Mr. Patrick Neary: Well, regrettably, by the time that happened, I think our own banking models were very well established and it was a question of making sure that the banks took account of the threats and challenges that arose because of Northern Rock, had started to kind of take action to address them to ... to focus on their liquidity and see to what extent they could conserve liquidity and reduce their lending or whatever. The focus was-----

Deputy Pearse Doherty: Did you have the power to go in and inspect, root-and-branch inspection, into financial institutions such as Anglo or Nationwide or AIB?

Mr. Patrick Neary: Yes.

Deputy Pearse Doherty: Did you authorise a root-and-branch inspection of those institutions?

Mr. Patrick Neary: I don't recall a root-and-branch number of inspections happening in relation to ... around the same time as the Northern Rock.

Deputy Pearse Doherty: Any time after even?

Mr. Patrick Neary: I ... I can't remember. I don't have that schedule now ... it's ... but there's something in the back of my mind saying there was ... a themed inspection carried out around that time but I ... I don't ... I don't recall with accuracy the time that that happened.

Deputy Pearse Doherty: I think you may be referencing the commercial property exposure of the financial institutions and also the five of five, I think, the five top institutions that you-----

Mr. Patrick Neary: It could be that.

Deputy Pearse Doherty: The question I'm trying to get the answer to is, what did you do? So when these reports come back and showed major exposure to commercial property and major exposure to individual lenders, not repeating myself, but the fact that 20 individuals held half the loan book in, in two of the institutions and similar patterns in others, what did you do?

Mr. Patrick Neary: Well, what happened in those cases were the findings ... the findings were collated. Each bank got ... now I don't ... I don't believe there were any high-priority items reported up along from those particular reports. I don't think the ... the, inspectors that carried out those classified any of the findings as high priority but there was some common threads like not getting net worth statements and things like that come to mind. But every single one of the banks that was inspected, they received a letter setting out the findings and I can only assume that that letter set out some remedial actions that were expected.

Deputy Pearse Doherty: Okay. Right, I'll move on. We're back to the letters. In evidence presented to the committee, we were told of a meeting that took place on 6 September 2008 which involved representatives from the Financial Regulator, AIB, Bank of Ireland, the purpose was to discuss the serious situation facing Irish Nationwide Building Society. Do you recall the meeting first of all before I go on?

Mr. Patrick Neary: There was a meeting arranged between Irish Nationwide and AIB and Bank of Ireland, it was a tripartite meeting.

Deputy Pearse Doherty: Okay. Were you at it?

Mr. Patrick Neary: No.

Deputy Pearse Doherty: No. Okay. At the meeting board minutes from AIB on 7 September suggest that ... they quote "The funding profile of the institution was weak, and it was unlikely to be able to refinance funding that was maturing periodically over the ensuing year, commencing in December 2008." It goes on to say, "The quality of loans was suspect and could require write-downs ranging from a benign 13% estimated by the [Financial Regulator], to 30%/50% estimated by Bank of Ireland". The minutes record of the Financial Regulator asked AIB and Bank of Ireland to put €2 billion each into Irish Nationwide. Later on Mr. Sheehy told representatives from the Financial Regulator "It was his '[which was Mr. Sheehy] understanding that the institution's loan portfolio would required to be written-down substantially, and, accordingly, that if AIB acceded to the [Financial Regulator's] request, AIB would, in due course, probably have to incur ... write-downs ... of €1bn [off] the funding line [they] provide." So the question I have to you is, this is AIB telling you that, or telling the Financial Regulator, that if they put €2 billion into Irish Nationwide they were going to lose €1 billion of it, did you concur with that view?

Mr. Patrick Neary: No. We did not concur with that view, I don't know what they grounded that view on.

Deputy Pearse Doherty: Okay.

Mr. Patrick Neary: And ... because as far ... as far as I was aware they ... they had no access to the loan books or to the assets of Irish Nationwide. The meeting was ... was called to see to what extent ... an in-market ... in-market assistance could be appointed and could be made available to Irish Nationwide. Around that time, just to put this in context, there was ... there was a statement issued by one of the rating agencies, which was proved to be incorrect, to say that Irish Nationwide was, was seeking to reach an agreement with its creditors or something like that, if my memory serves me right. And, as a precautionary measure to make sure that ... the thinking at that time was that if there was a liquidity difficulty in one of the smaller organisations that could be addressed by the market, that we should try and favour that solution.

Deputy Pearse Doherty: Okay.

Mr. Patrick Neary: So that meeting was arranged in that context, to discuss liquidity. And it came to naught in the end.

Deputy Pearse Doherty: Okay. Richie Boucher told the committee ... he said in his statement ... he goes, ‘‘I recall being shocked and shaken by the lack of information available to the executives of INBS and the Central Bank of Ireland on the liquidity position of INBS.” He went on to say:

> at some stage I said to my colleague, “We should leave this meeting”. We said, “We can’t carry on this discussion”.

How can it be, given you were getting daily reports on liquidity, that Richie Boucher was shocked and shaken by the lack of information that the Central Bank had on the liquidity position of Nationwide?

Mr. Patrick Neary: Richie Boucher would not have known what information we had on the ... on the liquidity of Nationwide because we wouldn’t have been in a position to share it with him because that would be absolutely subject to section 33AK, so he got no information about liquidity about Nationwide from us. A meeting was arranged, attended by the two large banks and Irish Nationwide. If Irish Nationwide chose to be, how would you say, coy or restrictive about the information they provided, look, I mean, that ... that may have happened.

Deputy Pearse Doherty: Okay. Can you comment on the decision ... on why the decision to nationalise Anglo was not taken on the night of the guarantee and what was your advice to Government or the Governor in this regard at the time and can you discuss if nationalisation of Anglo earlier would have sped up the resolution to the crisis?

Mr. Patrick Neary: Well, on the night in question, I wouldn’t say it was advice. We, the chairman and I ... when we revisited that meeting, the Governor had mentioned to us that the ... the ... the kind of choice that was being considered was a nationalisation of Anglo and a guarantee of the rest or a guarantee of everybody. When we entered the meeting we were asked to give a kind of view on that. We expressed a concern that if the guarantee wasn’t very sharp and focused, and if it left questions out there about its extent or who it applied to or all the rest of it, there was a doubt about its ... we were worried about how it would be received and how effective it would be. And the reason that we expressed that concern was that, earlier on in the month of September, the Minister had announced an increase in the deposit guarantee scheme and there was ... we were getting a lot of phone calls into our helpline, and into the consumer information office, about what was covered, and who was entitled to what, and all the rest of it. So our concern that we expressed that night was grounded in that.

Deputy Pearse Doherty: What was the arguments in favour? You mentioned that there were two options, when you went into, I think, the second meeting one was nationalising, one was a blanket guarantee, and the other was nationalising Anglo and a guarantee for the five other institutions. What were the arguments in favour of the second option, nationalising Anglo and guaranteeing the other five institutions?

Mr. Patrick Neary: Well, I hadn’t heard arguments that got the, if you like-----

Deputy Pearse Doherty: Got to that point.

Mr. Patrick Neary: -----distilled down the thing to that point, and, because we were at an earlier meeting, and then at the later one, this seemed to have crystallised in the meantime. And I mean, the outcome from depositors would have been the same, because if you got nationalised, your deposits were-----

Deputy Pearse Doherty: Yes, but you weren't aware, you weren't in the room when those arguments were taking place?

Mr. Patrick Neary: No, no.

Deputy Pearse Doherty: Okay, I'll move on. Mr. Neary, Dermot Gleeson gave evidence to the committee ... he was talking about a meeting, the meeting the night of the guarantee, and he says, and I quote:

> During the course of the night we suggested to the authorities that a sentence in their draft statement about the guarantee, which said something like [quote] 'Financial Regulator has informed the Government that all the Irish banks were solvent [end of quote] was probably unnecessary and possibly dangerous in the sense that Anglo shares would be traded on foot of it, which could lead to complications for the Government.

Now that was Mr. Gleeson. Eugene Sheehy of AIB made his own notes of the meeting, these have been presented as evidence to the committee. In them, Mr. Sheehy said:

> There were also issues in the Government's draft which we were uneasy about relating to attestations by the FR [Financial Regulator] that the system was solvent and that all banks were solvent. We felt there was clearly a risk in this statement if market participants purchased shares in companies once the guarantee was issued and it subsequently transpired that these companies were not as strong as contended.

Did you make that suggestion, that that statement be included in the draft?

Mr. Patrick Neary: Definitely not and in fact, I never had sight of that draft statement, and the Central Bank Act 1971, I think, makes it quite clear that ... because a bank is licensed under the Central Bank Act 1971 is not a warranty as to its soundness. And I think, I now that this is a speculative point, I mean, if it had been put to us at the meeting, the chairman and I obviously would have discussed it. But I would be pretty reluctant to agree to any statement like that - we don't give warranties as to soundness to anybody.

Deputy Pearse Doherty: Okay. Mr. Neary, you appeared on "Prime Time" on 2 October 2008 to discuss the domestic Irish banking system and the Irish bank guarantee. You said, and I'll quote it back to you, "The important thing is that risks emerge over the lifetime of the loan portfolio, and it's important that there is adequate capital put in there to absorb those risks, and by any estimate the Irish banks are so well capitalised compared to any banks, anywhere, across Europe, that I am confident that they can deal with any loans or any impairments that emerge in the ordinary course of business in the foreseeable future."

Mr. Patrick Neary: Yes.

Deputy Pearse Doherty: Given what you knew about Anglo, you had the information in relation to liquidity, capital, concentration of lending, corporate governance, given what you knew about Nationwide, which you had all of that information, and the same, how were you able to make that statement to the Irish nation on that night?

Mr. Patrick Neary: All of those institutions were in compliance with their ratios, and in the case of those two particular institutions, the ratios were pitched higher than everybody else. Not only were they in compliance with the ratios, but they had, as I just mentioned to you earlier, all the banks had some surplus capital as well. Some weeks before that, I had seen a table that had been presented, prepared, I think, by some international college of regulators, I can't remember where it was, which showed me where our required ratio stood in relation to the other countries in Europe, and we were close to the top of that.

Chairman: Mr. Neary, we had-----

Deputy Pearse Doherty: This is the final question. We have evidence, in this inquiry, from Bank of Ireland minutes, within days of you making this statement, that they were looking at an option of recapitalisation through the Irish Government. We know as a fact now that €10 billion was pledged by the Irish State within what, 70 days of you making this statement, that one bank was nationalised a number of days later. This wasn't, you know, this wasn't a case of trying to see far off into the distant, distant future. Within days of you making this statement, some of the major financial institutions in this State were coming knocking on the Government's door looking to be recapitalised. The question is, you knew, above anybody else in this State, what was happening under the bonnet of these banks. Do you still believe that the account that you gave was the best account, with all of the knowledge that you had at that time, in relation to the capital position of those banks-----

Mr. Patrick Neary: I-----

Deputy Pearse Doherty: -----withstanding any, any impairments that emerge in the ordinary course of business in the foreseeable future?

Chairman: Please allow Mr. Neary to respond.

Mr. Patrick Neary: Yes, on that night, based on the information that I had at my disposal ... at my disposal, I fully believed in the statement I made. Subsequently, matters emerged that, with the benefit of hindsight, would call that judgment into question, but based on the information that I had ... the knowledge I had that night, that statement was correct. That was my belief and it was stated honestly as my belief.

Chairman: I just want to clarify one other matter, because you mentioned it in your engagement with Deputy Doherty there, Mr. Neary, and that is your role and involvement with the domestic standing group. So it would be great if you could just clarify for us, were you a member of the domestic standing group?

Mr. Patrick Neary: No, Mr. Horan was the member of the domestic standing group.

Chairman: Yes. Was he delegated with that responsibility, to be there on your behalf? So he was there on your behalf, or was he there as the actual member or the acting *de facto* member?

Mr. Patrick Neary: He was certainly the acting *de facto* member, and when the group was set up first, and it had to be populated by people from both finance, ourselves, and the Central Bank, Mr. Horan was identified as the person who would represent the Financial Regulator. But that didn't preclude other people from, you know, attending in his absence or, I didn't preclude either the Governor or myself or the Secretary General of finance-----

Chairman: But on whose behalf was he attending?

Mr. Patrick Neary: Oh, he was representing the authority.

Chairman: It's not unusual for someone to delegate to a subordinate or a colleague that they would attend, but they are attending on behalf-----

Mr. Patrick Neary: Of the Financial Regulator, of the authority.

Chairman: And was he, so that's what I wanted, is the delegated responsibility of this, while Mr. Horan was attending, was that a delegated position to which you ultimately had responsibility for?

Mr. Patrick Neary: I can't ... I don't know how to answer that question-----

Chairman: I'll give you plenty of time.

Mr. Patrick Neary: -----Deputy, because ... that kind of suggests that there was a very formal appointment of Mr. Horan to his position in the DSG. I mean, it was a bit more pragmatic than that, that when the DSG was set up, it was a question of who's going from, who's going to be the person that goes to that meeting, and represents the Financial Regulator? And similarly in the Central Bank and the Department of Finance. And it was always Mr. Horan.

Chairman: Yes, I can appreciate that, Mr. Neary, but, there are two capacities, or maybe many capacities, but let me just focus on two capacities to which somebody can attend a meeting. Somebody could attend a meeting in their entirety as the person who has ultimate responsibility and deals with all engagements of that meeting, and walks out the door with there being no overhang whatsoever; and there are people who attend meetings on the behalf of an agency, an organisation or a group, who they then come back to and relate their activity on the domestic standing group, and that feeds into a line management level of responsibility and accountability.

Mr. Patrick Neary: Sure.

Chairman: Which of those two options was Mr. Horan performing?

Mr. Patrick Neary: Well, I think, in fairness to Mr. Horan, I'd have to go for the second option because, ultimately, he would report in to me and keep me briefed.

Chairman: So he was there. So while the position may have been delegated or operated by Mr. Horan, that responsibility was delegated but then ultimately fell on you.

Mr. Patrick Neary: Well, yes, I think I'd have to accept that.

Chairman: Okay. Thank you very much. Deputy John Paul Phelan.

Deputy John Paul Phelan: Thank you, Chair. At the start, Mr. Neary, good afternoon. Just to continue on from Deputy Doherty's question in relation to that "Prime Time" interview and that quote, which I won't read back to you, but whose responsibility was it to have you informed on the night in question before you went on "Prime Time" to make that statement? Bearing in mind that it was a matter of just a few weeks subsequent to that that the banks ... the initial recapitalisation of the banks took place?

Mr. Patrick Neary: Well, I think that responsibility would remain with me. I had to be sure that what I was saying, that I believed it to be true and that-----

Deputy John Paul Phelan: How do you explain then, that subsequently it transpired not just not to be true but to be spectacularly incorrect?

Mr. Patrick Neary: Well, I think what happened subsequently within some weeks of that is that developments in other jurisdictions emerge where the market ... there was a market expectation that the tier 1 capital levels that had been established under the existing solvency ratio requirements were too low. And other jurisdictions started to ... to essentially maintain a higher tier 1 and total capital levels. And it was something that, if you will, developed to satisfy the expectations of the market and as an indicator of financial strength, and it was in that context that the discussions started to centre around the need to demonstrate that the Irish banks could meet the higher capital requirements. That's a separate matter. That evolved subsequently and it was in response, I think, to market expectations.

Deputy John Paul Phelan: But I suppose the point I'm trying to make is that you made that statement on 2 October 2008?

Mr. Patrick Neary: Yes.

Deputy John Paul Phelan: Shortly after the guarantee.

Mr. Patrick Neary: Yes.

Deputy John Paul Phelan: And within a matter of weeks, the recapitalisation process was fully under way. Do you have any ... do you accept any responsibility for the fact, and I think you have indicated it in your first response, that you should have been better informed of the real situation within Irish banks before making that statement on the night in question?

Mr. Patrick Neary: Well, the facts I had at my ... at my disposal were that they were ... the banks were in full compliance with their capital requirements, our capital ... the range of our capital requirements was-----

Deputy John Paul Phelan: Okay.

Mr. Patrick Neary: -----well, compared favourably with other countries up the very top end and that there was surplus capital. That was my belief, that was what I believed, obviously, to be true, and that's what I said.

Deputy John Paul Phelan: Okay. You retired from your position on 31 January 2009. What was the reason for your retirement at the time and was there any outside pressure brought to bear on you leaving this position?

Mr. Patrick Neary: I don't know if there was any outside pressure brought to bear. Nobody came to me and said "Look, you better resign". There was an issue in relation to a corporate governance matter in a particular bank which I think reflected poorly on the authority and in light of ... in light of what had happened with the guarantee and the difficulties that were emerging, I felt that ... I felt that the authority's position and my position in the authority was, was going to be difficult for the authority that the focus would be on this and on my role and I felt that it might be better if the authority and I-----

Deputy John Paul Phelan: Can I ask you to comment briefly on your severance arrangements with the Financial Regulator, in terms of the payment and the annual pension provision?

Mr. Patrick Neary: That's in accordance, as I explained earlier on, my salary is a Civil Service grade equivalent. It's the same as the director general of the Central Bank and was 5% less than the Secretary General of the Department of Finance. So there was a relationship amongst all the salaries. We were 5% less than him and the offer made to me by the authority reflected the arrangements in the Civil Service.

Deputy John Paul Phelan: Do you-----?

Mr. Patrick Neary: So it complied exactly with the Civil Service scheme.

Deputy John Paul Phelan: Do you feel that those payments were appropriate?

Mr. Patrick Neary: Well, that's ... that's what the authority agreed to provide me with and I really don't have anything more to say about that. It was in accordance with the Civil Service salary arrangements.

Deputy John Paul Phelan: Can I ask you to briefly outline for the inquiry how you were recruited into the position of chief executive in the first place?

Mr. Patrick Neary: There was a full public competition, an international competition. It was led by, I believe, Amrop, who are international headhunters, and I competed for the competition and I was appointed out of that competition.

Deputy John Paul Phelan: You're not aware as to how many other people entered the competition?

Mr. Patrick Neary: I believe, I believe that the short list was 15 people, and then that was narrowed down from there.

Deputy John Paul Phelan: Okay.

Mr. Patrick Neary: But I don't know how many, how many applied at the start.

Deputy John Paul Phelan: And are you aware of any other internal applicants?

Mr. Patrick Neary: Yes. I am aware of one or two other people from internally.

Deputy John Paul Phelan: Can I ... I now want to turn to the period of the crisis itself and the immediate run-up to the crisis in 2008 and your interactions with financial institutions at the time. How do you think that those interactions shaped those institutions' perception of you and of the role that you held? In particular, do you think that you could have led bankers to take decisions that they might not otherwise have taken, because of the lack of pursuit of, you know, difficulties that may have emerged, particularly in reference to earlier points with regard to sectoral limits and other questions like that?

Mr. Patrick Neary: Well, I ... I'm not sure I get the full drift of your question. Sorry, Deputy.

Deputy John Paul Phelan: Well, we have heard evidence-----

Mr. Patrick Neary: Yes?

Deputy John Paul Phelan: -----already this morning that sectoral limits were a guideline.

You said they were an important guideline. I questioned you as to who they were important for-----

Mr. Patrick Neary: Yes.

Deputy John Paul Phelan: -----and I'm not sure that I got a particular answer to that question. But do you think that a perception was created within financial institutions, following on from your interactions with them, that would have led them to take commercial decisions subsequent to that perception being established in their mind that maybe they weren't going to be taken to task for breaching things like sectoral limit guidelines? I use that as an example.

Mr. Patrick Neary: Yes. I certainly had no sense of that. I think the commercial decisions made by any operation will have to be grounded on the facts that relate to their business, and the issues that they're faced with, and their boards, I would have thought, would make decisions based on facts and not on notional relationships or whatever.

Deputy John Paul Phelan: Can I ask you if you think that you have been personally vilified because of the role that you played at the time as chief executive of the Financial Regulator during the collapse?

Mr. Patrick Neary: Well, I suppose it was a difficult period for my family and myself, yes, I found it very difficult.

Deputy John Paul Phelan: Can you understand some of the comment made publicly as to, I suppose, the frustration and anger that taxpayers, shareholders, others may have felt that you weren't fulfilling your functions fully?

Mr. Patrick Neary: I most certainly can. I most certainly can, Deputy. I fully appreciate that and, you know, and I regret that very much.

Deputy John Paul Phelan: I want to turn now to, again, a point covered by Deputy Doherty. It's asking you to outline contacts between your office and some of the banking institutions with regard to mergers and takeover options in the period prior to the guarantee. Now, I have a reference, which is Vol. 2, page 89, which is a document I think that cannot be displayed-----

Mr. Patrick Neary: Okay.

Deputy John Paul Phelan: -----but I'm ... I'm in the Chairman's hand.

Chairman: Be careful to generalise.

Deputy John Paul Phelan: Yes, well it is a letter from the chief executive of an institution, which he wrote to you following on from a recommendation from you, it appears from the letter, that that institution should merge with another Irish institution, both of which would be subsequently guaranteed two weeks after this letter was published. And I ... in particular reference here to the answer you gave to Deputy Doherty, you said that on ... in the run-up to the guarantee a nationalisation of Anglo and a guarantee of the rest was what was considered on the night. And in light of this particular letter how do you reconcile those two positions?

Mr. Patrick Neary: What ... what emerged here was in that period before the guarantee, I think we were trying to see all options for consolidation, to what extent there could be, there could be alliances or mergers, or call them what you will, of institutions to strengthen institutions, strengthen their-----

Deputy John Paul Phelan: This was a letter that referenced two particular institutions-----

Mr. Patrick Neary: Yes.

Deputy John Paul Phelan: -----which some would say were ... no, were the most impaired, that they should ... and a recommendation from you to one of their chief executives, that you ... that they should merge. That's the letter I'm talking about. And two weeks later, you ... you admit, under questioning to Deputy Doherty, that, on the night of the guarantee, that nationalisation of Anglo and a guarantee of the rest was what was being considered. How ... how did things change so much in that two-week period that you could have been recommending something like this on 13 September?

Mr. Patrick Neary: No, there's no recommendation, as I recall it. There was a process where this institution looked at the other one to see if there was any possibility for merging the two and unifying the two. And this kind of ... this discussion took place, I think, in the context of what I mentioned to you earlier about the ... the ... that particular report about the smaller institution and that it was seeking to engage with its creditors. And we were asking everybody to look at everybody else, I mean. And this ... this ... I also believe, right, that behind this ... the motivation from this letter was that this particular institution may have seen that there might have been a benefit to the way in which it was being perceived by the market, if it was seen to, in some way, strengthen the other institution by a merger, right? I know that's a big convoluted but these people were saying if we ... if we take over the other, we'll be seen as white knights and it'll convince everybody that we're really much stronger than people are saying. So, I think there was a bit of motivation behind this letter.

Deputy John Paul Phelan: Okay. I want to change now to evidence that we had at the inquiry previously from Mr. Brendan McDonagh, formerly of the National Treasury Management Agency. He gave testimony previously to the inquiry and I want to quote him directly to you. He said "I think what was beginning to happen in September 2008 and, you know, my perception of it now, as opposed … other people have their own perceptions of it, but … was that the Department of Finance, I think, were becoming understandably concerned maybe about the Central Bank and the regulator and the banking system." What is your understanding of the concern that the Department of Finance had about the regulator, of which you were the chief executive at the time in 2008, September?

Mr. Patrick Neary: Well, certainly, and, you know, I would have to put an interpretation on this ... certainly, after the time of the guarantee and subsequent to that ... certainly there was a series of meetings that were arranged by the Department of Finance with all the banks to discuss business plans and discuss options from mergers and whatever. Now, at that stage, the Financial Regulator was not invited to participate in those discussions. Those discussions took place ... the Central Bank were involved, the Minister and the Department officials were involved, but we weren't. And there seemed to be ... it seemed to me that, for some reason or another, the Department of Finance were less than happy to have us there. Now, I don't know how to interpret that.

Deputy John Paul Phelan: How ... how did it seem? How ... how did that emerge, that thought emerge to you that they weren't happy to have you there?

Mr. Patrick Neary: I was curious to know why. And I remember it and - I'm being frank here in putting this forward - I ... it's in response to your question ... there seemed to be some sort of a view taken that they were less than happy with the Financial Regulator and ... now, but that's only an impression, no facts. The only fact I have is that we weren't involved in that series of meetings which I believe went on in Farmleigh.

Deputy John Paul Phelan: Yes. I want to ask you now, Mr. Neary, to 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. Can you comment on those for the inquiry?

Mr. Patrick Neary: The ... well, the stress tests were taken ... carried out, I think, every two years, and already this morning we were talking about the one that was carried out in 2006. I believe there was another one carried out in 2008. But those stress tests were carried out by the financial ... financial stability people in the Central Bank, with very, very little input from us. So ... but they confirmed ... they confirmed that, you know, their-----

Deputy John Paul Phelan: Okay.

Mr. Patrick Neary: -----that the banks were capable of withstanding-----

Deputy John Paul Phelan: Was there any change in the level of stress applied as a result of discussions between the regulator and the Central Bank between the 2006 and 2008 tests?

Mr. Patrick Neary: Not that I can remember being involved in. Now, there may have been a change in ... in factors that were in the stress test but I wasn't involved in those discussions.

Deputy John Paul Phelan: Okay. I want to refer to board minute-----

Chairman: Can you just stay with the documents ... just maybe ask, because we need to come back to it anyway, is can I maybe ask you your view on the deterioration in property values and how was this reflected in the stress test assessments carried out?

Mr. Patrick Neary: I can't recall that, Chairman. I wasn't involved directly in setting the parameters for the stress test, so I wouldn't be able to comment on that.

Chairman: No relationship to your functions and duties, no? Property values?

Mr. Patrick Neary: Yes, but in the context of the stress tests I ... I don't recall being involved in that or giving any view. I don't recall that process.

Chairman: Okay. Thank you. Deputy Phelan.

Deputy John Paul Phelan: I want to refer now to a board minute in the second half of 2007. It's in Vol. 1, page 123 of the document. Again, I'm not sure that it's one that can be publicly displayed, but I want to read the quote to you. It's recorded at a board meeting of the Central Bank and Financial Services Authority and it is as follows, "the underlying fundamentals of the residential property market appear to be strong and the current trend in prices would seem not to imply a significant correction. The central scenario is, therefore, a soft landing." This was the second half of 2007. First of all, I want to ask you who conducted this research. What was their, I suppose, qualifications to do so? And were there any dissenting views expressed at that meeting that you recollect with the research, as produced?

Mr. Patrick Neary: No. That research would have been carried out ... carried out by the economists in the financial stability area or in that area of the Central Bank and that conclusion would be based on .. on the various factors that they would have taken into account in their assessment. That would have been a professional assessment carried out.

Deputy John Paul Phelan: Was there any dissent, can you recall?

Mr. Patrick Neary: No. I don't recall that there was any dissent. That was the central conclusion. I don't think anybody said that there wasn't going to be a soft landing.

Deputy John Paul Phelan: Two more, Chairman. I want to ask you, Mr. Neary, what advice was provided to Government on liquidity and solvency for Irish financial institutions? Can you advise why it was the view of certain banks that two institutions could be allowed to fail as part of the options considered on that night in September 2008?

Mr. Patrick Neary: Well, I think that, from my recollection of discussions around that, is that those ... well, those institutions were interested in securing a guarantee for themselves. And I think that was their ... that was their overriding concern, to kind of "Guarantee us and, you know, don't worry so much about the depositors in the other institutions". And, you know, I ... I won't ... I don't think I can be led by that view that they say "Guarantee us and forget about everybody else". I mean, the assessment and the decision was grounded on what was considered to be the best thing to do on the night. And it was grounded on giving a guarantee to the depositors in solvent institutions. And, I think, while it wasn't there for the final ... the final, if you like, discussion and getting things down to the point of guarantee, guarantee plus nationalisation or guarantee in total, I mean, the reality of it is that, you know, these ... these individual institutions just seem to be looking after their own interests.

Deputy John Paul Phelan: I want to refer now to a quotation that was mentioned previously by Deputy Higgins in the first part of the day when he referenced the book called *The Bankers* by Shane Ross and a meeting ... sorry, a social event that took place on 26 November 2008. I want to ask you in relation to that: how often outside of that would you have had social contacts with chief executives and chairmen of the domestic banks during your tenure in the regulator?

Mr. Patrick Neary: Certainly, when I was chief executive, I don't believe I was at any, other than the kind of functions that I described earlier on which were, you know, official ... well, call them official functions, functions organised by representative bodies like the Institute of Taxation, the Institute of Bankers, Financial Services Industry Association and those. And the authority expected me to make an appearance at those and I did seem to attend those. It was part of my job to go those. But ... other ... I can't recall anything else, I mean, if there's something there ... you have a specific, I'd be able to confirm it or not but nothing springs to mind.

Deputy John Paul Phelan: I want to just to refer ... Michael Casey, who is a retired economist with the Central Bank, publicly commented in October 2008 on the nature of close relationships between regulators and banks and I want to quote him again directly: "The close relationships between regulators and banks, difficult to avoid in a small country, will have to be ended." How would you describe, yourself, the nature of the relationships between the domestic banks and you, as chief executive of the regulator, in the period that we're discussing?

Mr. Patrick Neary: Well, I would describe it as professional and I suppose, in fairness, I'd have to describe it as cordial ... I mean ... you know, it was professional and constructive. I mean, it wasn't in any way destructive but that's really as far as I'd go. I mean, it was just a normal business relationship between the regulator and the regulated institutions.

Deputy John Paul Phelan: Do you think that ... to refer to Deputy Higgins' earlier point, that this social event on 26 November 2008, a month and a bit after the guarantee ... now, you've said, with the benefit of hindsight, it shouldn't have happened but is that an acceptable excuse? At the time, what was going through your mind when you were attending that particular gathering? I'm not entering any value judgment. I'm asking what he was thinking when you decided on that particular night, that it was appropriate for you, as the Financial Regulator, to attend a social event at which most of the bankers that your institution was regulating were attending and just six weeks after a blanket guarantee for those institutions had been entered into by the State?

Mr. Patrick Neary: Yes, I accept that my attendance there, with hindsight, was ill-judged but on the night in question, I was motivated by the fact that I had very high regard for the retiring chairman. This was to mark his retirement and I felt I'd like to attend that particular thing to mark the occasion of his retirement. But, I mean, it's very difficult now, with the benefit of hindsight, to regard that anything other than ill-judged that it went ahead at all.

Deputy John Paul Phelan: And I accept your apology in terms of it, with the benefit of hindsight, but I'm just saying at the time this was six weeks after the guarantee.

Mr. Patrick Neary: I explained ... I explained the motivation. The motivation was motivated by, as I say, by my regard for the former chairman who was retiring and I wanted to attend the dinner in his honour.

Deputy John Paul Phelan: All right, thank you.

Chairman: Thank you very much, Deputy. If I can maybe just ask you, Mr. Neary, if you could outline your role and the role of the financial regulation team in the CSE and what review and actions were taken following these?

Mr. Patrick Neary: The?

Chairman: The CSE.

Mr. Patrick Neary: That's the crisis subgroup?

Chairman: Yes.

Mr. Patrick Neary: The crisis subgroup was a kind of a subsidiary of the financial stability committee and its job was to carry out things like the crisis simulation exercise and also to assist in making preparations for emergency liquidity and things like that. I, certainly, was involved in a crisis simulation exercise and various people ... members of staff were involved in the day-to-day work of the CSE. It was a kind of a co-ordinating committee but its main function, as I recall, was in relation to crisis simulation and stuff like that.

Chairman: And in recalling that, maybe you could share with us this afternoon, in hindsight, how effective was this exercise in light of the experience of the crisis itself?

Mr. Patrick Neary: I think the exercise was effective because it bore no relationship to what eventually emerged. I mean, what the crisis exercise was about, was how we'd react to a problem in an individual institution and I suppose in that context it bore very little comparison to what eventually emerged as a ... which became a systemic crisis, so it wasn't that something cropped up all of a sudden that nobody saw. But it did, kind of, show that, you know, the kind of areas that would certainly be called upon in the event that a crisis emerged like, "Have you got your collateral ready?", you know, these kind of matters. Have we got the information? Have we got the right people available?, etc., etc. So, it kind of ... the procedural issues would have come to light after the crisis ... crisis exercise.

Chairman: This particular part of your response there, Mr. Neary, that I note in that the crisis simulation exercises that you were doing had no semblance or similarity to what actually happened afterwards. So, did these stimulations serve any purpose?

Mr. Patrick Neary: Well, that's ... I think the main benefit is that it kind of identified through ... it's a kind of a process of trial and error, Chairman, that it identified areas that needed to be examined and followed up ... like ... and I've just given you a couple of examples that just come to mind. Like, the deposit protection guarantee scheme would have been one of them, the availability of proper titled collateral, things like that. Those were the kind of issues that cropped up, Chairman, from my recollection. It's a long time ago now since we had that, so ... that's as I recall it.

Chairman: Okay, thank you. Senator MacSharry.

Senator Marc MacSharry: Thanks, Chairman, and good afternoon again, Mr. Neary. I'm sticking to the list now, Chairman, but it's very similar to the question you just asked so at the risk of being repetitive. As a regulator at the time was your opinion of the usefulness of the simulation exercise and what outcome-----

Mr. Patrick Neary: Well-----

Senator Marc MacSharry: ----came as a result?

Mr. Patrick Neary: I think the idea behind them is very good and I think------

Senator Marc MacSharry: But specific to the crisis that came, I know that the idea of being prudent about the future is good but, in the light of what came, was it worthwhile, was it useful, was it valid or was it futile, with hindsight?

Mr. Patrick Neary: I think some of the outcomes from the crisis may have resulted in preparations being made that would have had to be made anyway later on as the actual crisis unfolded and as the Central Bank was wanting to make sure that it had arrangements in place for the emergency liquidity and things like that. So, that would have been done anyway and I think, maybe, the crisis exercise identified some of that work and it was done maybe a bit earlier than otherwise. But there was no real comparison between the crisis that emerged and the ... the deterioration in the liquidity position that occurred in the system and the kind of an exercise what we carried out.

Senator Marc MacSharry: So, in effect, it wasn't very useful?

Mr. Patrick Neary: In the particular case, there is no direct link but I wouldn't like to just disregard the exercise as being useless.

Senator Marc MacSharry: Okay. Who was responsible for creating and updating the stress test scenarios?

Mr. Patrick Neary: The financial stability department in the Central Bank had ownership of that procedure.

Senator Marc MacSharry: And how would you rate them in terms of the effectiveness for predicting the bank failures?

Mr. Patrick Neary: Well, I think this goes back to what we were talking about this morning. In the great scheme of things, it would have been good if the outputs from the financial stability committee and the financial stability report had identified, you know, issues that should be followed up and probabilities of things going to happen etc. I mean, for example, like the IMF were, you know, inclined to give a view, I think, in their assessments where, whereas the financial stability report carefully set out what they saw as the risks but never really kind of said, "Well, look, this risk is very likely to happen if we don't do something about it." So in that sense, I suppose the stress tests and the way they fed into the financial stability reports probably failed to deliver their full potential.

Senator Marc MacSharry: And would the lack of ... of what we were talking about this morning, the enforcement on the prudential side have contributed to that?

Mr. Patrick Neary: I suppose, you see ... you must ... you have to take it, I think, in its entirety. I mean-----

Senator Marc MacSharry: Well, I know that ... we all know the entirety. We are going through this ... tedious as it is for everybody-----

Mr. Patrick Neary: Yes.

Senator Marc MacSharry: -----the individual component parts so------

Mr. Patrick Neary: Yes.

Senator Marc MacSharry: -----would the fact that the practice was not to enforce the prudential regulation issues ... would that have contributed to the ineffective nature of the stress testing?

Mr. Patrick Neary: Well, I suppose and I .. I mean ... I don't want to get into any kind of nit-picking either. But let's not assume just for the sake of our discussion that there was a number of issues that we would like to have sanction but didn't sanction., that there was a list that we are saying, ''Here's me list, but, unfortunately, because of resources I can't do it''. I mean, there may or may not have been issues that we wanted to pursue, but if there were issues and if, say, the issues related to lack of control and oversight over, say, the management of the portfolio and sanctions weren't taken and that ... and that bad behaviour continued, well, then, of course, I'd agree with what you're suggesting, that it might have had a bearing on it.

Senator Marc MacSharry: Did the criteria for these tests pre and post-crisis change a lot?

Mr. Patrick Neary: I don't know what happened since the crisis. I don't know what they ... how they factor them in right now.

Senator Marc MacSharry: So you don't know.

Mr. Patrick Neary: I wouldn't have any idea.

Senator Marc MacSharry: Okay. Just on the night of the guarantee when ... when you were ... you were brought in ... would ... would you describe, with hindsight, your position as somebody who promoted the idea of a blanket guarantee?

Mr. Patrick Neary: No, I wouldn't. Our ... both the chairman and myself were very careful to express our concerns, but I mean I ... I didn't ... wouldn't have considered that, you know.

we'd be volunteering advice unless we were asked for it. And we ... we ... we ... were asked a view about the scenarios I described and we did indicate that the ... the guarantee of all the institutions was less risky in our view than the one involving the nationalisation and the guarantee because of the risk it might be misinterpreted by the market the following morning.

Senator Marc MacSharry: So when the Minister asked the regulator, did you agree with the AIB-Bank of Ireland view that two institutions needed to be nationalised and the rest guaranteed ... you disagreed with that, is that-----

Mr. Patrick Neary: I don't remember him asking ... I don't remember the option of two institutions being put-----

Senator Marc MacSharry: Yes, there's ... it's just ... it's on page 104, Vol. 2 there. You might like to take a look at it or get it up on the screen. Can we this up on the screen? This one? So we can see these minutes here and you'll see PN, presumably yourself, and JR and it says, well obviously, there's abbreviations but what it seems to say is the Minister asked the Financial Regulator did they agree with the AIB-Bank of Ireland that two need to be nationalised first - "FR, (PN) [presumably yourself in brackets] did not agree".

Mr. Patrick Neary: Well, I don't agree with what's stated in those minutes because we were asked about one ... a guarantee for one and, sorry ... one to be nationalised and guaranteed for the rest or all to be guaranteed. So I do not agree with ... with ... with what's stated there.

Senator Marc MacSharry: Yes, so the minute is wrong as far as you are concerned?

Mr. Patrick Neary: That's not, yes ... that's in conflict with my-----

Chairman: Dermot Gleeson, when he was inside here has some questions about those minutes as well so-----

Senator Marc MacSharry: Very good, oh yes, it was only just to get his view. I'm not judging one way or the other, yes. So you think-----

Mr. Patrick Neary: That's not as I recollect it.

Senator Marc MacSharry: They're questionable, okay. And which ... which institution was that or can we say? Which one?

Mr. Patrick Neary: Anglo.

Senator Marc MacSharry: Oh, Anglo, okay. Yes, that's fine. What weighting would you have applied ... when you were asked to give your various views, presumably was it the Minister that was asking you or the Taoiseach or-----

Mr. Patrick Neary: There was a kind of a general discussion around the table. I can't ... I can't visualise any direct line of questioning. There was a general discussion, everybody was saying what they had to say. But-----

Senator Marc MacSharry: Were you-----

Mr. Patrick Neary: -----but it could have been the Minister, it could have been the Taoiseach, it could have been somebody else saying well, ''What's the regulator think?", looking across the table. It could have been the finance officials that-----

Senator Marc MacSharry: Okay-----

Mr. Patrick Neary: -----asked the question but it was ... it came into the discussion.

Senator Marc MacSharry: And of ... of ... of ... there was various suggestions presumably going around the table, was there in terms of-----

Mr. Patrick Neary: At the, at the first meeting there was two sessions, right? With ... and the very first session that we weren't in there for a long time ... I'd say it was, if it was an hour would be the max that we were in first session. And that was kind of discussion the solvency and they were talking in general about what the options were that could be used and a variety of options that were available for use but no conclusion whatsoever was reached in the first session. Because when we came back in that the ... the situation seemed to have crystalised down to this choice. And we ... we had kind of thrashed this out-----

Senator Marc MacSharry: Were you in the room for the, for want of a better expression, eureka moment where they said, "Okay let's go with a-----

Mr. Patrick Neary: Well-----

Senator Marc MacSharry: ------let's go with an overall guarantee for everybody"-----

Mr. Patrick Neary: -----a consensus emerged in the room but-----

Senator Marc MacSharry: And was that consensus one that you supported?

Mr. Patrick Neary: In the ... in the end that consensus was that there ... that the consensus was seeming to favour a guarantee. Now-----

Senator Marc MacSharry: And on the night in question-----

Mr. Patrick Neary: -----but it's important to ... it's important to just on this one, Senator-----

Chairman: You have one more after this------

Mr. Patrick Neary: -----there wasn't a eureka point when I was in the room they said, ''Okay lads, that's it, decided", right? That consensus emerged ... Now, the chairman and I at ... at that stage the meeting was this ... our presence was there. We .. because there was another meeting seemingly going to go ahead. And I think, you know, with hindsight, what I learned since that the banks .. they met with the banks again. So the chairman and I left the meeting at that stage and we went to a ... we went to a room. So the eureka moment, while there was a consensus, I didn't see a decision------

Senator Marc MacSharry: You weren't there for it. I just have two very ... and I'll be as quick as I can. The ... the ... Professor Honohan, in his own personal view, advocated a position where, really we should have pushed for more time. ELA should have been provided, we should have got to the weekend and, for want of a better expression, called the EU's bluff and maybe they would have involved themselves in risk-sharing. Do you feel that was a viable option or was the solvency situation, considering outflows, such that there ... you were out of time or, was there time to do that? And one more after this and then I'm finished.

Mr. Patrick Neary: Based on my understanding, Senator, I think the ... you could have nursed Anglo to the weekend. Because as far as I know and some of this is that, with hindsight, so, you know, it's a ... it's an evaluation based on information that I've learned since ... that

Anglo were in a position because of ELA or whatever from ... from the Governor of the Central Bank to survive on the Monday ... or the sorry ... yes, they survived on the Monday. And then there was arrangements being negotiated with the banks to provide liquidity to get them to the weekend, right? So-----

Senator Marc MacSharry: Yes-----

Mr. Patrick Neary: -----I suppose-----

Senator Marc MacSharry: You think ... you think you could have-----

Mr. Patrick Neary: That could ... I presumed that could have happened, right? That that was an option and you could put the infrastructure in place-----

Senator Marc MacSharry: Yes, but in terms of your advice and outflows-----

Chairman: Senator, one final question-----

Senator Marc MacSharry: Yes, I have the last one.

Chairman: Ask it, please.

Senator Marc MacSharry: Yes, well. Perhaps somebody else will come back to this line so. But this is another question that I wanted to ask. We are having difficulty in our questioning over the period of time, getting to the bottom of the origin and source of the no bank should fail consensus that everybody seems to know, but nobody seems to remember who said it. Do you have any recollection or knowledge that you are able to underpin for us to say, well, it was the ECB, it was Brian Cowen, it was ... who was it that came up with the consensus that no bank should fail that everybody seems to know about, but nobody is prepared to underpin?

Chairman: Question made, Senator. Mr. Neary.

Mr. Patrick Neary: Yes, I ... I think. I can home in on one particular discussion that was held at the authority and I think it was around 16 September. And the authority ... there was a special meeting of the authority to consider, you know, just to take stock of the situation and there had been developments in relation to one of the ... one of the smaller entities. And the authority had a general discussion about the options available if that particular institution were to experience liquidity difficulties because at that time that followed on that famous declaration by that ratings agency, which was subsequently corrected, that there was difficulties with the institution. And the authority's consensus at that particular time was in favour of a nationalisation of that entity. Certainly, as we move closer ... there was this ... sense seemed to develop ... that, you know, nationalisation, you know, was less of an option and that the guarantee was more of an option because almost every institution was heading into extremely difficult circumstances. So, while at one stage it was thought "Well we only have one maybe that's going to have this liquidity problem and we can deal with that separately", as time moved on, the challenge was getting bigger. So, at some stage between the 16 September and the night of the guarantee-----

Senator Marc MacSharry: But sure-----

Chairman: You're interrupting the man ... he's answering the question. Continue, please.

Senator Marc MacSharry: I'm conferring with the Chairman, continue. So it wasn't, it just popped in there, like everyone else, did it?

Chairman: The man is answering the question. Will you let him continue, please, and we'll get him to conclude-----

Senator Marc MacSharry: But I'm listening. I'm not able to get the answer.

Mr. Patrick Neary: I'm just trying to trace-----

Chairman: Just finish the story please, Mr. Neary ... please, without interruption.

Mr. Patrick Neary: -----I'm just trying to trace the evolution ... the evolution of this, Chairman. I think, as we kind of got closer to the 30th ... or 29 September, there seems to be this kind of unspoken consensus emerging that maybe, you know, a one-bank guarantee solution ... or one-bank nationalisation solution is not the ... is not the preferred option anymore, that it's a bigger issue than that.

Chairman: Thank you.

Mr. Patrick Neary: I just want ... one other thing has just come into my head ... was that there was a kind of a gesture, if you like, in that direction when the deposit guarantee scheme was strengthened. That was around the 18th I think, or 19 September, if my memory serves me right, because, in the text announcing that, the Minister had made some statement that, you know, the Government would support the ... I don't have exactly the text ... but around that time, when the deposit guarantee was being strengthened, there was an indication that depositors' funds would be secure or whatever, I can't remember exactly the phrase. So, that may have been the factor in getting people thinking along those lines and maybe became a factor in making that solution more acceptable. But it's a speculative point, Chairman, and I-----

Chairman: I'd maybe draw a line under it there because you're moving onto speculation rather than informed opinion. Deputy McGrath.

Deputy Michael McGrath: Thank you very much, Chair. Mr. Neary, can you explain why the audits and other forms of analysis undertaken by the Central Bank and Financial Regulator failed to identify the looming issues that emerged in 2008 and '09?

Mr. Patrick Neary: Well, in the case of the Financial Regulator, I think, kind of ... our approach, again at the micro level, is to rely on the key indicators. The key indicators were capital, the level of non-performing loans and the need for provisions and the liquidity situation. And there was nothing emerging under any of those key indicators, certainly in relation to asset quality or capital, that caused immediate concern. The liquidity situation was the one that was troubling everybody.

Deputy Michael McGrath: Did the Financial Regulator ever assess worst-case contingency scenarios of a systemic bank failure? And, given the warning signals from Northern Rock onwards in mid-2007, why did the regulator not undertake such a contingency assessment?

Mr. Patrick Neary: The ... the ... this ... we're again moving across into the area of financial stability and, I think, that would have been an assessment that would have been, I think, mandated to the Central Bank to do it rather than us. We would've continued our focus on the individual institutions.

Deputy Michael McGrath: Okay. Chairman, I'd like to quote some of the comments from Judge Martin Nolan at the conclusion of a criminal case last year, which has been widely reported-----

Chairman: The legal advice I have is that you can't do that.

Deputy Michael McGrath: And the case was widely reported in the media.

Chairman: There are upcoming trials that may be related to the ruling and evidence presented at that trial.

Deputy Michael McGrath: Okay, thank you. Mr. Neary, the comments you made on "Prime Time" on 2 October 2008, were they representative of the views that you would have expressed to the decision makers three nights previously on 29 September 2008?

Mr. Patrick Neary: There were elements in that statement that would have been common to that night. The ... in the discussions at the earlier meeting, we were asked for our view as to the solvency position of each individual bank and we gave that view. I wasn't asked to compare ... to make any comparison between Irish banks and banks of any other jurisdiction, it was confined to the solvency position of each bank. So I went further, I suppose, on 2 October in that discussion than I would have had to go on the night of the guarantee.

Deputy Michael McGrath: Okay, but on the night in question, on the 29th, did you express the opinion to the decision makers that, in your view, the banks were solvent?

Mr. Patrick Neary: Yes.

Deputy Michael McGrath: You did, okay. Thank you very much. Can I just take you back to the issue I raised this morning in relation to Seán Quinn and the contracts for difference issue? When you did have the meeting with Mr. Quinn in January 2008, did you ask him at that stage the extent of the contracts for difference he had built up in the bank?

Mr. Patrick Neary: No.

Deputy Michael McGrath: Why not?

Mr. Patrick Neary: Well, first of all, I think, in the context of the conversation ... Mr. Quinn had said that he had contracts for differences that he had ... the ones that he had in financial stocks that he had gone long in and I took that to mean that whatever contracts he had, he had converted them into shares and, I mean, if they were ... if they were in any way a material holding in Anglo it would have cropped up in the share register. And if it was more than 5%, there would have been notification to us. So, otherwise, I mean, I didn't probe Mr. Quinn's personal investments, that's a matter for him and, you know, that may sound surprising but, you know, an individual's private financial affairs, I believe, are his own business.

Deputy Michael McGrath: Did he arrive unannounced at your office?

Mr. Patrick Neary: Yes, at very short notice, yes.

Deputy Michael McGrath: And what was the purpose of the visit?

Mr. Patrick Neary: He said it was ... a courtesy call or words to that effect. The contact was with my secretary and she set up the meeting because I got the impression that the man was in town and he was taking the opportunity to come in to see the regulator because he was the chairman of an insurance company.

Deputy Michael McGrath: But he did confirm in the meeting that he held some contracts for difference in Anglo Irish Bank?

Mr. Patrick Neary: No, he didn't say Anglo Irish Bank, he said financials which he had gone long in. I don't recall him ever saying that he had contracts for differences in Anglo Irish Bank.

Deputy Michael McGrath: Okay. And when you were considering the import and the significance of that and reflecting back on the meeting you had with David Drumm at the end of September 2007, did you link the two together in your own mind and decide on what course of action might be appropriate?

Mr. Patrick Neary: I can't make that statement with absolute certainty, that I made that link. But I can only ... I can only ... maybe attempt maybe to ... to determine what I might have concluded. David Drumm had come in and he had said there was kind of a rumour out there in relation to CFDs at Anglo and there was rumours certainly reported that-----

Chairman: Please mind now, Mr. Neary, and I will allow the question to continue but, with regard to the relevant section and specifics, to be maybe a bit more general than specific in some of your commentary, okay?

Mr. Patrick Neary: Okay, thanks, Chairman, thanks very much. That ... he was suggesting there was rumours about CFDs. Nothing - no facts or anything - emerged to support that. This meeting took place. There was nothing emerging from that meeting that ... other than, I think, looking back on it, what ... may have said to me at the time, "Well, at least there's no truth in the David Drumm thing", because Mr. Quinn said that he was long in financials. So, that to me was his assertion that he did not have CFDs in Anglo.

Deputy Michael McGrath: And then, going forward a few weeks, how did you subsequently find out? I think on 21 March you indicated that you found out the full extent of the CFDs. How did that come to your attention?

Mr. Patrick Neary: Well, I don't know was it ... at around 24 March. It was ... it was a Good Friday. The ... Anglo came down to a meeting in the Central Bank which was attended by the Governor, Director General, Con Horan and myself, and we were informed by the Anglo representatives that they had established that Mr. Quinn had this holding.

Deputy Michael McGrath: And, Mr. Neary, how did you feel when it subsequently emerged publicly that the extent of the stake built up in Anglo, by Mr. Quinn, was over 29%, that from November 2007 to July 2008. Anglo had lent just under €2 billion to Mr. Quinn to fund margin costs associated with the contracts for difference? How did you react to that when the full picture emerged?

Mr. Patrick Neary: Well, there ... that picture didn't emerge for quite some time about the extent of ... of the funding. I can't recall the timelines, I'll have to ... I'd have to go back and review records that weren't included in any of these packs, so I ... I really can't, with confidence, recall them now. But, obviously, I mean, we were faced with a major problem. A problem that, you know, was going to clearly call into question the ... how the ... these shares that would have been held as a hedge against the CFDs might affect the share price if they were shorted or speculated against or lent to shorters or whatever, and that, in turn ... and the real concern was that any ... any effect on the share price could be misinterpreted by the market and, say, indicate a lack of confidence by investors and that people would start withdrawing their funds ... if it could transmit itself into a liquidity problem very quickly. And that was our main concern, how that would transmit itself into a liquidity problem. And ... because a week or so before we learned about the contracts for difference we had, I think, imposed a ban on short selling of financial stocks, because ... because of rumours and because of ... there was the famous Patrick's weekend where there was a kind of a ... you know, a serious shock to the share price of the banks, and we believed that there was a lot of speculation going on, but it was a week later we found out, probably, why that was.

Deputy Michael McGrath: Okay. Thank you, Chair.

Chairman: Thank you very much, Deputy. So it's now just gone 4.30 p.m. so I propose that we will break until 4.45 p.m. and, in doing so, just to remind the witness that once he has commenced giving evidence, he should not confer with any person other than his legal team in relation to the evidence and matters that are being discussed before the committee today, and with that in mind, I suspend the meeting until 4.45 p.m. and remind the witness that he's still under oath until we resume. Thank you.

Sitting suspended at 4.33 p.m. and resumed at 4.57 p.m.

Chairman: Okay, okay. As we are now back in quorum, I'll bring the meeting back into public session and in doing so if I could invite Deputy O'Donnell please. Deputy O'Donnell you've ten minutes.

Deputy Kieran O'Donnell: Thanks, Chairman. Mr. Neary, I'd just like to clarify one or two small points on the contracts for difference. What date did David Drumm come to you about it originally?

Mr. Patrick Neary: I don't have a date, but it was some time in September I, I believe. But I don't have a specific date.

Deputy Kieran O'Donnell: So roughly three months later, you met with Mr. Quinn in the regulator's?

Mr. Patrick Neary: In January, yes.

Deputy Kieran O'Donnell: And did you request that meeting?

Mr. Patrick Neary: No, no, no.

Deputy Kieran O'Donnell: And the question, I suppose, is that, did you at that time look to draw down specifically about the particular institution of which Mr. Drumm had made you aware of in terms of potential build up of contracts for difference? Did you draw it down with Mr. Quinn, the actual specific institution?

Mr. Patrick Neary: No I, I ... the conversation, I just have to reflect for, for a moment Deputy. This is a while ago and I haven't looked at this for a long time. As far as I remember, the ... conversation was, came about this in a, in a circuitous way and ... we, we touched on contracts for differences. I didn't ask him outright: "Is it true that you have got contracts for differences in Anglo?". What Mr. Quinn indicated was that yes, he had some contracts for differences but he had gone long in the financials.

Deputy Kieran O'Donnell: And why didn't you draw down Anglo? Why didn't you specifically ask him about Anglo, considering that you had the CEO of one of the largest financial institutions coming to you about this specific issue?

Chairman: Remember 33AK now as well, Mr. Neary, here. And I'm just trying to avoid repetition as well in that regard. So continue, please.

Mr. Patrick Neary: Yes, it simply, the, the meeting with ... that happened with David Drumm was a particularly informal meeting and he had come in just to voice his concerns about CFDs and to establish as much what CFDs were, as much as who might have had them and it was in that context. Now, at that time I failed to link the two, and have no reason why I didn't ask him, it just is the way it transpired and the way in which the discussion went, which was a very brief courtesy call on Mr. Quinn, and ... unannounced, unexpected. And he had, he had essentially said, "look I have gone long on financials" and I took it to mean that there was no issue.

Deputy Kieran O'Donnell: You are aware that subsequent to that, the stake at that stage was worth 25%, it went to nearly 28% by the St. Patrick's Day massacre.

Mr. Patrick Neary: Yes, well, we didn't find out the extent of the stake until the Good Friday.

Deputy Kieran O'Donnell: And when did you become aware of the €2 billion that had been lent from the same institution to Mr. Quinn in respect of the purchase of-----

Mr. Patrick Neary: When ... when we got the March large exposures report, I think, at that stage, that would've come in around May ... I think, at that stage, we were alerted to the fact that there was a very significant increase in the facility to the Quinn Group. And ... it was at that stage ... that, I think, that we may have had a correspondence with Anglo in relation to the growth in ... in it ... in ... in------

Deputy Kieran O'Donnell: And what view did you take at the time? What view did you take at the time, Mr. Neary?

Mr. Patrick Neary: Well, we wanted to establish that there was proper security that the ... the loan was properly secured and I raised that in the letter that we issued to David Drumm at the time.

Deputy Kieran O'Donnell: And the fact that it was a loan being given for the purchase of shares in the same institution?

Mr. Patrick Neary: No, that ... that wasn't clear at the time. The loans, as we understood it at that time - to the best of my recollection now, Deputy - was that the loans were for working capital in the Quinn Group, right, that was the client, now what the Quinn Group, in turn ... you know, I can only presume, they were replacing funds that had been lent to Mr. Quinn by funds drawn down by the group from Anglo.

Deputy Kieran O'Donnell: Okay. And, finally, in hindsight now, what would you have done differently and do you think that the ... the domestic standing group minutes we had from a meeting yesterday in July '08 stated that the Quinn Group could have threatened the financial stability of the State ... in hindsight, what would you have done differently?

Mr. Patrick Neary: Well, you see, the harm was done, at that stage, and ... the ... the ... I think, when we briefed the authority on the build-up of CFDs, the initial concern of the authority was that this should be ... this should be minimised. And the engagement with Anglo was to seek to bring that about - that Mr. Quinn would dispose of his CFDs - because we were worried about the ... the speculation against those positions and the share price, and then the effect on confidence in the bank. So-----

Deputy Kieran O'Donnell: Yes, go on.

Mr. Patrick Neary: -----so, that's where the focus was in ... in putting ... putting the onus on Anglo to seek a way to reduce this.

Deputy Kieran O'Donnell: In hindsight, should a mechanism not have been there, from a regulation viewpoint, to be able to see that level of increase in contracts for difference in shares in Anglo under the radar?

Mr. Patrick Neary: We ... you see, this was the problem with CFDs, and there was no data being collected on CFDs. The CFDs, I think, were included in MiFID directive, which was being, I think, implemented around that time, and they were included in that but they hadn't been set up. And there was no way of establishing it.

Deputy Kieran O'Donnell: On the night ... on the guarantee, were alternative options to the eventual bank guarantee discussed at meetings in the days leading up to the announcement of the bank guarantee? And who presented those alternatives?

Mr. Patrick Neary: I believe so. There was a meeting the weekend before the guarantee, I think. It was attended by Con Horan, the Governor may have attended. I was briefed about that meeting, I wasn't at it myself. And a range of options were set out. I think they kind of went through options for all the banks and the various options, including nationalisation, guarantees, secure lending facilities and, etc.

Deputy Kieran O'Donnell: Okay, and they were presented?

Mr. Patrick Neary: They were presented, I believe, at that meeting. There was ... that meeting, I think, was held ... may have been held in the offices of the NTMA. I'm not sure now about that.

Deputy Kieran O'Donnell: Going to, we'll say, Vol. 2, PNE, page 89, the letter that was sent to you from David Drumm in Anglo Irish, where he said: "I strongly believe that the best solution to this issue is for the Minister to state publicly that no regulated Irish financial institution will be allowed to fail." Did you act on that?

Mr. Patrick Neary: That's page 89 ... is that----

Deputy Kieran O'Donnell: Yes, second last paragraph. Did you act on that? It was basically Mr. David Drumm from Anglo requesting that the Minister for Finance would publicly state that no regulated Irish financial institution would be allowed to fail. Did you follow up on that?

Mr. Patrick Neary: No, no, this ... this proposition didn't gain any momentum at all. It died in the water.

Deputy Kieran O'Donnell: Okay. Can you describe the events surrounding the options presented by Merrill Lynch at a meeting in the Department of Finance on 29 September '08. Were you involved in that on the night of the guarantee?

Mr. Patrick Neary: No, I wasn't involved in that.

Deputy Kieran O'Donnell: You weren't involved in that?

Mr. Patrick Neary: No, I was not, no.

Deputy Kieran O'Donnell: And can I go back again. Reflecting on it now, and you were the only financial regulator we had in Ireland, and we had a bank guarantee had been put in place which has resulted in gross of €64 billion of taxpayers' money, many people being in houses that are in negative equity. Do you still stand over all aspects of your interview on the "Prime Time" interview on RTE on the night of 2 October '08?

Mr. Patrick Neary: Well, I think that, with hindsight, and based on what emerged since in relation to those portfolios, that that assessment was optimistic.

Deputy Kieran O'Donnell: When you say "optimistic"?

Mr. Patrick Neary: Well, that I wasn't aware that there was these latent issues in the portfolios that were going to emerge so soon. I made that statement in good faith, believing it to be true in every sense, and clearly, you know, at that time there were latent problems in the portfolios that hadn't come to light.

Deputy Kieran O'Donnell: If you back there again what would you have done differently with that? Because that was a pivotal moment. Many people purchased shares and so forth-----

Chairman: That's fine for now, Deputy. Just ask the question.

Deputy Kieran O'Donnell: Okay, yes, sorry, yes. Yes. If you, in hindsight, if you were back there again now, what would you have stated to the nation on the night of 2 October '08 on "Prime Time"?

Mr. Patrick Neary: Well, I would answer the question I was asked truthfully, as I believed it to be the case at the time. I mean, I can't rewrite history. It's with ... now, when you look back, and you view all of these assessments in a different light, but at the time, based on the information I had at my disposal, I made that statement in good faith.

Deputy Kieran O'Donnell: And then finally-----

Chairman: Final question.

Deputy Kieran O'Donnell: Yes, final. Was there any ... over the years in which you both prudential regulator ... prudential director and the regulator was there ever a situation where you said there was a problem with the banks, that you felt there was a problem with the banks?

Mr. Patrick Neary: Not until the ... towards the end of 2007, beginning of 2008, I would have said there was an emerging liquidity problem with the banks. But other ... apart from that I would have said "No".

Deputy Kieran O'Donnell: When did you realise there was a solvency problem?

Mr. Patrick Neary: Well, the solvency problem came to light far later, or very much after-----

Deputy Kieran O'Donnell: From your perspective?

Mr. Patrick Neary: When did I-----

Deputy Kieran O'Donnell: As regulator, when did you believe, when did you come to the view that there was a solvency problem? When, as the regulator?

Mr. Patrick Neary: I wasn't the regulator. I had left the regulator before any solvency problem emerged.

Chairman: Okay, thank you very much-----

Deputy Kieran O'Donnell: You said post your ... post your leaving in 2009?

Mr. Patrick Neary: I actually ... that was my official date of leaving. I actually stood down as regulator in ... in just before Christmas.

Deputy Kieran O'Donnell: Of '08?

Mr. Patrick Neary: Of '08, yes.

Chairman: Thank you very much. I just want to return to the guarantee for one moment and then take a series of questions with you, Mr. Neary. We know what the final decision of the guarantee was, which was that it was a blanket guarantee to cover six institutions, and we know, from your testimony and other testimony that we have actually had, that there was a series of discussions and that those discussions moulded itself into a decision that ultimately became the six banks to be guaranteed.

Mr. Patrick Neary: Yes.

Chairman: And from those discussions maybe different people had different views over the course of the evening as to what the desired outcome would actually be. Was there anybody sitting around that table who presented the six banks blanket guarantee option right from the get-go?

Mr. Patrick Neary: No, I can't recall that, Chairman. In the earlier meeting there was a general ... just let me work through it in my mind. The earlier meeting there was a general discussion of options and we talked about the capital position. The second meeting was it had crystallised down into a choice between the two, so no, Chairman, I don't remember anybody coming in from the word go and saying, "We're guaranteeing everybody."

Chairman: Fair enough. If I can ask you ... if I can just bring up Vol. 1, page 123, and just go into some matters there as regards to the tone of the situation back in 2007, and the financial stability report as it was discussed then. And if I can just come down to the end of the page 123 ... there we go, yes ... and just a ... just quote the following paragraph to you there, Mr. Neary:

> Following the presentations, there was a detailed discussion on the content of the draft Financial Stability Report. The meeting considered that in the continuing turbulence and uncertainty in the financial markets since early August, the tone and comment in the Financial Stability Report will be of particular importance and sensitivity.

Can I ask you to comment upon this? Could this potentially have been an opportunity missed in not setting out key issues more starkly? And what, and who, drove this decision, and what contribution did you make to the discussion in the way that there was a very measured set out in the financial stability report?

Mr. Patrick Neary: I think, Chairman, in the context of that, the board of the Central Bank and the authority consisted of, I suppose, cautious people. And, you know, I think at that stage when the financial stability report was being prepared, I mean, there may have been a consciousness in the minds of the boards about the sensitive situation in the international financial markets. And it's ... I think ... I can understand that there may have been a note of caution that the emphasis should be on the strengths rather than the weaknesses, and that they wouldn't maybe spook the horses.

Chairman: After the final paragraph ... at the final section, it says, "Care should be taken to ensure that risks are set in the context of the strengths of Ireland's strong economic performance and prudential environment." So, you were talking about scaring the horses, is this kind of an overstatement to make ... a kind of show a strength, but there wasn't really a degree of strength behind the statement?

Mr. Patrick Neary: No. I would read the opposite into that. And I'm making an assessment now---

Chairman: Sure.

Mr. Patrick Neary: -----you know, of what I think would have been meant. It's not to overstate ... it's not to overstate the strength, but maybe, you know, to ... not to come out and, I suppose, overstate weaknesses either. It's to strike the right balance and present ... to present the thing in a way in which, you know ... while there was risks and that as perceived in the financial stability report.

Chairman: Mr. Neary, in around September 2007, there was a lot of discussion with regard to the stamp duty and what would actually happen to it. That discussion was reflected in a very, very significant slowdown in house purchases, because people were going to wait until the next budget to get clarity on that. There was a massive significant slowdown in the construction sector. We know that the construction sector was twice the size as to what it should have been; it was in an excess of 20% of the Irish economy, twice above what would be a sustainable rate. And there were a lot of systemic consequences taking place outside of the banking sector as well. In fact, something that will be drawn upon later when this inquiry moves into a different stage, in that when the bailout and everything else arrived, it wasn't just a banking crisis that the country was facing, there was a massive structural deficit as well that had to ... that required in adjustment of in and around €30 billion, which ... and all those other signs are actually happening in around there and then.

Can you say this afternoon that what was actually being put out in that financial stability report was fair and accurate and true reflection of what the books were actually demonstrating at that time?

Mr. Patrick Neary: Well, in the background that you have just presented there, Chairman, I think it does call this assessment into question. And, you know, I think reading that now and looking back on it, I think the message coming out from that statement to me is don't spook the horses. There's clearly that message there.

Chairman: Okay. I want to move on to another document there, if I can get it up on the screen. It's evidence book, Neary Vol. 1, page 181.

Mr. Patrick Neary: Page 181.

Chairman: Yes, it's coming up there now. It's on your screen there. In your statement to the joint committee, Mr. Neary, you stated that you were aware ... that you were "unaware of any incidences where supervisory issues uncovered by statutory auditors were escalated to the Authority." In the context of that statement, can you comment upon the three pieces of evidence noted below and I'll go through them, okay?

These are correspondence of statutory auditors to the IFSRA in respect of issues uncovered in financial institutions during the course of the statutory auditor ... audit between 2003 and 2004. In 2003:

In respect of institution X, following items were noted:

- "no detailed procedures manuals" were in place

- "no formalised controls in place covering the introduction of new products"

- Inadequacies and the monitoring of "moratorium accounts"

- Insufficient attendance at credit committee meetings

- Lack of documentation [and] supporting provisions

- Lack of overall review of credit portfolio.

Again in 2003:

In respect of institution Y following items were noted:

- Errors in annual facility review processes

- Errors in recent capital adequacy return

-High pace of growth in institution implies "management of resources and controls of this expanding environment is essential."

And then in 2004 and that year ending 2003:

In respect of institution X following items were noted:

- "understatement of non-performing assets"

- Error in Large Exposure Return for March 2003

- Error in Large Exposure Return for September 2003

- Large exposures to 2 particular sectors noted in sectoral return for 2003

Can you comment on whether, in your opinion, the response of the Financial Regulator to these issues was sufficiently robust?

Mr. Patrick Neary: Yes, they were followed up and in relation to X, which continued from 2003 into 2004, first of all, the matters that arose ... those errors and the procedures that gave rise to those errors were corrected and the reaction of the authority of that time was to increase the capital ... the solvency ratio requirement by one percentage point for that institution. So, there was, you know, in that sense, there was a penalty imposed on the institution. For the other institution, as far as I have been able to assess, what happened was that there was a firm sent in to review that ... those findings, following up from the audit and that they were corrected.

Chairman: I just want to move on and it's on a similar line, Mr. Neary, in regard to contrarian views. And in respect of the risks highlighted in the financial stability reports and views expressed by internal and external contrarian economists, did the authority give sufficient consideration to the adequacy of its prudential supervision procedures and if it didn't, why didn't it do so?

Mr. Patrick Neary: Well, the contrarian views that emerged or that, I think, you are referring to, you know, they were considered, I think, within the financial stability, if you like, cohort in the Central Bank and they take account of all views, pro and con, in relation to the assessments. Their view ... their prevailing view was that the economy was robust, it was growing, that there was no matter of immediate concern, the soft landing option was the emerging assessment for them. We were bound to take their assessment ... to take their assessment on board so that's------

Chairman: Just to round this off, so, and I'll bring in the next questioner. As I said, we heard about the tone and tenure of the 2007 financial stability reports and I assume these were discussed at board level, as we know. To your knowledge, who was ultimately responsible for the tenor and tone of the financial stability reports? Who had that editorial control as to this is the how the tenor and tone of the report would be presented?

Mr. Patrick Neary: Well, I suppose, following ... following from the discussion that discussion would be at the joint meeting of the two ... of the two boards and would be chaired by the Governor. And I think the Governor would have the final call on the ... he'd bring the thing together and it would be his final call and I think he would talk ownership of it at that stage.

Chairman: I was going to say something but I had to actually rule myself out of order so I'm not going to say it. So the ... the narrative and presentation of this document was set by the Governor. So the optical position as to the financial health and well being of the country would be one that, ultimately, would be decided by the Governor; that the state of the nation as so it was, Mr. Governor gets the final say in that.

Mr. Patrick Neary: It would be the Governor that would get the final say. He would make the state of the nation address and he would be the man that would present that in ... in public.

Chairman: Okay, thank you very much. Senator Michael D'Arcy.

Senator Michael D'Arcy: Thank you, Chairman. You have answered some of this previously, Mr. Neary, but I suppose I just want to scope the ... the last portion of it. With particular reference to the final solution of a blanket guarantee and the reaching of that, what other options were considered? You had representatives from AIB who thought there was a four-bank guarantee in place; Bank of Ireland, who were at the same briefing, understood there was a six-bank guarantee in place. Could you offer your understanding in relation to how we got to that position of a six-bank guarantee?

Mr. Patrick Neary: All I can report to you, Senator, is what transpired at the meeting ... the two meetings that I was at. And at the first meeting, the ... the focus was on trying to establish the position in relation to each of the banks. And there was some discussion as well there the Governor had advised about or arrangements that had been put in place to support Anglo overnight the previous night and ... and whatever. And there was a ... there was a brief kind of overview of the options that were available. And nationalisation being one and the guarantee being the other. But there was no ... when we were at that meeting, certainly no discussion as to preferred options or combinations of options or that, other than to just, if you like to describe the options that were available. So this is ... this is the menu of options we have and it was left at that. And when we came back, and this was several hours later - and I believe in the meantime there had been that meeting with the banks, the first of two meetings, I believe that did happen - the options had narrowed down to full guarantee or five and one.

Senator Michael D'Arcy: And you didn't participate in how-----

Mr. Patrick Neary: No, no. We weren't present for that.

Senator Michael D'Arcy: You ... you subsequently concluded your time with the IFSRA about four months later.

Mr. Patrick Neary: I ... just the run up to Christmas, yes.

Senator Michael D'Arcy: Can I ask you, subsequent to that, when you had left, about 15 months later, all of the NAMA moneys were transferred, the loans were transferred to NAMA from the covered institutions. Were you surprised with the level of discount considering that you had overseen... you had been the prudential director for ... from going back to 2003 and, subsequently, you were the CEO ... were you surprised with the level of discount?

Mr. Patrick Neary: Well, the level of discount, Senator, I think was a function of the change in price ... the valuation of the assets. That's a function of the market-----

Senator Michael D'Arcy: It was only 15 months later-----

Mr. Patrick Neary: Yes, but you know the ... the market just seemed to just crash and prices seemed to crash and I think the crash that arrived that nobody had foreseen. So I mean, that's a function of what happened.

Senator Michael D'Arcy: Had nobody foreseen it?

Mr. Patrick Neary: No, I don't think that the ... the depth and severity and the suddenness of the crisis was ... certainly wasn't foreseen at the time of the guarantee.

Senator Michael D'Arcy: You participated in an interview on "Prime Time" with Mark Little on 2 October, I think it was?

Mr. Patrick Neary: Yes.

Senator Michael D'Arcy: Did you see the ... the "Prime Time" interview with Morgan Kelly on 30 September?

Mr. Patrick Neary: No.

Senator Michael D'Arcy: You didn't?

Mr. Patrick Neary: No.

Senator Michael D'Arcy: And if I had said to you that Mr. Kelly said that a standard banking ... a standard property bubble in the United States would cost about 25% of the loan book, would you be surprised?

Mr. Patrick Neary: If a bubble in the United States-----

Senator Michael D'Arcy: A standard bubble, a property bubble in the United States, if the analysis would show it would cost about 25%? That was only two nights before you were on "Prime Time". You didn't see that?

Mr. Patrick Neary: I did not see that.

Senator Michael D'Arcy: Could I ... In that "Prime Time" interview, Mark Little put it to you that the fundamental weakness was that Irish banks had lent recklessly into the crumbling property sector. That was the position that he put to you and you said that that wasn't a fundamental weakness, that the difficulty was the liquidity, the international liquidity concerns. That was your position. Can I ... did you watch yesterday's, or were you aware of yesterday's hearing with Mr. Con Horan?

Mr. Patrick Neary: Yes.

Senator Michael D'Arcy: Can I, well if you watched yesterday you would have ... I read a portion of a section 33AK protected document, it won't come up. I'll read that portion again into the record Chairman:

> Irish bank share prices have continued to fall and have lost between 30% and 50% of their value since start of ['07]. [This document is dated November 2007] 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 [Merrill Lynch] setting out a negative perspective in the Irish banking sector because of property exposures.

Now, that was ten months before your interview with Mark Little. Were you aware of that, that's the document, that Mr. Horan attended for the domestic standing group, were you aware of that?

Mr. Patrick Neary: Well, I certainly ... I can't say that I would have had sight of a particular document prepared by Merrill Lynch and that was in Mr. Horan's possession. But I mean ... I ... we had to rely on the facts, on the facts as we knew them. And the facts as we knew them were that the solvency position was strong, the levels of non-performing were very low, there was essentially capital surplus to regulatory requirements in the system. Those were the facts, as I understood them. I mean these kind of commentaries were certainly out there but they seemed to contradict the facts. But this is all about confidence, I suppose, and do you know, it's about a view, and it was issued by brokers and that. You know, I don't want to suggest for a moment that there is an ulterior motive but I think you've got to be nevertheless careful in reacting to these assessments because you don't know the motivation behind them.

Senator Michael D'Arcy: Can I ask you, while we're speaking about motivation behind investors' viewpoints, in Simon Carswell's book, *Anglo Republic*, you were mentioned quite a bit, Mr. Neary, and I want to read a ... following the St. Patrick's Day massacre as it became known-----

Chairman: Please ask Mr. Neary first, "Are you familiar with the section in the book?"

Senator Michael D'Arcy: Are you familiar with the book?

Mr. Patrick Neary: No, I'm not, I never read the book.

Chairman: Senator D'Arcy, back to you.

Senator Michael D'Arcy: Okay. Well, I'll give you a quotation, Mr. Neary. On page 1 ... sorry, if you'll give me a moment, please. "Privately David Drumm told colleagues that he didn't believe that the regulator's investigation into alleged rumour mongering about the bank would go anywhere." Did you conduct an investigation into rumour mongering subsequent to the St. Patrick's Day massacre?

Mr. Patrick Neary: There was an investigation conducted by the markets department in the Financial Regulator, yes.

Senator Michael D'Arcy: So who instigated that investigation? Was it yours or was it as a result of executives from Anglo Irish Bank lobbying you for that investigation?

Mr. Patrick Neary: No, the ... there ... there was ... there certainly ... they certainly made comments to the regulator, there is no doubt about that, but they were not ... the information came in separately into the regulator in relation to that, to those comments and those rumours that were ... that were circulating and the ... I think Anglo certainly did make contact. I think it was with Mr. Horan that they made contact in relation to speculation against their shares. But we were going to do the, the investigation anyway.

Senator Michael D'Arcy: Can I also read on another passage, please?

Mr. Patrick Neary: Please, yes.

Senator Michael D'Arcy: The regulator also looked into the activities of ... can I mention these, this is in the public domain, Chairman?

Chairman: Well, I don't ... Mr. Neary doesn't know what's in the book, but if you can be general in it, I can try to facilitate it.

Senator Michael D'Arcy: Okay, I won't name the two traders.

Chairman: Okay. All right.

Senator Michael D'Arcy: Two traders at Davy's, who had been targeted by Anglo the previous autumn for advising clients to sell the bank stocks. Now, that was the previous autumn. There was also an investigation into Merrion, in which the CEO, Mr. John Conroy-----

Chairman: Can I ask you, Senator, what's the evidence you're trying to establish here-----?

Senator Michael D'Arcy: Well, I suppose, what, what I'm trying to, to pursue, Mr Neary, is were you acting in your own volition or was it as a result of you being pushed by a bank where there were concerns nationally and internationally about the standard of the bank's balance sheet? And brokers, independent, who give advice to their clients, were investigated as a result of who pursued whom. Was it you?

Chairman: Thank you. The question is made. Thank you. Response, Mr. Neary, and then I'll move on.

Mr. Patrick Neary: No, no, to the best of my recollection, Senator, the investigation was going to take place anyway because there was certainly information coming into the Financial

Regulator, in through the markets department, that there was rumours and ... emanating from different sources, and as the, as the regulator of good practice, you know, we decided that the markets department should look into this and establish what the position was. Now, absolutely, there was some contact by Anglo with us, in relation to this as well, but I don't believe that there was any ... I have no reason to believe that our action was in relation to-----

Senator Michael D'Arcy: Okay, well, I'll conclude on this now. I'll conclude on this, Chairman.

Chairman: We will move on because I'm not too sure where this is going.

Senator Michael D'Arcy: I just, to just conclude, from Mr. Carswell's book there was a sense among stockbrokers that Anglo and the regulator were working hand in glove. A letter sent to Merrion by Anglo's lawyers, I won't name them, on instruction from Mr. Drumm, threatened the firm with legal action over the traders' comments to a client and demanding a retraction of what he had said, was copied to the regulator.

Chairman: That's a narrative, now-----

Senator Michael D'Arcy: Yes, I'm reading it. Mr. Neary insists that, that his investigation was separate from Anglo's representation but Mr. Conroy was not convinced. You're telling me that the ... that you instigated the investigation, not upon anybody's request.

Mr. Patrick Neary: Absolutely. I mean, we made a decision to conduct the investigation because, as I just said, we were, we were aware of ... we were made aware of rumours. I, I mean, the markets department, that's what they do, they find out this kind of information, and I, I also accept that there was contact from Anglo in relation to it but that was not the driving force. We weren't, we didn't conduct the investigation because Anglo rang up and said, "You better investigate this". That was a coincidental factor in the investigation and it did happen, they did make representations.

Chairman: Okay, thank you. Deputy Higgins. Deputy, you have ten minutes.

Deputy Joe Higgins: Mr. Neary, Deputy Doherty already referenced the bank loan book reviews carried out at the instigation of the Central Bank and the regulator just before and just after the guarantee at the end of September and that became subsequently known as the Atlas report.

Mr. Patrick Neary: Yes.

Deputy Joe Higgins: Yes. Did the regulator of the Central Bank carry out any independent probes to test the veracity of the information which the banks gave to those auditing companies?

Mr. Patrick Neary: No, no.

Deputy Joe Higgins: Mr. Neary, isn't ... is it the case that huge Government decisions were made on foot of that information or that it influenced the direction of, and the quantity, for example, later, of recapitalisation amounts? It had huge implications. Why would the word of the banks be accepted without independent testing?

Mr. Patrick Neary: Well, I think, the findings of the PwC investigations in relation to non-performing assets and that coincided with information that we had, so there was no conflict. It confirmed the information that we had in the regulator. But ... but ... but-----

Deputy Joe Higgins: But, may I say ... may I ask you, Mr. Neary, wasn't the information you had also just dependent on the banks without having gone in and really examined it independently?

Mr. Patrick Neary: Yes, yes, I mean, that is true. That information was dependent on ... it was extracted from the books and records of the bank by PwC and would have been made available to them by banks.

Deputy Joe Higgins: And then, Mr. Neary, considering that only two years later some of these banks had massive haircuts - up to 57% in the face value of the loan book - would a reasonable person be right in thinking, perhaps, that the information in September 2008 from the banks was less than frank?

Mr. Patrick Neary: I don't think you can necessarily deduce that, unless we are suggesting it was deliberately put forward by the banks to deceive Pricewaterhouse but, I mean, a lot happened between September 2008 - in terms of asset values and the collapse in the value of property - and even a year later, I mean, it was a different world. So, as far as I'm aware, the professional approach taken by Pricewaterhouse was ... was ... while it did rely on the banks ... but it questioned and interrogated the information.

Deputy Joe Higgins: Yes, but would you agree, Mr. Neary, that it's less than satisfactory - or is it satisfactory to your point of view - that there was not a verification process to get behind the figures?

Mr. Patrick Neary: Well, I think in the particular circumstances, what the ... PwC were being asked to do was to try and validate our assessment at that time of solvency of the banks, which, if you will, was also based on returns provided by the bank.

Deputy Joe Higgins: Mr. Neary, after the week of the bank guarantee, which manifestly came about as a result of massive failings in the leadership and the management of all the main banks, did you, as regulator, advocate an immediate sacking or resignation of leading executives and a change of leadership in the banks?

Mr. Patrick Neary: No, Deputy, that didn't arise at the time.

Deputy Joe Higgins: Why not?

Mr. Patrick Neary: The belief ... the belief was that the issues were attributable to liquidity problems, to ... in the market, that matters outside, I suppose, the control of the management of the banks. And there was no, I suppose, evidence to suggest that the portfolios of the banks were in the situation they were in.

Deputy Joe Higgins: But, by any standards, Mr. Neary, is it not the case that two institutions were basket cases and that was quite well known to you and to other major banks who complained vehemently about them? Why was the leadership allowed to continue in Anglo and INBS in particular?

Mr. Patrick Neary: I think in the aftermath of the guarantee ... you know, the guarantee was seen as addressing the ... the issue, which was one of liquidity. It ... it was some time later that it started to emerge that these, if you like, management weaknesses and that were present. And, I think, at that stage there was ... what happened was there were public interest directors appointed to the boards and, I think, a gradual replacement of the management started to happen at that stage.

Deputy Joe Higgins: Did you feel under political pressure, Mr. Neary, not to insist on changes at the top of the bank?

Mr. Patrick Neary: No, Deputy, I have to say I've never ... was never put under political pressure.

Deputy Joe Higgins: Can I go quickly to a document that's not in your core documents, Mr. Neary, but it was in Mr. Grimes's and it is going to come up here in front of you in a minute. This is a minute of a meeting on 25 September 2008. A very high-level meeting in which the Taoiseach, the Minister for Finance, the Attorney General, yourself and the acting Governor of the Central Bank and the Governor, I think, attended.

Chairman: Just talk away about that. If Mr. Neary is not familiar with it, I'll just give him time to read it. Okay?

Deputy Joe Higgins: Yes.

Mr. Patrick Neary: Yes.

Chairman: Are you familiar with the document, Mr. Neary? If not, I'll give you-----

Mr. Patrick Neary: I have it-----

Chairman: -----a moment there to read it.

Mr. Patrick Neary: I have it now, yes.

Deputy Joe Higgins: Okay. The attendances, in the bottom half-----

Mr. Patrick Neary: Yes, yes.

Deputy Joe Higgins: Okay?

Mr. Patrick Neary: Yes. Okay, I have that, yes.

Deputy Joe Higgins: Very high level meeting.

Mr. Patrick Neary: Yes.

Deputy Joe Higgins: Do you remember this meeting?

Mr. Patrick Neary: Yes, I ... it must be this. Yes, I was there. I mean-----

Deputy Joe Higgins: Okay.

Mr. Patrick Neary: -----I remember a meeting-----

Deputy Joe Higgins: It's a minute, Mr. Neary.

Mr. Patrick Neary: Yes.

Deputy Joe Higgins: If I take you to the one, two, three, the fourth paragraph from the top, "There was a discussion of various forms of State interventions." Do you remember that? Or can you see it, rather?

Mr. Patrick Neary: I can see that, yes.

Deputy Joe Higgins: Yes. "The FR [Financial Regulator] (Pat Neary) said that there is no evidence to suggest Anglo is insolvent on a going concern basis"-----

Mr. Patrick Neary: Yes.

Deputy Joe Higgins: -----etc. Now the next paragraph:

> D [David] Doyle noted that Government would need a good idea of the potential loss exposures within Anglo and INBS - on some assumptions INBS could be 2bn [€2 billion] after capital and Anglo could be 8.5 [€8.5 billion].

What did you take that reference of Mr. Doyle to refer to? Did you take it to refer to, as some have, that, when capital was exhausted, essentially those two banks were insolvent?

Mr. Patrick Neary: I certainly had no sense of any assessment from anybody of insolvency in either of those two banks at that particular time.

Deputy Joe Higgins: Well, what does that minute mean?

Mr. Patrick Neary: I don't know what that means. I don't know what that means. Was it a side remark? I certainly ... I'm not familiar with any evidence to ground that. I mean-----

Deputy Joe Higgins: But-----

Mr. Patrick Neary: -----it's an assumption. I don't know. I ... I genuinely do not know what that-----

Deputy Joe Higgins: Do you have a minute of that meeting yourself?

Mr. Patrick Neary: No, I don't, I don't. In relation to these minutes, the question was, at that time, that these minutes were ... or these meetings were taking place under the protection of the Official Secrets Act. That's what we were given to understand and there was caution expressed about people taking their own minutes-----

Deputy Joe Higgins: Okay.

Mr. Patrick Neary: -----and retaining their own minutes, so that's probably the only-----

Deputy Joe Higgins: But-----

Mr. Patrick Neary: -----minute there is.

Deputy Joe Higgins: -----Mr. Neary, should at least that warning have led you not to say a few weeks later on the "Prime Time" programme, that the issues of the exposure to property and the liquidity issues were totally unrelated? Isn't it quite clear that there is looming issues of insolvency here?

Mr. Patrick Neary: Well, I mean-----

Deputy Joe Higgins: Is it?

Mr. Patrick Neary: -----if that statement was made, certainly, Deputy. I mean, if that statement was made and was in some way substantiated by the meeting and, you know, that assumption had been validated, it would have changed everything but I don't remember that statement or that ... those assumptions being shared or discussed or in any way convincing arguments put forward with any evidence to support that. I have no recollection of that particular sentiment being expressed. But it's there in black and white and, you know, if that was the strongly-held view of the Secretary General of the Department of Finance, I mean, I think he would have intervened very strongly and I would have expected that he would have argued very strongly to protect that assessment, that he wouldn't-----

Chairman: For the record-----

Mr. Patrick Neary: -----have allowed anything go ahead.

Chairman: -----the note is Kevin Cardiff's note, it's not Mr. Grimes'. note or anybody else's. The note is of Kevin Cardiff's.

Mr. Patrick Neary: Okay, yes.

Chairman: Okay. Deputy?

Deputy Joe Higgins: Mr. Neary, I want to go back very briefly to the bubble period again. Did you notice, around the 2002-2003 period, when banks like Allied Irish Banks and Bank of Ireland began to borrow very heavily on the bond markets, as opposed to relying on their deposits, which was the traditional thing in Irish banks up to then, did you notice this? Did you attach any significance to this as being a massive change in the policy of the banks and particularly when it was being lent on for speculative purposes, construction purposes and property-related spending?

Mr. Patrick Neary: If the practice commenced in 2002, it would have predated the regulator and if that had kind of established itself, I suppose, as normal practice for them at that stage, it may not have registered. I don't recall it registering as a major issue at the time-----

Deputy Joe Higgins: But one of your juniors-----

Mr. Patrick Neary: -----for either of the two banks.

Deputy Joe Higgins: -----Mr. Horan, who was here yesterday, became quite alarmed around 2005, particularly having studied what happened with the crisis in the Scandinavian banking system in the '90s.

Mr. Patrick Neary: Sure.

Deputy Joe Higgins: Were you aware of that history of a big bubble in Sweden, for example, among others-----

Mr. Patrick Neary: Yes but-----

Deputy Joe Higgins: -----and the dangers that should then-----

Mr. Patrick Neary: But just before ... just on that point, just to go back ... I mean, we've kind of ... in 2002, you know, the borrowing in the euro markets and that is one thing. I mean, by 2005 I think that ... that was probably established practice for all practitioners across Europe, to be raising money in those ... in that form in the international markets. I wouldn't think there is anything necessarily unusual about that. But in-----

Deputy Joe Higgins: Was it a huge change for Ireland and should red flags have gone up?

Chairman: I'll take your final question as well at this stage now because I need to bring ... to move on. Is that your final question, is it?

Deputy Joe Higgins: Well ... I have one more.

Chairman: Can you do it now and I'll get both of them together?

Deputy Joe Higgins: Right ... okay. Mr. Neary, the fact that the legislation of 2003 made you a promoter of the financial industry and also its regulator, and Governor Honahan referred to it in his report as a conflict, and there was reference from Mary Burke yesterday that there was pressure that the domestic banks would not be seen ... sorry, that the I ... International Financial Services Centre would not be seen as an offshore-----

Mr. Patrick Neary: Yes.

Deputy Joe Higgins: -----account, by having lower standards-----

Mr. Patrick Neary: Yes.

Deputy Joe Higgins: -----than the domestic banks.

Mr. Patrick Neary: Yes.

Deputy Joe Higgins: -----the insinuation perhaps being that everything was lowered in terms of regulatory requirements. Did that fact put enormous pressure on you, as regulator, essentially not to become the heavy, because as Governor Honohan said, I haven't time to quote it, there was significant Government backing for the idea of the IFSC as a light-touch regulation place?

Mr. Patrick Neary: No ... the-----

Chairman: You're kind of quoting out of context but the question is made, Deputy.

Mr. Patrick Neary: No ... I-----

Chairman: Mr. Neary.

Mr. Patrick Neary: That's a kind of a ... of a very kind of a complex scenario because the IFSC was certainly very well established and had plenty of banks operating in the IFSC before the Financial Regulator was established and before that legislation came in. And certainly, going back to the Central Bank days which we inherited, it was ... it was firmly established that there would be no distinction made between the domestic and the international banks operating and that the international banks would be kept to the same standard of the domestic banks, rather than the other way around. And certainly there was never any conscious change in that approach within the regulator to make any distinction between the two or to lower the standards down to the lowest common denominator.

The ... this thing of the promotion ... was ... it was a very difficult concept and it was irreconcilable with the role of a regulator and it shouldn't have been there. And it's not an area other than in kind of ... speeches and presentations that were done by the chairman, chief executive, very infrequently that there would be any kind of real attempt at promotion other than to illustrate and define the type of regulatory approach-----

Deputy Joe Higgins: Yes.

Mr. Patrick Neary: ----- that we had.

Deputy Joe Higgins: But Honohan says in page 108-----

Chairman: Sorry, Deputy, we have to move on, we're out of time. Deputy Murphy, please.

Deputy Eoghan Murphy: Thank you, Chairman. Thank you, Mr. Neary. I'd like to return, if I may, to something that was raised briefly earlier. Its the five by five big developer exposure inspection that you instigated in December 2007.

Mr. Patrick Neary: Yes.

Deputy Eoghan Murphy: Was that instigated at your request?

Mr. Patrick Neary: Well, it was carried ... it was carried out ... I think we might have had discussion at the authority and it emerged from that discussion at the authority about credit and about the position of the larger exposures. I think that may have been how it came about-----

Deputy Eoghan Murphy: When you say "the authority", you mean the board?

Mr. Patrick Neary: Oh yes, yes. Exactly.

Deputy Eoghan Murphy: Okay.

Mr. Patrick Neary: From a discussion on some of these matters.

Deputy Eoghan Murphy: And following that inspection in September 2007, two high priority findings came back in relation to one institution, but there were several medium priority findings, and I'm reading here from the Honohan report page 70. The second medium-priority finding was that "The inspectors noted that some estimates provided to the inspectors as to the overall indebtedness of Group exposures appeared to differ significantly from data available to the inspectors." In one debtor connection alone in one of the banks, the banks were off by €1 billion. So they had miscalculated the indebtedness of one of their borrowers by €1 billion and your inspectors found that out. So what did you do after you learnt that information?

Mr. Patrick Neary: That finding is ... it was a medium, a medium finding, medium-priority finding. I have no recollection of that being escalated to me.

Deputy Eoghan Murphy: So, a miscalculation or-----

Mr. Patrick Neary: Yes, sure, it was ... it's a very serious matter and I'm surprised that that was ... that didn't come to my attention.

Deputy Eoghan Murphy: It wasn't escalated to you at the time.

Mr. Patrick Neary: No. No.

Deputy Eoghan Murphy: Okay, and would you have been surprised after your inspectors finding that out that they then only held a 20 to 30-minute debrief with the bank?

Mr. Patrick Neary: Yes.

Deputy Eoghan Murphy: And the question is posed in the Honohan report, "At this rate, how much regard can the banks have had for the inspectors?"

Mr. Patrick Neary: No, and I think, you know, that's, that's a reasonable comment to make and I find it very, very difficult to explain why that finding didn't exercise people in the banking supervision area more, that they would have escalated and we could have assessed to see was there anything we could do about it.

Deputy Eoghan Murphy: Was this ever brought to your attention while you were-----

Mr. Patrick Neary: No, I was never made aware of that finding.

Deputy Eoghan Murphy: Okay. Well, should it have been?

Mr. Patrick Neary: Well, I think it ... with ... when you look back on it and see it in stark relief, I think it's something that, you know, I think merited escalation, yes.

Deputy Eoghan Murphy: So it should have been brought to your attention?

Mr. Patrick Neary: Well, I'm trying to be as kind as I can to the people and the process and what engagement went on in banking supervision without jumping to conclusions. It may have been acted upon in banking supervision but I think what we're talk ... what we're talking about here was, was I made aware of it, and the answer is, "No." But that doesn't mean that it wasn't acted upon or some, some, some follow-up action happened.

Deputy Eoghan Murphy: According to the Honohan report, which is sourcing Financial Regulator files, which it can't cite for legal reasons, it says, "Despite this catalogue of banking deficiencies [uncovered in the inspection], the full implications of the obvious lesson[s] - that loan appraisal[s] had been wholly inadequate and personal guarantees could not to be relied upon - does not appear to have been taken on board by the regulatory system."

Mr. Patrick Neary: Okay.

Deputy Eoghan Murphy: So it would appear from that statement that the people working for you did nothing about that.

Mr. Patrick Neary: Well, that seems to be what it's suggesting but, you know, as I say, I made ... I made to, you know, not to jump to judgment in relation to what happened in the assessment carried out by people in banking supervision.

Deputy Eoghan Murphy: Do-----

Mr. Patrick Neary: And there ... it wasn't escalated and that's, that's, that's what, what I'm saying.

Deputy Eoghan Murphy: Do you take responsibility for the fact that the people working for you failed to realise the significance of what they found and failed to report it to you?

Mr. Patrick Neary: Well, I mean, I can't avoid taking responsibility for that. I mean, ultimately I was the chief executive of the organisation, and-----

Deputy Eoghan Murphy: Okay.

Mr. Patrick Neary: -----you know, it's regrettable that that happened.

Deputy Eoghan Murphy: Thank you. In March 2008, yourself and Governor Hurley approached the banks in what was known as a "green jersey" agenda. Do you remember this?

Mr. Patrick Neary: I've heard ... I've heard this label attached-----

Deputy Eoghan Murphy: Okay.

Mr. Patrick Neary: -----to those meetings that happened around that time.

Deputy Eoghan Murphy: You went to financial institutions to ask them to provide each other with funding support in order to maintain the financial stability of the system. Is that correct?

Mr. Patrick Neary: Yes, what happened was the Governor attended a conference of central bank ... a global conference of central bank governors, and as I understand it ... I understand this anecdotally from chatting to the Governor that the Governor of the Bank of England had mentioned to him that they were trying to organise some sort of a pool, a liquidity pool amongst the banks in London, to be ... to have a pool of liquidity available in case any of the smaller institutions required liquidity and that they could have a market solution to the liquidity problems. And the Governor thought this was worth pursuing here.

Deputy Eoghan Murphy: Okay.

Mr. Patrick Neary: Our Governor. Governor Hurley. And we had this ... we did have a series of meetings essentially with the larger banks to see would they be prepared. And, in principle, yes, they felt there was merit in it but at the end of the day they were saying, "Well, look, if we're going to commit to this we need them to have some form of backing from the Central Bank." So it kind of ... it, it never really progressed.

Deputy Eoghan Murphy: So the approach had nothing to do with the fact that five months previously, one of the pillar banks had cut off funding to one of the other banks in the Irish system?

Mr. Patrick Neary: No.

Deputy Eoghan Murphy: Okay. Did the board of the authority know that you were doing it?

Chairman: Know which?

Deputy Eoghan Murphy: Know that he was making this approach with Governor Hurley.

Mr. Patrick Neary: That these ... that these conversations were going on?

Deputy Eoghan Murphy: That yourself and Governor Hurley were going to the banks making these requests.

Mr. Patrick Neary: I think we would ... I think we would have. I can't say that with absolute certainty, but we had a principle in the regulator that anything like that was certainly advised to the board. So, I may have, you know, as part of my update to the board as part of the CEO briefing, I may have included references to that.

Deputy Eoghan Murphy: And did the Deportment of Finance know that yourself and the Central Bank were doing this?

Mr. Patrick Neary: I would imagine that, similarly that, that would be something that would have been mentioned to them in the DSG by Mr. Horan. He would have been aware of that happening, but I, I, I unless there's a record that Mr. Horan said it and I wouldn't know.

Deputy Eoghan Murphy: Okay. And do you feel that this would have been an appropriate time in which to make an intervention in the Irish banking system?

Mr. Patrick Neary: Well, no, it wasn't for that purpose. I think what Governor Hurley was trying to do was to have, if you will, he wanted to avoid, I suppose, a commitment of public funds to any temporary liquidity situation. If it could be solved by players in the market by having a pool which could support an institution with a temporary drop in liquidity, so be it. It was a concept but it never really, because difficulties emerged and issues and we never pursued it any further.

Deputy Eoghan Murphy: You wanted to avoid the risk of having to use public money? So the risk was there?

Mr. Patrick Neary: Well yes, I mean, well, at that stage ... and it derived from the conversation that he had had with the Governor of the Bank of England, and it seemed like a good idea. And there were liquidity strains emerging and I suppose what the governor was trying to do was, well if we could have a fund that could be utilised to support a bank with a temporary liquidity problem, and you know, presumably they would be able post security and all the rest of it but we didn't get that far. It kind of, it didn't really progress very far-----

Deputy Eoghan Murphy: Did the approach fail?

Mr. Patrick Neary: Pardon?

Deputy Eoghan Murphy: Did this approach fail?

Mr. Patrick Neary: Yes, it ran out of steam because I think the, the conditionality that the, that the banks had ... were minded to seek, you know, essentially meant that the Central Bank was going to be underwriting it so it kind of fell asunder after that.

Deputy Eoghan Murphy: You said that you left in December '08, but my understanding is that you left on 9 January 2009 and you stayed in office, in the building until the end of the month.

Mr. Patrick Neary: Well, yes, but I mean I was essentially the, the chairman essentially put me on gardening leave I ... I had ... I had essentially handed over my executive responsibilities at that stage.

Deputy Eoghan Murphy: Can you comment then on what occurred between 8 January 2009, when the Irish Government formally notified the ECB that they would be recapitalising Anglo Irish Bank, to then 15 January 2009, when they made the announcement that they would be nationalising Anglo instead? What, what led to the change of decision and what discussion did you have in this regard?

Mr. Patrick Neary: I had no involvement whatsoever in those discussions.

Deputy Eoghan Murphy: And is there any relationship to that decision and to your resignation?

Mr. Patrick Neary: No, my resignation tied into matters which ... may well emerge in the courts about knowledge that we, we might have had about certain matters relating to ... I'm on dangerous ground here, Chairman, but no, what you're talking about it didn't affect that.

Deputy Eoghan Murphy: This is my final question then if I may, Mr. Neary, in relation to the work of the domestic standing group, and discussions for draft legislation for the Minister to take ownership or nationalise a financial institution. You remember these discussions that were held in the DSG about this legislation?

Mr. Patrick Neary: Yes, and legislation, I believe, was drawn up, I never actually saw it but I understand it was drawn up.

Deputy Eoghan Murphy: Okay, but in the domestic standing group meetings, there was a discussion had, and just to quote a minute from the 17 April meeting, which we can't bring up because of 33AK; from the Central Bank' side it was mentioned, for example, that the Financial Regulator might wish to direct an institution not to pay out a dividend, cancel bonuses or-and dispose of assets etc, to include that in the legislation. And there's two parts to this question, why would the Central Bank be recommending that the Financial Regulator might wish to direct an institution not to pay out a dividend as part of that legislation?

Mr. Patrick Neary: Well it must be that ... the payment of a dividend, I think, is at the discretion of the AGM and they decide the, the shareholders. And I mean the payment of a dividend is an immediate hit on, on their cash, cash reserves. And in fact I think that question may have been prompted by the fact that one of the, one of the large banks in the midst of the crisis did actually pay a dividend and I think some eyebrows were raised that the dividend was paid at the particular time it was. Even though the dividend was declared and agreed some months earlier and I think the the assessment of the board in that particular institution was, you know, that it was important for them to-----

Deputy Eoghan Murphy: We have that in evidence, we have that in evidence.

Mr. Patrick Neary: Okay, okay.

Deputy Eoghan Murphy: This discussion happened before the board decided to pay that dividend. But in 2008, over €1 billion was paid in dividends by the banks to their shareholders and that ended up being paid by taxpayers. So why was this power not put into the legislation?

Mr. Patrick Neary: I have no idea why that wasn't put in.

Deputy Eoghan Murphy: Even though the Central Bank was recommending to the Financial Regulator that they might want to put it into the legislation?

Mr. Patrick Neary: No, I ... I'm sorry, I can't, I can't illuminate that point for you.

Deputy Eoghan Murphy: It's the domestic standing group, you were responsible, as the Financial Regulator.

Mr. Patrick Neary: I certainly was, but I mean ... I-----

Deputy Eoghan Murphy: You signed the MOU for the DSG, is that correct?

Mr. Patrick Neary: Yes, look, I'm not arguing with you at all; I'm not disagreeing with you at all, Deputy. I'm merely stating that that discussion may have happened; it may have been a suggestion. I have no recollection of being briefed on that, and, it clearly didn't find its way into the legislation.

Chairman: I'll afford a few minutes here, Deputy, okay, because in your earlier discussion with me, we established your relationship with the domestic standing group, that it was a delegated power that you had given to somebody with the assumption that they were feeding that information back to you, so I'll go back to yourself, Mr. Murphy, Deputy Murphy, there, if you want to pursue this a bit further.

Deputy Eoghan Murphy: Well, I mean, I think I've pursued it, Chair, as far as we can if the regulator is saying that you don't recall ... I mean, I think it's amazing that the Central Bank, without trying to pass a judgment, would be thinking that the Financial Regulator might seek to have this included in legislation that was being drafted at that time by the domestic standing group for which you were responsible. It ended up in a €1.2 billion payout to shareholders, which the taxpayers then had to fund.

Mr. Patrick Neary: Yes, yes, yes.

Deputy Eoghan Murphy: And you don't recall this discussion, and you don't recall not looking for the powers, or looking for the powers?

Mr. Patrick Neary: No. I wasn't at that meeting, right, so let's be clear about that-----

Deputy Eoghan Murphy: But would you have been briefed on that meeting?

Mr. Patrick Neary: Well, I ... certainly, my recollection is that I was certainly kept up to speed on issues and matters that were in progress in the domestic standing group. That does not ring a bell with me.

Deputy Eoghan Murphy: Would that be a serious change in powers to be able to direct a bank as to whether or not it could pay out a dividend or cancel bonuses; or dispose of an asset?

Mr. Patrick Neary: It would be, because-----

Deputy Eoghan Murphy: So, why wouldn't you be briefed about it?

Mr. Patrick Neary: No, in the circumstances that, if the dividend wasn't ... hadn't been declared, I think it becomes a legal obligation ... as I understand company law, that once you declare a dividend, it's kind of, becomes a liability, and you have to pay it out to your shareholders; now I could ... I can be corrected on that. I would have contended that we would have had the powers to direct the bank not to pay a dividend before it was declared, and before it became a liability, so before they ever went near the AGM, and proposed the dividend, we could have, we could say to a bank, and we could put a direction on their licence, "You are not to pay dividends".

Deputy Eoghan Murphy: You had that power already?

Mr. Patrick Neary: I think we would have-----

Deputy Eoghan Murphy: So why didn't you exercise it?

Mr. Patrick Neary: I think we had the power.

Deputy Eoghan Murphy: Why didn't you exercise it in 2008?

Mr. Patrick Neary: I think we had the power-----

Deputy Eoghan Murphy: Why didn't you exercise that power in 2008? €1.2 billion was paid out.

Mr. Patrick Neary: Well, I ... I ... I can't recall any consideration being given to that at the time.

Deputy Eoghan Murphy: But do you take responsibility, then, for the €1.2 billion paid out in dividends in 2008, which you could have stopped?

Mr. Patrick Neary: I ... I ... let's be clear on this ...I'm the chief executive ... was the chief executive of the authority, and in that, in that sense, whatever happens in the organisation, the responsibility rests with me. And this question wasn't addressed. These banks declared their dividends, and paid their dividends. With hindsight, I suppose, if we had any view that the liquidity situation was going to emerge as tight, as badly as it is, that is something we may have considered, but we didn't consider it.

Deputy Eoghan Murphy: I beg your pardon, but you were already considering it, because you were going to the banks in March, because you were worried that they wouldn't be funding each other, and when you went to the banks to ask them to put together a private pool because you were worried about the risk of public money having to be used, they said, "Okay", but with a backing from the Central Bank, public money, and you said, "No", to them.

Mr. Patrick Neary: Okay, I accept that point, that that is true.... put that construct ... I can't recall that there was any ... evaluation of that particular matter in relation to dividends at the time. But I think, in relation to the, to the discussion we've had, if we wanted to stop a dividend, would we have had the powers? And I venture to answer in a constructive way, that yes, I believe we would have had the power to restrict the payment of a dividend in advance of any dividend being paid.

Deputy Eoghan Murphy: And you did not exercise that power.

Mr. Patrick Neary: But we did not exercise that power.

Deputy Eoghan Murphy: Okay. I'm finished then, Chairman. Thank you.

Chairman: Senator Susan O'Keeffe.

Senator Susan O'Keeffe: Thanks, Chair. Going back, if I may, just to clarify a couple of things that you mentioned earlier. You say you'd played a few rounds of golf with Sean FitzPatrick and Willie McAteer, and then, you didn't play any more golf with them, is that correct?

Mr. Patrick Neary: Certainly not since the early days of when I was appointed as prudential director.

Senator Susan O'Keeffe: Okay. Why did you stop playing golf with them?

Mr. Patrick Neary: Because I ... I ... I felt that, you know, at that stage ... I just felt it had become inappropriate that, you know, that kind of engagement should go ahead. I think a greater consciousness was starting to emerge that, you know, there was a kind of a conflict, if you will, between our role, as a regulator, and that kind of close engagement with individuals.

Senator Susan O'Keeffe: Would you have called them friends?

Mr. Patrick Neary: No, I wouldn't have ... they wouldn't be close friends. They were ... they were people that I knew, strictly and traditionally, from a golfing background, because we were part of a society that had grown up over years - a golfing society - and had ... I suppose, the contact with those people continued.

Senator Susan O'Keeffe: Did you ever play golf with Brian Cowen or with any politician?

Mr. Patrick Neary: No.

Senator Susan O'Keeffe: No. Did you ever have any private meetings with politicians across this period of time when you were the regulator? Because we've discussed lots of, sorts of, private meetings today.

Mr. Patrick Neary: One-to-one meetings?

Senator Susan O'Keeffe: Yes.

Mr. Patrick Neary: No, I had no one-to-one meetings but certainly there were occasions when representatives from political parties would come and maybe we'd give them briefings about regulatory developments and that. But there would be a group of people assembled to do that. So that would be normal enough, yes.

Senator Susan O'Keeffe: At the beginning of the contact for difference discussions that you began to have, did you treat that as a private matter ... that somebody had trusted in you to tell you the rumour or did you immediately inform your colleagues? Did you inform the Minister for Finance? Did you inform the Taoiseach? Did you have an emergency meeting? What did you do?

Mr. Patrick Neary: When ... when Mr. Drumm approached me first it was in a very exploratory, informal way-----

Senator Susan O'Keeffe: Yes, and you've said that.

Mr. Patrick Neary: -----okay? And ... but I did refer the matter to a colleague in one of the markets departments and I asked him to see could he make inquiries, had we any statistics, had we any way of finding out any information. So, yes, I immediately referred that matter to a colleague and-----

Senator Susan O'Keeffe: And did you ever refer to the Minister for Finance or to the Taoiseach's office or-----

Mr. Patrick Neary: No. No.

Senator Susan O'Keeffe: -----or to the Central Bank, to the Governor?

Mr. Patrick Neary: I have no recollection of bringing that to the Governor's attention at that time.

Senator Susan O'Keeffe: Because?

Mr. Patrick Neary: Well, no "because". As I say, there was no hard facts. It was Mr. Drumm coming in and saying, "Do you know anything about this rumour? Have you anything?" The rumour was out there and it was clear that Mr. Drumm ... well, if I can believe that his approach to me was, you know, above board, he seemed to ... to be trying to establish was there any truth in this rumour and did we know anything about it. So, I took that in good faith at the time.

Senator Susan O'Keeffe: No, that's fine. Did you ever have a meeting off site with, Seán Quinn or with Seán FitzPatrick ... out of your own office, I mean? As a private meeting?

Mr. Patrick Neary: As a ... in a private meeting?

Senator Susan O'Keeffe: Yes?

Mr. Patrick Neary: No.

Senator Susan O'Keeffe: No. Okay. When you turned up the night of the guarantee in Government Buildings, with your chair, who had invited you to that meeting?

Mr. Patrick Neary: Oh, the chair came to me, because he was in the office next door, and he said, "We have to go up to the Department of An Taoiseach." Right? So the ... the request for us to go to the Department of An Taoiseach came in through the secretariat, I presume, and because the chair ... I went to the chair first and he came in to me and said, "Listen, we have to go to this".

Senator Susan O'Keeffe: Can I just refer to a letter ... to a meeting that took place on 18 September. This document is already in the public domain, but not in your core book, but it was a meeting that Michael Somers John Corrigan, Brendan McDonagh, Kevin Cardiff, David Doyle, John Hurley, Tony Grimes, Brian Halpin, Jim Farrell and Patrick Neary all attended. And, at this point, the conclusion that John Hurley came to was to put a liquidity facility in place as soon as possible and then look at how to deal with the broader issues over the next week or so. This was particularly in relation to Anglo. Now, that never seems to have happened, I don't think, that a liquidity facility was put in place, and the broader ... or was it?

Mr. Patrick Neary: The ... the ... the Governor-----

Senator Susan O'Keeffe: It seems like a piece of advice that wasn't followed.

Mr. Patrick Neary: Well, you see, the Governor and the Central Bank, in relation to those ... those arrangements, may well have put that liquidity in place because that would have been all about validating collateral, putting various collateral in place, making sure they had the assets and the haircuts and that. That was a ... that's a technical matter that has to be done under ... as I understood it, EU ... sorry, excuse me, ECB arrangements. That wouldn't necessarily involve us, that was a matter, I think, for the Governor. And, you know, that's really ... I would ... explains that.

Senator Susan O'Keeffe: Okay. Given the level of crisis that was occurring at this time, how much, if any, contact did you have with European institutions, with the ECB, with anybody in Europe yourself?

Mr. Patrick Neary: No. They ... those relationship would have been handled through the Governor, through the ECB and the European communities. No, I ... I wasn't involved at any of those contacts.

Senator Susan O'Keeffe: Were there contacts happening?

Mr. Patrick Neary: I think the prudential director may have been in ... keeping in fairly close contact with his counterpart in the UK - literally comparing notes.

Senator Susan O'Keeffe: But not in Europe?

Mr. Patrick Neary: Not in Europe that I'm aware, no.

Senator Susan O'Keeffe: You mentioned earlier when Deputy Phelan raised the matter of the NTMA getting involved with meetings because there was a perception about the Department of Finance being concerned about the Central Bank, and you said yourself that you felt that there was some concern there. And you said, I think - forgive me if I'm ... haven't got this correct - that there were several meetings at Farmleigh that you were not invited to.

Mr. Patrick Neary: Correct.

Senator Susan O'Keeffe: You might just elaborate for us what that was about?

Mr. Patrick Neary: Well, I ... I think-----

Senator Susan O'Keeffe: About what time period we're talking about.

Mr. Patrick Neary: Well, I think ... as far as I remember, Senator, after the guarantee, the Minister of Finance launched a series of meetings with the banks. I think he was trying to explore with the banks where ... now that they had ... were in receipt of a Government guarantee, to what extent that could be built upon through - maybe consolidation of the banks and mergers, and whatever - and he was exploring those various options. And I just felt it's somewhat unusual that the regulator wasn't invited to participate in those.

Senator Susan O'Keeffe: Did you feel, coming up to the night of the guarantee that the regulator's office, if you like, was now somewhat slightly detached from what was happening?

Mr. Patrick Neary: No, I wouldn't say detached. But I mean, I suppose the ranking of the players would have changed. Certainly, the Department of Finance was the main driving force at that stage. They were in charge, if you will, of the solution of the problem. The Central Bank, being the people with the cheque book, were certainly up the rankings, and we would have ranked next, I think, in the pecking order in so far as, I suppose, our job was provide the information, the facts, the solvency, the liquidity information, and we were delivering that. But, you know, it got to a stage where the Department of Finance was managing the situation, were driving the situation, and the Central Bank were trying to put the liquidity arrangements in place to see ... to determine liquidity solutions and that.

Senator Susan O'Keeffe: Do you feel your advice, your Financial Regulator's advice, was heeded, if, indeed, you gave specific advice? Do you believe your advice was heeded on the night of the guarantee, or do you feel other people had already made the decision?

Mr. Patrick Neary: No, well you see, I've resiled from I'm saying that we gave advice. I ... we certainly we voiced a concern about choosing one option over the other. And I think we just wanted to alert the people in the room which would be making the decision, you know, that there might be consequences for going one route over the other. And we were worried, genuinely, that there would be confusion within the marketplace if different messages were sent out.

Senator Susan O'Keeffe: Can I ask you then - in your own statement on page 18, you say when you arrived at the meeting you say various things, "Mention was also made of the fact that the two larger banks had sought a guarantee for their deposit holders from the Government earlier that afternoon."

Mr. Patrick Neary: Yes.

Senator Susan O'Keeffe: Now, when we asked the banks, that's not ... they said they had asked for the meeting in order to tell the Government about the gravity of the situation because of the problem with Anglo.

Mr. Patrick Neary: Yes.

Senator Susan O'Keeffe: They never said they had asked for a guarantee for their own depositors. So perhaps you could elaborate for us?

Mr. Patrick Neary: Well, that's my recollection that it emerged from the meeting that the banks were ... had come in in the afternoon. Now, maybe I made ... maybe I ... I made a jump, but I have to be true to my recollection-----

Senator Susan O'Keeffe: Oh yes, absolutely.

Mr. Patrick Neary: -----but that's why I put it in. I took it from what I had heard in the discussion around the table, that the two banks had been in and they had looked for a guarantee. And that's my recollection, but that's-----

Senator Susan O'Keeffe: But did that-----

Mr. Patrick Neary: -----what I heard, and I have to be true to that.

Senator Susan O'Keeffe: Sure. But did that then form, as you sat around in that first portion of the meeting, did that form part of the conversation, that those two banks, the pillar banks, also needed to be guaranteed?

Mr. Patrick Neary: Yes, I think it probably did because the guarantee option certainly was, you know, to the forefront of considerations even at the first meeting. I mean, all the options were put on the table but, clearly, you know, the guarantee-----

Senator Susan O'Keeffe: It was to the fore?

Mr. Patrick Neary: -----the guarantee, in my opinion, was to the fore, even at that stage.

Senator Susan O'Keeffe: For all of the banks at that stage?

Mr. Patrick Neary: No, no, no, no, not for all the banks but it was certainly, you know, a very important option.

Senator Susan O'Keeffe: Okay, just clarifying ... I'm sorry, Chairman ... just clarify that for us because we are ... we have constantly been confused about this. I think you said earlier on that a consensus-----

Chairman: This is your final question now.

Senator Susan O'Keeffe: Yes it is. A consensus had emerged over the days before the guarantee ... the night of the guarantee, that a guarantee was the thing. Now-----

Mr. Patrick Neary: Yes, well-----

Senator Susan O'Keeffe: -----hang on just ... on that night in that first slot of the meeting, are you saying that there was still only a partial guarantee for some banks still being discussed or was it a blanket guarantee at that first part of the meeting?

Mr. Patrick Neary: No, I think at the first part of the meeting, all the various options that could be put into play were touched on like nationalisation, guarantees, guarantees for some ... now liquidation never ... was never an option that was discussed on that particular night, so it was going to be nationalisation or guarantees or some sort of a combination. And the meaning I took out of it was that before the day was out, that there was going to be some combination and that ... and my view was that the banks had indicated already that day what they would like to see coming out for them and that was the message I had taken out of the meeting. But that's my ... I'm just being true to that recollection. Other people may contradict that because I may have picked it up incorrectly in the discussion.

Chairman: Okay, thank you very much. Mr. Neary, I just need to deal with a procedural issue and this is entirely at your discretion. By my calculation there's maybe about 20 minutes, 30 minutes maximum left in today's hearing. If you wish to choose to take a break to end ... before we complete proceedings, that's entirely your call or if you choose just to continue the line of questioning for another 20 minutes or 30 minutes, we shall be able to conclude by then.

Mr. Patrick Neary: Keep going, Chairman, that's fine by me.

Chairman: Okay. Senator Barrett.

Senator Sean D. Barrett: Thank you, Chairman, and welcome back, Mr. Neary. The contrarians that you were describing to the Chairman there a while ago, what were they contrary about and where were they contrarian?

Mr. Patrick Neary: I think what I understood the Chairman to be referring to was comments made by prominent economists and, you know, to what extent that account was taken of those remarks.

Senator Sean D. Barrett: But these ... I understood the Chairman ... was contrarians internal to the Financial Regulator and internal in the Central Bank. Was that the group you were describing to the Chairman?

Chairman: If the Chairman could clarify, it was contrarians within ... inside your own institution.

Mr. Patrick Neary: Sorry, sorry.

Chairman: Back to you so, Senator. You're all right.

Mr. Patrick Neary: I'm completely confused now, Chairman.

Chairman: Join the club.

Senator Sean D. Barrett: I wish to re-enter the Chairman's question about the internal contrarians. Yes, thank you.

Mr. Patrick Neary: I have no strong feeling that there was a strong contrarian view emerging in the organisation. You know, the drivers of the financial stability report were the economic unit in the Central Bank and they would have taken account of ... presumably, they would have taken account of all views coming in to a consensus that they would then present further up along the line.

Senator Sean D. Barrett: Were there contrarians at the board level?

Mr. Patrick Neary: No, I think the discussions at the board level ... consensus was reached pretty quickly at the board level. There would be discussion about issues and that and I think more about, like, as we talked already about tone and things like that but I have no recollection of anybody putting up their hand and saying: “I fundamentally disagree with this.”

Senator Sean D. Barrett: Thank you. Now, Vol. 1, if I may bring you to page 118. Thank you.

Mr. Patrick Neary: Yes.

Senator Sean D. Barrett: These are minutes of meetings and ... the particular one: “An IFSRA update for the CBFSAI Board [on the] ... in May 2004 indicated that property Lending [at] (61%) and Development Lending (16%) were the main concentrations in the portfolio of Bank A. An internal sectoral limited of 20% was mentioned” and then it goes on that the, “Minutes of [the] ... Meeting the following month indicate that an answer was demanded from the bank but no further action was taken.” At a combined 77%, where the limit was meant to be 20%, was that an adequate response to that situation?

Mr. Patrick Neary: That meeting ... board meeting in May 2004-----

Senator Sean D. Barrett: That’s the one, yes.

Mr. Patrick Neary: -----they ... the authority said they wanted this matter pursued. A letter was issued to that bank on 7 July and a response came back on 13 July accepting the findings and putting ... addressing the issues that were raised in that ... in that particular ... in the particular issue.

Senator Sean D. Barrett: And did the 77% go back to 20%?

Mr. Patrick Neary: Well, no, I mean, the 77% ... the property lending and the development lending remained as is. The ... there was further ... there was further analysis provided in the response about the spread of that property lending - the 61% - and the geographical split and also the ... and elaboration of the sectoral split. I have a couple of notes here that I took and dividing it up between-----

Senator Sean D. Barrett: Yes, I think you’ve dealt with it I ... I’m satisfied, thank you, but it’s just that we’ve other questions and I see the clock running down. Now, you referred - with Deputy Doherty - to the very small number of people who were at the core of this ... that concentration. There was also, within that small number of people, a massive investment outside Ireland. Did that come to your attention in regulating those property transactions?

Mr. Patrick Neary: Yes, I mean, there was a geographical diversification within the book.

Senator Sean D. Barrett: Well, you call it diversification. Could it also be called a disaster, that the Irish taxpayer had to bail out people who had no transactions within the jurisdiction, that it was no benefit at all if people borrowed from banks, which then became insolvent, to engage in property transactions in other countries? Should that not have been a concern?

Mr. Patrick Neary: Well, I suppose, we'll have to wait and judge the outcome of that, Senator. I mean, to what extent the assets that were acquired and funded by the banks and were in the banks' portfolio ... how things transpired in the end, I mean, I don't know to what extent the values of .. of prime assets in London - property assets - did they behave the same way as assets here? Have they regained their value now? I mean, I seem to recall that some report from NAMA saying that the assets that they had acquired in London had taken very little diminution in value.

Senator Sean D. Barrett: Were you surprised by the 61% discount that NAMA applied?

Mr. Patrick Neary: Well, I was because it indicated the severity of the ... the sharp correction in property that I don't think was foreseen by anybody.

Senator Sean D. Barrett: Could I move on in that section, if I may? You have this group, in the first half of 2006, on page 122, said ''*the funding gap continues to widen, suggesting that the risk of a country-specific shock could pose liquidity or refinancing risks for banks*''. That was in the beginning of 2006, two and a half years out from the crisis. Nothing seemed to follow from that finding.

Mr. Patrick Neary: Well, that was at the interim... that was interim financial stability report and the central conclusion from that was that ''the banking system remains robust when measured by ...[asset quality], solvency, liquidity [current shock-absorption capacity] ... and the system ... leaves it ... well placed to withstand pressures from possible adverse economic and sectoral developments''. That's ... that's what ... that was what the central conclusion was from that.

Senator Sean D. Barrett: Moving on a year and a half, if I may, it says ''the tone and comment in the Financial Stability Report will be of particular importance and sensitivity''. So we are getting another year closer to the crisis and the minutes are worried about tone and comment-----

Mr. Patrick Neary: Yes-----

Senator Sean D. Barrett: ----- rather than anything quantified or anything precipitating a need to do something rather than write, you know, rather soporific minutes.

Mr. Patrick Neary: Yes, that's a fair point, Senator. I think it's one which we touched on earlier on that, in the whole context of financial stability, that it's disappointing that the reports that were issued, I think, offered no solutions or suggested courses of action to be followed up to kind of address the situation.

Senator Sean D. Barrett: And the last one we have of those minutes, page 125, there's mention twice of communications relationships, relationships communications ... at that stage was it more sociology than bank regulation?

Mr. Patrick Neary: That had nothing to do with banks. That particular ... that particular document, in the second half of 2007, was related to the collapse of a couple of conduits who were not regulated whatsoever by the regulator. But it happened, I think, in August, and I suppose the quietest month of the year and I think we were slow in our response, in our public response to dealing with the fall-out from those conduits. And, you know, it called in to question then ... there was a mix-up, well, were we responsible or not and you know, what did we supervise and what we didn't, and it was an unfortunate kind of a-----

Senator Sean D. Barrett: Thank you, yes. There's lessons learned from recent events. You mentioned in your statement that there were 86 people working in the economics section.

Mr. Patrick Neary: Yes.

Senator Sean D. Barrett: And none ... no economists in your section. Did that ever arise, "Let's get some of the economists upstairs down to help us in this vital area"?

Mr. Patrick Neary: No, and I think ... I think that's ... this brings us back, I suppose, to where we started off this morning talking about principles-led regulation, that it wasn't intrusive enough and I think, you know ... Dr. Honohan is right that the ... a more intrusive approach would have been desirable and I think economists would have had a great role is assisting the accountants and that, in that ... in a more intrusive review of banks.

Senator Sean D. Barrett: And calling on your 38 years of experience in central banking as well, I think the principles-----

Chairman: A question, Senator.

Senator Sean D. Barrett: Thank you, Chairman ... the principles doesn't work. Professor Black said fines would probably be paid by the company. Are we really looking for compliance at imprisonment in this sector for breaches?

Mr. Patrick Neary: It may well come to that, indeed, Senator.

Senator Sean D. Barrett: Thank you, Mr. Neary, and thank you, Chair.

Chairman: Thank you, Senator Barrett. And Mr. Neary, I just want to move towards a wrap-up. I've just got a couple of questions for you and then I'll invite the both leads in and if there is anything further you would like to add by means of closing comments today, I'll certainly welcome them from you. Just to deal with one matter and maybe if you could answer this for me, please, is: who did you feel you were accountable to during your time in the role as Financial Regulator?

Mr. Patrick Neary: To the authority.

Chairman: The authority?

Mr. Patrick Neary: Yes.

Chairman: Could you explain what you mean by "the authority" so I can be specifically clear on that?

Mr. Patrick Neary: Okay. In my day-to-day relationship, I would have dealt with the chairman and the chairman would have set my strategic targets and that in accordance with the strategy and he would have monitored my performance and all of that. I would have had that discussion with the chairman as a kind of a line relationship. But in relation to the delivery of the strategy and to the other functions, the administrative functions that were delegated to me, I had to account to the authority for those.

Chairman: Okay.

Mr. Patrick Neary: So the authority ... the power and the responsibilities rested in the authority, not in me. The authority then delegated certain administrative responsibilities to me to carry out its functions and it also agreed a strategy which we had to carry out as executives.

Chairman: And was the authority then ... who, in turn, was the authority accountable to?

Mr. Patrick Neary: Well, the authority had a mandate under the law, and it had to deliver on its mandate under the law ... and the Minister appointed it. I mean-----

Chairman: Do you mean the Financial Regulatory Authority now or are we talking to the overall board?

Mr. Patrick Neary: No, I'm talking about the Financial Regulator, the IFSRA authority, the ... the ... that's ... the IFSRA authority had the ... had the legal mandate to administer the legal regulatory requirements, all the directives, etc., that have ... across the insurance regulations, the markets regulations, the banking regulations, all of that-----

Chairman: Right, you see, it's not now that it's like the Holy Trinity over there, it's a mystery that we have to understand any theologists, but I am trying to get a feel as to what is actually over there. Is it the board ... like it's the CBFSAI or whatever it was, there's the board above that.

Mr. Patrick Neary: Right.

Chairman: Is that the board you're talking about when you're talking about the authority?

Mr. Patrick Neary: No, the authority is IFSRA, right, and the board above that is the CBFSAI, which is, you know ... these acronyms are very difficult. But let's say that there's a legal entity, let's call it a central bank for the sake of argument, for simplicity, and carved out of that is a subset, like, which is the authority, the regulator. The regulator legally acted, you know, in the ... legally was part of the Central Bank and all the actions it took was in the legal name of the Central Bank. But the law, as it was structured, to this carved out entity within the overall entity, gave us direct responsibility for discharging the obligations ... the legal obligations in respect of regulation.

Chairman: Okay. I just want to wrap up on two themes that need to just be kind of sufficiently covered. Why, in your opinion, did the Financial Regulator, and not the Central Bank, as guardian of ... as guardians of financial stability, host the financial round-table meetings with the banks?

Mr. Patrick Neary: Why didn't they?

Chairman: Yes. Would they not have been more appropriate in that regard?

Mr. Patrick Neary: The ... no, the Central Bank and the regulator attended the round-tables, and ... so it was a kind of a joint exercise.

Chairman: Okay, and can I maybe just ask you, as to the main purpose of these financial round-table meetings, were they to alert stability issues-----

Mr. Patrick Neary: Yes.

Chairman: -----or was the main purpose to affect moral suasion, to limit lending growth, and relaxation of lending policies?

Mr. Patrick Neary: I think it was in the context of the financial stability to, I suppose, outline the views of the Central Bank in relation to financial stability, and to communicate those views, and get a response.

Chairman: Okay, and did you feel that the intended message of the banks was brought home?

Mr. Patrick Neary: It's very difficult to gauge, I mean, you have to assume that when you're sitting down dealing with very senior people and, you know, you're in a discussion in relation to financial stability, that they would pay heed to what was said.

Chairman: Okay. Finally, just on that matter, do you feel that the banks were sufficiently aware of the risks of their business policies, their business models and their business products?

Mr. Patrick Neary: Well, you know, with hindsight, Chairman, I'm afraid I don't have much faith anymore in any of their business practices or policies or procedures, I regret to say. And I ... going back to the days of principles-led regulation, I think, you know, that was an essential core failure of that approach, was to put trust into these people.

Chairman: Okay, and I think you maybe just answered my next question for me, which was the type of products for home loans that were on offer between 2000 and 2006, were they a matter of concern for you?

Mr. Patrick Neary: Well, I think we touched on that earlier, Chairman, it was a kind of the professed position of the authority that a wide range of options should be available to customers, and that, you know, if there's ... if a 100% mortgage, for example, was considered suitable for a particular cohort of customers, that they should have the opportunity to avail of that and be advised accordingly and sold the product properly. And, you know ... there's merit, I suppose, in that approach.

Chairman: So maybe if I can ask you then, which is the last question, why was nothing done by the Financial Regulator to prevent a further relaxation of lending policies well before housing prices were clearly overvalued?

Mr. Patrick Neary: Just-----

Chairman: In this regard can we ... can I ask you, why was nothing done by the Financial Regulator to prevent further relaxation of lending policies well before house prices were becoming clearly overvalued? Like, what we have is a situation I ... when ... before you came to office, where somebody went down to get a mortgage, they had to put their income on the table, that was very heavily scrutinised, they were granted a mortgage on a ratio of maybe three times that, they had to come up with a 10% deposit on the property, they were expected to clear their mortgage within 20 years, and there was no such thing as 100% mortgage, and all the rest of it, and the house price was kind of somewhat within two to three times their income, and they would have it cleared in 20 years.

Mr. Patrick Neary: Well, I'm going to-----

Chairman: By end of your tenure it was out to 40 years, there was 100% mortgages, there was ... the ratios were eight to ten times people's incomes, and it goes on and goes on, and the fallout which is massive negative equity, because all of this credit and the relaxation of the application process to get a loan was becoming so stretched that more ... to keep up with the increasing prices of houses people were being facilitated more and more with a more elasticated product.

Mr. Patrick Neary: Certainly, the regulation was one aspect of this. I mean, I think there were probably other influences in the market as well. You know, there's two elements to what you are saying there, Chairman. First of all, there's the credential element, and then there's the consumer choice element. And I know an erstwhile colleague, the consumer director will be in talking to you in a couple of weeks and I think she'll be able to elaborate very well on the consumer dimension. In relation to the prudential dimension, the requirement was imposed that for new mortgages, they should be stress tested at 2.75% above the ECB rate for affordability purposes. So that was the prudential measure that was put in and also the increased risk rating was put in to increase the capital buffer. But the consumer dimension ... I mean, the former consumer director when she comes in, I think, will be far better, more eloquent at explaining the attitude of the authority to that.

Chairman: Okay, thank you. I'm going to move. Deputy Doherty, you've five minutes, then followed by Deputy Phelan and closing comments from yourself.

Deputy Pearse Doherty: Thanks, Mr. Neary, again.. Mr. Neary, when I was asking you about the PwC assessment and the Merrill Lynch assessment, you said it was to confirm what you knew yourself. Can I ask you are you ... were you made aware at the time of the Merrill Lynch report?

Mr. Patrick Neary: Was I aware of the Merrill Lynch report?

Deputy Pearse Doherty: Yes. Were you made aware of the findings?

Mr. Patrick Neary: Yes, I wasn't at that particular meeting where that was discussed but Mr. Horan would have briefed me, I think, after that.

Deputy Pearse Doherty: Were you satisfied with what was in it? Did it concur with your own assessments within the Financial Regulator in terms of the funding position and liquidity position and capital position of the banks?

Mr. Patrick Neary: Well, I'm not terribly sure that I can recall exactly what was in the report. It more or less ... I felt, my recollection of that report was that it went through various options rather than an assessment of individual institutions. Now I'm not sure but-----

Deputy Pearse Doherty: Maybe I will draw you to Vol. 2 of Patrick Neary core documents.

Mr. Patrick Neary: God, I missed that, I'm sorry.

Deputy Pearse Doherty: It is the memorandum of the Merrill Lynch report and there's been a bit of discussion earlier on in relation to the David Doyle note and I'll just come back to that in a minute. In relation to Irish Nationwide, this is on page 52 when you're ready.

Mr. Patrick Neary: Okay.

Deputy Pearse Doherty: In relation to Irish Nationwide, the Merrill Lynch report says ... it goes on to talk about the concerns of the influence of the chief executive. It says - this is the point here: "In the extreme stress case analysis the total writeoffs including loss of interest income would just deplete most of INBS reserves of €1.8 billion."

Mr. Patrick Neary: Okay.

Deputy Pearse Doherty: So Merrill Lynch is coming to the conclusion at the night of the guarantee or just before it, that extreme stress case scenario, INBS's capital is nearly entirely extinguished. In relation to Anglo Irish Bank, they say: "If one was to apply INBS stress case scenario [to] the writeoffs ... would [by] deplete ordinary shareholders in the lower category subordinated debt of €7.5 billion". Now, Anglo Irish Bank had about €9.6 billion, €9.7 billion of capital available at the time, so it would have depleted about what? ... about 80% of its capital and left it very close to insolvent. Was that your assessment?

Mr. Patrick Neary: No, that certainly gives a context to the remarks that you referred to earlier on from the Secretary General of the Department of Finance. That seems to tie in with what he's saying. No, that was not our assessment. I don't know what the extreme stress case analysis that they referred to was, and whether they stood over it or whether they backed it up at that meeting. It would appear to me that they must have backed off because otherwise the Secretary General would have taken a much tougher line, I think, in relation to what transpired. In relation to the first of those institutions you mentioned, there was also another group of consultants that carried out an assessment because the ... that particular institution, part of its strategy in previous years was this was up for sale, and there was a number of people interested in buying it-----

Deputy Pearse Doherty: Yes, I am aware of that. So, the question is, as the Financial Regulator-----

Mr. Patrick Neary: Yes.

Deputy Pearse Doherty: -----Merrill Lynch only had a number of days and suggested extreme stress case in INBS, their capital is nearly entirely wiped out and Anglo's capital depleted by about 80%-----

Mr. Patrick Neary: Yes.

Deputy Pearse Doherty: -----leaving them close to insolvency.

Mr. Patrick Neary: Yes.

Deputy Pearse Doherty: You dispute ... is that what your evidence is?

Mr. Patrick Neary: No, I'm not disputing that. All I'm saying, that that did not reach me, part of the briefing that there was any question mark over Anglo or Irish Nationwide opposed by-----

Deputy Pearse Doherty: Mr. Neary, this is ... sorry to interrupt you, this is the report that you're just after confirming that you had access to.

Mr. Patrick Neary: No, no, I ... this is the report that ... I understood that this was the report that was presented at the meeting that weekend; no?

Deputy Pearse Doherty: No, there was a presentation, I think, a couple of days earlier-----

Mr. Patrick Neary: Okay.

Deputy Pearse Doherty: -----to Cabinet. This is a memorandum from Merrill Lynch, which details the summary description of the reviewed institutions, goes on to annex 1-----

Mr. Patrick Neary: Okay.

Deputy Pearse Doherty: -----and 2 and gives an outline of all of the capital, all of the issues and then the options in relation to the number of options that the Government would have in terms of guarantee, nationalise Anglo, liquidity and so on and so forth. This is the full report.

Mr. Patrick Neary: Okay. Just on that, I just see there on the front page this is the report based on information at 6 o'clock on Sunday, 28 September. This particular report did ... I never had sight of this report.

Deputy Pearse Doherty: You never had sight of this report?

Mr. Patrick Neary: No, I never had sight of this report. When you were talking earlier on there, Deputy, I thought you were talking about the meeting that was held over that weekend where they ... was attended by the Governor and prudential director and that. I had never had sight of this report and it seems to have been something that came in late on the Sunday evening. And certainly in the discussions-----

Deputy Pearse Doherty: So, when was it ... when did you get the report from Merrill Lynch? Sorry?

Chairman: Just wrap it up, yes.

Deputy Pearse Doherty: Yes, but this is ... this is-----

Mr. Patrick Neary: I didn't get this report. Merrill Lynch, what ... I wasn't alerted to this at all.

Deputy Pearse Doherty: So, what report did you get from Merrill Lynch-----

Mr. Patrick Neary: I got-----

Deputy Pearse Doherty: -----and when did you receive it?

Mr. Patrick Neary: I received a briefing from, from my colleague who attended that meeting, that was the Saturday, I think, was it? It was around that weekend, with Merrill Lynch, and ... which may have even continued into that Sunday morning and there was no ... this issue was not floated to me.

Deputy Pearse Doherty: Mr. Neary, I need to get to the bottom of this-----

Mr. Patrick Neary: Yes, sure, yes.

Deputy Pearse Doherty: -----with the indulgence of the Chair. This company was paid a bucket load of money to carry out an assessment-----

Mr. Patrick Neary: Yes.

Deputy Pearse Doherty: -----of liquidity and capital ratios within the banks and options.

Mr. Patrick Neary: Yes.

Deputy Pearse Doherty: Was ... did you ever see the Merrill Lynch report? Was the Financial Regulator ever asked in relation to, do they stand over what Merrill Lynch viewed as the capital ... which is in black and white in front of me, in detail, of every one of the financial institutions - the liquidity position, the capital position - was the person who had access to this at his fingertips ever asked his opinion on this report?

Mr. Patrick Neary: The ... it's possible that ... that opinion was sought and discussed at the meeting that had taken place with Merrill Lynch the previous day that was attended by ... by the Governor and by the prudential director and that ... the prudential director would have been in a position to deal with this matter, had it been raised at that meeting by Merrill Lynch. The information we had was from Pricewaterhouse and also from Goldman Sachs in relation to this particular institution.

Deputy Pearse Doherty: And-----

Mr. Patrick Neary: And-----

Deputy Pearse Doherty: And can I follow this here-----

Chairman: Deputy, this is your final question now.

Deputy Pearse Doherty: This is my final. As you say, the meeting with the prudential director, which I assume may have challenged or may not have challenged some of what was in the report, but this report is based on information at 6 p.m. on 28 September, after the meeting with the prudential director, and still states that the extreme stress case scenario in INBS, and applying that to Nationwide, would deplete the reserves of one bank and bring the other bank close to insolvency and the question I would have is then you made this statement about ... that there was no issue about capital. We were the best capitalised banks in the world; that we could deal-----

Mr. Patrick Neary: Yes, well-----

Deputy Pearse Doherty: -----with any adverse issues and yet this report-----

Mr. Patrick Neary: Yes, absolutely.

Deputy Pearse Doherty: -----proves contrary.

Chairman: Let Mr. Neary respond and then we will move on.

Mr. Patrick Neary: And I fully ... I fully grasp where you're making the link here but if this report was presented to the Department of Finance on the evening of Sunday the 28th and the next meeting in relation to all of this was on the Monday evening at the guarantee discussion, this issue and these concerns were never discussed or raised at that meeting. So in the meantime, something must have happened to, to satisfy the Department of Finance that these findings were so extreme, that ... and so ... so unlikely to occur, that it had no impact on the solvency situation of those two institutions, as of that time. Now that it is a speculative point, because I don't know.

Chairman: Okay, thank you. Deputy Phelan.

Deputy John Paul Phelan: Thank you, Chair, Mr. Neary. Just a couple of quick ones at the end in relation to the fall in commercial property prices that took place from about September 2007 until September 2008 of 20% in value. In light of the fact most international bank crises have been caused by over-lending into commercial property in particular, was there any analysis carried out by you or people within the regulator's office, in that fall in commercial property values?

Mr. Patrick Neary: No, not that I can recall. The fact of the matter is that those declines in property values did not have any impact on the level of impaired loans. So ... clearly-----

Deputy John Paul Phelan: A 20% reduction in the previous-----

Mr. Patrick Neary: Yes, well you see it depends on the-----

Deputy John Paul Phelan: -----12 months

Mr. Patrick Neary: -----it depends on the LTV that was there in the assessment of the, of the, of the LTV. And ...it ... its a combination, I mean a loan is a combination of the repayment of the loan and the eventual LTV-----

Deputy John Paul Phelan: Okay.

Mr. Patrick Neary: -----and you know, all of these accounts were being audited from the point of view of establishing the-----

Deputy John Paul Phelan: But-----

Mr. Patrick Neary: -----the provisions.

Deputy John Paul Phelan: Okay.

Mr. Patrick Neary: And it wasn't picked up. So, you know -----

Deputy John Paul Phelan: But there was-----

Mr. Patrick Neary: -----the LTV-----

Deputy John Paul Phelan: -----there was no analysis of, of that fall in commercial property values in the previous 12-month period. By the-----

Mr. Patrick Neary: No. No.

Deputy John Paul Phelan: -----by the regulator-----

Mr. Patrick Neary: No. No.

Deputy John Paul Phelan: -----that you're aware of?

Mr. Patrick Neary: No.

Deputy John Paul Phelan: Okay.

Mr. Patrick Neary: Not that I'm aware of.

Deputy John Paul Phelan: Thank you. In relation to the Honohan report, page 16. There's a critique, if you like, by Professor Honohan of regulation in this country and I want to put the quote to you:

> a regulatory approach which was and was perceived to be excessively deferential and accommodating; insufficiently challenging and not persistent enough ... This was in an environment which placed undue emphasis on fears of upsetting the competitive position of domestic banks and on encouraging the Irish financial services industry even at the expense of prudential considerations.

Do you accept that criticism of-----

Mr. Patrick Neary: I think there's a, there's a lot, there's a lot of ... huge number of findings in there. I mean the fact that-----

Deputy John Paul Phelan: That finding though specifically, how do you feel it applies to-----

Mr. Patrick Neary: Well-----

Deputy John Paul Phelan: -----the Irish regulator of which you were chief CEO at the time?

Mr. Patrick Neary: Well, I think you have to relate that to the system of regulation. And I think I have conceded, I think, from the moment I came in here this morning that the system of regulation was a failure and this is similar to the system of regulation that's ... that was throughout Europe and I think it's in the context of that, that, you know, you have to make your adjudication. And you know, if, if what ... I mean, Professor Honohan I suppose is stating the obvious, that the principles-based system of regulation failed.

Deputy John Paul Phelan: I think he's saying even more than that in that comment. Finally, I just want to put it to you that ... or do you accept, I suppose that the question I'm asking, that there is a public perception that a combination of bankers, developers, politicians, regulators and others, have made decisions or not made decisions as the case may be, which have cost the taxpayers billions of euros, but that those self-same individuals have not suffered any cost themselves? Now that is a public perception that exists. Do you think that that applies to you in your position as chief executive?

Mr. Patrick Neary: Well, I imagine it does, yes.

Deputy John Paul Phelan: Thank you.

Chairman: Okay, thank you. I'm going to bring matters to a conclusion. Mr. Neary, we've been here since 9:30 this morning; it's been a long dialogue. But I'm just offering you the opportunity, is there anything you would like to say by matters of conclusion or final comments or remarks?

Mr. Patrick Neary: I'd like to thank you, Chairman. And I suppose it gave an opportunity to me, I suppose, to put the regulatory complexion on your discussions and I hope you've found it helpful. And, you know, it is clear that the system of regulation that we endeavoured to oversee was, was ... did fail. And I regret that very deeply, Chairman. So, other than that, I'd just like to thank you for the courtesy you showed me here today and to wish you well with the rest of your work.

Chairman: Okay, with that said, thank you very much, Mr. Neary, and thank you for your participation today, and for your engagement with the inquiry. And I now formally excuse the witness and bring matters to an end with the suggestion that the meeting is adjourned until 3.30 p.m. on Tuesday, 9 June 2015. Is that agreed? There's also packs to be picked up there as people are leaving.

The joint committee adjourned at 6.50 p.m. until 3.30 p.m. on Tuesday, 9 June 2015.