

# HOUSES OF THE OIREACHTAS

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## AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉI- REACHTA

### JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

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*Déardaoin, 11 Meitheamh 2015*

*Thursday, 11 June 2015*

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The Committee met at 9.30 a.m.

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#### 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.

not the standard of the loan book was the real issue for the Irish banking sector?

**Mr. Liam O'Reilly:** I would say-----

**Senator Michael D'Arcy:** The assets on-----

**Mr. Liam O'Reilly:** I would say another element in that was, particularly in the case of commercial loans to a small number of individuals, was the other big issue that cost money.

**Chairman:** Thank you very much, Senator. So, with that said, is there anything else you'd like to add, Mr. O'Reilly, before I bring matters to a conclusion?

**Mr. Liam O'Reilly:** No, just thank you very much for listening to me and best of luck with the rest of your inquiry.

**Chairman:** Thank you very much, Mr. O'Reilly. So, with that said, I'd like to thank you for your participation here today and for your engagement with the inquiry. The witness is now excused and I just ... before we suspend the meeting, there's just one matter we have to deal with in private session there with lead investigator Pat McLoughlin in a few moments. So, with that said, I'll excuse the witness and then very ... suspend for a few moments to go into private session.

*Sitting suspended at 1.16 p.m., resumed in private session at 1.18 p.m., suspended at 1.21 p.m. and resumed in public session at 2.41 p.m.*

### **Central Bank-Financial Regulator - Mr. Brian Patterson**

**Chairman:** I now propose that the Inquiry into the Banking Crisis resume in public session. Is that agreed? Agreed.

And can I ask members and those in the public Gallery to ensure that their mobile devices are switched off. Today we continue our hearings with the Central Bank of Ireland and Financial Regulator. At our session this afternoon, we will hear from Mr. Brian Patterson, former chairman, the Irish Financial Services Regulatory Authority. Mr. Brian Patterson was interim chairperson ... or, chairman of the IFSRA from November 2002 to April 2003. He became chairman of the Financial Regulator in May 2003, a position he held until April 2008. He was also a member of the board of the CBFSAI from May 2003 to April 2008. Mr. Patterson, you're very welcome before the committee this afternoon.

And before hearing from you, 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 are directed that only evidence connected with the subject matter of these proceedings is to be given. I would remind members and those present that there are currently criminal proceedings ongoing and further criminal proceedings are scheduled during the lifetime of the inquiry, which overlap with the subject matter of the inquiry. The utmost caution should be taken not to prejudice those proceedings. In particular, there are ... or, sorry, in addition, there are particular obligations of professional secrecy on officers of the Central Bank in respect of confidential information that they have come across in the course of their duties. This stems from European and Irish law, including section 33AK of

the Central Bank Act 1942. The banking inquiry also has obligations of professional secrecy in terms of some of the information which has been provided to it by the Central Bank. These obligations have been taken into account by the committee and will affect the questions asked and the answers which can lawfully be given in today's proceedings. In particular, it will mean that some information can be dealt with in 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 screen to your left and right. And members of the public and journalists are reminded that these documents are confidential and that 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 core documents. These are before the committee, will be relied upon in questioning and form part of the evidence of the inquiry. So if I can now ask the clerk to administer the affirmation to Mr. Patterson, please.

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

Mr. Brian Patterson, former Chairman, Financial Regulator.

**Chairman:** Once again, Mr. Patterson, welcome in before the committee this afternoon, and if I can invite you to make your opening remarks to the committee, please.

**Mr. Brian Patterson:** Okay. Thank you, Chairman.

In April 2002, I was asked to become the non-executive chairman of the interim Irish Financial Services Regulatory Authority, which we know as IFSRA, by the Minister for Finance, and with involvement also of the Minister for Enterprise, Trade and Employment. The authority was formally constituted in 2003 and I remained chairman until my term expired in April 2008. Because it may come up later, Chairman, I should mention that as from October 2007, I was dealing with a serious illness. As chairman of IFSRA, I was also, *ex officio*, a non-executive member of the board of the Central Bank.

In 2004, instead of the more cumbersome title Irish Financial Services Regulatory Authority, it was decided to adopt in everyday usage the simpler term, "Financial Regulator", to mean the whole organisation, and that is the meaning I shall use here. In this statement, I'll also use the term "authority" to mean the board of the Financial Regulator and "executive" to mean the CEO and his staff. I'll also refer to the board of the Central Bank.

My job was to manage the authority, that is, the board, and to ensure that its non-executive group of independent, senior people worked well together and worked effectively with the executive in developing and approving policies, strategies, plans and initiatives. The executive's job was to manage the organisation and to report to the authority on the ongoing work of regulation.

The first line of defence against a bank's failure and the responsibility for protecting its safety and soundness lies squarely with the bank itself - its board, its management, its risk committee, its compliance officer; the second line of defence is the bank's auditors; the third line of defence, at that time, was the Financial Regulator, responsible for the prudential regulation of

individual banks; and the fourth line of defence was the Central Bank, which retained responsibility for systemic financial stability. In the banking crisis which befell us here in Ireland, all of these defences failed for complex and interrelated reasons.

As well as setting up a completely new organisation, the Financial Regulator achieved much in developing its consumer protection mandate, in implementing very complex EU directives, as well as regulating insurance, credit unions and the many other areas under its supervision. However, it clearly failed in its duty to uphold the safety and soundness of Irish banks. As chairman of the authority, I accept responsibility for my part in that failure. It's something I regret deeply. Had I known then what I know now, things could have been very different. The authority and the executive of the Financial Regulator took their responsibilities very seriously. They were diligent, hard working and, at all times, acted in good faith. Contrarian opinions were encouraged. So why did things go so wrong? That is the question on which I'll try to shed some light, and to do so without in any way seeking to evade my responsibility. I'll outline a number of reasons that, in my view, led to the ultimate failure of banking regulation. I'll describe these briefly under two main headings - structure and practice.

Let me first deal with structure. The interim regulatory authority was set up in 2002 following a long debate which followed the McDowell report about how it might best be structured. The main issues were: one, which financial services should be brought into its remit; two, whether a new structure would be independent of, or be part of, the Central Bank; and, three, whether it should focus on consumer protection alone or be combined with prudential regulation. The impetus for an integrated and separate regulator to cover the whole of the financial services industry came from a number of sources. One, following the radical deregulation of financial services under Presidents Reagan and Bush in the US during the 1980s followed by the "Big Bang" deregulation of 1986 in the UK, financial services had become more deregulated, more complex and were converging across traditional sector boundaries, which, in Ireland, and for historical reasons, had been regulated by separate entities reporting to different Government Departments. No. 2, it was believed that banks and other financial services were mis-selling to their customers and that stronger emphasis need now to be placed on consumer protection. Three, the DIRT inquiry and a number of other matters in the 1990s had raised persistent questions as to how effective the Central Bank was in supervising the banks. So it was believed that a more independent structure with a substantial focus on consumer protection was required. However, there were strongly competing views as to how this should be done. Following a lengthy debate, the structure that resulted was a complicated compromise. The Irish Financial Services Regulatory Authority would have responsibility for both consumer protection and the supervision of individual financial services providers, including over 50 banking entities plus 30 EU banks operating on a "passport" basis into Ireland, two building societies, 180 insurance companies, 3,400 funds, 4,000 intermediaries, as well as re-insurance companies, stockbrokers and the Stock Exchange, bureaux de change, licensed moneylenders and 430 credit unions who were vocally opposed to the new regulatory arrangements. The organisation, with supervisory responsibility for over 8,000 different entities, had a lot on its plate. Of its approximately 350 staff, around 45 were initially allocated to banking supervision.

The authority reported to the Oireachtas through the Minister for Finance. It had a degree of independence, but, at the same time, operated within the overall framework of the Central Bank in what was to be known as the Central Bank and Financial Services Authority of Ireland, CBFSAI. The Central Bank and its Governor retained responsibility for financial stability and had powers to direct the authority in that regard; it remained the "competent authority" under EU directives; it was the sole point of contact with the ECB.

The web of accountabilities was, to say the least, complicated. Some observers described the new structures as unwieldy and unworkable. However, early on, the Governor and I decided to try our best to make them work. I should say at this point that the Governor and I had a good, professional relationship all the time through my tenure as chairman. In the initial stages, the challenge was to begin implementing the legislation, which at that point was still a Bill, and to build an entirely new organisation with staff who were then working in a number of different organisations and Government Departments. The regulator inherited most of its staff from the Central Bank and so also inherited, and was effectively constrained by, the Central Bank's HR policies, systems, and culture, a culture which, in my view, was generally hierarchical, deferential, cautious, and secretive. Accommodation and the critically important services of HR and IT systems were provided by the Central Bank. The bank was not a strong performer in either of these areas and this did slow down our banking regulators in coping with change, of which there was a lot in the period, and in developing their crucial data analytics capacity.

The Financial Regulator was given formal legal status in 2003, although its sanctioning regime was not in place until nearly two years later, and its ... the new legislative framework for banking supervision, under Basel II, was not in place until 2006. The authority had its own board of ten members, six of whom also sat on the board of the Central Bank, including myself as chairman and the CEO. None of the authority - the board - had any experience in regulating banks. There was some initial training for authority members in prudential regulation and financial stability. In hindsight, there was not enough.

At the time, those outside the regulator often saw prudential regulation as being in opposition to consumer protection. There was little or no acceptance that prudential regulation was, and is, in fact, the ultimate in consumer protection for depositors, for shareholders and, as we now know, for taxpayers. Some consumer groups even criticised the amount of resources the authority was then committing to prudential regulation, in so far as it used resources which, in their view, could have been better deployed to consumer protection. Through all of this time, looking back, there's a theme of taking prudential regulation for granted.

As an example of this mindset, the legislation laid down that the consumer director was to be a statutory, *ex officio* member of the authority; surprisingly, the prudential director was not. Early on we recognised this deficiency and we wrote to the Minister to put it on record that even though not written into law, we would treat the prudential director as if he were a full member of the authority, in the sense that he attended and participated in all meetings and received all board papers. The Minister agreed.

The priority given to consumer protection was exacerbated in those early years by a number of high profile consumer issues, for example, foreign exchange overcharging, which absorbed much time and energy of both the executive and the new authority. Many of the interactions with senior bankers on these issues were extremely robust. During one heated discussion in my presence, the CEO of a large bank threw a bunch of keys across the table to our CEO and asked him if he wanted to run the expletive bank.

Part of the CBFSAI mandate was to develop the financial services sector, although not at the expense of safety, soundness and stability – a responsibility more recently removed in the 2010 Act. While the regulator legally had no similar responsibility, it was widely believed that its remit included supporting the development of the industry. Hence there was an effort to ensure that rules and regulatory practice did not have a disproportionate impact on the operation and development of the financial services sector, particularly in relation to the IFSC. Following a fact finding visit to the US in early 2007, the CEO and I came to the view that the authority did



not have sufficient visibility of what was happening in international financial markets and, in particular, in the US. On return, I suggested appointing an international adviser to the authority. This idea, unfortunately, did not find enough support in the board of the Central Bank or of the authority and, in April 2007, I was forced to drop it. Again with hindsight, an international adviser might have alerted us to the risks in the US financial markets at that time and how these would come in time to impact the Irish banking system.

Let me turn to the powers of the regulator. There is some misunderstanding about the limits of the Financial Regulator's powers in relation to the banks. One, first, it had no powers, *per se*, of approval or disapproval over the banks' products like 100% mortgages. The regulatory framework was not designed around prohibiting products, but around imposing additional capital charges on more risky products. Second, while it did regulate full subsidiaries of foreign banks in Ireland, it had no powers of prudential regulation over EU banks "passporting" as branches into Ireland, and which were regulated by their home supervisor. The authority was very conscious that if, for example, the capital requirements on Irish banks were pushed too high, foreign banks which were already, or could move beyond our supervisory reach by switching from subsidiary to branch could have gained advantage over their Irish competitors. This was particularly the case with some aggressive UK banks, attracted to the Irish market by increased margins. Trying to regulate these foreign banks through their home supervisor was futile; the role of the ECB in supervision was, at the time, very weak, as was transnational co-operation between banking regulators.

The McDowell report had recommended that the regulator be given powers of administrative sanction so that it could challenge the banks more effectively, although most countries in Europe did not use sanctions as a core part of their prudential banking supervision. However, the power to impose sanctions on the industry took a long time to materialise. The legislation was not enacted until August 2004, and by the time statutory instruments and staff training were complete, sanctions were not available to the authority until late 2005, more than two years after vesting. This lag in giving the regulator powers of sanction may have weakened the new organisation in the eyes of powerful, and dare I say, in the case of a few increasingly arrogant banks. When eventually enacted, the legislation gave the authority powers to sanction without having to access the courts. Internally, there were real concerns about legal and possible constitutional challenge. If, in the early stages, the authority's sanctioning powers were to be struck down by the courts, it would have far-reaching consequences, and these concerns fed into a Central Bank culture which had already had in-built cautiousness and hesitancy.

Resourcing levels in banking supervision, as you've heard, were derived from the principles-based approach. It's worth noting that in the new, post-crash regulatory regime, a more intrusive, inspection-based approach required a 170% increase in staff resources. As you have heard, resources at the time were under considerable pressure. As well as carrying out ongoing supervision, they had, at the same time, to implement a raft of complex EU directives, particularly Basel II. Management in banking supervision did seek some increase in resources but there was a perceived need to keep a lid on costs and the procedure for getting approval for additional staff was extremely complicated. Even when approval was obtained, the filling of posts was constrained by, first, the inability to attract enough external candidates at the right level and, second, by the capability of the Central Bank's recruitment function. In relation to the first of these points, the regulator was constrained by the pay scales and HR policies of the Central Bank and its long-standing conformity to terms and conditions of the Civil Service. And there were three consequences of this: number one, it was virtually impossible to offer competitive market conditions and to bring in, particularly at a senior level, expertise from

outside, especially from the highly paid financial services industry. For example, on the basis of figures which are in the public domain, the authority would never have been in a position at that time to recruit a Matthew Elderfield. Number two, performance management systems and practices were very weak and number three, the organisation culture was formal and slow. The authority was obliged to take its IT and systems development from the Central Bank. Because of problems in this unit, it was a constant source of frustration and inefficiency to the whole organisation and to banking supervision in particular.

In summarising this part about structure, it's clear with hindsight that the Financial Regulator, as it was constituted, was not entirely fit for purpose. A modern Financial Regulator needs a board with regulatory experience and skills. It needs an enabling legal framework with strength to counter the naturally powerful influence of the banking sector. It needs to be well resourced, to have a fast-moving capacity to develop its IT capability and to recruit expert staff. It needs freedom of action and clarity in its legislative mandate that it's single-mindedly to prioritise the stability of the banking sector over other competing public policy goals.

Let me turn to regulation and practice. As you've heard *ad nauseam*, principle-based prudential regulation was at the time perceived internationally as best practice. It was the bedrock of EU banking supervision as enshrined in the Basel accords – to which the Irish Government was a signatory. It had therefore to be embraced by the Central Bank and was inherited and continued by the new Financial Regulator.

In an era of deregulation and belief in free-market policies, principles-based regulation was based on the belief that one, the market should be allowed to operate freely; the regulator should not interfere in product design or pricing and had no powers to do so. Two, responsible financial services providers were best placed to make decisions about their businesses and were required by government ... required to be governed by experienced managements and boards, backed up by risk committees, compliance officers and auditors. Boards were required to comprise of persons who were “fit and proper” and who operated in a transparent and ethical way. This would take, number four, place under regulatory oversight, with reporting, monitoring and risk-based inspections, backed up by strong enforcement.

As part of the EU push to develop the single internal market with a common regulatory framework, the Government had signed up to implement EU-wide, complex, data-rich, risk-based system of prudential regulation named Basel II, which was to complement the principles-based core principles of effective banking supervision. The regulator was required to adopt this system and to bring the Irish banks under its disciplines. Implementation of Basel II, completed in 2006, fell to the Financial Regulator. This work was extremely challenging, complex and detailed; it put a lot of strain on the Central Bank's systems development capacity. Critically, it temporarily diverted a large number of banking supervisory staff from day-to-day supervision at a time when, as we now know, the seeds of the banking crisis were already germinating. Ironically, the new Basel II framework did not prevent an EU-wide banking crisis and it was superseded in 2011 by a new accord, Basel III.

To strengthen its principles-based approach, in 2005 the authority set out to introduce a new fitness and probity regime for the directors of financial institutions. There was, inevitably, strong challenge from the industry. The authority sought legal advice, which was that constitutionally, no directors who were already appointed, could be reassessed and by implication potentially disqualified. In other words, they were effectively grandfathered or grandmothered. After the crash, the 2010 Act brought in extensive powers for the Central Bank to examine existing appointees – powers not available to the regulator before that time.

In a second move taken by the authority to strengthen its supervisory approach, in November 2004 the authority set out to use its discretionary powers under the Central Bank Acts to require compliance statements of directors in financial institutions. The consequential consultation process ran into a barrage of resistance from the industry. They deployed a range of arguments, including that this was inconsistent with the company law review group's report. Following extensive lobbying and discussion, the Department of Finance wrote to the authority in November 2006 asking it not to proceed with the necessary consultation process, "without first consulting the Department" – a clear signal to us that this did not have Government support. In retrospect, I believe we were mistaken not to have pressed ahead with this measure despite the extreme resistance that we faced.

Banking supervision collected data from the banks and carried out on-site inspections. The principles-based approach focused on checking banks' internal control systems and board minutes to assure the supervisors that their internal controls were operating. Instead of, for example, random sampling of loan files to challenge bank managements' assertions, the inspection methodology left actual judgements of what was prudent to the banks' managements. The dramatic rise in credit called for new information to be collected from the banks. However, the Central Bank just did not have the IT change management capacity to specify that data need or to implement it quickly, while also implementing Basel II and doing everything else it was doing for the Central Bank and for the ECB.

Within an often crowded agenda, the CEO and the prudential director reported on their supervision responsibilities at the monthly authority meeting. The prudential pack, which contained detailed data on an institution-by-institution basis, was a quarterly standing item on the authority's agenda and was discussed at length. Solvency ratios of the banks under supervision were examined and were continually seen to be within the defined limits. The pack included some details of major exposures of Irish banks including those to property developers. These exposures were examined by the executive and were the subject of detailed discussion with the institutions themselves. The executive assured the authority that all these loans had strong asset backing. With the benefit of hindsight, the valuations on which this was based depended on some kind of soft landing.

Chairman, I've omitted the next sentence which was in my written statement as I realised after I had submitted it that it was not fully correct.

**Chairman:** Okay, thank you.

**Mr. Brian Patterson:** The regulator had no powers to investigate the affairs of bank customers. After the crash, it emerged, as we know, that some large developers had never been asked by their bank to provide a statement of affairs nor had the bank properly assessed their net worth. In hindsight, the executive should examine ... should have examined this more closely and, if necessary, forced the banks to improve the standards of inquiry on which they based their lending decisions. The prudential pack did not include micro-trend statistics which could've become the focus of discussion had they been present. This reflected the view that the regulator was a micro-prudential supervisor only, with a mandate to ensure every individual bank had strong capital ratios, rather than to analyse if risk was building in the system as a whole.

Much has been said on the subject of sector limits. It is my understanding that the Central Bank had effectively relaxed these limits in the 1990s, prior to the setting up of the Financial Regulator, in order to encourage the development of the IFSC and in particular to facilitate the arrival of one large foreign bank which had a major sector exposure. It was then felt that



foreign and domestic banks had to be treated the same, a level playing field, in order to avoid giving substance to any impression that Ireland was host to an offshore centre that was being treated more lightly than its domestic banks. Furthermore, sector limits are notoriously difficult to define and so were used more as guidelines than rules. And as banking supervision got closer to the full implementation of Basel II, it became less and less tenable to give any weight to sector limits, which were to be superseded by the Basel II approach. Nevertheless, and again in hindsight, while sector exposure was monitored by the executive, we paid insufficient attention to this indicator.

The regulator paid close attention to the Central Bank's stress tests, which were largely carried out in the banks themselves under supervision of the Central Bank. As presented to the authority, they indicated that even under their most pessimistic scenarios, for example, slow-down in economic growth, rise in unemployment, the banks were well capitalised and capable of withstanding any external threats. However, in hindsight they did not factor in, number one: the degree of reliance on international wholesale funding which, as events were to prove, was highly volatile - the banks were borrowing short to lend long; two, the risk of a calamitous collapse in property prices and the consequent impact on the banks' balance sheets; and, three, severe economic recession, which impaired the ability of borrowers to repay loans. The authority took great comfort from the results of these stress tests. Had they shown a risk to any bank's solvency, let alone to the banking system as a whole, the alarm bells would have been ringing loudly and action would surely have followed.

The annual financial stability report, as you have heard, was issued by the Central Bank in each of the years 2004 to 2007, inclusive. The report was prepared by a joint Central Bank-Financial Regulator committee under the chairmanship of the then director general of the Central Bank. The report was based on the Central Bank's economic analysis and most recent stress tests, plus input from staff in banking supervision. Even though the magnitude of the risk was not properly understood, there was often disagreement in this committee about how strong the report should be in identifying risks to the banking system. The report was finalised by the Governor and the board of the Central Bank. As the clouds gathered, there were concerns that a strongly worded financial stability report could have resulted in the unintended consequence of causing the very collapse the Financial Regulator and the Central Bank were seeking to avoid. However, the Governor had regular one-to-one meetings with the Minister and it was believed that he could be more direct in private than he could be in public.

The authority was also given a false sense of security by a series of external reports: number one, audit reports on the regulated banks, which did not raise any concerns about liquidity or solvency; number two, the 2006 IMF financial sector assessment programme report, which gave the banks and the Financial Regulator a glowing report; number three, the PwC 2007 report, which again concluded that the banks were in good health and able to weather any storm; and, number four, the IMF report of September 2007, which found that the banking system is "well capitalised, profitable and liquid, and non-performing loans are low". Again, the authority took great comfort from these reports. They seemed to confirm what the internal processes and reports were saying, that is, that the banks were well capitalised, and could withstand any downturn or external shocks.

To summarise this section on practice, the regulator was operating a system of principles-based regulation, which was internationally accepted as best practice at the time. It was also embedded in the Basel II accord, a regulatory system to which the Irish Government was committed and which called for dramatic increases in data gathering from the banks. Implementing

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Basel II challenged the Central Bank's IT capability and diverted banking supervision staff from normal duties. None of the many internal processes or external reports that I have described raised serious red flags about the banks' viability or pointed to any of the cataclysmic events that were to follow. Had any of them shown a risk to the banks' solvency, let alone to the banking system as a whole, the alarm bells would have been ringing loudly and the authority would have been impelled to investigate and to take action.

In conclusion, Chairman, the Financial Regulator had an overly complex structure with an extremely broad mandate, which emphasised consumer protection as the main priority, with constrained powers and limited resources devoted to banking supervision. The complex entanglements with the Central Bank also limited the regulator's effectiveness in a number of ways. However, shortcomings in the structure do not alone explain why the system failed. The regulator's processes and reports and the findings of external scrutineers, any of which should have raised red flags or sent warning signals, all failed to do so. As a result, the authority simply did not see the enormity of the risks being taken by the banks themselves and the calamity that was to overwhelm them through the speed and severity of the crash. Had we known then what we know now, we would, of course, have acted more strongly and used whatever powers were at our disposal with the forcefulness required to rein in the banks' lending. But we did not know then what we know now. And so, as a key part of the defence against banking failure, the Financial Regulator failed in its responsibility to uphold the safety and soundness of the Irish banks. As a former chairman of the authority, that is something I will forever regret.

Thank you, Chairman.

**Chairman:** Thank you, Mr. Patterson, for your opening statement. And if I can invite Deputy Kieran O'Donnell to lead off. Deputy, you've 25 minutes.

**Deputy Kieran O'Donnell:** Thank you, Chairman. Welcome, Mr. Patterson. The memorandum of understanding between the Central Bank and the Financial Regulator dealt with the responses of both the Central Bank and the regulator. Was there clarity in what should have been dealt with by the financial regulatory board or by the Central Bank board? And that's coming from document Vol. 1, page 7. It's memorandum of understanding.

**Mr. Brian Patterson:** I don't need to refer to the document, Chairman, I understand the question.

**Chairman:** Thank you.

**Mr. Brian Patterson:** In my mind, the responsibilities were very clear. The Financial Regulator was responsible for the supervision and regulation of the individual banks. The Central Bank was responsible for overall systemic financial stability; quite clear, okay? Because the two organisations had this very complex dividing line, I think, looking back on it, that what happened was some of the accountabilities fell between two stools. Easier to see in hindsight, but at the time I guess we didn't realise this. And the financial stability report, which was where all this was supposed to come together, didn't actually do the business. And I think it was for this reason: were there concerns within the boards of the regulator and the Central Bank about the degree of bank lending and the risks they were taking? Yes, there were. There were concerns, and they were often voiced.

**Deputy Kieran O'Donnell:** By whom?

**Mr. Brian Patterson:** By various members of the authority, and by various members of the

Central Bank board.

**Deputy Kieran O'Donnell:** Did you voice them yourself?

**Mr. Brian Patterson:** Yes, I did.

**Deputy Kieran O'Donnell:** And where ... and how did ... how ... what was the outcome of that?

**Mr. Brian Patterson:** Well, this is what happens. Did the financial stability report accurately reflect those concerns? No, it didn't. Did the financial stability report contain recommendations for action? No, it didn't. Why? Because it couldn't. The financial stability report is not a suitable vehicle for flagging concerns about the banking system because it's a public document. And if the financial stability report had said XYZ bank or the banking system as a whole is looking very shaky and the Financial Regulator should take the following actions, there probably would have been queues outside the bank in the street the next day. So it wasn't capable, in my view, of doing that function. Now-----

**Deputy Kieran O'Donnell:** So you're saying the financial construct under which the new bank regulatory system was set up in '03 was flawed from day one?

**Mr. Brian Patterson:** I think there were flaws in it. But I was going to go on to say, if you'll excuse me, that we all lived in the same building - the Financial Regulator and the Central Bank, and all the executives and all the boards. We lived in the same building, we shared the same services, we had regular informal interaction with each other-----

**Deputy Kieran O'Donnell:** Had you an office on the seventh floor?

**Mr. Brian Patterson:** I did, a small one, yes.

**Deputy Kieran O'Donnell:** Right.

**Mr. Brian Patterson:** And we have-----

**Deputy Kieran O'Donnell:** But you made it ... you made it to the seventh floor?

**Mr. Brian Patterson:** I did make it to the seventh floor. We had regular interaction with each other and there were ample opportunities for executives and, indeed, board members to communicate to each other, to sit down and say "Look, I'm really concerned about this." And that's what didn't happen. Because out of the ongoing interaction between the regulator and all its people and the Central Bank, no proposals or recommendations for actions which were stronger or more urgent emerged, other than the ones that were in any case taken.

**Deputy Kieran O'Donnell:** Why not?

**Mr. Brian Patterson:** Because, and it goes back to the fundamental issue here ... because, collectively, the two organisations just didn't see the size of the risk that the banks were taking or the calamity which was going to overwhelm them in due course.

**Deputy Kieran O'Donnell:** And was that your ... your ... in your statement you make reference to the fact that the board was relying on the executive in terms of banking expertise. Should the regulator, in terms of the ... executive, have looked more closely at how loans were being granted by the banks?

**Mr. Brian Patterson:** Yes, absolutely.

**Deputy Kieran O'Donnell:** And at the time did you make that known to the CEO of the financial regulatory authority?

**Mr. Brian Patterson:** No, because at the time we didn't see what a disaster that would ultimately turn out to be. You can see these things very easily with hindsight, but at the time, no, in all honesty, neither I nor, I think, the members of the authority made that point to the chief executive.

**Deputy Kieran O'Donnell:** You have made reference in your statement ... that there was no one on the board of the Financial Regulator with any banking expertise. Now, you were ... you were appointed as interim chair back in April 2002.

**Mr. Brian Patterson:** Correct.

**Deputy Kieran O'Donnell:** So how did you allow a situation to develop where you had no one on the board of the financial regulatory authority, the section of the new ... which was set up specifically to regulate the banks, with ... it would be basically like having a restaurant with no chef?

**Mr. Brian Patterson:** First of all, what I said was that there was nobody on the board of the authority with banking regulation experience.

**Deputy Kieran O'Donnell:** Correct. But, sure, that's what the Financial Regulator ... was a key component of it.

**Mr. Brian Patterson:** No, I agree. I agree, absolutely.

**Deputy Kieran O'Donnell:** So you were there from the start.

**Mr. Brian Patterson:** Yes.

**Deputy Kieran O'Donnell:** So why did you not insist on people being on the board with, with bank regulation experience?

**Mr. Brian Patterson:** I was appointed chairman before the board was appointed-----

**Deputy Kieran O'Donnell:** Correct.

**Mr. Brian Patterson:** -----and I did try in conversations with the Minister and his staff.

**Deputy Kieran O'Donnell:** Who was the Minister at the time?

**Mr. Brian Patterson:** Mr. McCreevy.

**Deputy Kieran O'Donnell:** Right. And?

**Mr. Brian Patterson:** And his staff. I tried to make the point that the board needed to have regulatory experience. There were people with banking experience on it.

**Deputy Kieran O'Donnell:** What was the outcome of those discussions? What-----

**Mr. Brian Patterson:** It didn't happen.

**Deputy Kieran O'Donnell:** What did Mr. McCreevy say to you?

**Mr. Brian Patterson:** I didn't hear anything until the members of the, of the authority were announced in the media.

**Deputy Kieran O'Donnell:** So, you were ignored?

**Mr. Brian Patterson:** Yes, I guess.

**Deputy Kieran O'Donnell:** And why, if you were ignored, if you felt so strongly about it, why did you proceed to take up position as chair?

**Mr. Brian Patterson:** That's a fair question. I believed at the time that we had good people on the board; they were good people.

**Deputy Kieran O'Donnell:** But, sure, they'd no banking experience.

**Mr. Brian Patterson:** They had bank ... some had banking experience, but not-----

**Deputy Kieran O'Donnell:** Very little.

**Mr. Brian Patterson:** -----not banking ... No, no.

**Chairman:** We can't-----

**Deputy Kieran O'Donnell:** Sorry, okay.

**Mr. Brian Patterson:** We did have people with banking experience on the board, but not regulation experience. That's the difference, all right?

**Deputy Kieran O'Donnell:** Correct.

**Mr. Brian Patterson:** And there were other people from the financial services industry who had long experience. Also, I was told, and I believed that the executive had within it in-depth experience of banking supervision, banking regulation, that the whole system was well oiled and that it would work ... it would work well and it would serve the authority well. And on the basis of those two things, I decided to serve. With the benefit of hindsight, maybe I shouldn't.

**Deputy Kieran O'Donnell:** But in looking at it and taking that executive experience you're talking about, you were ... you announced the appointment of both CEOs, which were both Mr. O'Reilly, Liam O'Reilly, and Patrick Neary. So, what was the process by the ... the appointing panel, the persons for the executive team in the Financial Regulator who actually appointed the CEO? What was the process you went through? Who was on the board that interviewed these people? What was the process? How did you follow up with, with scrutiny in terms of their performance?

**Mr. Brian Patterson:** Okay. This, Chairman, will probably be a long answer because I need to-----

**Chairman:** Yes, I'll give you time for it, that's fine.

**Mr. Brian Patterson:** -----do justice to this. As you say, Deputy, in my time we appointed two chief executives, Liam O'Reilly and Pat Neary. And if I deal with the Pat Neary appointment, because I think the Liam O'Reilly one was similar.



**Chairman:** All right.

**Mr. Brian Patterson:** The first thing that we did was to develop a detailed job specification and a person specification and that would have included experience of prudential regulation, consumer protection, organisation, leadership capabilities, administrative experience and so on - very detailed document - and that was signed off by the authority. We recruited - not we recruited, we appointed an external executive search company to assist us with finding candidates with managing the process-----

**Deputy Kieran O'Donnell:** Who were they, Mr. Patterson?

**Mr. Brian Patterson:** I believe it was Amrop at the time. And to advise us generally on the selection process, and they then produced a list of candidates, which to my memory was around about 15 or 20, or something like that, that was whittled down to a final four or five. We then, we had in the meantime engaged a Finnish expert from Finland who had been the former head of financial regulation in Finland; I can't remember his name offhand, and he became part of our selection process as an independent assessor.

**Deputy Kieran O'Donnell:** I can give you his name, he was Kaarlo Jännäri.

**Mr. Brian Patterson:** He was indeed, thank you. And five members of the authority, plus him, making six in all, became a sub-committee of the authority to make the recommendation to the authority. We interviewed ... I chaired that process. We interviewed the four or five candidates on the short list; we split the group of six into two. They both independently interviewed the candidates, we then came together to discuss what we had seen. There was a lot of discussion, as inevitably there should be, and eventually a consensus emerged that in the case of Pat Neary, that he was the best person available to do the job. That recommendation was made to the authority, which approved it unanimously and it was then given to the Minister for formal approval.

**Deputy Kieran O'Donnell:** Do you believe in the circumstances where you had over 80% of the people interviewing, five of the six people were from the board with no bank regulation experience in both cases, interviewing for a position, do you believe that you recruited the correct person in the circumstances? Was it the appropriate process? You were setting up a completely new regulatory authority, why didn't you bring in someone from the outside? Both were insiders, both were promoted from within the system. Why did ye not ... why did we end ... do you believe ye appointed the correct people in terms of what Ireland needed at that time?

**Mr. Brian Patterson:** Can I deal with the first part of your question first? The fact that there wasn't in-depth banking regulation experience on the board was why we brought the Finnish expert in to the process to give that voice, and I think he did that very effectively, that's the first thing. Why did we appoint two insiders in the case of both Liam and Pat? The reality is that we were constrained by the policies and salary-----

**Deputy Kieran O'Donnell:** What was the salary on offer at the time?

**Chairman:** Hold on a second and just allow ... continue please, Mr. Patterson.

**Mr. Brian Patterson:** We were constrained by the policies and the salary grades of the Central Bank, which in turn were linked to the Civil Service, and bearing in mind that externally we would have been fishing in the financial services pool, known for its very high salaries and bonuses and all those kind of things, it was ... it was very difficult, if impossible, to attract

people to apply for this job who were at the right level of experience and seniority; and yes, we did get some external candidates but they weren't at the right level. So therefore, the process from the word go, was heavily slanted towards internal candidates.

**Deputy Kieran O'Donnell:** What was the salary on offer at the time?

**Mr. Brian Patterson:** I would have to check that. My feeling was that it was €140,000 or something like that.

**Deputy Kieran O'Donnell:** That's a considerable salary, Mr. Patterson.

**Mr. Brian Patterson:** It is, yes.

**Deputy Kieran O'Donnell:** So you're telling me that the only person you could recruit on both situations were people from inside the system on that level of salary?

**Mr. Brian Patterson:** That's the way it turned out. They were the best people available from the candidates that we had in front of us.

**Deputy Kieran O'Donnell:** And two things, do you not believe you should have had further banking regulation expertise where you had five of the six people with no bank regulation experience? Surely it should have been balanced in having people on the interview board with bank regulation experience? And what type of performance measures did you have in respect of the CEOs thereafter?

**Mr. Brian Patterson:** To the first question, no, I think we had enough in the Finnish expert, who was very vocal in these processes and who brought to the table in-depth knowledge and independent knowledge of financial supervision and financial regulation. In relation to performance assessment, the way this worked was that every year I had one-to-one meetings with members of the authority and I asked them what did they think of the performance of the executive and in particular the chief executive. So I collected their views, added my own, obviously, and then I had a discussion with the chief executive of the day about his performance.

**Deputy Kieran O'Donnell:** So these were members of the board-----

**Mr. Brian Patterson:** They were.

**Deputy Kieran O'Donnell:** -----who had no bank regulation experience?

**Mr. Brian Patterson:** Who had bank ... no bank regulation experience, correct. Sorry?

**Deputy Kieran O'Donnell:** So did you not think of getting an independent review of the CEOs in terms of people that would have bank regulation experience?

**Mr. Brian Patterson:** Not at that time, no, we didn't.

**Deputy Kieran O'Donnell:** Okay. Can I deal on a number of things. What is your view on, we'll say ... do you believe that the bank, the Financial Regulator, had sufficient powers to take direct action against banks during your tenure?

**Mr. Brian Patterson:** I used to think, Chairman, that we didn't, but now that I examine this with the benefit of hindsight, I have changed my mind. I've come to the conclusion that yes, we did. I've talked in my statement about the sanctioning regime, and it was late, and etc., etc. But the reality is that in banking supervision, we had other powers that we could have used. We

could have-----

**Deputy Kieran O'Donnell:** Like what?

**Mr. Brian Patterson:** We could have, well there's the famous old moral suasion, although I think in the climate of the day-----

**Deputy Kieran O'Donnell:** It's kind of become a bit of an echo-----

**Chairman:** I think we need to allow a bit of time. Only comment upon the questions, please Deputy? Okay.

**Deputy Kieran O'Donnell:** Okay, but it has become a bit of an echo.

**Mr. Brian Patterson:** I know. I realise that. I mean, I... if you'll forgive me for a moment, I remember when I was studying my economics, I think at the feet of Garret FitzGerald in UCD, and he told us about moral suasion, he said that refers to the eyebrows of the Governor. So in other words, if, if the ... if you were having a conversation with the Governor and he raised his eyebrows-----

**Deputy Kieran O'Donnell:** I suggest you should have listened.

**Chairman:** I suggest you get on there with questioning there, Deputy, and pull back on making remarks.

**Mr. Brian Patterson:** You asked me what, what powers we actually had. Moral suasion was one of them, but I honestly don't think that was working; the banks weren't listening. We could have attached conditions to licences; we could have done more in requiring capital requirements; we could have done more and done it sooner. What else could we have done? I suppose *in extremis*, we could have gone and asked for emergency legislation.

**Deputy Kieran O'Donnell:** Why didn't you do it?

**Mr. Brian Patterson:** Because, and I'm sorry, Chairman, I'll be saying this again and again. We simply did not see the calamity that was coming down the track.

**Deputy Kieran O'Donnell:** And what was your view on contrarian views like Morgan Kelly at the time? What was your view-----

**Mr. Brian Patterson:** External ones?

**Deputy Kieran O'Donnell:** Yes. That were saying there was major problems at the time as early as 2006.

**Mr. Brian Patterson:** I think those external contrarians, they were a small minority and their voice, I think, looking back, got drowned out by the what Peter Nyberg calls the "group-think".

**Deputy Kieran O'Donnell:** You're on record as saying that you had issues with what Morgan Kelly was saying.

**Mr. Brian Patterson:** I don't recall that.

**Deputy Kieran O'Donnell:** Do you not in terms of ... at a Kilkenny Chamber of Commerce do?

**Mr. Brian Patterson:** I remember the chamber of Kilkenny ... the Chamber of Commerce in Kilkenny do. I do, indeed, yes.

**Deputy Kieran O'Donnell:** Did you not make reference to Mr. Kelly's comments?

**Mr. Brian Patterson:** I don't recall it but if you tell me I did, then I did.

**Deputy Kieran O'Donnell:** Okay. Can I ... two quick things. You retired in April 2008 from the Financial Regulator as chair and a function was held a number of months later on 26 November 2008 in a hostelry close to Stephen's Green-----

**Mr. Brian Patterson:** Yes-----

**Deputy Kieran O'Donnell:** -----hosted by the Irish Banking Federation

**Mr. Brian Patterson:** Correct.

**Deputy Kieran O'Donnell:** , which was literally just over two months ... less than two months after the bank guarantee, that the Irish taxpayer put €64 billion ... ended up at €64 billion. Was it appropriate for you to take up that offer to effectively attend a function, which in Shane Ross's book, *The Bankers*, virtually all the big bankers who had been there on the night of the guarantee, were present?

**Mr. Brian Patterson:** I'm glad you've asked me this because I'll welcome the opportunity to get the facts on this straight. This small function, it was a small private dinner. It was a very sober affair, believe me. I was going through chemotherapy at the time and I didn't eat or drink very much at all.

**Deputy Kieran O'Donnell:** I appreciate that.

**Mr. Brian Patterson:** It took place in November of that year.

**Deputy Kieran O'Donnell:** Glad to see you recovered well.

**Mr. Brian Patterson:** Thank you. I ... it took place in November of the year. It was long after I had retired. It was a one-off event. I had never during my time, in ... as chairman, accepted private hospitality like that. I had been at industry functions all right. I'd never accepted private hospitality from any of the financial services providers and nor would I have, even during my tenure, or around the time of my retirement. This was seven months later and, therefore, for that reason, for myself, I was comfortable that that was okay to do, all right? When I realised that the executives had also been invited, and they were still in office, I was less comfortable, although it did go ahead. It had been ... incidentally, it had been organised some months before the guarantee, so it was in the diary for a long time. Looking back on it, I ... it wasn't appropriate for the executives to be there and I think they've said that in this committee and I regret that that happened.

**Deputy Kieran O'Donnell:** Was it appropriate for the Irish Banking Federation to be hosting a retirement do for the chair of the board that was regulating them?

**Mr. Brian Patterson:** On the basis that it was long after my retirement, I didn't see a problem with that.

**Deputy Kieran O'Donnell:** So you didn't see an issue with it?

**Mr. Brian Patterson:** No.

**Deputy Kieran O'Donnell:** In hindsight-----

**Mr. Brian Patterson:** For me, personally; for the executive, a different matter.

**Deputy Kieran O'Donnell:** Can I just ... on a small note. The issue of golf balls being provided, hosted by the Irish financial regulatory authority, were you aware of that?

**Mr. Brian Patterson:** I became aware of it when I listened to Pat Neary's evidence, yes.

**Deputy Kieran O'Donnell:** You weren't aware of it prior to that?

**Mr. Brian Patterson:** No.

**Deputy Kieran O'Donnell:** It didn't come up at the board level?

**Mr. Brian Patterson:** No.

**Deputy Kieran O'Donnell:** Can I just go back to your statement ... do you think it was appropriate?

**Mr. Brian Patterson:** It wasn't, no. I would mention, however ... I mean ... it wasn't appropriate ... so, let me get that straight. It actually arose out of the consumer side of the Financial Regulator and in the climate of the day, the consumer side wanted the public to be more aware of its functions and what it offered, right and this was part of some promotion pack that they commissioned.

**Deputy Kieran O'Donnell:** It was about driving golf balls-----

**Mr. Brian Patterson:** I'm not going to try and defend it, Chairman. It's not appropriate, I just wanted to-----

**Chairman:** I just ask you to move on actually, please, Mr. Patterson.

**Deputy Kieran O'Donnell:** Can I go to page 3 of your statement-----

**Chairman:** Drive on.

**Deputy Kieran O'Donnell:** -----and you said ... that's what I'm trying to do, Chairman ...

Many of the interactions with senior bankers on these issues were extremely robust. During [our] heated discussions in my presence, the CEO of a large bank threw a bunch of keys across the table to our CEO and asked him if he wanted to run the expletive bank.

When did that happen? Who was CEO at the time?

**Chairman:** No, he won't, that'll be sectioned.

**Mr. Brian Patterson:** And if I say, when it happened, Chairman, I'll probably give the game away as well.

**Deputy Kieran O'Donnell:** Why did you put it into your statement?

**Mr. Brian Patterson:** Because it's true.



**Deputy Kieran O'Donnell:** So ... and what was the actual circumstances around it?

**Mr. Brian Patterson:** It was a consumer protection issue. It wasn't a prudential issue and it was a very high profile one at the time and there was great heat in the system between the Financial Regulator and this bank. And there was a meeting between myself and the chief executive, Liam O'Reilly, at the time – that'll give you a timeframe - and the chairman and chief executive of this bank and it was at this meeting that this incident happened.

**Deputy Kieran O'Donnell:** Can I ask you two final things? Looking back now in hindsight - and you made reference there, there was measures available to the bank - did you have much interaction as chair – you reported it to the Minister for Finance - did you have much interaction with the Ministers of the time, Charlie McCreevy and Brian Cowen, in your time?

**Mr. Brian Patterson:** I met ... with the chief executive I met the Minister probably around twice a year, largely, I think, almost totally at our request and the purpose of that was, less to kind of report to the Minister, in some sort of supervisory capacity; it was more to keep the Minister informed with, for example, EU developments, directives and so on. And also, a recurring theme at the time was to ask the Government to strengthen the legislation in relation to credit unions which we were worried about at the time, something, incidentally, the Government was reluctant to do.

**Deputy Kieran O'Donnell:** Did you have discussions with the Minister of the time in 2006, where you spoke about the compliance statements and you got a letter back in November 2006 that not to proceed? Did you go to the Minister and impress upon him the need for this to happen? And also there was obviously worries at the board level in terms of the state of the loans in the banks. Did you, as chair, meet with the Minister?

**Mr. Brian Patterson:** In all of my interaction with the Ministers, other than the credit union issue, which I mentioned, I don't recall us discussing in any depth any prudential issues.

**Deputy Kieran O'Donnell:** Why not?

**Mr. Brian Patterson:** Because again and I'll be very boring on this, at the time we didn't see what was coming down the track. It's as simple as that. We didn't see it.

**Deputy Kieran O'Donnell:** So, looking back now, what would you have done differently. You were there for five years, okay-----

**Mr. Brian Patterson:** Yes.

**Deputy Kieran O'Donnell:** -----and during that time, the balance sheets of the banks and property loans were growing at about 30% per annum, consistently across all the major banks, and clearly ... and you had the ECB saying at the time that loans should have gone up by, maybe, up to 4% per annum. So, looking back now, are you ... do you believe that the financial, we'll say, regulatory authority failed in its role? And what would you have done differently?

**Mr. Brian Patterson:** Well, I've said, Chairman, very plainly in my statement that they did fail and I've accepted my responsibility for my part in that. What would I have done differently? In the first few years of the new Financial Regulator, there was a huge priority put on consumer protection. If you examine the agendas and the minutes of the authority, consumer protection loomed large.

**Deputy Kieran O'Donnell:** And yet, Mr. Patterson, there was no consumer interest on the

board of IFSRA, when it was established?

**Mr. Brian Patterson:** Well, I think we all spoke for the consumer. It was a public interest board. There weren't any specific consumer representatives, you're right.

**Deputy Kieran O'Donnell:** But you had a situation where you had no one with banking regulation experience and you had no one representing interests of consumers specifically.

**Mr. Brian Patterson:** Well, we had the consumer director. That was her job.

**Deputy Kieran O'Donnell:** But that was within the bank.

**Mr. Brian Patterson:** Yes, but it was her sole job to represent the consumers

**Deputy Kieran O'Donnell:** So continue, we'll say, in terms of what you would have done-----

**Mr. Brian Patterson:** Would have done differently? I would, looking back, have devoted more time in authority meetings to prudential matters, first point. I would have set up a sub-committee of the authority to work more closely with the executive in examining and digging into prudential returns, prudential matters. I would have led the authority to question the executive more closely on prudential matters.

**Deputy Kieran O'Donnell:** And do you believe that the credit sector concentrations and prudent underwriting standards were important to financial stability? And do you believe that there were adequate discussions of breaches of lending policy and sector risk concentration limits at board meetings of both the Central Bank and IFSRA? And when you're answering that, if there had been members of the board that had financial regulatory experience, would we have ended up in the situation where the Irish taxpayer ended up grossing €64 billion into the Irish banks?

**Mr. Brian Patterson:** I'll answer the second question first. If there had been more experience or skill in banking regulation as opposed to banking and banking regulation on the board of both the authority and the Central Bank, I think there's a good chance that we could have avoided at least the worst of what happened and I would include-----

**Deputy Kieran O'Donnell:** Did you-----

**Chairman:** Give him time to respond, now, Deputy.

**Mr. Brian Patterson:** I would include in that having one or two people with international experience, particularly the United States, and we didn't have those.

**Deputy Kieran O'Donnell:** Did you not consider looking for it at the time?

**Mr. Brian Patterson:** Not at the time, no. Well, I mean, I told you that in 2006 I suggested that but I wasn't getting anywhere with it. The ... can ... can I take the first question?

**Deputy Kieran O'Donnell:** The credit concentration limits and the-----

**Mr. Brian Patterson:** Yes, sector limits. Of course, they're important in banking supervision. And with the benefit of hindsight, again we can see just how important they ... they were. I said in my statement that my belief is that sector concentration limits were, in effect, relaxed in the 1990s in order to facilitate the development of the IFSC. And I think that, sort of, became

the conventional wisdom that sector limits were there all right and yes, they would be looked at and so on but they wouldn't be strongly policed. And with the benefit of hindsight that ... that was wrong. They should have been, and strong enforcement action should have been taken with the banks to bring that back into line.

**Chairman:** Fine, thank you, Deputy. I ... just before I bring in Deputy Doherty there, I just want to get some clarity on a couple of matters there with you, Mr. O'Reilly, or sorry, Mr. Patterson. One is just to come back to Deputy O'Donnell's earlier question there in regard to the appointment of staff and so forth. The question I have for you is: was performance monitored and assessed and by whom?

**Mr. Brian Patterson:** Was the CEO's performance?

**Chairman:** Yes.

**Mr. Brian Patterson:** As I said in response to the Deputy, we did have a process for monitoring the performance of the chief executive and, indeed, his key lieutenants. And that was ... that involved the authority as a whole.

**Chairman:** What ... what were the benchmarks of the targets or specific key performance indicators that would be looked at?

**Mr. Brian Patterson:** We had developed a very detailed strategy which, I think, is in the core documents, and the chief executive's objectives fell out of that. They ... they were intrinsically linked to the strategy and he was required to report quarterly to the authority on the implementation of the strategic plan and that formed the core of his performance assessment.

**Chairman:** Okay.

**Mr. Brian Patterson:** That included, incidentally, sorry, Chairman ... it included the safety and soundness of the banks.

**Chairman:** Up to 2006 or that period, was there ever a senior Central Bank or regulatory position appointed that came from outside the public service?

**Mr. Brian Patterson:** At a senior level, I think not.

**Chairman:** Okay. So ... and that would be ... would you be fairly clear on that or that would be your assumption?

**Mr. Brian Patterson:** I'm just running through my memory, Chairman, and I can't think of an example or at a senior level, which is what we're talking about-----

**Chairman:** Yes.

**Mr. Brian Patterson:** -----that there was an external appointment, no.

**Chairman:** Okay. For the Financial Regulator's position, the CEO's position, can you recall how many people applied for that post and how many came from the public service?

**Mr. Brian Patterson:** As I said in response to the earlier question I ... my memory it was about 15 or 20 in the long list.

**Chairman:** And were they all private or public?

**Mr. Brian Patterson:** No, they were mostly public.

**Chairman:** Mostly public-----

**Mr. Brian Patterson:** Public sector, yes.

**Chairman:** All right. And given what you said earlier, it was inevitable that the appointment was going to come from the public sector most likely.

**Mr. Brian Patterson:** It wasn't inevitable, Chairman, but it was heavily slanted in that direction, yes-----

**Chairman:** But the ... okay but the ... traditionally that would have been the appointment-----

**Mr. Brian Patterson:** Yes-----

**Chairman:** -----so it would be consistent with that. Thank you. Deputy Doherty.

**Deputy Pearse Doherty:** Go raibh maith agat, a Chathaoirligh. Fáilte roimh an tUasal Patterson. I'm glad to see you're in good health before us today. Can I ask you just in terms of some of the dates? You retired from the board in April of 2008, is that correct? And you mentioned to us that you were in a ... you were ill for a period and I don't want to intrude in relation to that. But can you ... were you fulfilling the duties of chairperson up until April 2008 or were ... did your illness happen prior to that and impede in that ... in that position?

**Mr. Brian Patterson:** Sure, and I don't mind talking about this because it's all on the public record anyway.

**Deputy Pearse Doherty:** Okay.

**Mr. Brian Patterson:** I was diagnosed with cancer in October 2007. I had a major operation. I was expected to return to normal service in January but I developed secondaries and I had a year of chemotherapy, which included the dinner which was referred to. At the time, I put in place ... there was no legal ... legal deputy chair position. But I ensured when I was in hospital that my ... the man who eventually was my successor, Jim Farrell, that he chaired the authority meetings and was available to the executive at all time. And then when I had the second round of it, I put in place that system again. I went to the Minister in February of 2008 and said that I was not ... I didn't want to seek reappointment and he wasn't maybe going to reappoint me anyway, but I certainly didn't want to seek reappointment. So I put him on notice that as of April, he had to have a new chairman. Did I fulfil my duties? Not 100%. Absolutely, I was ... I was ... I wasn't firing on all cylinders. But I believe that I put in place arrangements to make sure that the authority was in good hands.

**Deputy Pearse Doherty:** Okay ... okay. In relation to your own experience and skills, did you have the necessary experience and skills to become the chairperson of the board from 2003 onwards?

**Mr. Brian Patterson:** I think there are ... there are two parts to this answer, Deputy, if I may. The first is that in relation to governance, organisation development, leadership, human resources, consumer stuff, yes, I had a lot of experience in those kind of areas. In relation to banking regulation and banking supervision, I had no experience. And when I was being asked to become the chairman, I pointed that out to the Minister. I was reassured at the time that

consumer protection was going to be the majority of this job, and that prudential regulation was already in good hands through the executive and the Central Bank and that, therefore, I shouldn't worry too much about that.

**Deputy Pearse Doherty:** That's ... I appreciate that. And that's what happened at the time. You gave your reflections to the committee in relation to how a board should be constituted in terms of experience and skills based on hindsight, based on where you are today. Based on where you are today, looking at your own position, did you have the necessary experience and skills to fulfil the role that you were challenged and tasked with?

**Mr. Brian Patterson:** If I look back, it would have been far better that the chairman of the authority from its inception would have had either banking experience, or better still, banking regulatory experience. And I didn't so, therefore, the answer to your question is "No".

**Deputy Pearse Doherty:** Okay. You've mentioned, and, indeed, Deputy O'Donnell has mentioned it, but you've mentioned it in response to myself in terms of that ... that dinner they ... what's been dubbed as the "bankers' last supper". Can you just explain to me how that came about? Who made the phone call? Did somebody phone you and say, "We have an idea of bringing all the chief executives together to have dinner with you or-----"

**Mr. Brian Patterson:** I had ... I had a phone call from the chief executive of the IBF and he said, "We're thinking about having a little dinner for you to mark your retirement." This was ... this was, as I say, months after I had retired. And that was how it started.

**Deputy Pearse Doherty:** So months after you retired but ... which is April, but before the guarantee which is September.

**Mr. Brian Patterson:** Correct, correct. It was around about, I don't know, probably around June or something like that, July.

**Deputy Pearse Doherty:** Did he ... did he mention that he was planning to invite the likes of David Drumm and Eugene Sheehy and Richie Boucher? Did he tell you that these-----

**Mr. Brian Patterson:** I don't think they were all there, incidentally but-----

**Deputy Pearse Doherty:** No, I think some of them didn't turn up-----

**Mr. Brian Patterson:** Well, some of them maybe, but some of those names I don't think I've ever met some of those people.

**Deputy Pearse Doherty:** Okay.

**Mr. Brian Patterson:** He didn't, no, he didn't.

**Deputy Pearse Doherty:** Okay, did he suggest ...did you ask who would be there or?

**Mr. Brian Patterson:** No, I didn't, no, I didn't think at the time-----

**Deputy Pearse Doherty:** No, just turn up on the night-----

**Mr. Brian Patterson:** It was to be ... it was to be a small dinner and that was it, you know, I didn't see it was a big deal-----

**Deputy Pearse Doherty:** See who was there, okay. It's reported that you defended your ...



you defended your role as chairperson of ... of the authority at that dinner.

**Mr. Brian Patterson:** No, I think we talked about fishing.

**Deputy Pearse Doherty:** Okay, so there was no speeches and-----

**Mr. Brian Patterson:** No.

**Deputy Pearse Doherty:** Okay. Listen, we'll move on from that. I don't think it's the burning issue here. One of the statutory objectives of the Central Bank is the promotion of the financial services industry in Ireland. In your view, was there a conflict between the objectives of the Financial Regulator and the responsibility for prudential supervision?

**Mr. Brian Patterson:** I think, in hindsight, there is ... there is some conflict, yes. And I think where that comes home to roost would be in, for example, when we were considering the additional capital requirements that you heard about from Con Horan ... when we were considering that, one of the things that ... that would have weighed heavily with the authority and, I guess, with the executive and also with the Central Bank, because they had to sign off on those would have been that by placing additional capital requirements on the Irish banks, we were setting them at a competitive disadvantage with the foreign banks which were operating in Ireland on a passport basis, yes? And in that sense, the responsibility to develop and to nurture the Irish financial services industry would have ... would have come into ... into people's consideration.

**Deputy Pearse Doherty:** So was the light-touch regulation, or not, adopted as a result of not wanting to distort the promotion of the Irish Financial Services Centre?

**Mr. Brian Patterson:** I don't think that was the reason, Deputy. I think ... I think that principles-based regulation was around a long time before that.

**Deputy Pearse Doherty:** Well, maybe I'm not ... I'm not talking about principles-based, which obviously can be dubbed as right-touch ... light-touch regulation. I'm talking about super light. I'm talking about the fact that administrative sanctions, additional capital, which all happened within a principles-based regulation model. But those didn't happen, as you outlined the reasons why some of them didn't happen. Did that type of, kind of, super light regulation take place as a result of the impact that could take place as a result of the ... contrary to that could have an impact on the financial services centre?

**Mr. Brian Patterson:** I don't see it like that. I think they were, kind of, separate events. Now, undoubtedly, a principles-based regulatory approach suited the foreign banks coming into the IFSC; I won't deny that. But I don't think that was the genesis of principles-based regulation. It was around for a long time before that.

**Deputy Pearse Doherty:** Do you have a view in relation to whether there was a two-tier or a two-track type of regulation? This was suggested earlier on by the previous witness, that in relation to, for example, I think, its administrative sanctions that there was ... or sorry it wasn't administrative sanctions, it was concentration levels, that there was a two-tier type of regulation, that the firms in the financial services centre weren't getting the letters in terms of breaching concentration levels?

**Mr. Brian Patterson:** That's not my understanding; in fact, on the contrary. I think both the executive and the authority set out to have a level playing pitch and that the guys in the IFSC and the Irish banks would be treated the same. Whether it actually transpired like that, I can't

say.

**Deputy Pearse Doherty:** Okay. So we have seen, as committee members, evidence, for example, of letters to and fro, to and from banks, from the Financial Regulator, that talks about the concentration levels.

**Mr. Brian Patterson:** Yes.

**Deputy Pearse Doherty:** Okay, and we know the rules, 200% for one product, 250% for both. So are you telling us that that approach was also adopted with financial firms in the Irish Financial Services Centre, that banks who breached those limits were also being written to by the regulator?

**Mr. Brian Patterson:** I'm searching my memory, Chairman, to see can I come up with any evidence of that, and I can't. So, therefore, I have ... in truth I have to answer your question "I don't know".

**Deputy Pearse Doherty:** Okay, that's fair enough. In your view, did the Financial Regulator have sufficient staff to carry out its tasks in relation to consumer protection and the introduction of the IFRS capital directive and its other statutory roles?

**Mr. Brian Patterson:** I'll probably have to take those one by one. Did the consumer protection division have enough staff? I think, yes, it did. I'm sure Mary O'Dea would probably disagree with that but I think, from my vantage point, yes, they did have enough staff. What was the second one?

**Deputy Pearse Doherty:** I've asked in relation to consumer protection and in relation to the introduction of the IFRS capital derivative and its other statutory roles also.

**Mr. Brian Patterson:** Well, if I can, sort of, bundle that under prudential regulation?

**Deputy Pearse Doherty:** Yes.

**Mr. Brian Patterson:** The prudential regulation division, on banking supervision, in particular, did not have enough staff.

**Deputy Pearse Doherty:** Okay.

**Mr. Brian Patterson:** I think that's quite clear. They didn't have enough staff even for principles-based regulation.

**Deputy Pearse Doherty:** Can you explain why additional staff weren't hired?

**Mr. Brian Patterson:** I know you've been in to this with some of the previous witnesses. There was a perceived need to keep a lid on costs, first of all, and there are reasons for that which I can go into if you wish ... perceived need to keep a lid on costs. The process for getting approval for additional staff was quite convoluted and lengthy. It had to go through a whole lot of filters so that by the time it came to the authority, it probably had been watered down quite a lot, and the authority's budget and remuneration committee would have interrogated the executive quite strongly on the need, as they should have done, on the need for additional staff. The fact that we levied 50% of our costs on the industry was also a factor and industry watchdogs were forever waiting to pounce on us for increases in resources which would impact the size of the levy. And then, to crown it all, even when approval had been given for extra staff, we were

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unable to recruit them and so the ... the members of the authority and the budget and remuneration committee were probably entitled to say, "Why are you looking for extra staff when you haven't even filled the posts that we gave you six months ago or a year ago?"

**Deputy Pearse Doherty:** I'm interested to hear you saying about the fact that the industry has to bear 50% of the cost of regulation. You're suggesting that the ... a factor in relation to not hiring additional staff would be the fact that these institutions would be on your backs in relation to it in terms of that their levy would have increased?

**Mr. Brian Patterson:** It was one of many factors, I'm not suggesting that that was a show-stopper.

**Deputy Pearse Doherty:** But it was a factor?

**Mr. Brian Patterson:** Yes, it was a factor, yes.

**Deputy Pearse Doherty:** I'm surprised at that obviously-----

**Mr. Brian Patterson:** I mean ... and one of the things that was ... one of the things that-----

**Deputy Pearse Doherty:** I'm just surprised at the information. I'm not saying it's right or wrong or whatever, I'm just surprised it's-----

**Mr. Brian Patterson:** I want to be clear, Chairman. I'm not saying it was a show-stopper-----

**Deputy Pearse Doherty:** No, it's just it was a fact that was there for discussion.

**Mr. Brian Patterson:** It was there somewhere.

**Deputy Pearse Doherty:** Yes.

**Mr. Brian Patterson:** And I'll go one step further on that. The funds industry in the IFSC is highly sensitive to the costs of fund approval.

**Deputy Pearse Doherty:** Yes.

**Mr. Brian Patterson:** And that was a ... an internationally competitive market for funds setting up in Ireland and we were often very conscious of the cost that would be levied on funds and how that compared with the costs that would be charged, say, by Luxembourg or somewhere like that.

**Deputy Pearse Doherty:** Can I go on to ask you was there severe punitive action ever proposed or discussed at the IFSRA-Central Bank board level for breach of lending policies within banks or for breaches of the sectoral risk limits?

**Mr. Brian Patterson:** Were there severe penalties ever discussed? The answer is "No".

**Deputy Pearse Doherty:** No. Regarding financial stability round-table discussions between the Governor of the Central Bank, the regulator and the banks themselves, were these meetings used to raise the financial stability concerns of the Central Bank and of IFSRA in relation to what could be described as the two most important emerging factors, that is, the change to the funding composition of the banks and the aggregate lending exposure of banks to the construction sector?

**Mr. Brian Patterson:** I wasn't present at those round-table meetings so I can't really comment on what was raised or not.

**Deputy Pearse Doherty:** Okay. Mr. Patterson, during your time with the Financial Regulator's office, were you aware or not of the links between wholesale funding and commercial and residential property development in the Irish domestic banking system?

**Mr. Brian Patterson:** The link between wholesale ... the borrowing short to lend long thing, yes?

**Deputy Pearse Doherty:** Yes.

**Mr. Brian Patterson:** At the time, no, I wasn't sufficiently aware of it.

**Deputy Pearse Doherty:** Did the board ever discuss any of that ... these issues?

**Mr. Brian Patterson:** In that ... in those terms? No. But to be fair there were concerns often voiced within the authority about credit risk transfer, about sectoral limits, about the risks that certain banks were undertaking ... yes they were discussed.

**Deputy Pearse Doherty:** Yes but in terms of the wholesale lending-----

**Mr. Brian Patterson:** That particular bit of it-----

**Deputy Pearse Doherty:** Borrow short to lend long-----

**Mr. Brian Patterson:** I don't recall that coming up, no.

**Deputy Pearse Doherty:** We've had Mr. Dan McLaughlin, economist with one of the financial institutions before the committee and he said in his evidence, and I'm just quoting it for you, he said:

The other thing I would point out is the major losses for the Irish banks were not in residential property, they were in commercial property ... in commercial property. Not many people, if I recall, wrote anything about commercial property, and that was what caused the damage for Irish banks' profitability and caused them to require significant capital inflow ... injection from the State, not residential property.

Do you concur with the view that it was commercial property not residential property that, ultimately, caused the banks to fail?

**Mr. Brian Patterson:** I think it was both.

**Deputy Pearse Doherty:** You think it was both?

**Mr. Brian Patterson:** I don't think it was one or the other.

**Deputy Pearse Doherty:** Okay.

**Mr. Brian Patterson:** But I would bow to his economic expertise, but my impression, or my judgment, is that it was both.

**Deputy Pearse Doherty:** Did the board have discussions in relation to these exposures of commercial property and ... both on commercial property and on residential property?

**Mr. Brian Patterson:** Yes.

**Deputy Pearse Doherty:** And how ... what type of discussions did you have in relation to them?

**Mr. Brian Patterson:** There were ongoing concerns voiced about, as I said, about sector concentration, about the size of the banks' loan books and how they were growing. Not everybody shared that view. I mean, my recollection is that probably two, maybe three, members of the authority expressed those concerns on a fairly regular basis but they didn't convince the rest of the authority and they didn't convince the executive.

**Deputy Pearse Doherty:** Did the board ever think or discuss, did they ever, kind of, say, "I think there's a property bubble here"?

**Mr. Brian Patterson:** The board of the authority I don't think did.

**Deputy Pearse Doherty:** Okay.

**Mr. Brian Patterson:** The board of the Central Bank did.

**Deputy Pearse Doherty:** Right. I was on ... you're on the seventh floor I was on the seventh floor on one occasion when I met with Governor Honohan and while I was waiting for him to come in one of the things that I actually ... it impressed on me is you are up so high and you see the entire skyline of Dublin. And I was just sitting there while I was waiting for the meeting thinking about how many cranes would have been in the sky during the period that we're discussing and how difficult it would be not to just look out this window and see what was going on below you. Is that something that impressed on you in relation to your period there as chairperson, just that you couldn't look out any window from that seventh floor without seeing Dublin littered by cranes in a construction frenzy?

**Mr. Brian Patterson:** Absolutely, yes. I used frequently to go into the room where you see the cranes and on one or two occasions, I actually counted them. And, yes, of course, you couldn't escape it.

**Deputy Pearse Doherty:** But you didn't think there was a bubble?

**Mr. Brian Patterson:** I thought that there was a bubble but I didn't believe that the bubble was as severe as it later turned out to be and nor did I realise how quickly and severely the crash would come, when it came.

**Deputy Pearse Doherty:** Okay. I'm going to refer to your core booklet, it's Vol. 2, page 3, and I ... I'll quote the section anyway, but it's Vol. 2, page 3. This is a summary of draft minutes from the financial stability co-ordination committee in April 2004, and the summary reads:

... the CBFSAI had not convinced market participants that there may be "systemic risk" building up in the banking sector. Indeed, he indicated that there may be a "degree of euphoria building up in the property lending markets, and that the boards and managements of banks are being myopic about the potential risks."

That's in April 2004. Is that a fair report of the discussions to your knowledge of the time?

**Mr. Brian Patterson:** I remember reading that but I can't find it in the reference that you gave me. Page 3 of Vol. 3?

**Deputy Pearse Doherty:** Page ... Vol. 2.

**Mr. Brian Patterson:** Oh, Vol. 2, I beg your pardon.

**Deputy Pearse Doherty:** It's on the screen. It's on the screen.

**Chairman:** It's on the screen in front of you.

**Mr. Brian Patterson:** Okay, I have it here, yes. That's a ... that's a minute of the financial stability co-ordinating committee, yes?

**Deputy Pearse Doherty:** Yes.

**Mr. Brian Patterson:** Yes, of which I was not a part, so I don't ... I don't remember that discussion.

**Deputy Pearse Doherty:** Yes.

**Mr. Brian Patterson:** So, can ... sorry, can you ask the question again, please?

**Deputy Pearse Doherty:** I'm asking ... that's a minute of the ... is the ... is that a fair report of the discussions that may have been happening at board level at the time? Was there discussions of this nature being ... was this reported in to the board? Were you made aware of the fact that the ... the CBFSAI had not convinced market participants of the systemic risks building up in the banking sector?

**Mr. Brian Patterson:** I don't ... I don't remember that being reported specifically in that language. What I ... what I was aware of, and that was in 2004 ... what I was aware of was that there were some robust discussions going on within the financial stability co-ordinating committee and that there were some disagreements about what the financial stability report could or could not say in relation to the build-up of systemic risk. So, I don't ... I don't know if that answers your question, Deputy, I-----

**Deputy Pearse Doherty:** Okay, so ... okay. Were there ... were you aware of the fact that - in 2004 - that there was suggestion, from the CBFSAI, that there was systemic risks in the banking sector?

**Mr. Brian Patterson:** Yes, I was aware, yes.

**Deputy Pearse Doherty:** Okay, what were the systemic risks that you were aware of?

**Mr. Brian Patterson:** The systemic ... by the time 2004 came, I think there was a growing realisation in the whole of the building - I mean, you can ... you can say the authority, the ... the Central Bank board, and their ... and their executives - that the pressure was building in the economy, the pressure was building in the housing market and the commercial property market and that ... that these were clouds on the horizon. Yes, that there was a realisation of that. But ... but, I suppose, what's behind your question is that why didn't we act.

**Deputy Pearse Doherty:** No, the ... the question I ... I wanted to, first of all, find out what you thought was the problem at the time. What did you think was not just a risk but a systemic risk.

**Mr. Brian Patterson:** Okay. Okay.



**Deputy Pearse Doherty:** In my view, big difference ... in my view, so it's ... it's just ... so in your view the systemic risk was ... was what?

**Mr. Brian Patterson:** I ... I don't think it was as specific as that. I ... I think at that time my sense of it was that the economy was overheating and that this could have consequences. I ... I do recall, at one of the joint board meetings, when the financial stability report was being discussed - and it may have been later than 2004, just to be clear - I remember saying something like that we didn't really understand why the economy ... all the variables that were at work in why the economy was growing as strongly as it was and why the housing market was growing as ... as strongly as it was and that, therefore, some confluence of events, I remember using these words, some confluence of events, which we could not foresee, might actually turn the whole thing on its head.

**Deputy Pearse Doherty:** Okay. I'm gonna ... pressed for time so want to just move to this ... this area here. Mr. Patterson, in 2006, Fitch placed the Irish banks on a lower rated category for macro-potential risks. We know, from the evidence that was presented to Liam O'Reilly, that this was brought before the financial stability co-ordination committee in 2006. The reference - for the secretariat - is in core book, LOR - Vol. 3, 42, but I'm not ... not going to go into quoting from it. The report itself was covered in *The Irish Times* on 8 September 2006 and the newspaper reported that, according to Fitch, and I'm quoting from *The Irish Times* at the time, it says:

Ireland has a high-quality banking system, but also runs an above average risk of a systemic failure.

[...]

Fitch note[d] that private sector credit as a percentage of [...] GDP will reach 190% in 2006. When this is taken together with the rapid growth in private credit, 21.7% according to the survey, Ireland falls into the "MP[1]3" category, which is Fitch's highest measure of the risk to economic stability.

Was the response of the Financial Regulator, and the Central Bank ... what was the response of the Financial Regulator and the Central Bank to this downgrade by Fitch?

**Mr. Brian Patterson:** I ... I don't recall the specific downgrade or, indeed, that ... that report, but I ... I guess it's part of the ... the overall level of concern that, as I've said earlier, was building inside ... inside the two organisations, about risks and about systemic risk in particular. The ... the problem in all of this is that there ... there wasn't sufficient alarm in either of the two organisations to impel better action.

**Deputy Pearse Doherty:** I'll ... I'll try and sum up in this ... in this questions here. See, you were the chairperson, so you were the ... one of the main people, one of the most important persons within the entire organisation. You ... you say in your statement that if you know ... if you knew then what you knew now, you would have acted differently. My question is: what do you know now that you didn't know then, given what I've suggested to you - for example, Fitch pointing out concentration of lending, other reports that would be available in terms of concentration of lending, sector limits being breached, and so on? What do you know now that you didn't know then?

**Mr. Brian Patterson:** First of all, I need to point out that the authority - other than the executive posts - were all non-executive, and I was non-executive, and, therefore, I relied, and so

did the other members of the authority, very heavily, on what the executive would bring to the table in terms of their analysis, their proposals for action, their concerns, etc., etc. And what I know now, to answer your question, that I didn't know then, was how the ... the extent of the risk, both in individual banks - and we know who they are - and systemically, I did not understand the extent of it, and nor did I appreciate-----

**Deputy Pearse Doherty:** But what do you mean by "the extent of it"? Sorry, just, what do you mean, in specific terms ... what do you mean by "extent"?

**Mr. Brian Patterson:** By how close to the wind the banks were sailing.

**Deputy Pearse Doherty:** Sorry, again, what do you mean by "how close to the wind the banks were sailing"?

**Mr. Brian Patterson:** The risks they were taking.

**Deputy Pearse Doherty:** The risks in what? Like-----

**Mr. Brian Patterson:** In ... in both the wholesale funding, which ... which you ... you've referred to and also in the size and the ... the nature of their ... their loan book.

**Deputy Pearse Doherty:** But, would the size and nature of their loan book not be reported to you, as a board, for any of the years that you were chairperson of that board?

**Mr. Brian Patterson:** Yes, the prudential pack that I ... I've mentioned had data in that but it came accompanied with very reassuring noises.

**Deputy Pearse Doherty:** Yes, but you knew the size and scale of the----

**Mr. Brian Patterson:** Yes. Yes.

**Deputy Pearse Doherty:** Okay. So, you ... you knew now what you knew then in relation to the size and scale. I'm really trying to go down to the point of, you know, this statement that you make, if you knew then what you knew now things would be different. I ... I'm struggling to find out what you didn't know then that you now know now.

**Mr. Brian Patterson:** What ... what I-----

**Chairman:** I'll bring you back in at the end but I'd like you to answer that as best you can, Mr. Patterson.

**Mr. Brian Patterson:** Sure. Sure. Fundamentally what I know now that I didn't know then is what actually happened, in terms of what happened in terms of the freeze on liquidity, how that impacted the banks and led very quickly to solvency issues and how those led, in turn, to the need for the bank guarantee and the bailout and all of that whole sorry tale of events. I did not know then that those were going to happen. That's really what I meant.

**Chairman:** Okay, can I maybe reframe that question before I move on to Deputy Phelan. The proposition being put forward by Deputy Doherty, and this committee, is that the information was available then. You're stating, Mr. Patterson, that you may not have been intimately informed of it but are you disputing the proposition that the information was in the ether at the time? It's not something that laterally came onto the table.

**Mr. Brian Patterson:** No, no, I'm not disputing that, Chairman.

**Chairman:** Okay.

**Mr. Brian Patterson:** The ... the information was there, I mean, I read the paper just as-----

**Chairman:** Okay. Who had it?

**Mr. Brian Patterson:** In one sense, we all had it-----

**Chairman:** Okay.

**Mr. Brian Patterson:** -----and I'm not trying to be glib about it. But, a ... a non-executive board does rely on its executive to really distil it, to point it, and ... and to back it up with proposals as to what we're going to do.

**Chairman:** Okay. Okay, but earlier in your testimony this afternoon, Mr. Patterson, you made reference to the Central Bank board having discussions on ... with regard to the property growth and so forth but that this did not come up on the IFSRA ... the ... the ... your own board. But there were so many common directors as we know, sure you were all meeting in one manifestation or another on the seventh floor. So are you saying because it didn't happen here, it was not going to happen over here in terms of discussion?

**Mr. Brian Patterson:** If I recall Chairman, I think the point I was trying to make was that the Central Bank board rightly had a focus on the systemic stability issue, whereas the authority board rightly had a focus on the individual institutions.

**Chairman:** Yes, but is it not like kind of two hands of the one being, that to lift something it requires both. I will bring in Deputy Phelan after this-----

**Mr. Brian Patterson:** Absolutely.

**Chairman:** -----because in your earlier statement today, you talk about the powers and you speak about 100% mortgages and not having the powers to approve or disapprove a product. Now, the purpose of the entity that was created in 2003 for better or for worse was to cover a whole load of areas and put structures in place where they would interface with one another. So if you were not empowered at one end to deal with what you saw as a problem, you could talk to the other hand and say "do you have actions that you can take?" and we know from our engagement with Mr. Hurley that there was a series of measures that the Central Bank could have used. The reasoning for maybe choosing not to use them is a different debate. But even in the interest, the situation of 100% mortgages, okay you're telling us that you didn't have the powers at the time but did you turn round to anybody who did have the powers and say do something about this?

**Mr. Brian Patterson:** The answer to your question, Chairman, is no, and let me explain. What I referred to in my statement is that the authority didn't have legal powers to approve or disapprove products *per se*, but that doesn't mean it didn't have other powers. And as I think I've said, the regulator had powers to try and curb and could have curbed the issue of 100% mortgages. Now why did it not do so? It didn't do so because number one ... I think there are a couple of reasons, number one, because the approach at the time was not to... what's the word I'm looking for... to become involved in products but the two things that the authority could do would be to police through consumer protection how they were sold. Were they being sold inappropriately to the wrong people? Because for some people, 100% mortgages would be okay. Not a majority but for some people they would be okay. To police how they were sold and also

if the authority felt that the loan book was becoming risky, more so than it should be, then to impose additional capital requirements, which ultimately was done. So that was the approach and that seemed to be again in line with the famous principles-based regulation.

**Chairman:** Deputy Phelan and then we'll break.

**Deputy John Paul Phelan:** Thank you Chairman. Good afternoon Mr. Patterson. Can I ask you firstly your views on the efficacy, it is bound to have been touched on by some of the previous questioners, but the efficacy of principles-based regulation and did those views change from the time that you were appointed chairman and through your time as chairman and subsequently?

**Mr. Brian Patterson:** At the time, principles-based regulation seemed to be the right thing to do. That was heavily influenced by the fact that everybody was doing it, bar I think the US and maybe Germany and rules-based regulation did not work too well for them either. So it was the generally accepted international best practice, all right, and as such I suppose it was accepted without enough question by everybody. I became part of that groupthink, if you want to call it that. Did my view change over the years? No it didn't. Did it change subsequently? Yes it did, because we can now see clearly that number one, it wasn't up to the job. The whole of Europe sees that now and has changed the way they regulate and also particularly I think in the case of Ireland, it wasn't backed by sufficient intrusion because you can have rules and you can have principles and you can have different levels of intrusion with both. We had principles-based regulation with not a lot of intrusion and that wasn't correct.

**Deputy John Paul Phelan:** Can I ask you following on from the first question, I think, from Deputy O'Donnell, in relation to your appointment, why do you believe yourself that you were chosen or did you have a discussion with the then Minister for Finance or the Minister for Enterprise I think you referenced in your opening statement? I am not sure who that Minister-----

**Mr. Brian Patterson:** My discussion was with the sec gen of that Department at the time, and later with the Minister. Why do I think I was chosen? I'm not trying to be smart but I guess you should ask them that. I had experience in the private sector of boards and governance, I knew a good bit about consumer issues because the companies that I worked for had consumer markets. I knew about organisation development and it was put to me that this is an organisation-building task. We have to build a new organisation from scratch and you seem to know a thing or two about that so...

**Deputy John Paul Phelan:** Effectively from your opening statement you have given examples that while it was a new organisation, really from a staffing point of view people were coming across from the Central Bank so a new structure may have been created but the same operatives, to use that maybe awful term, were in the places they might have always occupied, is that correct?

**Mr. Brian Patterson:** Not completely because there were quite a number of staff transferred from Enterprise, Trade and Employment. Credit unions and people like that were over in a different part of the world, the Registrar of Friendly Societies regulated the credit unions so... but the majority of the staff did come from the Central Bank, yes.

**Deputy John Paul Phelan:** You had extensive experience in management in a number of leading national and international businesses, is that fair to say? I want not to dwell on what has

been asked previously but you highlighted in your opening comments about the absence of experiencing bank regulation from the membership of the board and you said that you suggested to the Minister that should be rectified and that that call wasn't implemented or was ignored. You did however highlight the fact that, you said training was provided for the board members. In hindsight this was not enough. Who was responsible for that and what did training consist of?

**Mr. Brian Patterson:** My recollection, because we are going back a long way here, my recollection is that we had something like two afternoons of training, which was laid on by the Central Bank people themselves, in various aspects of prudential regulation. As the months and years went by, we often had special briefings by specialists within either the regulator or the Central Bank on specific issues, like EU directives and things like that as well, outside the formal board meetings but with the benefit of hindsight it just wasn't enough.

**Deputy John Paul Phelan:** It was too ... okay, it was too limited. Can I then also follow on, on to page 4 of your opening statement where you stated under the heading of "Resourcing", the final two bullet points there, where you said that performance management systems and practices were very weak and organisation culture was formal and slow. Can I ask what did you do as chairperson to try and change those two particular difficulties, which seem to be more of, on the face of it at least, a managerial difficulty rather than resourcing *per se*?

**Mr. Brian Patterson:** I tried very hard to introduce a more hard-edged performance management culture in the organisation. I can't say I was wholly successful with that. I tried in everything I did within the regulator to instill a culture which was more fast-moving, less formal, more action-oriented. I can't say I was wholly successful in that either.

**Deputy John Paul Phelan:** I am going to present a position and I am trying not to be leading because I know the Chairman will be on to me but somebody who comes with such a distinguished CV in terms of management to the position that you were appointed to, to come in here and give your presentation - and I have no reason to doubt your integrity in giving it - but to lay out criticisms which are of a managerial nature and then say that you were not successful in dealing with them, there's a bit of a glaring contradiction or difficulty there from the point of view of the general public, in trying to reconcile those two situations. Can you try to?

**Mr. Brian Patterson:** I'll try. First of all, I was a non-executive chairman. That means I was in the building one or two days a week maybe. I think to bring about deep-rooted culture change in an organisation which was fairly resistant to culture change is ... it takes a long time. You can't do it overnight. It would take ongoing and energetic leadership by a chief executive and a team of executives to make that happen and I wasn't in that position.

**Deputy John Paul Phelan:** But you were the chairman or acting chairman for five and a half years?

**Mr. Brian Patterson:** Correct.

**Deputy John Paul Phelan:** Which is a long time in corporate terms.

**Mr. Brian Patterson:** It is a long time. I would not say that I had no impact. If I gave that impression that would be wrong. I would have set fairly stretching goals for myself in what kind of change that I could bring about and against those standards I was not wholly satisfied with the amount of change I was able to bring about.



**Deputy John Paul Phelan:** Okay. I then want to turn to another quote from your opening statement and I think ... seem to have lost what page it was on, but I'll read it to you. You said that "The authority was very conscious that if [...] the capital requirements of Irish banks were pushed too high, foreign banks which could move beyond our supervisory reach could [...] have gained advantage over their Irish competitors." Did you see your role, and the role of the regulator, therefore, as more protecting the interests of Irish banks, rather than regulating their operation?

**Mr. Brian Patterson:** There was a conflict there between what might have been done in terms of simply attending to the safety and soundness of Irish banks, as if they were the only banks on the playing pitch and, at the same time, not putting them at a competitive disadvantage *vis-à-vis* the foreign banks who were operating in Ireland and you may recall that, in particular, two of the UK banks were behaving very aggressively at the time. And, yes, that was an issue and it often came up in discussion - both in the board and outside the board - as to how you reconcile those two things. And, as I mentioned, I think in response to Deputy Doherty, that when it came to the capital requirements that were imposed in 2006, that was an issue, as to how far we could push it without seriously disadvantaging the Irish banks.

**Deputy John Paul Phelan:** Are you suggesting that, fundamentally, the way the organisation was structured, in that sense, was a deep flaw, effectively, from the beginning; that it hampered what many people would perceive as the primary function of the regulator, which would be to regulate?

**Mr. Brian Patterson:** I think, if we had our time over and had the powers, because this was in the legislation and it was subsequently taken out in the 2010 Act ... that ... that requirement to support and develop the industry shouldn't have been present.

**Deputy John Paul Phelan:** I only-----

**Mr. Brian Patterson:** It was less a structure question, more of a mandate question.

**Deputy John Paul Phelan:** I only have one minute left, so I want to ask you one final question. On page 1 of your presentation, you outlined a detailed, four line of defence structure against bank failure. First of all, I wanted to ask briefly from whose point of view are you ... is that constructed? Is it from the point of view of the taxpayer, the State, the shareholders? How did you come up with that construct?

**Mr. Brian Patterson:** I don't think it's particularly new. I think it is in everybody's interests. It's in the bank's own interests, it's in the customers of the banks, the shareholders' interest, the taxpayers' interest, the whole society interest that those four lines of defence hold ... hold well.

**Deputy John Paul Phelan:** Would you hold to the view, as I suspect - this is the last one - that many taxpayers who might be watching here today that, fundamentally, the regulator is the first line of defence, from the taxpayer's point of view, in terms of banking supervision and banking failure and, like, while the boards may have a responsibility, particularly for shareholders, but that the regulator's primary ... and was that first line of defence, from a taxpayer's point of view?

**Mr. Brian Patterson:** I'm not trying to evade the responsibility here, let me make that quite clear, but, in my view, the first line of defence is the bank itself and its board and its management because it is a requirement of a bank that it behaves in a prudent and ethical way and the



banks can't be absolved of that responsibility.

**Deputy John Paul Phelan:** But the taxpayer has been left with a-----

**Mr. Brian Patterson:** No, absolutely, I agree.

**Deputy John Paul Phelan:** -----€7 billion of a bill.

**Mr. Brian Patterson:** Yes, I understand.

**Chairman:** Okay, questions have been made and just before I go to the break, I just want to finish some lines of questioning that have been dealt with you, Mr. Patterson. The first one there is that you mentioned at the time of your appointment, you had a conversation with a Secretary General. Which Secretary General was that?

**Mr. Brian Patterson:** That was Tom Considine.

**Chairman:** Okay, thank you very much. And in regard to your own appointment and the, sort of, performance monitoring, or key performance indicators or that, what goals were you given and how were they monitored?

**Mr. Brian Patterson:** I was not given goals by anybody, Chairman, I set them for myself and, as I said in relation to another question, they were embedded in the strategy. And I saw it as my job to oversee the implementation of that strategy.

**Chairman:** Would that be described as self-regulating?

**Mr. Brian Patterson:** For myself?

**Chairman:** Yes.

**Mr. Brian Patterson:** Well, the only person who could have set objectives and goals for me probably would have been the Minister and he didn't do that.

**Chairman:** Okay, all right. And just on one issue with Deputy Doherty's question there, when you were asked were severe punitive actions ever proposed for breach of lending policies within the banks or breaches for sectoral risk limits, you said they weren't; is that correct?

**Mr. Brian Patterson:** I'm sorry, Chairman, could you say that to me again?

**Chairman:** When you were asked about severe ... was there ever severe punitive action ever proposed for breach of lending policies within banks or for breaches of sectoral risk limits, your response to that was, "That ... that never happened".

**Mr. Brian Patterson:** If you define "severe penalty" as, for example, revocation of a banking licence, or something of a really strong nature like that, no, it wasn't.

**Chairman:** Okay. Were they ever discussed?

**Mr. Brian Patterson:** No, not at that level of severity, no.

**Chairman:** Okay, but was the issue ever discussed, that we might have sanctions?

**Mr. Brian Patterson:** I don't recall there being ... I mean, there were discussions about sanctions, of course, but I'm ... I'm following the question as-----

**Chairman:** Yes.

**Mr. Brian Patterson:** -----in relation to severe sanction-----

**Chairman:** Okay.

**Mr. Brian Patterson:** -----at that level of almost nuclear option.

**Chairman:** Okay. Well, for breach of lending policies with banks and sectoral limits, the ... one could propose that the ultimate outcome was the nuclear-----

**Mr. Brian Patterson:** Oh no, you could.

**Chairman:** -----disaster.

**Mr. Brian Patterson:** Yes.

**Chairman:** That it wasn't an option, we actually ended up there. So, what I'm trying to just nail this down, and then we'll go for coffee, was there a high-level discussion with regard to taking some sanctions at some level or other, at your level and across the board and we know that that didn't happen, so I just want to find out was it discussed and why was it not progressed out of that discussion, if there was a discussion?

**Mr. Brian Patterson:** There ... I may ... I may have given the wrong impression here, Chairman, so forgive me if I did. There were discussions about sanctions. One particular bank, which I can't name, there were sanctions applied to them. There were discussions about the capital requirements, obviously, which is a form of sanction, so yes, there were discussions about sanction. I interpreted, I think it was Deputy Doherty's question, as to the extreme sanction and, I think, my answer was in relation to that; that there weren't, to my memory, discussions about the nuclear option or anything like that.

**Chairman:** Thank you very much. I now propose that we go for a break and to remind the witness, in doing so, that once he begins giving evidence that he should not confer with any person other than his legal team in relation to his evidence and matters that are being discussed before the committee. With that in mind, I propose that we kind of take an approximately ... maybe a 12-minute or a 15-minute break. We'll try to get back around 4.40 if that's agreeable. Is that agreed? Okay, thank you.

*Sitting suspended at 4.27 p.m. and resumed at 4.48 p.m.*

**Chairman:** We'll go back into public session. Is that agreed? In doing so, can I invite Senator Michael D'Arcy.

**Senator Michael D'Arcy:** Thank you, Chairman. Mr. Patterson, you are welcome. I'm glad to see you're healthy and well.

**Mr. Brian Patterson:** Thank you.

**Senator Michael D'Arcy:** Can I ask you to look at Vol. 1 of your documents, page 19? Yes. And I'm just looking at the members of the board. There are ten people there. Of the ten members of the board, how many of them had financial and regulatory knowledge or experience?

**Mr. Brian Patterson:** Of the ten ... I'm just looking here ... four would have had regulatory

or financial services experience ... sorry, five.

**Senator Michael D’Arcy:** So, half the board did and half the board wouldn’t have had any.

**Mr. Brian Patterson:** Yes.

**Senator Michael D’Arcy:** And, with hindsight, was that a wise selection of the board?

**Mr. Brian Patterson:** With hindsight, no. And I think what’s specifically missing, as I indicated earlier, is any experience of financial regulation, *per se*. Because of the ... well, excuse me, I included in my five the two executives, Liam O’Reilly and Mary O’Dea, both of who would’ve had, obviously, regulatory experience. But none of the non-executives had regulatory experience. There were people from the financial services industry - one banker, one from the insurance sector - who knew about the financial services sector but they had never been ... experience as being a regulator.

**Senator Michael D’Arcy:** Mr. Patterson, on page ... on Vol. 2 of your documents, page 54, and I put this to Mr. O’Reilly this morning also, the Nyberg report, on section 4.4.2. The last line of that section: “Indeed it was even suggested that detailed enquiries by the [Central Bank] regarding the basis for the [Financial Regulator’s] assessments could have been regarded as an unacceptable intrusion into the autonomous status of the [Financial Regulator].” Did you ever feel that the Central Bank attempting to inquire into your role or the role of the IFSRA board was an unacceptable intrusion?

**Mr. Brian Patterson:** Absolutely not.

**Senator Michael D’Arcy:** Where do you think Mr. Nyberg came up with that analysis?

**Mr. Brian Patterson:** I can’t tell. I see that when I read this recently, I put “??” in the margin. I, my style is to be very open. I welcome question, I welcome dissent and I can’t imagine how I, for one anyway, would have felt it was an intrusion.

**Senator Michael D’Arcy:** Can I put it to you, Mr. Patterson, that the consolidated data was available per institution to IFSRA or the Financial Regulator’s office, that consolidated data was not available per individual institution? The institutions themselves had their own data. And again I put this to Mr. O’Reilly this morning, that the ... you were the only body who had knowledge of the people who were at the highest end of the lending spectrum. And Mr. O’Reilly said that it wasn’t until 2007, which is your era, that there was a realisation that some of these high lenders were ... lent to multiple financial institutions. Could you comment why that it was so late in the day that the Financial Regulator’s office, it took them so long to find out that that was the case?

**Mr. Brian Patterson:** I’m afraid I don’t know. I didn’t see that part of Liam O’Reilly’s evidence this morning. I’m remembering the prudential pack where presumably this would have appeared, and I remember seeing consolidated loan data in one of the tables, but I don’t ... I wasn’t aware that it only appeared then and, accepting that it did, I can throw no light, I’m afraid, on why it didn’t appear before that.

**Senator Michael D’Arcy:** Okay. The genesis of the growth started around 2001 and you came in shortly after that. The growth, the figures that we have is around 30% year on year, compound, by the banks. Did you realise that that was a dangerous level of growth?

**Mr. Brian Patterson:** At the time, no. Again, if we’d all been steeped in prudential regula-

tion or been trained in it, I suppose that would have rung more alarm bells for us than it actually did. So at the time, I don't think it caused necessarily a big stir. I know it may sound hard to believe that now with the benefit of hindsight but that's the truth of it, it didn't cause a big stir.

**Senator Michael D'Arcy:** The FSRs that came in the name of IFSRA, the Financial Regulator-----

**Mr. Brian Patterson:** The financial stability report?

**Senator Michael D'Arcy:** Yes.

**Mr. Brian Patterson:** They came in the name of the Central Bank.

**Senator Michael D'Arcy:** Or the Central Bank, sorry.

**Mr. Brian Patterson:** Yes.

**Senator Michael D'Arcy:** But it was IFSRA who would have collated them along with the Central Bank?

**Mr. Brian Patterson:** Well, the Central Bank took the lead.

**Senator Michael D'Arcy:** Yes.

**Mr. Brian Patterson:** It was predominantly a Central Bank output.

**Senator Michael D'Arcy:** The level of personal indebtedness, which was itemised as a particular vulnerability, in 1995 was 71% of GDP ... I've collated these figures from the FSR reports. In two ... of GDP. In 2007, 12 years later, the figure of GNP in the IFSRA ... or in the FSR report was 248%, taking this country to the most personally indebted nation within western Europe. Was that not highlighted to you, as the chairman of the Financial Regulator's office, at any stage?

**Mr. Brian Patterson:** Not *per se*. No.

**Senator Michael D'Arcy:** Did you notice it?

**Mr. Brian Patterson:** Did I notice it? There was ... I don't, I don't notice the particular figures, but-----

**Senator Michael D'Arcy:** Were you aware that the citizens of this country-----

**Mr. Brian Patterson:** Yes.

**Senator Michael D'Arcy:** -----went from being low debt-to-GDP ratio-----

**Mr. Brian Patterson:** Yes.

**Senator Michael D'Arcy:** -----to the highest in Europe?

**Mr. Brian Patterson:** Yes, I think I was aware of that at the time, yes.

**Senator Michael D'Arcy:** And should action have been taken to prevent that?

**Mr. Brian Patterson:** Yes, action should have been taken to correct that, absolutely.

**Senator Michael D’Arcy:** Again this morning I put to Mr. O’Reilly, Mr. Patterson, that principles-based regulation in this jurisdiction was similar to principles-based regulation in other jurisdictions. And yet our crash in the banking sector was 40% of GDP, a multiple times that of other countries. Can you explain how we were so much worse than other jurisdictions with the same principles-based regulation?

**Mr. Brian Patterson:** I ... I think it’s because our crash was systemic. I mean, in the UK another principles-based regulator, they had some spectacular banking crashes like RBS and Northern Rock, but they didn’t bring down the whole banking system. Because it’s a bigger country, the banking institutions, presumably, are more broadly spread. Ours was so concentrated and so intense, I think, that that accounts for the ... that unfortunate difference.

**Senator Michael D’Arcy:** And what brought down our banking sector? What was the primary reason?

**Mr. Brian Patterson:** The primary reason was that, as we now know, that bank lending, particularly into the profit ... the property sector, both domestic and commercial, and for all kinds of reasons which we’re beginning to understand, got out of hand. The banks were borrowing short to lend long. And when the crash came, and I do believe that international factors played a part in stimulating that crash, that it ... it just ... it rolled through the whole system.

**Senator Michael D’Arcy:** Just going back to Nyberg report: willingness and ability to act, to take action. Do you believe there were effective tools, instruments available to deal with the excessive credit growth and sector risk concentration, and can you assess the use and the efficacy of these instruments?

**Mr. Brian Patterson:** As I said, in answer to an earlier question, I now believe that there were instruments available to the regulator that could have, if deployed with sufficient urgency and force at the right time, could have curbed the lending, and, presumably, headed off the worst of ... of what happened, maybe not all of it, but the worst of it, and they weren’t used, and that’s a cause of great regret to me. They should have been.

**Chairman:** Thank you very much, Senator. Now I’ll invite Senator Marc MacSharry. Senator, you’ve ten minutes.

**Senator Marc MacSharry:** Thanks for being here. The Financial Regulator proposed a number of initiatives to impose more explicit requirements on banks, such as the directors’ compliance statements, corporate governance guidelines, and the fit and proper requirements. These proposals were not ... they were not fully successful. What was your view of these initiatives, and can you describe the circumstances in which the board chose not to implement the original proposed-----

**Mr. Brian Patterson:** Yes.

**Senator Marc MacSharry:** -----the original proposal for these initiatives?

**Mr. Brian Patterson:** I’ll have to deal with them one by one.

**Senator Marc MacSharry:** Yes.

**Mr. Brian Patterson:** The fitness and probity regime: the regulator set out with great intent to introduce this new ... this new regime, and it ran straightaway into a brick wall, as I recall it, because the industry obviously pushed back. They used all kinds of arguments about set-

ting the Irish banks with competitive disadvantage, “Here we go again”, etc. And having taken legal advice, my recollection is that the legal advice was that we would be unable to examine and potentially to disqualify existing directors; and this goes something, if I remember it, it was something to do with the constitutional protection to a right to earn a living, something like that. And that, therefore, people already in ... in ... office, which is 99% of them, could not be brought into this new regime, and with that realisation, I think the regulator had to think again. I do believe that later on a new regime was put in place. Initially, it could only examine new appointees, but with the 2010 Act, as I understand it, they were able to go back and ... and question and reassess existing office holders. That’s the fitness and probity one.

The directors’ compliance statements: again the regulator set out to use the powers under one of the Central Bank Acts to require directors of financial institutions to sign these compliance statements. And the industry, and it wasn’t just the industry, I think IBEC and other organisations were up in arms about this. And the barrage of resistance that we got to those was very substantial and I was aware there was a lot of lobbying going on at Government level and ultimately, the Department of Finance, as I said in my statement, they wrote to the regulator and said we weren’t to go ahead with the consultation because we were required to do consultation on all of these things. We weren’t to go ahead with the consultation without seeking their permission, if you like, first. Now, what happened in that event was, that there was coming down the track, from left field, a consolidation of financial services legislation because there had been layers and layers and layers of legislation and it got very complicated and the Department had planned to consolidate all this into a couple of updated Acts and the decision was taken to try and address it again through that process. Yes.

**Senator Marc MacSharry:** Let’s take directors’ compliance statements - what would be in a directors’ compliance statement?

**Mr. Brian Patterson:** A compliance statement would require directors of financial institutions to sign up to the fact that they were in compliance with all regulations, that they were in compliance with health and safety and all the usual stuff that compliance statements go for. But, particularly, that they were fulfilling their duties to manage the bank in a prudent fashion. That’s what would have been in it. I remember one ... the chairman of one large bank wrote a letter to me which was about materiality and he argued strongly that because there was no materiality clause in this, that if he hadn’t bought his dog licence or something, you know, that he couldn’t sign it, which I thought was a bit crazy but however. But there was a lot of push-back.

**Senator Marc MacSharry:** And what were IBEC saying?

**Mr. Brian Patterson:** The same thing.

**Senator Marc MacSharry:** You had mentioned them.

**Mr. Brian Patterson:** They were saying that this shouldn’t be done, that it was-----

**Senator Marc MacSharry:** But why were they saying it? I mean ... you know ... okay, it shouldn’t be done. There was a lot of people saying this, there was lobbying but what were they saying? We shouldn’t do this because ... why?

**Mr. Brian Patterson:** Because all the arguments were put forward that there is no materiality, that it would put the Irish banks at a competitive disadvantage and I think there were other arguments ... I can’t remember them all. It was in conflict with the law ... the law review group which had issued its report.



**Senator Marc MacSharry:** Did you feel these were bogus or valid concerns?

**Mr. Brian Patterson:** At the time, I thought they were valid. With hindsight, we should have pressed ahead and done it anyway.

**Senator Marc MacSharry:** Okay.

**Mr. Brian Patterson:** And if the Government had growled at us and said “No, you can’t do it”, I mean, we should have taken that on.

**Senator Marc MacSharry:** Okay. Did you ask that your own authority members would have a compliance statement themselves?

**Mr. Brian Patterson:** They regularly signed declarations and stuff under the ethics in public office but that’s a slightly different issue. No, is the answer. No.

**Senator Marc MacSharry:** Okay. You mentioned, perhaps with Deputy Doherty earlier on but certainly with some of the previous questioners, that there was a huge amount of interaction as you went about your business in your role with all the other executives, whether they were in the Central Bank or the regulator. Everybody knew each other. They were there on the seventh floor and you had a small office there. During that period, do you remember interacting at all with the chief economist from the Central Bank, Mr. O’Connell?

**Mr. Brian Patterson:** Recall that I’m a non-executive ... I’m not an executive, so therefore I’m in the place one or two days a week maybe ... sometimes more. Did I see Tom O’Connell from time to time? I did but I didn’t have any regular interaction with him.

**Senator Marc MacSharry:** Do you ever recall any interactions where he was a dissenting voice for the policy or direction?

**Mr. Brian Patterson:** No, I don’t. I saw some of his evidence yesterday and I don’t recall any of that.

**Senator Marc MacSharry:** Okay. And you wouldn’t be aware or are you aware of any attempts by him to get stuff before the board of the authority overall?

**Mr. Brian Patterson:** No, I’m not. I mean ... I ... and I ... as in all organisations when things come to a board, they’ve been through a lot of discussion and debate amongst the executive until they’re eventually in a state that the board can digest them and I can only assume that that’s where the difficulty lay ... that he was referring to.

**Senator Marc MacSharry:** Do you think it’s reasonable or not that an executive at the kind of level of director general or deputy director general or chief economist would have difficulty in getting concerns before the board?

**Mr. Brian Patterson:** I think it depends whether they’re right or not and I’m not trying to be smart about this. If ... if a crazy idea comes up, I think it’s absolutely right that the ... the line of accountability in an organisation would filter that out, but if ... if it’s sensible and right then it .. it could amount to censorship.

**Senator Marc MacSharry:** So do you feel that if there were dissenting voices coming from some of these senior executive positions, but not just on the board, were saying things like, ‘We need to reel in the banks’ lending policies’, would that kind of information have been

suppressed or prevented from getting to board level because, for example, it might spook the horses?

**Mr. Brian Patterson:** Could it have been suppressed before it came to the board, is that your question?

**Senator Marc MacSharry:** Yes, I mean is it ... do you think that that's-----

**Mr. Brian Patterson:** I think it's likely, yes.

**Senator Marc MacSharry:** It's likely.

**Mr. Brian Patterson:** I think it's likely because I think there was, particularly in the later years, around ... I'm guessing around 2006, 2007 there was a real - how should I put it - a real fear about spooking the horses.

**Senator Marc MacSharry:** So do you feel then that the directors of the overall authority ... you were the chairman of the ... the regulator but you were also a board member of the overall authority. Do you feel that information was kept from you for fear that you might determine something that might spook the horses?

**Mr. Brian Patterson:** I certainly didn't at the time.

**Senator Marc MacSharry:** But with the benefit of hindsight now, are you saying that?

**Mr. Brian Patterson:** Well, if Tom O'Connell came before this committee and under oath said he was prevented from giving information to the board then I accept that that must have happened.

**Senator Marc MacSharry:** With the ... and this has been touched on quite a bit already in terms of the lack of regulation experience of your own authority. Given that lack of knowledge of regulation, was it possible that the authority were, for want of a better expression, "easily led" on complex regulatory considerations? And how did you mitigate against this?

**Mr. Brian Patterson:** There were a few members of the authority who had a lot of financial services experience. We had one banker, one insurance chief executive and one other member who had good knowledge of the financial markets, and they did ask good questions and they did raise concerns but that's as far as it went.

**Senator Marc MacSharry:** Were your colleagues political appointments?

**Mr. Brian Patterson:** Well, well, all members of the authority were appointed by the Government.

**Senator Marc MacSharry:** Did you have a sense that they were appointed on merit or do you feel it was in any way because of a particular affiliation, politically or-----

**Mr. Brian Patterson:** I can't say. The ... the ... I will say this that ... I mean, first of all, let it be ... let it be understood I have no political affiliations myself. I'm not a member of any political party and ... and I never encountered either in the board of the authority in the Central Bank anybody making very overt political statements as being the Government should say ... would say this ... I never came across that.

**Senator Marc MacSharry:** Yes, Mr. O'Connell as well said yesterday that in his view that

some of his dissent did not make it through because of again, in his view, it said in his statement, ‘the property and political interests at the board’. Would you agree with this? And, very finally after that, you might answer if you were ever lobbied on an issue to do with regulation from outside interests.

**Mr. Brian Patterson:** I was surprised at Tom O’Connell’s statement about the board being full of political and property interests, or whatever way he put it. I mean, I was aware, as I guess we all were, that some members of both boards did have links to Government. That ... that was pretty common knowledge. But I never, ever experienced-----

**Senator Marc MacSharry:** What would define a link is all that I, yes that’s all-----

**Mr. Brian Patterson:** Well, there was one former Minister.

**Senator Marc MacSharry:** Yes.

**Mr. Brian Patterson:** There was one former fundraiser and so on. And they’re ... that’s all on the public record. There’s nothing ... there’s nothing secret about that. So I would have been aware that there would have been those linkages, but I don’t ever recall an instance where somebody was thumping the table and saying, “You know, I’m speaking on behalf of the Government or a political party and this is the position that I want the authority or the Central Bank to take”.

**Chairman:** -----lobbying ... on being lobbied on particular issues.

**Mr. Brian Patterson:** I was never lobbied, no. I have no recollection of any time when I was lobbied on behalf of Government or a political party or anything like that.

**Chairman:** Okay thank you. Senator Sean Barrett. Senator, ten minutes.

**Senator Sean D. Barrett:** Thank you very much. Welcome Mr. Patterson. The stress tests that you describe in section 2.6 on page 7 of your presentation here today. You say the authority took great comfort from the results of the stress tests. Who brought them to you? Did an individual from the Central Bank bring them in to you?

**Mr. Brian Patterson:** I recall that we had a lengthy presentation on a couple of occasions, probably once a year, from members of the Central Bank staff, who had been engaged in the stress tests and they presented the results of the stress tests to us. There was a long discussion and I remember coming out of those meetings thinking “Wow, you know, it all looks okay”. And that would have been alongside other concerns that I would have had about some of the things that Senator D’Arcy spoke about, and here were the people who were intimately involved with the stress tests saying “We’ve looked at it this way, we’ve looked at it that way, we’ve turned all the dials up and the banks are still okay”.

**Senator Sean D. Barrett:** And one bank hired a number of PhDs in mathematics to work them out. But I mean, your criticism of them today is incisive I think, in your statement today, what they left out. So this was sort of a kind of a mumbo-jumbo that ... that was useless.

**Mr. Brian Patterson:** Looking back on it, yes it was. At the time it appeared to be very reassuring and very, very ... what’s the word, very professionally done. It was only with the benefit of hindsight that you could see the holes in it.

**Senator Sean D. Barrett:** You say, on your summary 2.9, “The regulator was operating

a system of principles-based regulation which was internationally accepted as best practice at the time.” I think you’ve already answered that with my colleague, Senator D’Arcy. Whatever version we were applying, at a 40% of GDP fiscal adjustment costs to pay for banks, I mean nobody else was doing that except Iceland, and you mentioned Germany, so did we take ... and I would put forward Canada, which is in the World Economic Forum ratings of financial stability and banking stability - it has won it outright for the last seven years - but were no other models except what seemed like a wrong interpretation of ... in Ireland ... ever considered by your board?

**Mr. Brian Patterson:** No other models were ever seriously debated at the board, to answer your question. I think the problem, with the benefit of hindsight, is that while we adopted the European approach to regulation through principles-based there are two other elements missing. We weren’t intrusive enough, because you can have principles-based regulation with a heavy intrusion, and we didn’t, and also our enforcement action was too little too late.

**Senator Sean D. Barrett:** You refer to the Central Bank in your verbal presentation, I think it’s in the written one, that it had a culture which is hierarchical and secretive. Was that an obstacle in the task you were trying to perform?

**Mr. Brian Patterson:** It was unusual to me. I’ve lived most of my life in the private sector where those words wouldn’t be used. So I found it somewhat strange and I had to occasionally bite my tongue in going about my business. I always have a preference for an organisation that’s much more fast moving and doesn’t rely on formality and secrecy to the same extent.

**Senator Sean D. Barrett:** You refer on page 7 that that PwC report found the banks were healthy in 2007. Were accountants measuring different things than we would now measure to comment on whether a bank would survive another three months or another three years?

**Mr. Brian Patterson:** I guess they must have been, Senator. I mean, I can’t remember what was precisely in their report or what their methodology was but with the benefit of hindsight, it almost beggars belief that they could come up with such a report when ... with what we know now. So to answer your question they must have been looking at the wrong thing.

**Senator Sean D. Barrett:** And in Vol. 3, Mr. Chairman, in relation to ... on page 22, we have the meetings on supervision, pages 22 and 23. Did you attend those meetings, Mr. Patterson?

**Mr. Brian Patterson:** These are ... the financial stability committee?

**Senator Sean D. Barrett:** Yes.

**Mr. Brian Patterson:** No, I did not.

**Senator Sean D. Barrett:** And, were those minutes supplied to you?

**Mr. Brian Patterson:** They ... no, I don’t believe so, no. I don’t think so.

**Senator Sean D. Barrett:** Yes. Because, I mean, there’s a statement on page 22, late summer 2007, “The domestic economy and banking system remain sound and there is no cause for alarm”. Well, did you come across people on the seventh floor who ... who believed that?

**Mr. Brian Patterson:** Yes, I did.

**Senator Sean D. Barrett:** And ... and what was the ... I mean, you know, all the things which you've been documenting about loans to deposits, sectoral concentration and loan to value ... why were they not noticed? I mean, was ... was this the kind of corporate culture that you found strange or was there any explanation for how people could be so wrong?

**Mr. Brian Patterson:** Yes, I know. It ... it's hard to understand it in the ... in the light of what we know now. I ... one possible explanation, and I was reflecting on this in ... in recent days, is that, because the financial stability report could not, by its nature - and I mentioned this earlier on - give ... give rise to ... to concerns, or panic, it had to be quite positive and quite optimistic ... because of that I ... I begin to wonder whether that didn't infect people's thinking. So, you know ... you edit out all the ... the difficult bits out of the financial stability report in case it would spook the horses and then it's only a short step to saying well, that must be true.

**Senator Sean D. Barrett:** In early 2008, on the next page, "The commercial property loan book (of the Irish banks) was found to be well diversified on a geographical and sectoral basis [...] this diversification benefit may be offset somewhat by the potential increased comovement between international property prices during a global adverse shock." These were properties which NAMA discounted by over 60%.

**Mr. Brian Patterson:** I was gone by then, Senator, but ... but nevertheless, I mean, you ... you look at that and you wonder, I agree.

**Senator Sean D. Barrett:** Yes. Mark Carney, in his speech - the ... the Governor of the Bank of England - last night said, in looking at their system, "individuals must be held to account". Were individuals ever held to account during your time?

**Mr. Brian Patterson:** No, is the answer. I mean, if ... we ... we haven't talked about one bank X, which shall be nameless, and some of the governance problems that arose in ... in that bank, and a lot of them centred around one individual. And, no, the answer is they weren't held to account. And they should have been, of course.

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

**Chairman:** Thank you very much, Senator. Deputy Michael McGrath. Deputy, ten minutes.

**Deputy Michael McGrath:** Thank you very much, Chair. You're very welcome, Mr. Patterson. Can I just start by asking you, apart from the publication of the financial stability reports over a number of years, how did the Central Bank and IFSRA ensure that the Government was at all times well informed about the macroeconomic situation and ... and trends?

**Mr. Brian Patterson:** The macroeconomic situation and trends would ... would almost totally have been embodied in the Central Bank's annual report, it's quarterly bulletins, in the regular meetings with the ... which the Governor had with the Minister, as well as the financial stability report. There would have been a number of communications from the Central Bank to the ... the Minister, that the macro piece would not have been within the regulator's remit.

**Deputy Michael McGrath:** Okay. You said that, in your role as chairperson of the board, a non-executive position, you'd find yourself in the building or in the office one or two days a week. Typically, how many hours work a week would being the non-executive chairman of the board involve?



**Mr. Brian Patterson:** It ... it varied greatly. In the early years I ... I was in there three, four, five days a week, for long days - I don't work an eight hour day. And then, later on, it varied. If there was ... if there was some issue happening that required a lot of ... a lot of my time, I would be in, but other days there wouldn't be. It ... it varied a lot but ... and when I say one or two days a week, I think that was probably how it averaged out, I never measured it.

**Deputy Michael McGrath:** So ten to 20 hours a week maybe?

**Mr. Brian Patterson:** Yes, something like that, yes.

**Deputy Michael McGrath:** Something like that. And, was there a fee attaching then to ... to the position?

**Mr. Brian Patterson:** Yes, yes.

**Deputy Michael McGrath:** And how much was that say, for 2006 or '7?

**Mr. Brian Patterson:** There were ... there were two elements. I was paid something like €20,000, I think, as the director of the Central Bank, and €50,000, as the chairman of the regulator, which came to, I know, €70,000 non-pensionable and fixed.

**Deputy Michael McGrath:** Okay. Just on the issue of the powers that the Financial Regulator had, it strikes me that there is something of a difference between what you said verbally and what's in your ... your written report, and, you indicated a ... a change in your thinking. Was that a very recent change in your thinking, that the ... that the Financial Regulator did have adequate powers to intervene?

**Mr. Brian Patterson:** Yes, it is fairly recent. I ... when I was preparing for this hearing, obviously I did quite a lot of research and I listened to a number of the testimonies that have been made here. I read a lot of stuff and I came to the conclusion that the regulator did have powers that it could have used and didn't, which only deepens my regret.

**Deputy Michael McGrath:** Sure. Because your written statement in section 1.2, which starts on page 3, it makes a number of points about powers, that you didn't have ... that the regulator, sorry, didn't have the power, for example, to disapprove of specific products like 100% mortgages. You make the point about foreign banks which are passported in here and you didn't ... the regulator didn't want to disadvantage Irish banks through the regulatory approach. You talk about the delays in the administrative sanction regime coming online, as such. And then at the very end, in your conclusion, you refer to "constrained powers". So are you revising those points?

**Mr. Brian Patterson:** I am, to a degree, yes.

**Deputy Michael McGrath:** Okay.

**Mr. Brian Patterson:** What I wrote in the statement, which is now, I think, four weeks old or something ... what I wrote, I wrote in good faith. It was only subsequent to that that I really had to face up to the fact that, in truth, there were powers there that could have been used.

**Deputy Michael McGrath:** Sure. But, in preparing your statement ... and over recent months, you had the benefit of the official reports which were published and they dealt quite comprehensively with the issue of the powers available to the Financial Regulator and the Central Bank and yet you kind of left the issue of powers hanging there in your statement. It wasn't



entirely clear.

**Mr. Brian Patterson:** I accept that. That is a criticism I accept. You're right that the Nyberg report, for example, does outline a number of powers. I tended, when the Nyberg report was published, to not want to take that on board, but I have now.

**Deputy Michael McGrath:** Okay. The annual financial stability reports ... you make, I think, quite an important point that, in a sense, it almost had to be sanitised because of the risk of stoking fear or spooking the horses, as you put it. But doesn't that go to the very heart of the integrity of the document? I mean, you said earlier on that the financial stability report didn't reflect the concerns of board members. Isn't that quite an extraordinary situation, that people who would have been reading that report and relying on that report, that it really didn't give the full picture?

**Mr. Brian Patterson:** I don't think it did, no. And ... and I believe now that the financial stability report is an inappropriate way of communicating any concerns there are about banks or the banking system for the reasons that you have summarised very well. But at the time it was. That was the way, at least publicly, it was done. The real issue about integrity of the process is whether actions followed from it, not what was written in the report. Because absent the report ... let's put that report to one side for a minute and say, yes, it had to be optimistic and not to frighten the horses and so on. Nevertheless, the concerns that, I think, existed within the two boards and the executive could have found their way into stronger and more urgent action and they didn't.

**Deputy Michael McGrath:** Sure, but I would put it to you, Mr. Patterson, that the words contained in the report were very important. People relied on that report. Businesses might have made investment decisions on the basis of the Central Bank's assessment, that the fundamentals were strong, there would be a soft landing, that there are risks but they are manageable. You know, individuals were reading the headlines in the newspapers and on the broadcast media where, you know, there was a strong sense from the Central Bank that, you know, everything's going to be fine. People were relying on that and I put it to you, you know, was the financial stability report a fully honest document?

**Mr. Brian Patterson:** I don't think it set out to tell lies and if you read the commentary very closely and read between the lines, I think you can get a sense of a growing level of unease in it. And, indeed, some of the analysis that was in the back of it, and I think Tom O'Connell referred to this yesterday, was showing a lot of the concerns. But I remember being in the central board discussion about the final signed-off wording of the financial stability report and there were voices in ... in ... in-----

**Chairman:** What year was this report, Mr. Patterson?

**Deputy Michael McGrath:** This probably would have been 2006 or '07. And I remember voices in the board saying "No, we can't say that because, if we do, we will bring about the very thing we're trying to avoid".

**Chairman:** This was the 2006 to 2007 report not the-----

**Mr. Brian Patterson:** It could be ... it would be one or either.

**Chairman:** Okay. Sorry, Deputy.

**Mr. Brian Patterson:** I can't remember which, but certainly later in the period.

**Chairman:** Deputy McGrath?

**Deputy Michael McGrath:** But would it have been better to not publish a report at all, rather than publish a report that didn't reflect the concerns of board members?

**Mr. Brian Patterson:** Yes, I agree, and, as we know, it is no longer published, it's not a document that's done anymore. But I think, given the size of the problem that had begun to evolve in 2006 and 2007, if the Central Bank came out and said, "We're not going to publish a financial stability report this year", that itself would have set off the alarm bells because I think there comes a point ... let's see if I can describe this properly. In the early days, the financial stability report probably had to reflect only mild concerns, and so maybe it was able to do that. As the pressure cooker developed more and more pressure inside it, the financial stability report should have reflected greater concern but, paradoxically, it had to be even more constrained than it had been before because of the fear of bringing about a run on the banks. So, it got ... you get caught in this kind of dilemma, that no matter what way you jump, you're in trouble.

**Deputy Michael McGrath:** But I would put it to you, Mr. Patterson, that people don't expect the Central Bank to be engaging in spin.

**Mr. Brian Patterson:** No, but it didn't lie. I mean, I'm not suggesting that the financial stability report-----

**Deputy Michael McGrath:** I didn't say-----

**Mr. Brian Patterson:** -----contained lies.

**Deputy Michael McGrath:** I didn't say that there were lies involved, but, I mean, you've made what I would regard as quite a significant statement, that the financial stability report didn't reflect the concerns of board members.

**Mr. Brian Patterson:** Of all board members.

**Deputy Michael McGrath:** Of all board-----

**Mr. Brian Patterson:** Yes, because there would have been some board members who would have said, "No, it's fine." I'm not suggesting that those concerns were unanimously shared across the two boards, they weren't, but there were concerns.

**Deputy Michael McGrath:** But there was an overriding requirement or a feeling of necessity to, in a sense, dilute, water down any major concerns-----

**Mr. Brian Patterson:** Yes.

**Deputy Michael McGrath:** -----that you might have had-----

**Mr. Brian Patterson:** Yes.

**Deputy Michael McGrath:** -----that the board might have had.

**Mr. Brian Patterson:** Yes.

**Deputy Michael McGrath:** Okay. Can I just finally ask you, Mr. Patterson, we had evidence from Patrick Neary. He told the committee that Mr. David Drumm raised the issue of

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Seán Quinn's contracts for difference with him in a private meeting in September 2007. Was that matter brought to the attention of the board? And I'm conscious you became ill quite shortly afterwards but can you recall?

**Mr. Brian Patterson:** I was out of action from early October to December of that year so I'm afraid I can't answer your question, Deputy. I don't know.

**Deputy Michael McGrath:** You can't recall when the issue first-----

**Mr. Brian Patterson:** No, I can't.

**Deputy Michael McGrath:** -----came to the board.

**Mr. Brian Patterson:** I have no ... I have no memory of that meeting and that issue around the contracts for difference ever being discussed in the authority.

**Deputy Michael McGrath:** Ever?

**Mr. Brian Patterson:** Not in my time, no.

**Deputy Michael McGrath:** Okay, thank you.

**Chairman:** Thank you, Deputy. Deputy Joe Higgins.

**Deputy Joe Higgins:** Mr. Patterson, could you explain to us the link between the micro-prudential regulation for individual institutions, how that then led to sector analysis and to ... how that fed into macroeconomic analysis for the Central Bank itself?

**Mr. Brian Patterson:** The supervision of banks required them to submit returns, and there were a lot of them, and they would have been analysed by the banking supervision unit and from that would have emerged some composite data on bank exposures and things like that. Those exposures would have been known to the economists and the analysts in the Central Bank who were conducting the stress tests and who were in the financial stability unit, doing work on financial stability, so it all emerged from the reports and returns that the banks gave to the banking supervision people and indeed some of the inspections that they were carrying out. But, as I've said-----

**Deputy Joe Higgins:** And this found its way to the board then?

**Mr. Brian Patterson:** Yes.

**Deputy Joe Higgins:** The boards.

**Mr. Brian Patterson:** Yes, yes.

**Deputy Joe Higgins:** Okay. And can I therefore take you again to Vol. 2, page 3? Deputy Doherty already referred to this and from a meeting in 2004, April-----

**Mr. Brian Patterson:** Yes.

**Deputy Joe Higgins:** I'm allowed to quote, aren't I?

**Chairman:** Well, this isn't actually an-----

**Deputy Joe Higgins:** Yes, its-----

**Chairman:** You can certainly refer to the document in front of you, Deputy.

**Deputy Joe Higgins:** Yes. So, let me just rehearse it again that: “X reported under Financial Stability Matters on recent discussions at the boards of the [Central Bank] and [the regulator]”.

**Chairman:** That’s showing on the screen at the moment now.

**Deputy Joe Higgins:** Yes.

**Mr. Brian Patterson:** I’ve got it here, yes.

**Deputy Joe Higgins:** Okay. So, presumably, this is then an analysis of the information that has been fed in from the banks and the regulator looking into the banks. Okay, X then suggested that the Central Bank “had not convinced market participants that there may be “systemic risk” [that’s in inverted commas, suggesting that that’s the very word that was used] building up in the banking sector” and “indicated there may be a “degree of euphoria building up in the property lending markets and that the boards and management of banks are being myopic about the potential risks.”” Now, would you agree that that is a really serious assessment - very early on - in April of 2004 of what was happening?

**Mr. Brian Patterson:** Yes, I would.

**Deputy Joe Higgins:** And would agree, therefore ... or would you agree as well, Mr. Patterson, that the next sentence “X outlined a work programme including a “roadshow” designed to convince the bank boards of the “rationale to curb lending” no [direct] regulatory action was [recommended].” Would you agree that that is an enormous contrast to the seriousness of what went before? And would you agree that it is, or is not, a pathetically inadequate response?

**Mr. Brian Patterson:** I would agree that there is a major contrast between the first part that you quoted and the second part, yes, I would. In the ... in the time of that statement being made, the regulator was still practising principles-based regulation.

**Deputy Joe Higgins:** Yes. And let’s move on a little bit with that, because we have to try and get ... I would like to try and get, if we can, to where the source of what I suggest to you, and you can come back later, is this shows a paralysis by the Central Bank and regulator in view of the seriousness of what went before. I want to get, or to tease out, what’s the source of that inaction, which you’ve agreed with.

**Mr. Brian Patterson:** Yes.

**Deputy Joe Higgins:** And then you said yourself ... sorry, the regulator’s annual report of 2006, that “[The] principles led approach to regulation is the right model for Ireland [...] It both allows and requires banks to manage themselves.” And then, in your opening remarks ... no, your opening written statement to us, on page 3, you said “there was an effort to ensure that rules and regulatory practice did not have a disproportionate impact on the operation and development of the financial services sector – particularly in relation to the IFSC.” Now-----

**Chairman:** I’d leave the questioning now, Deputy, to allow the witness to respond and I’ll bring you back in again.

**Deputy Joe Higgins:** Yes, but I want to put two or three quotes-----

**Chairman:** Okay, okay.

**Deputy Joe Higgins:** -----to him because its all of the same theme, Chairman. Mary Burke from the Central Bank gave evidence here, “believing that the authorities did not want a stricter regulation regime for Irish banks because the IFSC could then be seen as an area with less regulation that might be compared to an offshore financial haven”. And, Mr. Patterson, you make almost precisely the same point in page ... oh dear, its all my stuff here ...in page 6 and 7 of your written statement, when you say “It was [...] felt that foreign and domestic banks had to be treated the same - in order to avoid giving substance to any impression that Ireland was host to an off-shore centre that was being treated more lightly than its domestic banks.” Is this the secret of the riddle? That there was an international deregulation of the financial services, massive competition and that this ... did this then result in a race to the bottom that was reflected in this policy that was adopted by the regulator?

**Chairman:** Mr. Patterson?

**Mr. Brian Patterson:** Yes, thank you, Chairman. No, I don’t believe that was the cause of it. I’ve been following your logic all along and I agree with you that the response to the analysis of the risk is inadequate, to say the least. But my belief is that the source of the inaction, if that’s what you call it, came more from the fact that the regulator believed it was following a principles-based approach, right, and that therefore the banks bore the responsibility for managing themselves and for not exceeding prudential risk, etc. And the reference to a roadshow in the second part of that quotation, in my view, comes under the heading of “moral suasion”. In other words, we’re going to go out and we’re going to talk to the banks, we’re going to point out to them what’s happening and we’re going to - to go back to what I said earlier - raise our eyebrows at them and say “You know, you shouldn’t be doing this,” and that the banks would then take corrective action.

**Deputy Joe Higgins:** Yes. The problem there, Mr. Patterson, is - we’ve said it to the previous witness - the evidence from the banks is that some of them had engaged in huge cheating at the taxpayers’ expense.

**Mr. Brian Patterson:** I think-----

**Deputy Joe Higgins:** Why should you assume that they would be paragons of virtue?

**Mr. Brian Patterson:** The principles-based approach put the responsibility for prudent management of their affairs onto the boards of management of the banks. Now ... with hindsight, that didn’t work. I’m not arguing that point. It didn’t work. And the enforcement actions, which were available to the regulator, moral suasion, capital requirements, etc., etc., either didn’t work ... the moral suasion thing just didn’t work because the banks weren’t listening, yes, whereas in old God’s time, they probably would have listened.

**Deputy Joe Higgins:** Yes.

**Mr. Brian Patterson:** The capital requirements were in ... were deployed, but too little too late. Conditions to licences were used, I believe, only very sparingly, so there were a number of powers there that could have been used that weren’t used. But it all goes back to ... and I know you’re fed up listening to this - it all goes back to the fact that the regulator believed principles-based regulation was the way to go.

**Deputy Joe Higgins:** Yes, but the point I’ve been trying to tease out is why that? And then the IDA ... you know, a very serious body in this country, said to businesses and to banks coming in, “The Regulator has disappplied its powers of supervision.” It was policy, was it or was

it not?

**Mr. Brian Patterson:** Did the IDA say that?

**Deputy Joe Higgins:** In a *Ship of Fools*, which is a book by Fintan O'Toole, the IDA is quoted verbatim as saying, in attracting in these enterprises, that "The Regulator has disappplied its powers of supervision."

**Mr. Brian Patterson:** Right. I hadn't ... I wasn't aware of that.

**Deputy Joe Higgins:** Okay. Can I ask you then, lastly ... or maybe second lastly.

**Chairman:** No, you're just allowed these. Drive on.

**Deputy Joe Higgins:** A few years ... not too long, but a few years after you retired, Mr. Patterson, you were quoted in the *Irish Independent* on 4 December 2010 ... I couldn't find the speech unfortunately, but you're quoted as saying in relation to the bubble and the crash, "We were all responsible"... this writer said that you said, "We were all responsible," he said, several times in a speech that extolled, among other things, that ... a democracy that allows a change of government without military coups ... I think we're all grateful for that. But do you really believe that - that ordinary people were responsible for the bubble?

**Mr. Brian Patterson:** I wasn't suggesting that.

**Deputy Joe Higgins:** No.

**Mr. Brian Patterson:** This, I think, is the same speech that was referred to in Kilkenny.

**Deputy Joe Higgins:** It is in Kilkenny, yes.

**Mr. Brian Patterson:** Yes. And if you recall the date, I think we were just a few weeks after the bailout and I believed that we were in the business of talking ourselves down as a country and the speech that I gave at the time tried to ... perhaps unsuccessfully, to focus people on all the positives that existed in our country and how we still had a lot of freedom, because a lot of people were saying we'd lost our sovereignty. I didn't believe that was the case. We certainly had lost our economic and financial freedom, but ... and that was the reference to-----

**Deputy Joe Higgins:** Yes. He also says, incidentally, Mr. Patterson, that you vowed at that meeting in future to avoid negativity, no longer read Morgan Kelly, no longer watch Vincent Browne, read Shane Ross or listen to Joe Duffy. Can I ask you: do you agree with Mark Carney that there should be jail for bankers and financial institution senior personnel who deliberately defy regulation and laws?

**Mr. Brian Patterson:** I think there should be severe penalties for people who defy the law.

**Deputy Joe Higgins:** Should they go to jail?

**Mr. Brian Patterson:** If necessary, yes.

**Chairman:** Thank you very much, Deputy. Deputy Murphy.

**Deputy Eoghan Murphy:** Thank you, Chairman, and thank you, Mr. Patterson. I just wanted to clarify a couple of things briefly from your opening statement and from the testimony we've already heard today. Just on page 3 of your opening statement, when you talk about the



Central Bank's mandate, part of it being to develop the financial services sector. And you say, "While the Regulator legally had no similar responsibility, it was widely believed that its remit included supporting the development of the industry." So where did that belief come from?

**Mr. Brian Patterson:** It was written into the Central Bank and Financial Services Authority of Ireland Act, all right? So CBFSAI, that horrible acronym, had it as a legal responsibility, and the Financial Regulator, even though it had its own Act, operated under the aegis of the overall umbrella of CBFSAI. And I think that was the main reason why it was believed that the Financial Regulator also had that responsibility.

**Deputy Eoghan Murphy:** Was this discussed within the Financial Regulator?

**Mr. Brian Patterson:** Was it discussed as a policy that either we should or should not have this?

**Deputy Eoghan Murphy:** Yes.

**Mr. Brian Patterson:** No, I think it was more assumed.

**Deputy Eoghan Murphy:** Assumed, okay. So no conversations with the CEO about whether or not he should be spending time attending certain meetings or presentations.

**Mr. Brian Patterson:** I don't recall any of those conversations, no.

**Deputy Eoghan Murphy:** Okay, thank you. Just further down on that page and responding to what Deputy McGrath raised with you in relation to your powers ... so that first point there that you have no powers, *per se*, of approval or disapproval over the banks' products like 100% mortgages. Did you have the power?

**Mr. Brian Patterson:** No, we didn't ... it wasn't written into law that we ... that the banks had to come to us to have their products approved, because if that had been the case, there would have been a long queue. But my ... my belief is that we could have curbed 100% mortgages by using other levers.

**Deputy Eoghan Murphy:** Levers through the banks, in terms of?

**Mr. Brian Patterson:** In other words, what do I mean? We could have imposed additional, even more capital requirements than we did, although that would have run into some issues, like the anti-competitiveness issue and so on. But we could have imposed more stringent capital requirements; we could perhaps have gone at it through the consumer code, right, that it was inappropriate to be selling these 100% mortgages, certain classes of people; we could have attached conditions, conditions to banking licences, that they couldn't ... which effectively would've banned them.

**Deputy Eoghan Murphy:** Was any of this discussed at the time, on the board or with the CEO?

**Mr. Brian Patterson:** No, not to my knowledge.

**Deputy Eoghan Murphy:** Was any level of attention given to this introduction of this new product, 100% mortgages-----

**Mr. Brian Patterson:** Yes, it was discussed. Now, at the time the banks who were doing this tried to assure us that this would ... these products would only be sold to a very small mi-

nority of people, for whom it was appropriate. Now, as we know now, that wasn't the case, but that was the assurance given at the time.

**Deputy Eoghan Murphy:** And despite the concerns, and they've already been referenced earlier in the proceedings over the increase in mortgage lending that was happening in the banks, as expressed in the 2004 financial services report ... stability report, excuse me, you took those assurances?

**Mr. Brian Patterson:** At the time, yes.

**Deputy Eoghan Murphy:** Okay. And did you ever think to recommend to customers that they should not take on these mortgages?

**Mr. Brian Patterson:** I think you heard from Mary O'Dea yesterday that she and her team were quite strident in their advice to consumers that they had to be very careful in approaching a bank looking for 100% mortgages.

**Deputy Eoghan Murphy:** Okay, but it was never, you know, a move authorised by the board to say go out and say to people, "Do not take these mortgages"?

**Mr. Brian Patterson:** Well, Mary O'Dea would have discussed this at the board, I believe, and the board would have supported that, yes.

**Deputy Eoghan Murphy:** She didn't meet opposition at the board?

**Mr. Brian Patterson:** Sorry?

**Deputy Eoghan Murphy:** She didn't meet opposition at the board?

**Mr. Brian Patterson:** No.

**Deputy Eoghan Murphy:** No, okay. Just moving on then to, to page 4 and it's in page 6 as well of your statement. You make two references to IT systems, and I'm just wondering ... you talk about problems in the IT unit and then later on you reference how these problems impacted upon your ability to conduct on-site inspections of the banks. Are we talking about a simple IT problem, or are you implying something else here in terms of co-operation from the Central Bank?

**Mr. Brian Patterson:** I've got to be careful here, Chairman. There were significant problems in the Central Bank's IT unit and the net result of that was that their responsiveness to the needs of the Financial Regulator and, in particular, banking supervision was inadequate. I'm ... I'm trying to be very careful here.

**Deputy Eoghan Murphy:** Okay.

**Mr. Brian Patterson:** Because otherwise I'll end up naming names.

**Deputy Eoghan Murphy:** Okay ... but the inadequacy then impacted upon the regulator's ability to conduct on-site inspections?

**Mr. Brian Patterson:** Yes.

**Deputy Eoghan Murphy:** And so what was the result of that then in terms of getting in more adequate systems or fixing the problems that you were encountering?

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**Mr. Brian Patterson:** The ... we tried a number of things. We developed MOUs between the regulator and the IT unit. I think the chief executive, what's the word I'm looking for, assigned a particular responsibility to one of the senior executives to pay close attention to this and to have regular meetings with IT to see how things were going. So those things were attempts to try and speed things up and to move it more quickly but we were, nevertheless, a prisoner of the Central Bank's IT unit. We did not have the capability of the authority to go outside.

**Deputy Eoghan Murphy:** Okay. And did this ultimately then lead to a lack of information as to the bank's individual levels of lending, credit quality, exposures, when we come into the crisis period?

**Mr. Brian Patterson:** It certainly impaired the banking supervision unit's ability to keep pace with that, yes.

**Deputy Eoghan Murphy:** Okay. Thank you.

**Mr. Brian Patterson:** And at the same time, I mean, the data requirements for Basel II were just enormous-----

**Deputy Eoghan Murphy:** Okay.

**Mr. Brian Patterson:** -----and all that was going on at the same time.

**Deputy Eoghan Murphy:** Okay. Just moving on then to compliance statements on page 6 of your opening statement. And you talked about the Department of Finance getting involved and giving a clear signal that this did not have Government support, your move to conduct compliance statements. Did you need Government support?

**Mr. Brian Patterson:** We certainly didn't need Government resistance.

**Deputy Eoghan Murphy:** Can you elaborate on that?

**Mr. Brian Patterson:** If ... I think it was believed in the authority at the time that the Government actively did not want us to proceed with this. And that got expressed to us through the Department of Finance and this letter that they wrote saying, "Do not proceed with the consultation without coming back to us."

**Deputy Eoghan Murphy:** Is that ... thank you. Is that appropriate that they do that?

**Mr. Brian Patterson:** I guess if the Government thinks that we're on the wrong track, they're entitled to express a view. Now, in fairness, the Department of Finance was quite careful in the way it structured this, you know. It said, "We don't want you to proceed with the consultation, but by the way, you retain the right to impose this on individual institutions if you see fit."

**Deputy Eoghan Murphy:** Okay.

**Mr. Brian Patterson:** So they were reminding us that "we still own the ball", you know.

**Deputy Eoghan Murphy:** Okay. And then just moving on then, further on that page, relates to the prudential pack and it's already been addressed, but that first paragraph under 2.5, you said: "The Executive assured the Authority that all these loans had strong asset backing." But was anyone checking? In the Financial Regulator's office, was anyone actually checking the quality of these assets?

**Mr. Brian Patterson:** I think that's one of the fundamental problems, that the ... because the inspections were only focusing on process and not on content, that they weren't picking up the fact ... and I think in some of the core documents, there's the result of a themed inspection in, I think, it is 2008-----

**Deputy Eoghan Murphy:** This is the five by five?

**Mr. Brian Patterson:** Yes, yes. Where they discovered late in the day that net worth statements were very flaky. They either didn't exist in some cases or they hadn't been independently verified and that some of the tests that the banks were believed to be applying to loan requests weren't being applied. So in other words, the ground on which that was based was very shaky.

**Chairman:** Hang on a minute now, Deputy.

**Deputy Eoghan Murphy:** Yes, I was just in the middle of a question. Thanks, Chair. Just in relation to that process though, because in that five by five exposure test that was done into the big developers, it was found in one of the tests that one of the banks in terms of calculations of an exposure to one individual borrower, was out by a billion. But it also noted that the - and I'm paraphrasing here - that the significance of that wasn't understood by the regulatory system..

**Mr. Brian Patterson:** Yes.

**Deputy Eoghan Murphy:** So it wasn't ... was there a knowledge gap as well, in terms of understanding the asset quality?

**Mr. Brian Patterson:** I wasn't around for that particular bit of it, I had gone by then, but, yes, I think the answer to your question is yes, there must've been a knowledge gap.

**Deputy Eoghan Murphy:** Okay.

**Mr. Brian Patterson:** But I am surmising because I wasn't there.

**Deputy Eoghan Murphy:** Okay, thank you. And then just a final question in relation to your opening statement and again, it's on page 6 and it's in relation to the IFSC, talking about sector limit and it came up earlier. You talked about, the Central Bank had effectively relaxed these limits in the 1990s, in particular to facilitate the arrival of one large foreign bank which had a major sector exposure. It was then felt that foreign and domestic banks had to be treated the same in order to avoid giving substance to any impression that Ireland was host to an off-shore centre that was being treated more lightly than its domestic banks.

**Mr. Brian Patterson:** Yes.

**Deputy Eoghan Murphy:** So what you're saying there is we relaxed the sector limits to attract one particular bank and as a result in terms of, I suppose, looking for fairness, we then relaxed the limits for everyone else.

**Mr. Brian Patterson:** That's what I'm saying, yes.

**Deputy Eoghan Murphy:** Okay. Do you think that's perhaps a perverse way to approach sector lending limits? That in order, you know, to change the rules for one so they must then be weakened for everyone else.

**Mr. Brian Patterson:** I didn't say that the rules were changed, because the sector limits

were still there and they were still subject to reporting-----

**Deputy Eoghan Murphy:** It's been relaxed.

**Mr. Brian Patterson:** -----but they were relaxed. I think what happened, and this was way back in the 1990s ... and I could stand corrected, I put this as my belief ... that the approach was to relax the stringency of that for that reason in order, as I say, to attract in a large foreign bank into the IFSC. With the benefit of hindsight, that was a bit crazy.

**Deputy Eoghan Murphy:** But if the standards were then relaxed for everyone else-----

**Chairman:** This is your last question, because I have to move on.

**Deputy Eoghan Murphy:** -----doesn't that imply that there's something ... there's a problem there? And it implies it not in hindsight, but at the time-----

**Chairman:** Sorry, Deputy, I'm going to have push you. You're out of time, and you're out of questions. Make your comment and I'm moving on.

**Mr. Brian Patterson:** Sorry, I couldn't get the questions.

**Chairman:** Sure I'll give it to you briefly there.

**Deputy Eoghan Murphy:** If you're relaxing the sectoral limits?

**Mr. Brian Patterson:** Yes. For one bank.

**Deputy Eoghan Murphy:** For one bank, and then as a result have to relax them for everyone else, doesn't that imply that ... I mean, doesn't that imply that you're approaching this the wrong way in terms of regulation?

**Mr. Brian Patterson:** The tail wagging the dog, in other words?

**Deputy Eoghan Murphy:** Excuse me?

**Mr. Brian Patterson:** The tail wagging the dog?

**Deputy Eoghan Murphy:** Yes.

**Mr. Brian Patterson:** Yes, yes it does. I mean, with the benefit of hindsight, that was a crazy thing to do.

**Deputy Eoghan Murphy:** At the time, though. At the time shouldn't that have been very obvious that the tail was wagging the dog?

**Mr. Brian Patterson:** I don't know, because I wasn't there then.

**Chairman:** All right, thank you. Mr. Patterson, I just need to deal with one matter or two before I bring in Senator O'Keefe, and that was: was there an internal guidance/manual on how to handle breaches of principles or other regulatory measures?

**Mr. Brian Patterson:** There may have been within the executive, Chairman, and my guess is there would be, but I don't remember seeing that at the level of the authority.

**Chairman:** Okay, so who would be in possession of such a manual, or where would it be

located?

**Mr. Brian Patterson:** I guess the prudential director but I'm guessing. I don't know.

**Chairman:** Okay. I was just looking at your report for 2006, it's a summary of the annual report of Financial Regulator, and I see yourself there and the team, there's 13 of you in total. Looking at the skills composition of that team now, do you think that it was adequate for the, sort of, challenges that we were going to be facing into from 2006 onwards?

**Mr. Brian Patterson:** I think I've touched on this before. The members of the authority, and there are some executives there in that group photograph again, it did have people who had experience of the financial services industry. We'd a banker, we'd a chief executive of an insurance company, we had one individual, I think he had retired by then actually, who had deep knowledge of financial markets, so there was a level of understanding about financial services *per se*, yes? What was missing, other than in the executive, was experience of financial regulation, and what was also missing was an international perspective.

**Chairman:** Okay. I just want to ... this is the team for the regulator's office, and have you just said that what was missing there was an expertise in financial regulation?

**Mr. Brian Patterson:** Amongst the non-executives.

**Chairman:** Amongst the non-executives.

**Mr. Brian Patterson:** Amongst the non-executives, yes.

**Chairman:** Okay, all right, thank you. Senator O'Keeffe.

**Senator Susan O'Keeffe:** Thanks, Chair. After 2004, when the IMF and the OECD and ECOFIN all clearly recommended a tighter fiscal stance and the building up of a cushion for the time when income from property-related transactions would fall, can you say why, in your view, the Central Bank's recommendations to the Minister didn't more forcefully alert this particular issue?

**Mr. Brian Patterson:** I think it goes back, Senator, to what I said earlier in terms of the ... No. 1, that any concerns about the banking system or individual banks, it's not appropriate to make those in public, so they wouldn't have been visible to the public. And also perhaps an inappropriate feeling that everything all was better than it was.

**Senator Susan O'Keeffe:** Do you think that, given that the Central Bank's whole approach was to not say things in public for fear of spooking the horses that then ... that actually led to a reluctance also to grasp things internally?

**Mr. Brian Patterson:** Well, I-----

**Senator Susan O'Keeffe:** The very fact that you weren't doing it externally?

**Mr. Brian Patterson:** I referred to that earlier, and it's possible, we're into psychology here, it's possible that that was the case. I've no evidence, *per se*, that that was the ... that there was cause and effect there, but I think, on reflecting about it, that it's at least possible that in drafting a fairly - what's the word?- anodyne financial stability report, that that somehow or other got into people's thinking. It's possible.

**Senator Susan O'Keeffe:** On page 7 of your own statement, you refer to the regulator pay-



ing close attention to the Central Bank's stress tests, which were largely carried out in the banks themselves under supervision of the Central Bank. Does that mean that the banks themselves were very much involved in the stress testing, and was the supervision on a permanent, you know, were they there all the time, or was it that they'd drop in and out and have a look, how did that ... do you know how that actually worked?

**Mr. Brian Patterson:** My understanding, and I could stand corrected on this, my understanding is that the Central Bank laid out the methodology for doing the stress tests - and I think there was some reference in one of your previous witnesses about the IMF having an involvement in that ... in 2006, I think it was - so they would have laid out the framework and the methodology for doing it; it was then left to the banks to actually do all the number crunching, which they understood. I'm ... I can't answer your question as to whether people from the Central Bank were looking over their shoulders while they did that. I don't know.

**Senator Susan O'Keefe:** So, so if the banks were left, if you like, to do the number crunching, as you put it, then, in a way, there was no way of knowing, really, how close and verified-----

**Mr. Brian Patterson:** Yes. To my knowledge, their wasn't, but I ... I could be wrong on that.

**Senator Susan O'Keefe:** Yes, okay. I think I heard you say earlier on that you ... if you like, you would have preferred an organisation that was a little bit more ... what was the word you used ... a little bit more dynamic?

**Mr. Brian Patterson:** Yes.

**Senator Susan O'Keefe:** I think that was the word you might have used. Did you find that ... that there was a mismatch, if you like, between your own expectation, perhaps, when you took up the post and when you realised then what the organisation might have been like, that it was less dynamic than you might have imagined?

**Mr. Brian Patterson:** Let me say at the start that perhaps it's appropriate that a central bank and a regulator is a bit slow and, whatever word you want to use, because it does ... it is a public sector body; it does have serious responsibilities and it can't afford to cut corners or take risks and things like that. So let me get that on the record. But yes, I mean, I had worked in chairmanship roles in the public sector before, so I wasn't a complete novice, but the extent to which the Central Bank culture was as I described it did come as a little shock to me.

**Senator Susan O'Keefe:** Because you say actually, on page 2, you say, "...the culture, which in my view was generally hierarchical, deferential, cautious and secretive", so they're four quite strong words. Of those would you have ... were any one of those more ... had a greater impact than any of the others, or were they collectively creating a kind of culture?

**Mr. Brian Patterson:** I was interested yesterday listening to Tom O'Connell, and what he was describing was a hierarchical culture, because he was saying, "Here I was shouting and screaming and trying to get my view across but the guy above me wasn't hearing it, full stop". That's hierarchical.

**Senator Susan O'Keefe:** And wasn't, perhaps, allowing things to be heard either. It would have been-----

**Mr. Brian Patterson:** Absolutely, yes, I agree, I agree.

**Senator Susan O’Keeffe:** But the secretive aspect, perhaps, also, is that something you’d like to dwell on?

**Mr. Brian Patterson:** I would tend to downplay that.

**Senator Susan O’Keeffe:** Well you’ve used the word yourself.

**Mr. Brian Patterson:** I know I have, but if you asked me which is the most important it would be bottom of my list, probably, because I think to a very large degree a central bank has to be secretive. It can’t conduct all its business out in the open air.

**Senator Susan O’Keeffe:** Yes, and I notice, and forgive me Chair, because I thought actually this was in the book for Mr. Patterson; it’s actually Mr. Neary’s book, but ... and if it isn’t familiar you can, of course, stop me. It actually relates to the interim financial stability report to the board of the Central Bank in the first half of 2006. It says, this ... this document, this is one of our accumulated documents:

.... raised the alert on the financial stability risk from private indebtedness, re-accelerating house price growth and strong loan volume growth of the Irish banks. It also raised concerns on the strong rise of loans to commercial property-related non-financial corporates which had played a minor part in the commentary of former financial stability reports to date.

Now people have talked about the appropriateness, or not, of financial stability reports in the ... that one seemed to me to be quite robust. There’s strong suggestions in there about house price growth, private indebtedness, and commercial property.

**Mr. Brian Patterson:** Yes.

**Senator Susan O’Keeffe:** So, if this kind of information was available to you at this time, why then .. and it goes back to my colleague, Deputy McGrath was saying earlier, how ... how was it then that this really wasn’t becoming available in an emphatic a way as it might have done, even if it couldn’t to the public, but privately among the people who really needed to know.

**Mr. Brian Patterson:** Yes, no, no, I accept that. The document you’re referring to-----

**Senator Susan O’Keeffe:** It’s the-----

**Mr. Brian Patterson:** -----was it a draft, was it a draft or-----

**Senator Susan O’Keeffe:** It’s called the Interim Financial Stability Report to the Board of the Central Bank in the First Half of 2006.

**Mr. Brian Patterson:** I don’t recall that but ... but I’m not denying it. I think this is the problem, and we’ve touched on this a number of times this afternoon, that ...there ... inside the organisation there were concerns. There were concerns in ... you’ve heard from one of the economists ... there were concerns in the executive; there were concerns in the board of the regulator; there were concerns in the board of the Central Bank. The fact that those concerns didn’t get aired raucously in the financial stability report, I think, we understand the reason why that couldn’t be. So, the real question to ask is why was the regulator and the Central Bank not

then impelled to act. It's in the absence of action that the problem lies.

**Senator Susan O'Keeffe:** Yes.

**Mr. Brian Patterson:** And my belief is that ... that some combination of believing that the principles-based approach was the way to go and that you would flag these risks to the banks and that they would then respond accordingly, which they didn't. It was ... the fact that the IFSC was over there was some kind of an issue as well and then there was inbuilt into the culture just a slowness to act. It's some combination of all those things.

**Senator Susan O'Keeffe:** And do you think that that slowness to act extended all the way through 2008? I appreciate you had been ill and you weren't there but I'm ... you would have more than a grasp of what had gone on.

Because looking at it now, as we are, there was a lot of knowledge accumulating ... yet nobody ... everybody was sitting on their hands waiting for something else to happen, it appears. So, was there a slowness to act all the way through until it literally came to a cliff edge and then everyone said, "Oh, my God, we'd better fix it"?

**Mr. Brian Patterson:** I don't ... I wouldn't go that far, Senator. You've heard Con Horan talking about 2005 and 2006 and his efforts in 2005 to get additional capital requirements, which eventually happened in 2006, and, in fairness to the authority, they were right behind that. There was no member of the authority saying we shouldn't be doing this and there were ... and I know there were some actions taken against bank X that we haven't talked about to try and deal with the governance problems there, including capital requirements. So ... there ... yes, there were actions taken ... it wasn't that people did nothing. I think the problem is it wasn't urgent enough and it wasn't enough.

**Senator Susan O'Keeffe:** And, again, the public might expect the Central Bank in all its guises to be more urgent and to act more quickly. That's a reasonable thing to accept.

**Mr. Brian Patterson:** They would, yes. Absolutely, yes-----

**Senator Susan O'Keeffe:** Again going back and I raised this morning the idea of the financial institutions funding the Financial Regulator. What is your view of that relationship?

**Mr. Brian Patterson:** There was ... when it came to the funding model for the regulator, there was a long debate about what was the right way to go and, eventually, the consensus was that we would do it 50-50. Fifty because the belief was that the industry should pay at least a good chunk of it but not all of it and the reason for not levying 100% on the industry was to avoid what's called regulatory capture - that if the industry was paying for all of it, then we might fall under the stray too much.

**Senator Susan O'Keeffe:** And was regulatory capture avoided in your view by that system or would you say?

**Mr. Brian Patterson:** Not entirely.

**Senator Susan O'Keeffe:** Would you just like to clarify before I finish?

**Mr. Brian Patterson:** Okay. I think that ... was it Professor Honohan or Peter Nyberg, I can't remember, said that the regulator was too deferential to the banks and, in retrospect, I think I would accept that, yes. That's one of the findings ... I accept most of their findings,

incidentally. And if you're deferential to the banks, then you are suffering some element of-----

**Senator Susan O'Keeffe:** Was that deference apparent to you when you were the chair?

**Mr. Brian Patterson:** Not as much as it is with hindsight.

**Senator Susan O'Keeffe:** Do you think maybe you were deferential to the banks then also?

**Mr. Brian Patterson:** I don't believe so, no. I don't ... I mean that robust meeting that I referred to when the keys were thrown across the desk, that wasn't being deferential.

**Senator Susan O'Keeffe:** Okay, thank you.

**Chairman:** Thank you very much. I'm just going to wrap up with a couple of questions and then invite the two leads in, Mr. Patterson, and I just want to go back to some matters and that is that clear concerns were expressed by the regulator about the risk of asset growth at some banks before the onset of the crisis. Did the CBFSAI examine the possibility that this might be a systemic problem?

**Mr. Brian Patterson:** I'm sorry, Chairman, I don't have the question.

**Chairman:** Sorry, the ... what I'm discussing in general is how the focus was applied by the Central Bank and the regulator on the underlying assets of the banks and consideration given to reviewing the quality of bank assets. So, in that regard, it would seem that clear concerns were expressed by the regulator about the risk of asset growth at some banks before the onset of the crisis.

**Mr. Brian Patterson:** What period are you talking about?

**Chairman:** I would be talking from 2002 onwards and that will probably bring me to a question later on as to when the crisis was actually embedded by your view but during this time, did the CBFSAI examine the possibility that this might be a systemic problem?

**Mr. Brian Patterson:** I don't recall any discussion on that, Chairman.

**Chairman:** Okay, so coming onto the second part of that so, when do you think the crisis was actually embedded? Not when the crisis was visible and in full flow. It is like a house collapsing. Sometimes the crisis begins when the house is actually being built because it's not being constructed properly. When do you think the crisis was embedded?

**Mr. Brian Patterson:** I could probably mount an argument for going back in the 1990s. And I would include in that the radical deregulation of financial services that happened in the US and the UK and which Ireland followed. But I guess in more substantive terms, my judgment, there isn't a magic date when you say they rang a bell and said it's now started. My judgment would be that it was some time around 2006, 2007.

**Chairman:** That it was embedded by then or it was too late by then?

**Mr. Brian Patterson:** I think by 2007 it was getting too late.

**Chairman:** Okay, right, thank you. Now can I also ask you to outline your view of the nature of the relationship between the Central Bank-Financial Regulator and the banking institutions and in particular, discuss whether criticism of this relationship was expressly raised by employees of the Central Bank or Financial Regulator's office and the nature of that criticism,

if there was such criticism?

**Mr. Brian Patterson:** The relationship between the regulator, Central Bank and senior bankers, is that it?

**Chairman:** And banking institutions, yes.

**Mr. Brian Patterson:** Banking institutions. How was the relationship? I think my experience of the relationship was ... was pretty few and far between. I didn't have a lot of contact with the banking institutions. The chief executive and I met the chief executive of the major banks probably once or twice a year for a working breakfast. And incidentally, at the end of those meetings we always asked the ... the bankers: "Is there anything that we should know about that you're not telling us?" And they always said: "No, it's all fine. Thank you. Can we go now?" "And the second part of the question, Chairman, was this voiced by staff?"

**Chairman:** Yes, for instance, one of the earlier witnesses here, I think it was Ms Burke-----

**Mr. Brian Patterson:** Yes, I know what you are referring to.

**Chairman:** -----made, made an observation or gave testimony here that she would have seen senior officials arriving in and going up a floor above her and coming back out with ... and the question is what are they doing here, what does that mean?

**Mr. Brian Patterson:** Yes, I know. I was surprised to hear that evidence because I have no knowledge of that. I would have taken it that if such meetings happened, that the executive would have kept their people informed.

**Chairman:** Right.

**Mr. Brian Patterson:** And I think Pat Neary and others may have said that after Mary Burke.

**Chairman:** But could this propose and maybe you could clarify this as to whether they were both formal and informal channels of communications coming from both the Central Bank and the Financial Regulator's office during this period?

**Mr. Brian Patterson:** To the ... to the banking institutions?

**Chairman:** Yes.

**Mr. Brian Patterson:** There were certainly formal meetings, you have heard of the round-table meetings and, and that. And this is Ireland and this is Dublin. So people, you know, they attend industry functions and they bump up against people and so on and so forth. So there would have been quite a level of informal contact, I guess. But if you are talking about you know, a senior banker ringing up and saying will you need to meet in a pub and talk about something, I don't believe that happened.

**Chairman:** There's a famous line from "The West Wing" where two guys are walking down the corridor and there's a guy coming up the other side. And 'he's got the hump', as they would say in Cork. And one guy says, "What's wrong with him?" and he says, "Well, he thinks decisions are still made in meetings". That's what I mean by informality.

**Mr. Brian Patterson:** Yes, yes. I'm sure there would have been informal contact. I'll say we are a very social country. But was that done with evil intent? I don't believe so.

**Chairman:** Okay. All right, thank you very much. So we are back to finishing matters off. So I can invite Deputy O'Donnell in to wrap up, please and then Deputy Doherty.

**Deputy Kieran O'Donnell:** Should the stress tests have been carried out by the Financial Regulator rather than the Central Bank?

**Mr. Brian Patterson:** The stress tests should have ... the supervision of them should have been more intrusive. But all the data that went into them was in the banks. So it was only the banks I think that could produce the data.

**Deputy Kieran O'Donnell:** Yes, but you were regulating the banks. You had a detached entity in the Central Bank setting the stress tests on which you basing the information. So I am asking you, would it not have been a lot more practical that the Financial Regulator should have been setting the stress tests for the banks? You're a practical man.

**Mr. Brian Patterson:** No, I understand what you are saying, Deputy. I, I think it probably didn't matter who actually did it. What's more important is-----

**Deputy Kieran O'Donnell:** Of course it matters. Sure they ... the regulator had the, had the knowledge of what was happening, so the question I am asking, based on the knowledge base-----

**Mr. Brian Patterson:** Yes.

**Deputy Kieran O'Donnell:** -----would it not have made a lot more sense for the regulator be setting the stress tests for the banks for which they were inspecting, rather than the Central Bank, who was not inspecting the banks?

**Mr. Brian Patterson:** My answer is that it's more about what the framework was, whether it was correct and whether the supervision of the work done in the banks was at the level it should be. That's the-----

**Deputy Kieran O'Donnell:** Right. Secondly, is it fair to say that based on the fact with the principles-based regulation put the Financial Regulator third down the line of protection, that, and the fact that the board of the Financial Regulator had no-one with financial regulatory expertise, so you couldn't actually oversee the quality of work being done by the executive? That in substance, legally, the Financial Regulator was required to regulate the banks but in substance the banks were regulating themselves and controlling their own risks. In substance now, not legally, in substance.

**Mr. Brian Patterson:** No, I know what you're saying. In substance, I think I'd go a long way in agreeing with you, yes. I wouldn't use the expression, "The banks were regulating themselves", I think that's too extreme.

**Deputy Kieran O'Donnell:** So what would you say?

**Mr. Brian Patterson:** I would say that principles-based regulation, I know you're fed up hearing this word, clearly laid, and no banker could say he didn't understand this, it clearly laid the responsibility for safety and soundness primarily and firstly with the bank itself.

**Deputy Kieran O'Donnell:** But in essence, the Financial Regulator was not doing anything to assess the risks the banks were taking in respect of loans?



**Mr. Brian Patterson:** It wasn't doing enough.

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

**Chairman:** Thank you, Deputy Doherty.

**Deputy Pearse Doherty:** Go raibh maith agat. A couple of quick questions here. Can I ask you did the board ever investigate the claims made that an internal auditor of AIB had reported to Liam O'Reilly the foreign exchange rip-off that was happening at the time, which was the bank had to pay back over €30 million? Did it ever investigate those claims?

**Mr. Brian Patterson:** By talking to the individual himself, is that what you mean?

**Deputy Pearse Doherty:** In any way. Did you discuss it, did you discuss the claims? Not the event itself which, the investigation which happened in 2004, the claims that Liam O'Reilly was informed of these matters in 2001 and 2002.

**Mr. Brian Patterson:** I don't have any memory of that, no.

**Deputy Pearse Doherty:** That's fine. In relation to your role on ... as chairperson of the board, can you tell us, at the peak time how many, if any, other boards did you serve on, along with being chairperson of the board of-----

**Mr. Brian Patterson:** Around about the mid-2000s you're saying?

**Deputy Pearse Doherty:** No, well ... the time where you were most busiest on boards if you had-----

**Mr. Brian Patterson:** Most busy ... of other boards, I was the chairman of two others.

**Deputy Pearse Doherty:** Two others, okay. And in relation to ... was the board aware of the concerns and the problems around IAS 39 in terms of auditing?

**Mr. Brian Patterson:** Can you expand a little?

**Deputy Pearse Doherty:** IAS 39 is-----

**Mr. Brian Patterson:** Which one is that?

**Deputy Pearse Doherty:** There's been a lot of discussion in relation to it, it's in relation to the fact that the auditors aren't allowed to account for future losses.

**Mr. Brian Patterson:** Yes, I know the one, yes.

**Deputy Pearse Doherty:** Was the board aware of the shortcomings of this issue?

**Mr. Brian Patterson:** Not at the time, no.

**Deputy Pearse Doherty:** Not at the time, in your tenure, is that what you're saying?

**Mr. Brian Patterson:** Yes.

**Deputy Pearse Doherty:** Yes, okay. And can I ask you in terms of what Deputy McGrath was saying in terms of the stability reports, the financial stability reports, would it be accurate or not to suggest that the financial stability reports could be described as misleading?

**Mr. Brian Patterson:** It's not a word I'd like to use but I know where you're coming from. I think that they're ... I've said ... I've said that the financial stability report, with hindsight, is an inappropriate vehicle for communicating issues around the banking system and that's why it's been stopped. And I think that the people, including myself, who were responsible for signing off the financial stability reports, particularly in the years 2006, 2007, were in a real bind as to what you could say and what you could not say. And as I said, paradoxically, the higher the level of risk, the more constrained you have to be, it kind of works in this way. So from that point of view, they're not an appropriate vehicle for doing that. The issue is whether or not those who could take action did take action and the answer is they didn't.

**Deputy Pearse Doherty:** I appreciate all of that, and with all of that bearing in mind, in your view, was the financial stability reports that were issued misleading? Or could they be viewed as misleading?

**Mr. Brian Patterson:** I wouldn't like to say a straight "Yes" to that because I would imagine that there could be all kinds of hostages to fortune if I did say that.

**Chairman:** Can I maybe rephrase it and ask you, were the financial stability reports an accurate reflection of what was happening at that time and what needed to be conveyed?

**Mr. Brian Patterson:** They didn't properly outline the risks and the potential consequences of what was happening in the banking system.

**Chairman:** Okay, thank you.

**Deputy Pearse Doherty:** Thank you ... sorry, but, that you were aware of, is the key point. We all know that they didn't highlight the risk, but the ... the risk that the boards were aware of, is that correct?

**Mr. Brian Patterson:** Yes.

**Deputy Pearse Doherty:** Okay, thank you.

**Chairman:** Okay, thank you very much. With that-----

**Deputy Michael McGrath:** Chairman-----

**Chairman:** Yes, sure.

**Deputy Michael McGrath:** -----Mr. Patterson, you're ... you're under oath, you're a compelled witness, and you were asked a straight question there, and I will just rephrase it. Like, do you believe that the financial stability report accurately reflected the collective views of the board of the Central Bank and IFSRA?

**Mr. Brian Patterson:** It didn't ... I'll say what I said before. It didn't sufficiently explain the risk to the banking system as a whole.

**Chairman:** Okay. Thank you very much, Mr. Patterson. Is there anything else you would wish to add before we bring matters to a conclusion?

**Mr. Brian Patterson:** Well, I can just say two things very quickly, Chairman, I won't detain you. No, there's been ... there's been a lot of discussion about the responsibility of the Central Bank, the responsibility of the regulator, and to me you can parse it and ... and look at the legalities and the structure and everything, but the reality is both organisations shared the same

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building, they shared the same services, they had common employer, they were committed to working together, so that's not the issue. The issue is, how was it that they collectively failed to act sufficiently? That's the issue. And the last thing I'd like to say is, in trying to shed light on why I think the system failed, I don't want to create any impression that I'm evading my own responsibility, because I've fessed up to that, and I still regret it and I will regret it all the days of my life.

**Chairman:** Okay. Thank you. With that said, I would like to thank you, Mr. Patterson, for your participation today with the inquiry and for your engagement, and now to formally excuse you, and to thank you once more. Before I go into an adjournment, just to let members know that there are documents in the room to be collected, and please ensure that they bring them away as they're leaving today. So I now propose the meeting is adjourned until 3.30 p.m. on Tuesday, 16 June 2015. Is that agreed?

The joint committee adjourned at 6.18 p.m. until 3.30 p.m. on Tuesday, 16 June 2015.