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AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉI- REACHTA

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Déardaoin, 25 Meitheamh 2015

Thursday, 25 June 2015

The Committee met at 9 a.m.

MEMBERS PRESENT:

Deputy Pearse Doherty,	Senator Sean D. Barrett,
Deputy Joe Higgins,	Senator Michael D'Arcy,
Deputy Michael McGrath,	Senator Marc MacSharry,
Deputy Eoghan Murphy,	Senator Susan O'Keeffe.
Deputy Kieran O'Donnell,	
Deputy John Paul Phelan,	

DEPUTY CIARÁN LYNCH IN THE CHAIR.

Nexus Phase

Central Bank-Financial Regulator - Professor Patrick Honohan

Chairman: As we have a quorum, the Committee of the Inquiry into the Banking Crisis is now in public session. And can I ask members and those in the public Gallery to ensure that their mobile devices are switched off. Session 1 of today's hearings is a discussion with Professor Patrick Honohan, Governor of the Central Bank of Ireland. In that regard, I would like to welcome everyone to the public hearing of Joint Committee of Inquiry into the Banking Crisis. Today we will continue our hearings with senior figures from the Central Bank who had key roles during the crisis period.

This morning and this afternoon we will hear from Professor Patrick Honohan, Governor of the Central Bank of Ireland. When Professor Honohan appeared before this inquiry earlier this year the purpose was specifically to discuss his report on the banking crisis. In this morning's session we will focus upon the period of Professor Honohan's tenure, from his appointment in September 2009 to October 2010, while this afternoon's session will focus on developments in the period from November 2010 to December 2013. The then Governor of the Central Bank of Ireland, Patrick Honohan, was appointed on 26 September 2009. Before his appointment as Governor, he was Professor of International Financial Economics and Development at Trinity College Dublin from 2007. Prior to this he spent almost a decade at the World Bank, where he was a senior adviser on financial sector policy. He recently announced his intention to retire later this year. Professor Honohan, you're very welcome before the inquiry this morning.

Professor Patrick Honohan: Thanks very much, Chairman.

Chairman: Before hearing from the witness, I wish to advise the witness that by virtue of section 17(2)(l) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to this committee. If you're directed by the Chairman to cease giving evidence in relation to a particular matter and you continue to do so, you are entitled thereafter only to a qualified privilege in respect of your evidence. You're directed that only evidence connected with the subject matter of these proceedings is to be given. I would remind members and those present that there are currently criminal proceedings ongoing and further criminal proceedings are scheduled during the lifetime of the inquiry which overlap with the subject matter of the inquiry. Therefore, the utmost caution should be taken not to prejudice those proceedings.

In addition, there are particular obligations of professional secrecy on officers of the Central Bank and the IFSRA in respect of confidential information they've 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 some of the terms of information which has been provided to it by the Central Bank. These obligations have been taken into account by the committee and will affect the questions asked and the answers which can be lawfully given in today's proceedings. In particular, it will mean that some information can be dealt with in a summary or aggregate basis only, such that individual institutions may 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

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

here in the committee room. For those sitting in the Gallery, these documents will be displayed on the screens to your left and right and members of the public and journalists are reminded that these documents are confidential and they should not be published ... none of those documents should be published or so displayed. The witness has been directed to attend a 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 with that said, if I can now ask the clerk to administer the oath to Governor Honohan please.

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

Professor Patrick Honohan, Governor, Central Bank.

Professor Patrick Honohan: So my introductory remarks today, Cathaoirleach, will necessarily have to be very selective to respect the time limits. So I'll cover, in essentially chronological order, matters that were dealt with in my written statement. First, the recapitalisation of the banks in 2010 in the context of NAMA purchases, then the September 2010 bank funding cliff, the move to the EU-IMF programme in November 2010 - which, understandably, is this afternoon's topic but I'll cover it all in one ... remarks today - the programme structure and, finally, the improved funding conditions which helped to make the programme a success. I will conclude with a few remarks about institutional change.

So on recapitalisation of the banks, given the existence of the watertight guarantee enacted through the CIFS legislation of October 2008, in designing policy with regard to bank capitalisation I was guided by a fixed principle, informed by the Central Bank's statutory mandate, that any event of default by a bank - as would trigger a large cash call on the State - was to be avoided in view of the financial instability that this would cause. In practice, this implied that the Central Bank had to ensure that all of the guaranteed banks would continue to maintain regulatory capital compliant with international standards. This would help ensure that they had access to the ECB standard liquidity facilities as well as, where necessary, ELA. As the NAMA purchases would necessarily be staggered over a period of months, the Central Bank decided to take the announcement of the valuations of the first tranche of NAMA loan purchases as the occasion to establish the necessary capital infusions for Allied ... for AIB, Bank of Ireland and EBS, the going concern guaranteed banks selling loans into NAMA.

When they became available late March 2010, the initial NAMA valuations, based only on the handful of exposures that had been fully valued in time for that date ... these entailed much higher percentage losses than had been generally expected by industry specialists. So the capital requirements announced by the Central Bank at the end of March 2010 - in what was known as PCAR 2010 - assumed that all of the NAMA purchases would involve haircuts as large as the first tranche. They also took account of forward-looking loss estimates in a base case and stress scenario of the non-NAMA books. For example, a flat 5% loan loss estimate much higher than that assumed by the banks' managements themselves was applied to the residential mortgage portfolios. Given the prevailing uncertainty surrounding these badly impaired portfolios, there was still a large margin of error which might eventually consume the apparent surplus above the international minima ... the international capital standard minima. Unfortunately, the later tranches of NAMA purchases which became available in August and September did imply much higher losses, with the result that additional capital requirements had to be announced in September for AIB and also for Anglo at that time - in that case because of Anglo management's estimate of additional costs implied by the wind-down plan that the Government had just already announced in the same month.

NEXUS PHASE

Now, the September 2010 bank funding cliff. Faced with a steep cliff of bank liabilities ... liability maturities in September 2010, I gave some consideration to possible alternative courses of action which might be recommended to Government. As explained in my written statement, the only safe way forward seemed to continue to rely on ELA while also pursuing all possible steps to rebuild confidence and recognising that recourse to an IMF programme would be the fall-back position. By that month, September 2010, most informed international observers began to factor in a likely need for Ireland to enter a programme of official financial assistance. The main influences were the perspective rapid increase in ELA - due to the funding cliff, which arose because it was the end of the initial guarantee period - and the growing evidence that the Government's multi-year fiscal plan at that stage would not stabilise the debts ... the State's debt dynamics. The drip feed of bad news about bank recapitalisation needs did not help.

Now, the move to the EU-IMF programme: by 4 November 2010, when spreads on ten-year bonds exceeded 500 basis points or five percentage points and depositor outflows were accelerating, also reflecting a loss of confidence, it was clear to me that application for a programme could no longer safely be deferred and by, well, the following week, I guess, 11 November, the Minister for Finance had agreed to exploratory discussions with troika officials in Brussels. Delayed until 14 November, apparently because of the need for the troika to agree a strategy among themselves - though that's conjecture, I guess - these discussions, attended by about 20 Irish officials, confirmed that there was a basis for full negotiations on a programme which, with the approval of the Minister, began in Dublin on 18 November. These meetings took place in an increasingly tense situation of national and international media speculation, market tensions, which had brought the yield on Irish Government ten-year bonds above 8% and considerable international official alarm at the highest levels.

So, on the structure I would just say the following, the EU-IMF programme structure, the programme finally agreed with the troika, it largely reflected the four-year budgetary plan which was published by the Government at the outset of the negotiations, or during the course of the negotiations might be more precise. Indeed, in the negotiations, the target date for reaching the threshold deficit level of 3% of GDP was pushed back to 2015. But would the implied degree of fiscal adjustment be sufficient to bring the public finances back onto a sustainable path? Here the remaining question mark over the banking system was key. All in all, the Central Bank found the financial terms of the programme disappointing and unsatisfactory, especially in regard to the high interest rates and the lack of some kind of insurance mechanism against tail risks in the banks. Nevertheless, it was crystal clear to me that no better terms could quickly be achieved. Therefore, having set out these concerns, I advised the Government in writing that it should proceed on the basis of the programme, given that the alternative of struggling forward without access to market finance would have been more economically damaging. If the programme proved unable to deliver a sustainable debt path, as seemed at that point possible, even likely, then the financial terms could probably be renegotiated. It is a fact that, had programme funding not been availed of, much more severe spending and tax adjustments would have been needed.

Now, the better financing conditions that subsequently made the programme a success. Indeed there were subsequent, considerable improvements in the terms of financing, not least through the reduction of EU interest rates from the initial level of about 5.7%, 5.8% per annum and the lengthening of the loan maturities and subsequently through the carefully designed financial arrangements around the liquidation of IBRC, especially the so-called promissory note exchange. And these improvements, combined of course with close adherence to the budgetary targets in the following three years, allowed the Government to take the decision to

exit the programme on schedule at the end of 2013. Despite the risks and pressures involved at the outset, recourse to the EU-IMF loan proved to be a successful policy move for Ireland, limiting the need for fiscal austerity because funding was made available in amounts and at costs far below what the market would have offered and underpinning a relatively rapid return to confidence. Successive Governments' adherence to the programme in difficult political circumstances helped restore Ireland's international reputation for disciplined macroeconomic management, a reputation essential for sustained recovery of employment and incomes.

So, just a few words on other aspects. I ... clearly I've omitted a lot that could be said, including in particular on the areas of institutional reform that were introduced in the Central Bank since 2009 to enhance the bank's ability to deal with new tasks, as well as upgrading its capacity to deliver on the remainder of its mandate, having regard to the weaknesses that had been identified. Very extensive changes in regulatory and supervising staffing, methodology and culture brought into the Central Bank, 2009 to 2013, have been documented in papers submitted by the Central Bank to the inquiry and I believe that the smooth transition of the prudential aspects of Ireland's supervision of banks to the ECB's single supervisory mechanism in November 2014 testifies to the credibility of the transformation that was achieved in those years.

On the rehabilitation and restructuring of banking in Ireland, I suppose the central banking, aside from the recapitalisation aspects in this period, I have spoken repeatedly to Oireachtas committees about the disappointingly slow progress in dealing with non-performing loans, especially, but not only, mortgage arrears. Banks have now got reasonably effective systems in place to deal with collection and restructuring on the scale needed, but they did not introduce adequate system until chivvied or harassed by the Central Bank from late 2011. The mortgage arrears targets introduced in early 2013 simplified a quantitative assessment of progress being made by the banks. An increasing number of loan restructurings, designed to be fully sustainable, have been agreed. Compliance with the restructured payment schedule is high, though deeper restructuring would be desirable, as it would arguably increase assurance that borrowers would not fall again into arrears and would also reduce debt overhang in the economy at large. However, despite all of the efforts, including the initiation of court repossession proceedings, there is still insufficient engagement between borrower and lender in a large number of cases, resulting in lengthy delays, leave the borrowers in a limbo of over indebtedness and hamper both the borrowers' and the banks' ability to put the crisis behind them.

So, in conclusion, in the period under review the Central Bank has sought to help the Irish economy recover as much as possible from the calamitous economic and financial losses resulting from the collapse of the bank-driven boom. As far as banking regulation and macro-prudential policy are concerned, these are complex and ever changing fields of endeavour, demanding skilled and committed officials. The failures of the past provide lessons for the present, and at the Central Bank, we have tried to learn and apply those lessons.

Chairman: Governor, thank you for our opening remarks. We'll get questioning on the way, and if I ... in doing so, can I invite Deputy Pearse Doherty. Deputy, you have 25 minutes.

Deputy Pearse Doherty: Go raibh maith agat, a Chathaoirligh, agus fáilte roimh an tUasal Honohan. Agus go n-éirí an bóthar leat agus tú ag éirí as do phost, agus tuigim fosta go seo an chéad píosa fianaise a tugadh dúinn i nGaeilge, leis an seanfhocal a thabhair tú isteach le d'óráid so tá fáilte roimhe sin fosta. Can I ask you, first of all, Professor Honohan, do you believe that the Central Bank had sufficient powers to take direct action against banks, if it becomes necessary to avoid financial stability crisis again? Do we have the powers now?

Professor Patrick Honohan: Yes, I think we do. Now, first of all, there were always a lot of powers. We have strengthened those powers and made them more specific. We discussed a lot in the last number of years whether ... to what extent powers should be made specific. I took the view from time to time that it was better to leave the powers general rather than specific because if you ... if you ask ... go back to the Oireachtas and ask for very specific powers, the courts may subsequently interpret that as a decision of the Oireachtas not to interpret the general powers broadly. However, our approach has been to request a lot of powers and this ... especially the act of 2013, the Supervision Enforcement Act, made ... gave very specific powers on regulation. In addition of course, these big banks are all now being supervised by the SSM and so you have the European powers are brought into place, so that gives you not only legal powers but it gives you probably a greater degree of implicit power, with the weight of the SSM behind it. But I'm not just relying on that.

Deputy Pearse Doherty: Can you give, maybe, the committee an example of two powers that you have now, as Governor of the Central Bank, that your predecessor didn't have that would have had or possibly could have had an impact in the period running up to 2008?

Professor Patrick Honohan: It's a very long Act. One power, which I think could be important, is the fact that we can now in our administrative sanctions process, the enforcement powers, we can now impose fines of much larger than they were before, 10% of turnover rather than, you know, €5 million was an absolute maximum. So to the extent that that changes the environment and the threat level for a violation of the sanction. But, but for the large banks ... well, okay, and the other one I will mention is, a power that was used in the case of macro-prudential measures last year, the loan-to-value, loan-to-income ratios. I believe we could've used the old powers to do that, but actually we have used the new powers under the legislation to do that. So they're very specific. Nobody can argue that ... nobody is going to run off to court and say I think your exceeding what was envisaged in the 1942 Act, because the powers are very specific to do that.

Deputy Pearse Doherty: Thanks for that, Professor Honohan. Would I be right in saying that, like, the two examples that you gave me were the increase levels of fines, but the fines ... there was a level of fine that existed to your predecessor which was not utilised, and the second one was the loan-to-value ratios that could've ... that the power existed by your predecessor, but wasn't utilised either? So in ... while I acknowledge that there is enhanced powers now, is there ... was there ... is there anything that was simply not there in terms of a power that you have now that they didn't have?

Professor Patrick Honohan: Well, I ... first of all, I should say the ... those administrative sanctions ... I think they were only brought in in 2004, so that was ... you know, it was at a certain point. I'd like you to get a legal opinion rather than my opinion. My opinion is - and is in a lot of things - is go for it, the Central Bank Act gives us a lot of powers and that would have been the case ... you know, those are the powers there for a long, long time. So my belief would be try it - if it's challenged, if the court strikes it down, go to the Oireachtas and show ... and say to them, "Get it." So ... but you'll certainly find many lawyers and legal advisers to the Central Bank who say "No, Governor, you're wrong - you don't have that power." But I think that these things sometimes need to be tested.

Deputy Pearse Doherty: Okay. I appreciate that. The IMF mission in 2009 referred to the lack of a resolution regime. Can you explain the delays in initiating such a regime in Ireland, bearing in mind that the UK implemented one by way of its Banking Act in March 2009?

Professor Patrick Honohan: Now, the resolution Act that we brought in in 2010, okay, is ... is not as far reaching as it might be. So we have new resolution legislation coming down the track now in the light of the BRRD directive and that resolution can actually distinguish between ... between creditors and say “You’re going to lose,” and “You’re going to lose more money than if we had proceeded towards a liquidation.” At least, as I understand it, it can have that effect. The 2010 Act doesn’t allow that. It’s a very light kind of resolution power. The British power ... the British legislation was very complex. It was brought in ... British environment is a more complex financial environment. We could have adopted it and work was going ahead to bring in resolution legislation to ... if we’re talking about 2009-2010, why was it not introduced sometime in the course of 2009? We weren’t going to use anything like this while the guarantee was in place because to trigger a resolution of one of the institutions would have caused all the creditors, even the ones that weren’t due to be paid for five or ten years, to come immediately knocking on the Government’s door and say “You told us this was guaranteed. Pay us now.” So everything was frozen in terms of restructuring banks or resolving them, so there was no need ... I ... and so I asked the Minister for Finance ... I said, “What about ... what about resolution mechanism?” He said, “Hold ... let’s hold on that because it’s ... it’s only going to cause trouble and give us no benefit in that course.” And I think then the fact that we were ... we introduced ... we ... the Government proposed and the Oireachtas voted, a piece ... an effective piece of resolution for what we needed to do very quickly in December 2010 shows the degree of preparation that was there. It was going to come in. So in that period 2009-’10, I think it was moot as to whether we had it or we didn’t have it - we weren’t going to use it until after the guarantee.

Deputy Pearse Doherty: From instigation ... from the point where a decision was made to introduce that resolution regime to the point where it was published-----

Professor Patrick Honohan: Yes.

Deputy Pearse Doherty: -----what type of timeframe are we talking about?

Professor Patrick Honohan: Well, this is quite interesting, Deputy, because I was astounded. We had ... we, in the Central Bank, helped, you know, the Department of Finance and the parliamentary draftsman and ... or through the Department of Finance, with the drafting of this kind of legislation. And there were ... there were many meetings going on about the nature of this resolution mechanism and I was getting some briefings on it. It’s not my special area so I wasn’t really very close to it. Suddenly ... suddenly I discovered that the whole draft that was being worked on was not going to be the draft now and there was another draft. So somebody else was working, you know, presumably in the Department of Finance, on another track with a faster and cleverer piece of resolution legislation. So the preparatory work was being done and it was quite quick. It was brought in in December ... December 2010 and I think the press ... the “go” button was only in the context of the troika programme. But, obviously, the preparatory work had been done.

Deputy Pearse Doherty: What I’m trying to find out, and maybe you don’t know this, but we’ve had ... we’ve had evidence to this committee saying that bringing in a resolution regime would have taken too much time, that there was constitutional issues and so on and so forth. But, as you say, we brought in a type of regime in 2010. The question is: how long did it take? Because we brought it in at a certain stage. Did it take three years, four years, five years, you know, or was it a number of months from-----

Professor Patrick Honohan: It was a light piece of legislation. I suspect that work must

have been going on with some specialist for a few months ... but it was tidied up. But it wouldn't past muster if you say, "Now we've got a state-of-the-art world-class resolution which allows imposition of losses to different classes of customer." And that's what a lot of people talk about, "Why didn't you have a resolution legislation which allowed the imposition of losses on bondholders and not on the borrowers?"

Deputy Pearse Doherty: I'll come to that in a while. Can you comment on the Central Bank's analysis carried out to identify the amounts of €3.5 billion in capital for AIB and Bank of Ireland that was announced in 2009, February 2009, was provided at that time? And why did the Government proceed with this amount for AIB given that it ultimately required a capital injection on €19.8 billion?

Professor Patrick Honohan: Okay, so this is before my time so this is the first wave. And as I understand from reading the papers, its not actually covered by my earlier research as well so I'm a little bit ... what I understand is that it was based on ... the was it Pricewaterhouse produced reports and they came to the conclusion that bolstering the bank capital to that extent would give comfort to the market and give sufficient comfort that the Irish banks were sufficiently capitalised. Obviously the work that was done up to then was not sufficient, and the sufficient work really wasn't done until well into 2010 to really know. What was missing in all of that analysis was a loan-by-loan quality review as is now the term AQR - asset quality review, is becoming ... it's not stress testing, it's not what will happen if things go wrong. But it's what is the true value? Accountants may look at something and apply some rules of thumb, but what is the true recoverable value ... that work wasn't done.

Deputy Pearse Doherty: Do you have any idea why that work wasn't done, given that the drip feeding of capital into these banks could have caused a concern that ... "where will this end" for the markets?

Professor Patrick Honohan: Yes, so I'm ... and I do accept a degree of responsibility with this, because when I came in I also did not initiate that kind of loan by loan analysis because I was told ... first of all, the large loans have already been analysed to the extent ... by Pricewaterhouse and all those people, and the banks' data systems do not allow this sort of information to be gathered. And I probably took too much on trust that all of these international firms had been studying these things, and they must have squeezed as much information as was available out of them. Subsequently, when we engaged the other American consultants, BlackRock, they were very .. we were in a different world then of course, we were under the troika saying, "You do this and do that." And we spent, I can't remember the number but its disclosed, €20 million or €30 million to do that work on a scale which I hadn't really imagined. This is sort of new enough territory.

Funnily enough, in the early months in the job, I remember one of my counterparts in, well actually I can mention, it's the Swedish governor, he's a friend, he said, "I hope you're getting BlackRock." And I said, "Well we have some people." But I should have taken him more seriously because I didn't realise the ramping up of the detailed loan-by-loan analysis which they would insist on, and when insisted on it was possible to get that out of the banks. Some of the banks couldn't do it, but got enough of it to be able to do it. And BlackRock people did it and then I made sure that our own Central Bank people reverse engineered what BlackRock where doing, so now we can do it as well and we get quarterly drops.

Deputy Pearse Doherty: It was a troika requirement as opposed to an Irish requirement. It was the troika that-----

Professor Patrick Honohan: Yes.

Deputy Pearse Doherty: Okay. Can you comment on the whether the level of co-operation by the banks contributed to the amount of capital ultimately required or not?

Professor Patrick Honohan: I just don't know anything about that. I did see some inter-change, I didn't watch all the ... with some of the Department of Finance officials and sugges-tions about whether the banks were co-operating. I just don't know. I do ... I could comment for the period that I was involved, from 2009, 2010. That part, the banks were very resistant to the idea that the losses would be anything like what we were suggesting in March 2010. First of all the NAMA losses, they couldn't believe it, they said these ... and they wrote very tough letters ... saying "You can't impose this on us, it's just based on a handful of loan valuations." But we held our ground. And the idea that there could be 5% loan losses on residential property, they thought was completely off the wall. So, I think rather than ... rather than them have ... knowing something and not wanting to tell, I think, they, too, were still in a state of denial and didn't realise it.

Deputy Pearse Doherty: Professor Honohan, on ... in your statement, on page 3, it deals with the options in relation to the banks and the capital buffer that the banks would require. The ... option 1, which you outline, is asking the banks up an unquestionable "ample capital buffer" to cover all eventualities, which you say "would have triggered an immediate loss of market confidence in the Government's finances (putting paid, for example, to the chances of the Government being able to avoid an IMF Programme)." The second alternative, you say, is basically, where they provide ... where capital is provided or is acquired by the banks to cover the first tranche of the NAMA losses but you say that, in doing that, which you say is "The only safe way forward seemed to continue to rely on ELA while also pursuing all possible steps to rebuild confidence ... and recognizing that recourse to an IMF Programme would be the fall-back position." Now, it was in March-----

Professor Patrick Honohan: March 2010.

Deputy Pearse Doherty: March 2010. So, the two options seem very clear to me. That ... the first option was, ask the banks to get the capital that you think they may need to cover all eventualities, which would've resulted in a possible IMF programme and the second option was to go with a minimal approach but also having recourse to an IMF programme if need be. Was it ... so, IMF seemed to be very much under consideration here at that early stage, that the decision ... the capital requirements of the banks in either option could've required this State's requiring an IMF Programme, i.e., putting the State's solvency at risk as a result of the capital required by the banks.

Professor Patrick Honohan: Okay, well, just to clarify a couple of points. The first op-tion, which was where I started before I really looked at the numbers was, "Overcapitalise, put in more than could possibly be considered necessary because, that way, everybody would say 'Well, the Irish banks are overcapitalised.'" And there were countries that were doing that. Switzerland did that, they raised the capital requirement enormously for their big Swiss banks. And it's a standard play book for people in financial crises. Overcapitalise the banks and then you're not going to have a problem and you get the money back later and don't worry about it. But the problem is ... that's okay if the problem is on a scale that the Government can eas-ily - because it will be the Government, nobody else is going to put in that - can it do ... can it put in that amount of money - putting in that amount of money - if it destabilises the Govern-ment itself? So we didn't, in any way, short change the banks. We didn't just pay for the first

tranche, we paid for all the future tranches but at the percentage losses for the first tranche. And I thought that the percentage loss on the first tranche, which were the biggest loans, I thought they would be the worst loans - they would be the loans that went to the biggest and, you know, most extravagant property developers. That turned out not to be true. But it seemed like a reasonable ... a reasonable benchmark and going to the ... to overcapitalise, that was where we walked into the IMF territory-----

Deputy Pearse Doherty: Let's go with what actually happened-----

Professor Patrick Honohan: Yes.

Deputy Pearse Doherty: -----after BlackRock.

Professor Patrick Honohan: Yes.

Deputy Pearse Doherty: We did overcapitalise the banks.

Professor Patrick Honohan: Yes. Well, yes ... we ... the standards kept on going up and they're continually going up-----

Deputy Pearse Doherty: Yes.

Professor Patrick Honohan: -----so I'm not sure that I would like to say that we overcapitalised the banks. The NAMA ... the subsequent NAMA calculations generated a further €8 billion of losses and in the end we put in another €17 billion ... so €8 billion minus €17 billion, €9 billion. €9 billion ... is the €9 billion justified? Actually, I think some of the €9 billion is definitely justified because the loan losses on residential mortgages will not come out as low as €5 billion.

Deputy Pearse Doherty: Professor, the statements at the time, in this House and elsewhere, was that the banks were the most capitalised banks in the world. That the capitalisation of the banks were in the high double digits ... high teens, which was way beyond the regulatory requirement for capitalisation. So, the question is: how could we, you know ... I put it to you, that we did overcapitalise the banks, which eventually turned out to be option 1, which in option 1 in your scenario would've put us in a collision course with the State's solvency.

Professor Patrick Honohan: Now, I agree with you on this very important point but I think we are slipping, perhaps, into the later territory. But the idea that you capitalise the banks even if it brings down the State, that idea tends to be prevalent among banking specialists who are not interested in the fiscal accounts, they just want the banks to be safe. And it doesn't work. It doesn't make the banks safe, and it doesn't make the sovereign safe. But that's maybe in the other part, yes.

Deputy Pearse Doherty: Can I go to the footnote on page 3, and this is where we're focused on coming up to the September 2010 and the funding cliff?

Professor Patrick Honohan: Yes.

Deputy Pearse Doherty: And you say that you considered possible alternative course of actions which might be recommended to Government. And you elaborate on that, you say "One such possibility was for the Government to abrogate the bank guarantee (in respect of Anglo and [Irish Nationwide Building Society]) in August or September 2010 and ... bail-in the bond holders and potentially large depositors." You go on to say that there was risk with that and

the ECB could force you to reverse that measure. What I'm interested in, Governor, is ... and obviously that wasn't suggested by the Central Bank, just for clarity. But as Governor of the Central Bank, you were suggesting as a possibility that the Government breach their legislative commitment on the bank guarantee and their moral commitment to the banks that they gave on the night of the guarantee in relation to Nationwide and Bank of Ireland, and to burn ... and burn bondholders and bail in some of the large depositors. I'm interested in how could ... just your thought process in relation to coming to that consideration, you know? I know that you didn't proceed with it, but your thought processes in relation to that?

Professor Patrick Honohan: Well, first of all, many ... several outside observers in public and in private suggested that some course of action along these lines would be correct. I think they were not accurately informed about the legal status of the guarantee or of the political environment in which any action of that might take but given that serious people with experience in banking and international finance were saying this, it had to be considered. And I felt it's important to put down in a footnote here, and only in a footnote, that we weren't just blithely proceeding and not considering all options. This is an option that had to be considered, you know, it wouldn't be a question of the Government, it would have been a question of the Government working with the Oireachtas, with the legislation. This is all under Irish law. You know, Irish law can be changed. But, as you say, the moral commitment is very strong and in my view equal or essentially equal to the moral commitment, as well as the legal commitment, of Government, of straight Government debt. And that's an argument not fully recognised by a lot of the outside observers who said, "Why are you paying for the banks? Banks are banks," you know, "you can get new banks, creditors, private creditors are private creditors." They didn't realise that the obligation to the creditors of the banks had become equal in importance to the-----

Deputy Pearse Doherty: And your considerations-----

Professor Patrick Honohan: -----status of debt holders.

Deputy Pearse Doherty: And your consideration of revoking the bank guarantee at that period and burning bondholders and large depositors, you say that the risks to this being successful was that the ECB might have demanded that the procedure was reversed, and that we would be back at square one, we'd be back at the first point where the guarantee was still in effect and we would have lost market confidence. Was that the main consideration that you had in relation to not recommending this to Government?

Professor Patrick Honohan: No, it's only one. I think it's one that people can resonate with given what happened subsequently. But another one is that ... well, in my mind was, if there had to be a restructuring of Irish debt, if Irish debt was not going to prove to be sustainable, and many people were saying that it was not, then which part of Irish debt could most safely be restructured? And it seemed to me that trying to restructure this banking thing, while the banks are open and everything is going on, is just not going to be a safe way of proceeding. So if it proved to be ... restructuring proved to be essential later, which it did not, then it could have been done in a more orderly way, as has been done in a number of other stressed countries using non-banking. It's not that I have a particular preference for any particular creditor, but, yes.

Deputy Pearse Doherty: Okay. Governor Honohan, I'm referring to your core booklets, Vol. 1, page 68, and the document is a memorandum for the Government, "State Aid Notification of Capital Support for Anglo Irish Bank, Irish Nationwide ... and [EBS]". It's dated 8

February 2010 and the final paragraph says:

The method proposed by the Minister to support Anglo and ... INBS through the issue of a Promissory Note is certainly not an avenue available for AIB or Bank of Ireland who are in need of further capital and may be required to receive this from the State for example through the conversion of the State's Preference Shares or further purchases of bank equity by the [National Pensions Reserve Fund]. This is because, unlike Anglo and INBS, the State would wish to demonstrate that the investment into the two banks was a commercial investment into viable institutions and the banks were viable in the medium-term and capable of remunerating or re-paying the capital injected into them.

Based on that statement, is it the view that at that stage, where the promissory note was being issued to INBS, that there was an understanding that, and Anglo, sorry, the promissory note issued to Anglo and INBS, that there was an understanding that both of those institutions were not viable in the medium term, unlike AIB and Bank of Ireland and the second thing is that they were not capable of remunerating or repaying the capital injected into them, which is stated here, that AIB and Bank of Ireland would be?

Professor Patrick Honohan: So I ... this is obviously a statement by the Minister to, to the Government to explain what he's proposing. But I think certainly the promissory note, the Anglo and INBS, a smaller case, but take the Anglo case, at the end of December 2009, the new management team, who were pretty strong people, had already assessed that the losses on their loan book were going to bring them below the capital requirements. So they said, "What are you going to do about that?" I said, well, you're going to have to bring the capital up to the capital requirements, for the reasons I've given in my opening statement, and you'd better go to your owner, Minister for Finance, and see what he's going to do about it. So he did provide a letter saying that the Government intended to do something like this. A lot of consideration was given to how that would be arranged and the promissory note mechanism was designed to achieve three or four objectives, only one of which it achieved, which was to make the bank ... bring the bank back to financial soundness. So it gave them something for nothing, which gave the bank something for nothing, in the sense of ... so it wasn't going to be remunerated, over time, from the profit and loss account of the bank. Well, no, wait a minute, I'm not sure that ... I'm overstating it there, because ... no, well that's not right, because the calculations would have shown that it was able to remunerate it over time. But it's not on a basis, on a basis of risk that the private sector would not envisage. So the calculation-----

Deputy Pearse Doherty: Just to clarify, so the €30 billion, the €30 billion that was put into Anglo on the promissory note, you're saying that the documentation that you may have access to, which showed calculations that you mention, showed that that money would be paid back to the State at a certain point in time?

Professor Patrick Honohan: Yes, over a long period of time, because that's the ... given that they put in enough money to generate interest off the rest of their business. There were projections showing that this would be enough, they were given that amount of money and they were going to, the State was going to be remunerated, things were going to pay back, through to 2025, and there was going to be just enough money to wind it up; I think that's the way it was calculated.

Deputy Pearse Doherty: Sorry, hang on, sorry, would you, yes, I appreciate that, but if you were winding it up, because the promissory note-----

Professor Patrick Honohan: No decision was taken to wind it up at that stage, so it would be continuing for 20 ... I remember the tables that showed for 20 years, or 25 years, exactly what was going to happen in profit and loss and the flow from the bank and there was going to be enough money at all times. There was not going to be another deficiency, and the calculation was made-----

Deputy Pearse Doherty: Yes, but that's not the question, the question is, the promissory note was constructed in a way where there was a drip of capital going into Anglo Irish Bank over a long period of time, more than a decade. The question is, was the Government of the view that that money would have come back to the Government at a point in time? Because the point that I'm making here, in terms of the Government's note, is to say that unlike AIB and Bank of Ireland, where they expected that they would be capable of remunerating or repaying the capital injected into them-----

Professor Patrick Honohan: No, no, no, this is the Government saying, "That's ... that money is down the drain unless something really surprising happens and Anglo suddenly turns back into profit", which was believed by some people and indeed other parts of the Anglo management were developing a plan to build the entity up and start making profits and so forth, so you could imagine that it could be done but on a base case, it wouldn't.

Deputy Pearse Doherty: Okay, thanks.

Chairman: Thank you very much, Deputy. Thank you, Professor Honohan. Deputy Eoghan Murphy, 25 minutes.

Deputy Eoghan Murphy: Thank you, Professor, you're very welcome. I just want to continue with Anglo, if I may, for a moment. When you came in in September 2009 and became Governor of the Central Bank, how significant was Anglo for you coming in? I mean, was it the majority of your work or was it just another piece of a puzzle that you had to solve?

Professor Patrick Honohan: Well, not on a day-to-day basis. It's not as if it took all the time because ... but it was a very big ... it was evidently a very big problem. In my mind, it was always going to be the bulk of the losses and those losses were, in my mind, a lot bigger than most people believed. So I thought this was going to be the real driver of losses and that there were going to be losses in the other banks too that might force them into full State ownership but that the big shortfall would be on Anglo.

Deputy Eoghan Murphy: Your starting position was the PwC analysis at the end of '08.

Professor Patrick Honohan: No, I didn't rely on the PwC analysis in broad terms of "Where is this all going?" I was ... PwC weren't looking at the residential loan book; they weren't looking at the small business lending; they weren't looking at, you know ... they were primarily looking at, as far as I can remember now, at the big business, the big property loans.

Deputy Eoghan Murphy: When you came in September, I think the first €4 billion had just been provided to Anglo in terms of capital between June and September, so what did you do? I mean, the banks just received this money, I mean, off the back of that capitalisation, then do you go in and do another loan analysis or a first-time quality of the asset or-----

Professor Patrick Honohan: The first thing I did in this space was to say, "We need to think now towards the recapitalisation of the banks which will follow from NAMA." I set up a team to prepare, not just looking at the loan losses of some parts of their book but looking

forward to recapitalisation needs and, eventually, the date decided was March 2010, but even in, I guess, October or November of 2009, I had set up a team with ... mandated to arrive at ... from looking at all of the loan book and the rest of what the banks had because they had assets like the Polish subsidiary and so forth that could be netted off ... could be sold and netted off.

Deputy Eoghan Murphy: So, from the moment you started then as Governor, you were working towards figuring out what the further recapitalisations for Anglo would be?

Professor Patrick Honohan: Yes.

Deputy Eoghan Murphy: Okay. So, and did you have any idea at that time in September that, say, the recapitalisation that took place in March, I think it was €8.3 billion with the possibility of a further €10 billion being invested which was later, had you any idea it was going to be on that scale?

Professor Patrick Honohan: Yes.

Deputy Eoghan Murphy: You did?

Professor Patrick Honohan: Yes. No, I mean, I came to a ... before I was appointed, I came to a committee here in the building and I said I think the range of uncertainty is very wide, about €50 billion wide, so it could have been, like, €45 billion or something like that, as a total net cost of the problem. When I came in, there were some calculations had been done on the basis of ... but extrapolating into the rest of the portfolio I said ... I remember saying quite clearly, I think it was my first meeting of the Central Bank board, I said, "This looks like a €25 to €30 billion problem." It turned out to be a €40 billion problem so----

Deputy Eoghan Murphy: That was in September of '09, that meeting with the board?

Professor Patrick Honohan: Yes, yes.

Deputy Eoghan Murphy: Okay.

Professor Patrick Honohan: So ... so it didn't surprise me. What surprises ... there were ... the range of reserves were very wide, so there were disappointments. The surprise, I think, was ... came in ... we already knew that AIB was the weaker of the two big banks but the extent to which it was weaker surprised on the downside and particularly after about October 2010 and then, subsequently, it became apparent when we did the analysis later on. So that was the biggest surprise. The scale of Anglo losses were, yes, pretty clear they were going to be that big.

Deputy Eoghan Murphy: Your advice to Government then from September was always that this money has to be put into Anglo, that there was no other possibility or no other mechanism that could be put in place?

Professor Patrick Honohan: Yes, the guarantee was there.

Deputy Eoghan Murphy: So that money had to be given. And in terms then of the promissory note and that arrangement, that structure, where did that come from? Whose idea was that?

Professor Patrick Honohan: The exact design ... let me see if I can remember the ... so in order to achieve this capitalisation, you needed to put in an asset into AIB ... into Anglo which was worth something and the something was a calculation that was made but when ... so, I certainly suggested that a Government obligation of some form be put in. I was thinking in

terms of a conventional bond but several other people, especially in the Department of Finance and colleagues in the Central Bank, started to look at other advantages. If you put an asset that was an eligible asset for normal ECB monetary budgetary policy lending, then you ... then they could use it as collateral and they wouldn't have to use ELA. They were already using ELA from February or March, I think, of 2009. So that would have been an advantage. Perhaps the obligation if it was structured in a certain way would not appear as one of the liabilities of the State in the general government debt. That was another objective. There was a third objective which I can't remember so there were three. I mentioned three of four. In the end, I think, it only satisfied the capitalisation that the ... it did end up on the Government's debt and it was not eligible for ECB monetary policy purposes, despite ingenious attempts to make it satisfy.

Deputy Eoghan Murphy: Alan Ahearne, an adviser to Minister Lenihan, has implied in his writings that it was the intention of the Government to renegotiate the promissory notes at a later stage when they were entered into.

Professor Patrick Honohan: Well, I'm glad he didn't say that to me because that would have put me in a very awkward position. You say, "Oh, this is a great asset of the bank but they are actually not going to pay", so that would not have put me in a good position.

Deputy Eoghan Murphy: You would've been involved in those conversations though.

Professor Patrick Honohan: Well, I didn't have to be accepting this as being collateral for ELA and the Government ... if one side of the Government was saying to me, "Oh, you know, this stuff, that's a joke, we are never going to pay that stuff." Then I couldn't accept it as collateral, could I? I'm the bank-----

Deputy Eoghan Murphy: Okay, so if it is the case though that's what the Government was thinking at the time-----

Professor Patrick Honohan: I don't know-----

Deputy Eoghan Murphy: -----but if it is the case, were they incorrect? I mean, was it disingenuous on their part then to put forward that structure to you?

Professor Patrick Honohan: I never interpreted that note as not having a full obligation on the Minister for Finance. It's-----

Deputy Eoghan Murphy: Okay-----

Professor Patrick Honohan: -----it says so on it. That's what's written-----

Deputy Eoghan Murphy: Okay.

Professor Patrick Honohan: -----and the Minister never suggested to me that he wasn't going to pay it.

Deputy Eoghan Murphy: Okay, thank you. Moving forward then to March 2010 and Anglo record, I think, the largest corporate loss in Irish history, further recapitalisation for Anglo, for other banks and you say that from mid-April 2010 you could see the need that Ireland might need a bailout. You had a conversation with Minister Lenihan who was at a eurozone meeting and you said to him-----

Professor Patrick Honohan: Yes.

Deputy Eoghan Murphy: -----"We might be next for to need a bailout".

Professor Patrick Honohan: Yes. I remember it clearly. I was in France at a conference ... coming back from a conference and because I remember ... sometimes you remember these telephone calls because they are in vivid places. So I remember him saying that. He said, "Well, we ... do you think it's a good idea? I have to ask you". He liked to be very formal: "I have to ask you your advice on whether we should go ahead and support and put Irish money into this Greek programme that's being envisaged." So I think it was 10 April and I said, "I think you should", and he said, "Yes, I have the same view because, you know, we are going to make money on it because we are borrowing at this and we are going to get this amount of money", and I said, "That's not the reason", I said, "The reason is we could be next". "Oh no", he said, "No, no, I've been talking to the people in Brussels and they say Portugal is next."

Deputy Eoghan Murphy: So, were you surprised at that response?

Professor Patrick Honohan: No. You see ... was I surprised? I was worried because Ireland was being held out because of the excellent, I have to say, excellent, well-organised fiscal response engineered by the Minister and by the Government to ... a prompt response to the looming fiscal crisis and the actions that were taken, I think, in the summer of 2008 and then also in the early budget brought forward budget in October 2008. Ireland was being praised in Europe as having been ahead of the curve, taking the corrective actions early on. But what I was beginning to be conscious of was that it might not be enough and particularly with these bank losses, it was not ... we were in a delicate situation and I ... he was being, as other Ministers were, they were being praised in Brussels for, you know, having coming out of everything and it wasn't ... we weren't out of everything.

Deputy Eoghan Murphy: Did the Minister and the Department see the difficulties that you foresaw or were they blind to them? Did they not want to-----

Professor Patrick Honohan: No, no. They were not blind to them because, in fact, you know, and I remember around these times of the capitalisation, the PCAR discussions, how much money are the banks going to need, you know, and various calculations being made. They were shifting from day to day and the finance officials, most of whom you were talking to were there saying, "This will sink the State." This sort of ... I mean, they wouldn't have used that phrase but they were very, very worried about the billions that were going to be required for the banks.

Deputy Eoghan Murphy: This is in April 2010?

Professor Patrick Honohan: In March 2010.

Deputy Eoghan Murphy: In March, okay.

Professor Patrick Honohan: Yes, when we were heading towards that announcement which was a very big announcement overshadowed by the Greek crisis. Journalists came to me in the autumn and they said "What are you doing about your banks?" I said "Well, we recapitalised them". "Oh, I never noticed that, I was busy in Greece". So that very big recapitalisation, which was by far the biggest recapitalisation, it was noticed here, there were, you know, big television programmes about "black day for Ireland" and all that sort of stuff.

Deputy Eoghan Murphy: So they're saying ... they're looking at the banks and saying this will sink the State. Are they talking after that recapitalisation is made there ... there's still

a worry there about the banking system?

Professor Patrick Honohan: Well they were less worried than some of the earlier numbers that we were bringing ... coming out. Then we discovered ... anyway ... some of the earlier numbers that were coming out in rough drafts were bigger than we ended up with. A little bit bigger.

Deputy Eoghan Murphy: Then, if we look at May 2010, the IMF head here in Ireland speaks to you about a precautionary line of credit for the country. You raised this with, you say, Merrion Street in ... in your writing, but I wasn't clear. Merrion Street is the Department of Finance?

Professor Patrick Honohan: Yes, so this is another interesting phone call which I took in Heathrow Airport in the place that you used to go down in the tube to the plane. So I got a call from Ashoka Mody, who we know was subsequently in here and he ... out of the blue he said "You know we're coming, we're coming later in the month for the Article 4." Yes I know. "And we're just wondering would you think Ireland would be interested in one of these precautionary programmes?" And I knew that ... there are a number of ... two particular precautionary programmes, I'm not sure which one he was talking about. One of them was for countries that were really considered very well run, very well managed but just vulnerable to pressure from the market. Mexico, I think, qualified for one of these and may have taken one of these ones. And I thought this might be quite good, we'd get a ... we'd get a seal of approval, potential access to money and it might be good. But I didn't think it as a wonderful thing which would have really been, you know, let's go for that, because if I had, we would have been advocating it as well.

I don't recall, perhaps you can tell me did I say in that paper that I actually spoke to the Department of Finance or did they speak to me? I think he ... I think he went on and raised it with the Department of Finance and somebody mentioned to me "Were you talking to Mody about this - it's not going to happen, no, no", something like that.

Deputy Eoghan Murphy: You said "Although storm clouds were still only on the horizon I could see some advantages but was quickly put in my place by Merrion Street officials".

Professor Patrick Honohan: Yes, I don't think I called them, I think they ... it came up in conversation ... "Were you talking to Mody about this?", "Yes I was", "It's not going to happen, no, no, they won't do that."

Deputy Eoghan Murphy: And that was the Department of Finance, when you say Merrion Street?

Professor Patrick Honohan: Yes, yes, yes. Who was it? I don't know. Was it Kevin? Kevin says he can't remember, so ... I ... it could have been ... I don't want to drag people in-----

Deputy Eoghan Murphy: You advocated for it and it never progressed from there?

Professor Patrick Honohan: No, no, no. I said to Mody "Try it, I think it might be a good idea."

Deputy Eoghan Murphy: Okay, sorry, you said to Mody, "try it"?

Professor Patrick Honohan: Mody, I said to Mody, "Try it, they may not like it but I think it might be a good idea", but it's not ... it wasn't for me to-----

Deputy Eoghan Murphy: It didn't go anywhere?

Professor Patrick Honohan: It didn't go anywhere, no.

Deputy Eoghan Murphy: Okay. Then, looking again at the bank funding cliff from September, which you mentioned in your opening remarks. You say that you got on to the ECB at the end of July 2010 to make them fully aware of how the dependency on ELA was shaping up, but it's not until September that Mr. Trichet contacts Minister Lenihan demanding to know what Ireland was doing about the position and looking for a team to go to Dublin. So what happened between July and September if this was so serious?

Professor Patrick Honohan: Yes, it is a bit funny. So, I wrote at the end of July and I fully expected then in August ... early meeting to be pulled aside and you know, "What do you mean saying this?", this is, you know ... dead silence, which I took as good news, they must have figured this out themselves, this is no surprise in my letter. So I wrote another letter in ... in August. I shouldn't really be going into a lot of detail about communications within the Euro-system, to some extent I'm writing on behalf of Ireland, of course, which is what allows me to talk about them at all. So I ... obviously I provided full information at the end of August again. Then, of course, I did get the response, the concern and the anxiety was starting to build there.

Deputy Eoghan Murphy: So, the dead silence then, are you saying you thought that meant good, they know what's happening? But you don't think they did understand the situation?

Professor Patrick Honohan: I'm not sure, I'm not sure whether they ... they may have just felt well, it's very good of him to keep us informed about these things but it seems to be nothing very serious. And, of course, then in the course of August a number of things happened to raise the temperature quite a lot. There was the third tranche of ... I can't remember when that was announced but I certainly became aware of the third tranche of NAMA losses and then there was downgrading of S&P, by S&P, so it wasn't surprising that at the beginning of September it wasn't just any communication from me that had the ECB starting to really get worried about the trend in ELA because it wasn't clear how this would be reduced. The money was flowing out and where ... how would it flow back in?

Deputy Eoghan Murphy: Okay, and did Mr. Trichet have the power in September, or the authority, to call the Minister for Finance here and say "We're sending a team from the Commission, you have to do something about this"?

Professor Patrick Honohan: No, no, not ... that wouldn't be his style or his power at all, but he would be more inclined to say ... to talk to Brussels and Brussels would say "You have the excessive deficit procedure, we want to look and see how the public finances are going", and then I'm sure Jean-Claude Trichet would have said to Brian Lenihan, "The situation is ... seems to be very bad, I think you should look at it and people in Brussels will help - we can help." So, it would be that kind of thing, it wouldn't be a kind of ... here we are, as you sort of imply, "Here we are to mandate some things at you." It is a collegial environment, though as Kevin Cardiff has pointed out, behind the collegiality there are red lines and-----

Deputy Eoghan Murphy: This is my final question in this area. You are satisfied that the Department was fully aware?

Professor Patrick Honohan: Yes, yes. What I would say is that in July, if I go back to July, not about just the banks but on the fiscal situation, our economists in the Central Bank alerted me in the middle of July, they said that the fiscal situation is going badly wrong, and I said I

know it's not going to be. "No, no. it's worse than you think", so they did sums out and ... they ... those ... I had concerns then that maybe Finance weren't sharing the view that we had at the Central Bank, that the fiscal situation, banks aside, was going to go off track. And I got my colleagues to speak. I said "I'm not going to write a formal letter to the Minister but you make it clear at the official level our position on this" and we continued that dialogue and eventually at the end of August I remember talking to Brian Lenihan and saying to him, "You know your debt ratio is going to be 100% of GDP at the end of the year?" "No," he says, "no, you're wrong, you're wrong." So there may have been some differences on the overall fiscal but not on the banking situation, full sharing.

Deputy Eoghan Murphy: Okay, thank you.

Professor Patrick Honohan: And that's a difference of analysis, not a lack of communication.

Deputy Eoghan Murphy: Yes. The domestic standing group fell into abeyance just prior to the crisis really reaching its peak in September in terms of the guarantee, the DSG.

Professor Patrick Honohan: Well yes ... in September, which year are we talking about now?

Deputy Eoghan Murphy: 2008.

Professor Patrick Honohan: Okay yes. Well, I don't really know about that. What I understand about the DSG is it didn't ... it met at a certain level but they weren't the deciders and now it had reached the decider level so it's quite different.

Deputy Eoghan Murphy: The financial sector stability group, I'm just curious about, did that replace the DSG, is that something different?

Professor Patrick Honohan: What we have now, we meet as the principals. Why do we call them the principals? Because when the troika were here, there were meetings at a technical level and then people would say "There's a principals' meeting". And then we would say "Yes, but we want to have a meeting before that - it'll be the domestic principals." So, it'll be five or six of the senior people and we still call it the principals and I pointed out that this is actually the domestic standing group, which we have to have, and we meet on a monthly basis.

Deputy Eoghan Murphy: And the membership is? Who are the principals ... it's the Central Bank?

Professor Patrick Honohan: Me from the Central Bank with my two deputies, Derek Moran from the Department of Finance with his second secretary and a couple of assistant secretaries and the NTMA, Conor O'Kelly and his No. 2, so basically that----

Deputy Eoghan Murphy: And is it a decision-making forum or is it just a discussion and analysis forum?

Professor Patrick Honohan: No it's ... when I say it is the deciders for each ... the deciders in our individual institutions, so that's very important. It has no collective decision-making power. Obviously, the Secretary General is answerable to the Minister, so we share views and we say "Why don't you do this?" and "Okay, but I'll do it under my own authority" and we're not ... we don't actually ... it's not a unitary decision-making body, no.

Deputy Eoghan Murphy: And, just to confirm or to clarify, this new structure came in, or this new arrangement came in when ... this meeting of principals?

Professor Patrick Honohan: When it ... I think we started to meet on a more regular basis with proper minuting and proper pre-set agendas as soon as the first troika mission had gone. We said "We've got to do this on a more organised basis". But before ... that's at the beginning of 2011, but in the course of 2010 we were in constant session, if you like. We weren't having regular meetings because we were having meetings semi-continuously. So, it wasn't as if there was a breakdown of communications at all, except with one little exception, on a certain date, which may come up in the discuss later, when it wasn't funny, people left, got left out of the loop-----

Deputy Eoghan Murphy: And, this group then ... this, kind of, cross between the DSG and what would become the FSSG, was it ever involved in discussions ... we spoke with Mr. Cardiff yesterday about, you know, possibly preparatory work in case Ireland was to find itself outside of the euro, a unit preparing papers, scoping papers, was it ever involved in that work? Were you aware of that work?

Professor Patrick Honohan: Okay, so look, there were ... there's a lot of contingency work going on. When any contingency work on any matters were not minuted in, or discussed in that forum, they were taken offline in a different way. There's a lot of technical ... a lot of technical work on different contingencies. Lots and lots of contingencies were done in each of the agencies and there was a lot of sharing of information. But most of that work, obviously, is technical work and doesn't happen-----

Deputy Eoghan Murphy: Were you aware that the contingency was being looked at in the Department?

Professor Patrick Honohan: Lots of contingencies were being looked at in my entity and in others, and there was a sufficient linkage between all of the contingency work that I am aware of. They may have been doing other contingency work that I wasn't aware of but I-----

Deputy Eoghan Murphy: But you were aware of this?

Professor Patrick Honohan: I'm aware of various contingency actions. But I'm not saying what those contingencies were about, because I'm trying to be forthcoming in my response to you, but if you're saying the contingency about this and that, I'm not, I'm not-----

Deputy Eoghan Murphy: Okay. As it happens I'm running out of time so I have to move to my next question. But, on dividends, because we had this in evidence from Mr. Neary, when he was in with us previously, in 2008 €1.2 billion in dividends was paid out to shareholders by the Irish banks, banks later be guaranteed in September, and so that, that liability effectively came onto the taxpayer. Did the Financial Regulator have the power in 2008 to stop the banks paying out dividends?

Professor Patrick Honohan: Oh, I believe so, yes.

Deputy Eoghan Murphy: Why would the domestic standing group be discussing the possibility of legislation that would give that power to the regulator in 2008 if he already had it?

Professor Patrick Honohan: I suppose you're back, to some extent, to what I was saying to Deputy Doherty, that-----

Deputy Eoghan Murphy: You wanted to specify the-----

Professor Patrick Honohan: -----that, oh, you know, do we really have the power. What ... an example of one thing that we don't have the power to do, it seems, according to all the lawyers, that we might want to do, which is close to the area of dividends, is we don't have the power to oblige the banks to change their loan loss provisioning, because that's a matter for their judgment and the approval of their auditors. I think we probably have that implicit power but the lawyers say "No you don't have that power." Now, that's very close to that territory of saying, "Okay, if you're saying that you can't pay dividends, why can we not pay dividends?" "You can't pay dividends 'cause you don't have enough capital." "We do have enough capital, we're showing 15% capital" or whatever number they were ... they were showing. "You shouldn't be showing 15% capital because you haven't made enough loan loss provisions." "Loan loss provisions are a matter for us, not a matter for you, the regulator." So, I believe they did have the power but I suppose there would be some lawyers who say you don't.

Deputy Eoghan Murphy: Okay. Just the final area I want to look at-----

Professor Patrick Honohan: I don't think they tried though to ... very hard to get them to stop paying dividends, 'cause I think they ... in some of the papers, including 2008, I believe ... or 2007, 2008, I think that ... I saw in some papers that the idea that well, it wouldn't weaken the banks in the stock market if they ... so it would be a bad signal, so it would be better to stay out and companies sometimes pay out dividends when they haven't made any profits in order to achieve stability. But, given what happened subsequently, it does seem like a mistake to have allowed them.

Deputy Eoghan Murphy: And you're not aware of Mr. Neary making an effort to try to stop them to pay out the dividends?

Professor Patrick Honohan: I don't want to dispute his evidence, I didn't see whether he said that or not.

Deputy Eoghan Murphy: He said he didn't have the power, but he didn't, yes. My final question is in relation to aggregate debtor concentrations across the banking sector because the Central Bank didn't pick up on these prior to the crisis. So, was this due to information deficiencies in the Central Bank's management information centre, is it due to a lack of regular monitoring and do you now have the systems in place so that you could pick up on these large exposures, these debtor connections?

Professor Patrick Honohan: Yes. I think it was a consequence of not looking at the bank risks in a quantitative way and doing the analytics on where the risks lay, concentration instead on the governance structures, which are important, but ... so they just didn't look at those kinds of numerical things until the ... in 2007 when they discovered all these crossovers. We have ... we've introduced a credit register, you have legislated for it, and the ... it's being constructed now, there's a firm doing all the software. So, over time that will build up a ... not just for the big debtors, a comprehensive picture of all of the indebtedness of borrowers of any reasonable scale. But, for the big borrowers, the ability was there to do it, they were known. That's how they did this big study in saying, let's take the five biggest property developers and let's go to the biggest banks and see how much they owe each other. That's an extraordinary ... I never saw anything like that in any other country. There's ... the lack of information. And the banks did not want there to be a credit register in this country because the big banks thought "We have a lot of information about the market, if a credit registry is created, everybody else will have

that information.” So, in a concentrated banking market, that’s one of the evils of a concentrated banking market, is that you ... the main players don’t want to reveal the information.

Deputy Eoghan Murphy: But, just on that five-by-five debtor connections which you wrote about-----

Chairman: Last question, Deputy, very last question.

Deputy Eoghan Murphy: Yes, very good, Chair. You wrote about in your report, in the Honohan report, and you talked about the high-level priorities and the medium-level priorities, and one of the medium-level priorities that was found out was that in one of the banks they didn’t realise that one of their debtor’s exposures to another bank was worth more than a billion. They had it at a couple of hundred million but it was more than a billion and that the importance of this didn’t seem to be understood by their regulatory system. Can that happen again? Could such a thing happen today?

Professor Patrick Honohan: No, no I don’t think so. No I don’t think so and it’s a kind of ... the situation we’re in at present, in the ... with the Irish banks, it just doesn’t arise. They aren’t making those big loans but with the systems that we have in place and the expectation of a drilling-down and analytical work, looking to see where the profit’s coming from, what’s the business model, who are they lending to, what are the magnitudes involved, what are the biggest ... and all of that information is being assembled, so that lack of information couldn’t arise.

Deputy Eoghan Murphy: Okay, thank you. Thank you, Chair.

Chairman: Thank you very much. I’ll just deal with a couple of matters and then I’ll bring in the other questioners, Governor. Governor, I just want to look at the 2009 period when you came in and what measures were maybe brought in to tighten up the system or to toughen up the regulatory regime. And if I could ask you, what changes did you implement in 2009 to ensure the appropriate supervisory or enforcement action was taken against the banks for breach in regulations?

Professor Patrick Honohan: Yes. So, we changed everything really. I mean, one of the ... one of my best decisions, if you like, was to recommend to the ... recommend to the board of the Central Bank the appointment of Matthew Elderfield, who was such a together person, with enough experience of a well-organised regulatory structure and the dynamism and management skills to make it happen, and so he mapped out, from the word go ... and he was in 1 January 2010, but he ... we were already talking to each other in the previous months. He mapped out, first of all staffing. He said “You’re way understaffed and you’ve got to separate the functions”. Take enforcement, which is the question you’re asking me, Chathaoirligh, enforcement has to be taken right away from supervision. Of course, they have to talk to each other, the supervisors will feed the enforcers with information, but take it right away so that once the job has been identified, that there’s a breach here that has to be followed up and pursued, that that will not now contaminate the day-to-day examination of ... forward-looking examination, and is taken to a directorate where specialist skills are applied to documenting the breach, deciding whether it’s sufficient to warrant ... or what kind of action is warranted and then pursuing it. I would say, I know you’re ... this is an area where I’m really surprised at how procedurally heavy the law makes it, in ... to go from the step where you say “That bank did this and they shouldn’t have done that and they should pay a sanction of €5 million for it”, the steps to be taken from there to there are very, very heavy. And, it also applies to sanctions against individuals, even more so, and so that’s why some of these things go on for years.

Chairman: And, can I ask you how you would assess the adequacy of the assessment and communication of both solvency and liquidity risks in the banking institutions at ... back then, and the sector today, comparable what was in place pre-crisis?

Professor Patrick Honohan: Yes. Well, I think on solvency, the ... what I said earlier to Deputy Doherty about the loan-by-loan analysis and the capacity to watch those loans now from quarter to quarter and to see the evolution of the defaults and the corrections. And that's a huge improvement, that's a quantum leap and it is not just a one-off that we did for the time of the troika, we made sure that we had the capacity to do it continuously. That's really big. Liquidity forecasting, I think, was already ... had been put in place fairly well by the time I arrived so I don't think we found the need to go any further than that. I'd say, though, and I know, maybe you don't want a long answer, but still I would caution that, although we're in a different world and it's a quantum leap, we still have the residential mortgages and still the SME loans, they are very long-tailed, we still don't know for sure what's going to be recovered from. I wouldn't like to say we've got it down to the last decimal point. There's still quite a lot of uncertainty about particularly the huge number of mortgage arrears and just how much will be paid in the end.

Chairman: Would you consider that to be the dominant legacy issue and a priority issue as of now?

Professor Patrick Honohan: I think it's not just the mortgage but also small business lending, that is, I think, the big legacy issue for the economy arising from the banks. The banks themselves have challenges going ahead. They have the measured capital according to the standard measures are sufficient. That was being tested by the SSM and so on and so forth, but some of the nature of the capital, the rules about capital are changing so some of the items that are counted as capital now will not be counted in a few years' time, so they have to build their profits in order to get there to make sure that they retain that capital going forward and also they have these very low yielding tracker mortgages which are a big drag on their profitability so that it's very hard for them to build that capital. So there are a number of legacy issues to be dealt with.

Chairman: I want to go back to the Honohan report for a moment there, Governor, and in the report it's evidence book, Vol. 3, page 69. You stated in the Honohan report:

The division of responsibilities between the Governor, the CBFSAI and IFSRA was novel and contained the hazard of ambiguous lines of responsibility especially in the event of a systemic crisis. However a number of provisions helped guard against any conflict.

That was the Honohan report when you published it. We have since had a number of personalities that were covered in the Honohan report before this inquiry and if I can refer to two of them in particular. In their statements made in front of the bank inquiry, John Hurley and Patrick Neary gave their views of their responsibilities before and during the crisis. How have your thoughts on their respective responsibilities and the responsibilities of the Central Bank, CBFSAI, and the Financial Regulator, IFSRA, and how these were acquitted/developed in light of these statements?

Professor Patrick Honohan: Well, I think it confirms what I found in the discussion leading to the report that the micro-regulator, Neary, would have done a lot more if he had any concept that the whole economy could go into a crash, and the macro-regulator, the Governor, would have done a lot more if he realised how vulnerable and exposed the banks were to these individual loan losses. That is what they stated and that is really the legacy of the lines of re-

sponsibility that did not actually say all that clearly what were you to do, but, you know, taken together, the institution had the powers and the responsibility to look after these things. That is what it did not actually manage to do.

Chairman: I'll go back to my earlier question there when I asked you about what changes did you implement in 2009. There's a fair bit of reading there, Governor. There's bullet point after bullet point after bullet point of changes that you made and I'm not going to go through them one by one. Were all of those changes there within the existing legislation during Mr. Neary and Mr. Hurley's tenure?

Professor Patrick Honohan: Yes. We didn't need any of the legislative changes to introduce the institutional changes.

Chairman: Okay. So it's-----

Professor Patrick Honohan: Except, of course, there is a single board.

Chairman: It runs for something like 20 pages. This is the evidence book, Vol. 2, pages 97 to 117. You are telling me that 20 pages of measures did not require any legislative change from the time of Mr. Neary and Mr. Hurley to your period?

Professor Patrick Honohan: Well, yes, I mean ... I'm not sure whether ... obviously these ... yes, they were busy. They were well organised and they were busy and they were doing a lot of things but I'm sure if you got some of the former colleagues who were working on that will say, "Oh, that's very self-serving. Well, we had something like that. It wasn't exactly the same, we had it from 2006, so ...". I don't want to exaggerate but there has been a huge change in the whole way business is done and I would say the most important thing that we did was we created an environment, I think, where people can say, "I think you're wrong and I hold to the view that this and that." They don't always get their way but-----

Chairman: One final thing and I am just going to remain with the Honohan report if you don't mind, Governor. We've had a lot of testimony and evidence here before us with regard to the extent and the preparation of legislation that would have been enabled the nationalisation of Anglo. Evidence we have heard both this week, last week and the week before would strongly indicate that the legislation was more or less ready to go and Anglo could have been nationalised within a couple of days. Drawing from your own views in the Honohan report and your own comments with regard to what should have happened in Anglo in and around the period of the guarantee, would you have now revised your view on that or are you still of the same opinion? And if you could, could you maybe just share what your opinion now presently is with us with regard to that matter?

Professor Patrick Honohan: Okay. So it is time to distinguish between nationalisation and then what would you do with the liabilities. I think the nationalisation should have been done based on what they knew at the time. They knew the business model was broken, they knew the bank was-----

Chairman: Excuse me for a second, I forgot to ask you this. The evidence that we have here at the committee at the moment, it would present the scene that the legislation was more or less there and it was legislation used in ... In your report, were you aware that the legislation was that evolved?

Professor Patrick Honohan: Yes, I was. They prepared the legislation, I understand, for

INBS. Then they said “We can tweak this here and here. Actually it doesn’t mean that much even though it’s a building society and a bank.”

Chairman: I’ll just bring it back on your own thoughts.

Professor Patrick Honohan: There is nothing new from that point of view so I think they ... the reason to take control of a bank that is so deeply troubled is that the management of that bank - and I am not speaking to the individuals - any bank that is so troubled has ... the incentives change and it becomes risky to leave that in the hands of-----

Chairman: So to ask you what is your view then on what should have happened to Anglo, given what has come out in recent weeks and what was in your report? Should it have been nationalised or should it have been wound down in two or three days or what should have happened to it?

Professor Patrick Honohan: It should have been nationalised; that’s clear.

Chairman: Completely?

Professor Patrick Honohan: It should have been nationalised then or at the end of the week. It should have been nationalised. The harder question is what should they have done with the liabilities. Should they have guaranteed the liabilities or not? That’s where if you had known that and this exotic idea that if they had known that there was going to be €30 billion of losses what should they have done. I think we should really set that aside, because they did not know, but I don’t change any of my views that I’ve written down.

Chairman: Thank you very much. Senator Marc MacSharry.

Senator Marc MacSharry: Thanks, Chair. Morning, Governor, and thanks very much for coming in again. After your appointment in 2009, what did you do to ensure that you had sufficient resources for the supervision that you wanted to implement?

Professor Patrick Honohan: We hired a lot of people. We hired a lot of very able people at all levels. So already the appointment process for the head of financial regulation, which was still the chief executive role at that stage under that legislation, was well advanced and it was down to just a shortlist of people so we hired a very good person there. And then with his help we headhunted some people and we just advertised other people and we made a raft of senior appointments and then we bolstered the staff right through the organisation. So 2010-’11 shows a huge increase in the actual numbers of staff that we had, not just the approved numbers which went even higher and we never actually reached the higher approved numbers. We, sort of, paused before we reached that, but it’s a very big increase. So, I mean, the numbers from ... if I take the Central Bank as a whole, combining the Central Bank and the Financial Regulator, in ... end of 2009 ... was 1,045.6 people and two years later, at 1,372.7 people. The Financial Regulator went from 379 to 622.

Senator Marc MacSharry: Was there any difficulty in getting the levels of expertise that you required?

Professor Patrick Honohan: Yes, but it was easier then for ... than it is now for two reasons: first of all, it was a very weak economy, so, particularly for youngsters and that, not many jobs, so ... and also, for the more senior people, there was the ... I think, the excitement and challenge of a turnaround situation that they come in. Now, it’s ... people say, “Okay, Ireland is

done, I've more interesting work in London" or whatever.

Senator Marc MacSharry: And were you bound by the salary caps and so on of the ... of the public service over here?

Professor Patrick Honohan: We were bound by the legislation that governed ... the FEM-PI, the successive FEMPI legislations; bound by the pension levy, which was an onerous thing; and then the reductions, the FEMPI reductions that were in the budget of, whatever it was, November 2010, October ... November 2010. Well, we found ... we held ourselves to be bound by those and we were certainly bound by the FEMPI 2013 ones, which actually ... and that brings us into another time period for the afternoon, but those have had a very severe effect because we were the only organisation that had actually hired people in the period 2010-'11 and so when the reductions, 2013, they came to people ... not people who had floated up and got great salary increases and now have lost some but people who had come in at market price. They could get the job ... a job somewhere else and now they were having their salary cut. So it is an issue. It's a bit of a problem.

Senator Marc MacSharry: But at the time it wasn't difficult, you're saying, to get people, the salary wasn't really an issue, people were-----

Professor Patrick Honohan: It was difficulty because it was ... it was a huge increase. It was risky, it was risky to hire so many people at the same time and, fortunately, we didn't have any major disasters.

Senator Marc MacSharry: Before your time ... we heard from people on the regulatory side and the Central Bank itself saying that additional staff were required and it was very difficult to get the people with expertise due to salaries and others. Was this a credible view in-----

Professor Patrick Honohan: Oh, I think it is. It's always a view ... it's certainly the case today. We are quite constrained today and it's ... and it's a common complaint of regulators all over the world. A few countries just ignore it, ignore the sort of sense of comparability with public service salaries and that and they just pay whatever it takes and they ... they pay very high salaries but the skills required for the Central Bank are very high and they're very marketable. If you know the sort of stuff that you need to know to be a good financial regulator, or a good central banker in general, you're probably able to walk out and increase your salary by quite a lot. So if salary is important to you, which it is to a lot of people, then you will stay for a while.

Senator Marc MacSharry: Post-2004, after administrative sanctions were brought in to the Central Bank, when you came in then in 2009, were you ... what was your view as to the reason for no prudential regulation breach enforcement in that period?

Professor Patrick Honohan: Well, I think that there was a ... an attitude which certainly was felt at the level of the people in charge of enforcement of low legal risk, "We do not want to lose cases, so if there are cases we can't be sure of winning, we won't take them." I made it clear, and then Matthew, when he came in, completely in support of that, that we will take legal risk. If we think we're right, we will go for it and if we fail, then we ... you know, we will have a story that we can justify because we felt we were right.

Senator Marc MacSharry: But at that time was there any justifiable reason ... I know it predates your time but, I mean, given your knowledge now and looking back and helping us to assess an opinion of the period, do you think that the lack of enforcement of prudential regula-

tory breaches at the time was right, was reasonable - the focus on the consumer side, rather than the prudential regulation side?

Professor Patrick Honohan: No, I think that in some cases it wasn't. I'm going to be fairly careful because it's not impossible that, you know, that issues can ... going back even into those periods can be subject of matters even now.

Senator Marc MacSharry: We heard from the then chief economist, Tom O'Connell, I think, some weeks back, and he spoke of how he, on a personal level, was consistently recommending different courses of action but that again, in his words, at the time he had great difficulty, despite his proximity on the seventh floor, in getting his views through to the board and indeed despite the fact that he had the opportunity to brief the board on different issues from time to time. I asked him at the time was this view ... did he feel this was credible, given the fact that he reported directly to the Governor. What's your view?

Professor Patrick Honohan: Well, you know, what ... one thing I think I identified in my report was the lack of follow through. So, I think you can find a lot of people ... I noticed that in the organisation, trying to change it, that people will express a view and not ... not expect it to be acted upon because, if you look back over the years, not many things were acted upon. Sometimes when they were acted upon, it didn't work out very well, as in the case of the Irish Trust Bank, going back - "Well, let's not do any of that because it failed in 1974; we don't to have any of that" - so ... so I think maybe when somebody like Tom O'Connell says, "It was obviously a disastrous situation was unfolding", but what was he going to do about it? That's the question, you know, that action ... action is required to solve these problems, not just talk.

Senator Marc MacSharry: And what should he have done?

Professor Patrick Honohan: Well, I mean, the ... I'll point to our macro-prudential measures that we took last autumn. Not exactly those, but that sort of measure should have been developed in detail. He should have said ... I could imagine a discussion between a chief economist and a Governor saying:

Look, Governor, I know you're busy in Frankfurt and whatever but I want ... we've noticed something here and we think it's a worrying situation, it's unstable and we think some measures should be taken. And we've looked at the 1942 Act and we do have the powers and I'd like your authorisation to prepare a paper which would outline this and we'll present it to the board.

And that's what the other man, who was also in here with you, Con Horan, did on his side and he required additional requirements and they were ... they were put in place after a lengthy discussion, but they were put in place and they weren't sufficient but, you know, that ... you know, follow through; do something.

Senator Marc MacSharry: This was on directors' compliance statements and concentration limits?

Professor Patrick Honohan: No, no, in ... the one where the ... additional capital requirements on large loans ... property developer loans.

Senator Marc MacSharry: Okay, I just have two other questions. Tom O'Connell also said that ... and referred to the political and property interests on the board. When you took over in 2009, did you feel that there were political and property interests on the board?

Professor Patrick Honohan: Well, I knew all those people, in terms of what was happening, but I wasn't feeling that kind of ... that kind of ... any kind of pressure or that. So, I don't know. That ... it's ... it seems to be a bit *ad hominem*. When I saw that board, I would ... only worked with them for nine or ten months, but they were ... they were serious people, they were concerned people, they were acting professionally, so maybe ... I don't know what they were thinking, but they weren't doing or saying anything that would have-----

Senator Marc MacSharry: Concerned you in that regard?

Professor Patrick Honohan: -----advocated a particular-----

Senator Marc MacSharry: Finally then, what was your experience of the interaction with the international authorities during 2009 and 2010 and how was Ireland perceived internationally? And, again, while it refers back to a previous period, when you took over and in your international ... with the ECB, for example, were you able to appraise yourself of the validity or invalidity of the opinion which has been put forward and the evidence that's been given here by many people that, through John Hurley, the message to the Irish Government, the Central Bank, was that no bank should fail?

Professor Patrick Honohan: Okay, so ... and this relates to ... I suppose to some extent to Mr. Trichet's interaction with the ... with the committee and so on and so forth. And I ... I spoke to Mr. Trichet some months ago, and maybe a year ago, because there was an article in the *Irish Independent*, maybe an interview with him or something like that, and he was ... I met him at a function and he was rather concerned that it was being portrayed that in some sense that the ECB had imposed a guarantee on Ireland ... that sort of area. And, what he said to me ... he's a very consistent person. You know, you asked him four or five times different things and he gave the same answer, and he's very consistent. So even a year before he came, or some number of months, he said, "Patrick, the message I gave to Ireland was the same message as I gave to everybody, that we must stand behind our banks." And so, when I heard him say repeatedly in the Royal Hospital, "no message to Ireland, no special", what I understood, what I interpret him to be saying is, "no special message to Ireland." So I was telling them, we must all stand ... we must. So there's some bank in trouble in Ireland: "There are banks in trouble everywhere, we must stand behind our banks." So that's how I interpreted it, and that's how interpret even ... If you isolate one or two of the sentences that he said, it looks as if he didn't talk to Ireland at all, that he was busy in Brussels, or something like that, but that's not what he means. So I don't know the exact nature of the phone calls or whatever that he had. I don't know why I don't know, but I can't get to the bottom. He obviously can't remember who did he call at a particular moment exactly, but ... because there were lots of phone calls going on. I can't get to the bottom of exactly who called what when. If you listen to what Brian Lenihan said on the interview that he gave to Dan O'Brien and, at first sight, it seems as if he got a call from Trichet, and Trichet told him whatever he said - I won't read it because it's there. But then if you listen to it again, it says that Lenihan got a message on his phone from Trichet and he followed up on it and he got the message that was coming from Trichet. He doesn't ... never says he actually spoke to Trichet on that occasion so ... I don't know why we can't exactly disentangle exactly what was said at that point because it seems that it's rather innocent.

Chairman: A short supplementary, Deputy ... or Senator, you're out of time-----

Senator Marc MacSharry: If we had, and again I know I'm going back to other territory, but if we had said actually to use your words, we're going to intervene Anglo and INBS and we're going to-----

Professor Patrick Honohan: Not to pay the depositors.

Senator Marc MacSharry: -----and were going to bail them in, could the ECB have pulled the ELA support?

Professor Patrick Honohan: They could have, but would they? No.

Senator Marc MacSharry: Big gamble?

Professor Patrick Honohan: No.

Senator Marc MacSharry: Yes? It would be a gamble though would-----

Professor Patrick Honohan: No.

Senator Marc MacSharry: Okay.

Professor Patrick Honohan: They would not have pulled it, because they gave ELA to several other banks that week.

Chairman: We're running out of time now, Senator. We're coming back in ... I just want to wrap up this. Just coming back to the question that Senator MacSharry asked you, there's another aspect to that as well in regard to your experience of the interaction with the international authorities during 2009 and 2010. One of the purposes of that question was to see was that all the international authorities and our other partners in Europe, how would you describe that relationship during that period? And how was Ireland perceived specifically internationally during that period?

Professor Patrick Honohan: Well, I think it did change quite a lot in ... the perception changed quite a lot in the late summer of 2010, so when I came in 2009, I realised that nobody was particularly concerned about Ireland. They were concerned about Greece and they were concerned about other issues, about how they were going to manage this, all of the liquidity and the ... but nobody was saying, "Poor you." I remember Fitch downgraded Ireland and I thought, you know, not surprising at all. Some people were saying, "They downgraded you. I suppose we're all being downgraded." So there was a sense that we were okay. It was kind of ... there were ... things had become pressured, but they were ... we were okay. But it was really the change in attitude in August of 2010 and September, and, in September, we were absolutely in the centre of attention. And I remember one senior colleague saying, "I'm afraid that Greece is Europe's Bear Stearns but Ireland will be Europe's Lehman's." That was in September 2010. So, the view of Ireland had changed dramatically and it had changed dramatically because people had woken up to the scale of the banking losses being incurred by the State and paid for, and the prospective budgetary situation.

Chairman: And I suppose did we or did we not have international credibility concerns with regard to how the perception of the State was being viewed from other authorities and other nations, with regard to how credible we would be able to deal with the difficulties that we were going to encounter, both as a nation and as a Government?

Professor Patrick Honohan: I never got to exactly the bottom of why the suspicion grew that some ... that they were going to suffer from the Irish situation ... exactly what they perceived. Did they perceive that Ireland was going to heedlessly increase its indebtedness and not adjust at all and lead to a great crisis or do so deliberately or were they just surprised at what they hadn't noticed? I remember another person saying to me, "Why did you have to buy all

those loans at these knockdown prices ... the NAMA loans? Why did you have to weaken your banks in that way?" So they were grasping at reasons how there had been a loss, because Ireland had this image of being so well run, and then that was suddenly, drastically looking under suspicion, but, turned around later.

Chairman: Okay, thank you very much, Governor Honohan. It's now just coming up to 11.15 a.m. I'm proposing that we break until 11.30 a.m. and with that said, if I can remind the witness that once he begins giving evidence he should not confer with any person other than his legal team in relation to their evidence or matters that are being discussed before the committee. With that in mind, I now suspend the meeting until 11.30 a.m. and remind the witness that he is still under oath until we resume. Thank you.

Sitting suspended at 11.17 a.m. and resumed at 11.38 a.m.

Chairman: As we're back in quorum, I now propose that we go back into public session. Is that agreed? And our next questioner is Senator Sean Barrett. Senator you've five ... or ten minutes.

Senator Sean D. Barrett: Thank you very much, Chairman, and welcome to the Governor ... back again. You ... you said that it was a pointless cosmetic exercise when the Irish authorities were pressed by the troika to merge Anglo with the INBS and the EBS with AIB and it served no strategic purpose. What did you have in ... in mind in that reconfiguration, if you like, of Irish banking?

Professor Patrick Honohan: Well, it was clear that Anglo and INBS were heading towards a wind-down. They had no future, this was already decided by ... by the Government. I think, probably, the troika people felt that somehow they ... it would be a safer situation going forward if there were no depositors in a bank that was heading towards a wind down. So, that seemed to be probably their thinking behind it but I don't think it was worked through. So, as far as the Irish side were concerned, we were just orderly winding those entities down, as indeed has happened subsequently. Merger of EBS to AIB ... AIB had lots of problems themselves ... and, I think it's axiomatic in this kind of ... in ... in a banking crisis, if you have two weak banks this ... the seemingly attractive solution to merge them and make one strong bank never works, it always ends up as two ... as one large weak bank. So ... but EBS was small enough for AIB to be able to bolt it on and not really suffer too many management distractions. So, we were relaxed about that. We did recognise that EBS, as a small bank - monoline bank - probably didn't have a very strong future, so-----

Senator Sean D. Barrett: But you referred, before the break, to "the evils of a concentrated banking market". Is that a problem we're now going to face?

Professor Patrick Honohan: Yes. And that was ... and certainly in the case of ILP, as Kevin Cardiff mentioned yesterday, there was a ... there were views in the troika that ILP should also be merged into AIB, or something like that. And on the Irish side, we ... well, we had different views. Some of us didn't want to stand very strongly against that view, but we were very concerned about the lack of competition with the other banks having retreated. So in the end, it was decided to strengthen ILP's capital and keep it going.

Senator Sean D. Barrett: You were speaking to us before the break again on how you're impressed with BlackRock compared to previous examinations of Irish banks. Could you tell the committee and those watching in, what the main extra measures BlackRock brought to this

particular issue?

Professor Patrick Honohan: What they did was, and I'm sure there are other firms that do that nowadays, so I'm not making an emotional ... they had a research group ... a consultancy group that ... what they brought was an insistence on collecting as much data as possible and confronting that data with little models that they had that projected what losses would occur depending on what you knew about those loans. So, you take a loan and you say, "What do we know about this loan?" If it's a residential mortgage, you mightn't know an awful lot - you'd know the location, you'd know the loan-to-value ratio at origination, you might know something about the income of the borrower at origination - these could be used to predict. Also, you will know ... because of the location, you will know what the unemployment rate and the trend of unemployment is in that location. So you use that sort of information to project forward and over ... actually, they projected over 40 or 45 years, the likely loan losses. To some extent, it's ... their models are over-ambitious, but they distance the calculation of losses from the emotion and the touch-and-feel of the loan officer and the attitude of the bank management. They put it ... distance it and put it into a mathematical box and it produces a result, which may not be correct, but it's not going to be a result that has been filtered by rose-tinted spectacles.

Senator Sean D. Barrett: And are you bringing that new knowledge to the meetings that bank auditors have with your regulatory staff?

Professor Patrick Honohan: Yes. The exercise that was carried out in September and October 2013, which was the subsequent exercise following the BlackRock exercise of March 2011, we engaged a lot of auditing firms to second guess the auditors of the banks and we got ... you know, there are only a small number of big firms but we got ... if auditor A had done the job for one bank, we'd get auditor B to come in and second guess, doing it on a sample basis of this loan-by-loan calculation not exactly using the BlackRock models, we have those in our back pocket, but the loan-by-loan assessment with their awareness of what that BlackRock exercise had conducted. So with the AQR that we have done now is not just a repeat of the BlackRock exercise, we can do that in-house. But that's not what the SSM wants and we do it in a different way.

Senator Sean D. Barrett: So again, people looking in would be reassured that Irish banks are much better monitored to prevent a recurrence of what this committee's been examining-----

Professor Patrick Honohan: Well, they are, but as I have stressed, the uncertainties are still there. They're not at all as wide as they were, but there are uncertainties there.

Senator Sean D. Barrett: One of the things that we wanted to do is to reduce the loan-to-deposit ratio to 122.5% instead of what was an unsustainable 180%. How is progress going? Are we closer to 122%?

Professor Patrick Honohan: We are under ... I think we have achieved all of those targets if you regard those as ... I remember that a target ... a very precise target of 122.5%, you can imagine that it came as a compromise between an apparently unobtainable larger number and a smaller number that we wanted. But there's a point on that loan-to-deposit ratio, again in the area of competition which you're interested in, Senator, and that's that we were concerned that the banks would start bidding aggressively for deposits in order to boost the loan-to-deposit ratio and indeed, that happened and we had to get ... make sure that that goal was defined in such a way that it wouldn't cause a deposit price war. It did cause a deposit price war but we managed to negotiate with the troika a revision of that, so that the war ended and still they got the target.

Senator Sean D. Barrett: Now you referred this morning, at the end of your speech to us, that you've spoken repeatedly to Oireachtas committees about the disappointingly slow progress in dealing with non-performing loans, especially mortgage arrears. What do you think should happen there?

Professor Patrick Honohan: Well I think ... basically, we're out of tools now. I have no new tools to propose in this area. What's happening now is a progress through the courts, unfortunately, and that's a very protracted process. It will resolve this issue over time. It's taking much longer but I have no new proposals to make at this stage on that. I think ... you know, often when I come to the Oireachtas committees, I find one side of the story is, Deputies, and perhaps understandably, concerned about the distress in which heavily-indebted families and SME owners are, and they want deeper debt restructuring, which I also do, and they want more time to be given, etc., etc. But there is another side to it and that is constantly from outside Ireland, particularly in troika people, they would've pressed for much faster, "If you can't get this loan repaid, repossess." There would've been very much that pressure all the time, which we resisted and some people may think that we have erred on the side of causing a longer delay because we have resisted the faster repossession route.

Senator Sean D. Barrett: I note the IMF calls for "more efficient repossession proceedings" and so that would cause concern to lots of people.

Chairman: Time, Senator.

Senator Sean D. Barrett: And the mortgage arrears over 720 days, are rapidly rising as a proportion of the totals. So this problem is getting worse, isn't it?

Professor Patrick Honohan: I don't see it as getting worse because if this is ... if you can imagine, there are some arrears will be resolved. So they get resolved within maybe a year or two and other arrears are going to take years and years, so they slip from being 90 days to 360 days to 720 days. They're just there and they accumulate in the bucket of below ... beyond 720. So, what doesn't fall out the other side is resolutions, repossessions ... that's why that percentage increases because the end state isn't reached.

Chairman: Thank you, Senator.

Senator Sean D. Barrett: Thank you. Thanks, Chair.

Chairman: Senator Susan O'Keeffe.

Senator Susan O'Keeffe: Thanks, Chair. Mr. Honohan, when you became the Governor, NAMA was already in train. In your view, was NAMA an optimal solution for the financial institutions, for the borrowers and for the State?

Professor Patrick Honohan: I think NAMA was a good solution for the State. I'm not sure it was a good solution for the borrowers. It was a terrible solution for the banks, if you think ... if by the banks, you mean the bank management and bank shareholders. They were basically wiped out. The bank shareholders were wiped out and you know, a lot of the senior managers. So, I think it was good for the ... it put behind us that part of the distressed loans of the banks. It didn't attempt to take all of the distressed portfolio from the banks. I think it would've been very hard to do that because distress was so prevalent in the banks. You would've been taking all of the banks' business away and they wouldn't have been dealing ... the customers wouldn't ... the whole society would be lacking banking business. So, it could've been more ambitious,

but ... and there were, I think ... I think Peter Bacon talked about a more ambitious NAMA, which would be a larger NAMA, but I think it was probably prudent to stay with the large property developer and borrowers.

Senator Susan O’Keeffe: Do you think or have you considered that you might’ve proposed an alternative solution or alternative solutions if you’d been in a position to do so at the time?

Professor Patrick Honohan: No. I did actually have sight of the ... Peter Bacon is somebody that I’ve known professionally for years, and he did ask me, he said, “You know about bank write-downs ... What do you think of this idea?” Or, “What do you think should be done first of all?” And then a few weeks later, “What do you think of this idea?” And so I did have sight of the proposal, and actually the reason I had sight of the proposal was that Brian Lenihan, who I’d been in touch with, as we talked about on a previous occasion, about fiscal matters, he said, “Why don’t you look at what Peter Bacon is cooking up?” So I did, and I wrote to the Minister and expressed my views on it, and I generally was supportive of it. I was a bit concerned at that stage, as many people were, that it would be used as a way of gifting money to the banks, so that the haircuts would not be steep enough, and that the banks would be let off the hook, and that NAMA would be ... would end up taking huge losses. Now it looks like that’s not going to happen, and, of course, there was the mechanism of the subordinated debt, which introduced a buffer, which was basically something that I suggested.

Senator Susan O’Keeffe: And you advised the Minister accordingly in your letter to him?

Professor Patrick Honohan: Yes. No, I ... well, the first letter, I think, probably didn’t come around this subordinated debt idea, but that I floated later on.

Senator Susan O’Keeffe: When the chief executive of NAMA was before the public accounts committee in January 2011, he said that the average loan discount on the first tranche of loans moved from the 30% as advised by the participating institutions to the eventual loan discount figure of 58% overall. So what was your view on that discount level?

Professor Patrick Honohan: The way in which the calculations were done was heavily negotiated with DG Comp, the European Commission. They were very alert to the danger that banks would be given a gift by excessively generous pricing, and so that was heavily negotiated. How that would be done - there’s a kind of art of property valuation which ... all sorts of rules of thumb which property people seem to believe in. Of course, it depended on where the properties were, what were the collaterals, were the personal guarantees any good, all of that had to be put into the calculation, the likely dividends, or the likely interest payments, so I didn’t attempt to second guess all those calculations, but I was insistent against any suggestion that this overall 30% figure that was floated in September of 2009 would become a de facto target. I said they must go through the calculations and come out with an honest and straightforward figure. Of course, it was a big number then, because they’d very short notice that it was going to move up into the higher ranges in March. It was really oh, oh, so ... and then, was it going to get worse? We didn’t know.

Senator Susan O’Keeffe: What was your response or were you surprised or not about the large debtor concentrations in financial institutions and the level of interest roll-up? Did that come as a surprise to you or was it what you might have expected?

Professor Patrick Honohan: By that stage we knew a lot about ... everybody knew about the big borrowings and so forth, and special arrangements, and it’s bad banking, but it’s what

we see in this, sort of, environment, so I'm only saying what-----

Senator Susan O'Keeffe: So ... more or less by then?

Professor Patrick Honohan: It's, you know, but they were ... yes. Not really surprised.

Senator Susan O'Keeffe: I think you said earlier that on 10 April 2010, you'd had a conversation on the phone with Mr. Lenihan?

Professor Patrick Honohan: Yes.

Senator Susan O'Keeffe: Yes. And you talked a bit about a bailout. Had you considered, prior to that yourself, did you actually know when you came into the job as Governor that there was inevitably going to be a bailout?

Professor Patrick Honohan: I knew ... this is ... it's a, kind of, "Can we get through this without a bailout?" And I don't want to be in a situation where the Central Bank, through some misstep, has caused a loss of confidence that would trigger an unnecessary bailout. That was in my mind from the very word go. Not that the bailout was bad, but that this would mean that ... to lose confidence means that the cost of funding is going to be enormous, and your ... well, just look at the political ramifications and the distress to society, not in terms of the pay cuts and the social welfare and all that, that adjustment has to happen. But the sense of control, loss of control by the public sector and the private sector when it happens is-----

Senator Susan O'Keeffe: No, was it ... but you're saying it was in the back of your mind as you took on the job that that was-----

Professor Patrick Honohan: Oh yes, we could be in this territory, yes,.

Senator Susan O'Keeffe: So when Mr. Mody rang you in May 2010, are you saying that that was a random and surprise call? I mean, he was the assistant director of the IMF. He just randomly called you and said, "Hey"-----

Professor Patrick Honohan: Well, I mean, Mody was the point man for Ireland, okay?

Senator Susan O'Keeffe: Of course.

Professor Patrick Honohan: And he was coming every year. And also, I happened to, as it happened, I knew him years ago when we both worked in the World Bank. So I'd see him coming around when he comes on Article IV missions, even though I wouldn't be in Government, he'd come to the universities and that. So it wouldn't be surprising for him to, say, to call me, or to call Kevin. But I wouldn't ... he wouldn't be calling me every month until we went into the programme. He'd come around once a year or whenever I'd be in Washington, I'd meet him.

Senator Susan O'Keeffe: But, I mean, what literally prompted him on that day at that moment?

Professor Patrick Honohan: He was coming for an Article IV mission.

Senator Susan O'Keeffe: Yes, yes.

Professor Patrick Honohan: So what are we going to do? He must have ... I'm just supposing ... they'll say, "Okay, an Article IV mission for Ireland, routine matter. So what are we going to do to Ireland?" "Well, Ireland's got pressures." "What pressures?" "Well, the banking

system is,” and so on. So, “What could we recommend to Ireland?” “Maybe a precautionary programme?” “So, oh, that’s a great idea, because we only have Mexico and I think ...” “ So maybe, yes, maybe we could ... well, find out, see if they’re interested.” “I know the Governor, I’ll call the Governor.” That sort of thing.

Senator Susan O’Keeffe: Okay. So why ... but why didn’t you pursue it? Would it have been a-----?

Professor Patrick Honohan: Not for me. It’s entirely a matter for the Government.

Senator Susan O’Keeffe: No, no, but why didn’t you recommend it to Government? Why did you----?

Professor Patrick Honohan: I said, “You call them and see what they say.”

Senator Susan O’Keeffe: Okay.

Professor Patrick Honohan: And then I was told then, “No”.

Senator Susan O’Keeffe: But you could have been in ... you could have recommended?

Professor Patrick Honohan: I don’t think it was very material. It ... you know, would it have been better or not? I don’t know.

Senator Susan O’Keeffe: How could it not have been material, Mr. Honohan, if the IMF was offering you a precautionary line? How could that not be material?

Professor Patrick Honohan: In six months’ time, we had a real line. So it ... okay, the step I took was to tell Mody, “I think you should raise it with the Government because I think it’s a good idea.” He raised it, I presume ... well, I know, because they came back to me and it was shot down. But I think it was ... it’s more that it reflects, first of all, a sense that the IMF team thought we were being well-run, because they didn’t give these things to countries that were not being well-run, and that there was that sense of concern. We weren’t there blithely going along saying, “Everything’s fine here.” We were aware of the concern.

Senator Susan O’Keeffe: Was it appropriate that BlackRock, the company that you spoke of earlier, ended up acquiring a stake of just over 3% in Bank of Ireland?

Professor Patrick Honohan: So that’s a very interesting point. We were very ... so I know this issue arose in the context of some other potential advisers to us around that programme where some firm said, “Well, we could help you on this, but we want to have your assurance that you will not block us from buying into this stuff.” We were very open about what we found in the different banks; the financial measures programme document was very, very open and explicit. So any advantage that they might have had ... I actually ... you’re putting this to me now, but it’s ... all I’ll say is that there was nothing in the contract preventing them from doing that, and we chose that company because we had to choose very quickly. It was strongly recommended to us by the troika is what I understand. I didn’t have that direct experience but senior colleagues were strongly recommending that company. I knew from my previous discussions with others that it came as reputable. There are separations. There’s a consultancy and there’s a fund management, so-----

Senator Susan O’Keeffe: But should there have been something in the contract, Mr. Honohan, that would have prevented them? Or would that ... was it, in fact discussed and they

wouldn't sign up to it because they ... and you needed them in a hurry?

Professor Patrick Honohan: No. I don't recall that it was discussed with them at all. I do remember the other firm. The other firm were afraid that we would slap them down and say subsequently that they wouldn't be allowed to do any transactions. So-----

Chairman: Final supplementary, Senator.

Senator Susan O'Keeffe: Yes, can I just-----?

Professor Patrick Honohan: I didn't personally get involved in the BlackRock contract, so I'm not closely ... I'm just trying to remember whether I actually ... I probably actually ... I probably signed the contract because it was a very large sum of money, but I certainly wasn't involved closely myself in the negotiation of the matter and that. So I'm afraid I'm not briefed. I'm not trying to evade it, but I'm not fully briefed on that and whether it came up as an issue; it might have come up as an issue. And I'm not sure what holdings they had or how ... now subsequently. So I'm sorry not to be ready for this question.

Senator Susan O'Keeffe: Finally, when you say that the focus on the night of the guarantee as being excessive, and you say yourself, in fact, that actually time should have been taken to allow for consultation. Is it not the case that because the time was not taken for that consultation that you refer to yourself, that, in fact, the guarantee, if you like, set us up, ultimately, for the bailout, so-----

Professor Patrick Honohan: Well, I think the reason that I think that it's over-emphasised, even if we'd taken the time, even if we'd consulted with everybody else, even if we'd tried to get risk-sharing, at the end of the day we would not have avoided the bailout because-----

Senator Susan O'Keeffe: We would not?

Professor Patrick Honohan: No, because these costs were ... we would have ended up incurring most of the costs directly or indirectly. For example, even if all ... even if the bondholders were not going to be paid, and it's just going into a normal liquidation-----

Chairman: I'm going to move on now, that's a different one for this afternoon.

Senator Susan O'Keeffe: Sorry, I wasn't trying to-----

Chairman: Yes, I know that. The next questioner is Senator Michael D'Arcy. Senator D'Arcy.

Senator Michael D'Arcy: You're welcome back again. Governor, can I ask about the funding cliff that appeared from mid-2010 onwards? It was obvious that there was a very serious difficulty arising. Mr. Cardiff, in evidence, spoke about the guarantee and the guarantee being the attempted solution, but, subsequent to that ... it was the two years and two months afterwards that the convergence of a number of factors-----

Chairman: You're going into the bailout now, Senator, and I'm going to stop you because two years two months later after the banking guarantee ... or after the bailout, is the banking guarantee. That's going to be dealt with this afternoon.

Senator Michael D'Arcy: I'm aware of that, Chairman.

Chairman: Okay, that's fair enough.

Senator Michael D’Arcy: So was the factors that arose between the guarantee and the bailout ... could you just discuss those further, Governor, with us, please, because there was three or four crucial items: NAMA, PCAR, recapitalisation and nationalisation of Anglo and then a corporate bank run then as well? Could you discuss those a little bit further, please, and the impact of those on forcing us into a bailout?

Professor Patrick Honohan: So, first of all, the funding cliff did not become evident in May 2010, the funding cliff was evident ... certainly from the time that I started in September 2009. I constantly asked, as I said earlier ... they kept on saying “Well, there’s going to be these maturities of debt in this week and that week.” I asked “When is the worst month?” and they said “The worst month .. the next month is always the worst month, but after that it’s September 2010”. And that’s because, after the guarantee, as I understand it, the banks issued bonds and deposits to mature at or before ... shortly before the guarantee. So it was well known this was going to be a cliff; so we’re going to have to do something to build sufficient confidence in the banking system that the depositors, when they get to the end of September, will say, “Oh yeah we’ll just roll that over for another year”. That’s, of course, what we failed to do. But what did we ... how did we try to do it? We tried to do it by getting a ... convince ... to take the uncertain bad loans from the property developers - which were the big problem: if they weren’t there we wouldn’t have this problem, take them off the banks’ books, recapitalise the banks and keep the public finances obviously in a convincingly convergent way. This was the game plan, and it didn’t work. Why did it not work? It didn’t work because the losses were too big and because ... then in September-----

Senator Michael D’Arcy: Why were the losses too big?

Professor Patrick Honohan: Because the loans were so ... that had been made in 2005, ‘06, ‘04, were too bad and the collaterals weren’t good enough and so forth. And remember that NAMA - people often say “Oh, well, things got a lot worse and, you know, the problem was 2010 and 2011.” NAMA was paying the price at the November 2009 prices. So NAMA wasn’t saying, “Oh I’m sorry now, I was going to pay this amount but the prices have just fallen in March and April and May”. The prices continued to fall. It’s lucky they came back because otherwise NAMA would be heading for a big loss. So those losses were embedded and when it became evident to the market ... and probably the timing of the way it became evident, in August and September of 2010, coming just to the cliff, nobody was going to roll their deposits. Now why did we not clean up the banks, close down this one, Anglo was there as a running sore, why did we not close it down? If we’d closed it down, as I mentioned before, the guarantee was there and all of the bondholders would say “We noticed that you guaranteed all this stuff, and our bond isn’t due until 2011 or 2014 or some date like that but our bond also contains an acceleration clause that says if a bank is closed down, then our bond falls due immediately. So it’s due immediately. Government, you have guaranteed this, pay the money.” So, we couldn’t do any of those drastic steps, which might have helped build confidence - though it’s very hard to build confidence by closing a bank, as you see even nationalising Anglo in January 2009 had a ... the way it came out, had a very adverse effect on confidence, which was not expected; not expected at all, that nationalisation in January of 2009. I think it probably ... adverse confidence, this relates to your question, what was done, I think the fact ... oh no, I’m sorry, I’m going into, risk going into territory that’s-----

Senator Michael D’Arcy: Was there surprise at the level of discount?

Professor Patrick Honohan: Yes.

Senator Michael D’Arcy: There was surprise.

Professor Patrick Honohan: Yes, definitely, including me.

Senator Michael D’Arcy: Major surprise?

Professor Patrick Honohan: Well, yes, I mean, we didn’t expect ... it was outside the range of what we expected.

Senator Michael D’Arcy: What was the ... you said you spoke with Peter Bacon who, in evidence, said that his report was presented to Government March ‘09, and his figure was €35 billion impairment.

Professor Patrick Honohan: Impairment, yes.

Senator Michael D’Arcy: When was it understood-----

Professor Patrick Honohan: But the impairments on the Irish banks were much, much more than that.

Senator Michael D’Arcy: That was 20% on the €158 billion loan book. When, and at what stage, was there a realisation that the banks were going to cost the State tens of billions rather than billions?

Professor Patrick Honohan: I think it was, with a range of uncertainty, it seemed likely certainly by the summer of 2010 ... sorry, no, no, 2009, before I came in. But how many tens of billions? It ended up that the cash outlay ended up €60-something billion, now it would be €40 billion, so, yes. I would have said, middle expectation, €20 billion to €30 billion. As I said to the board of directors, €25 billion to €30 billion as at that stage, September 2009.

Senator Michael D’Arcy: The-----

Professor Patrick Honohan: I would clarify that point as well. By ... if I’m not mistaken, by November of 2009 NAMA had had one go at valuing one loan with one bank. So this was a sort of pilot exercise and it came out at a discount much higher than the bank itself acknowledged ... or they felt it was wrong and they certainly didn’t want them to extrapolate on this basis and they called me in a panic saying “Oh no, you’ve got to do something about this, we can’t be heading into this risky territory.” So already there, there were warning bells that the valuations could be much worse than the banks were saying.

Senator Michael D’Arcy: Can I just move, Mr ... or, Governor, please, in relation to the SSR legislation. Deputy Doherty spoke to you at the start of the meeting. We’ve been told it was very complicated and, it was on the basis of it being very complicated legislation, that potentially there were constitutional difficulties and other difficulties and that was the reason why it was dropped. It was concluded in your time of office, passed and moved.

Professor Patrick Honohan: A very light version.

Senator Michael D’Arcy: A light version.

Professor Patrick Honohan: Not unconstitutional.

Senator Michael D’Arcy: The DSG chose not to progress this. Should it have been progressed and was it possible to provide the light version, that we currently have, and would that

have been a very useful tool in light of the circumstances that arose on 29 September '08?

Professor Patrick Honohan: No, I think, to get the ... to get a big bail-in or something like that at the time, you would have needed a heavy version and probably an unconstitutional version. Even implementing the BRRD, which is potentially very heavy, it will be challenging. It will be challenging in respect of existing debt, so the RRD legislation ... European legislation on resolution, requires banks to hold sufficient "bail-inable" debt. Now, can you *ex-post* declare existing debt to be bail-inable or do you have to create new debt? This is an open question. So, the resolution legislation which was very quickly developed in ... and introduced in, I think, in December 2010, was ... came on time ... in time. It was going to be of no use to us during the period, September 2008 to September 2010 because we were not resolving any bank at that stage because the Government guarantee was in place. But the preparatory work was going on, obviously.

Senator Michael D'Arcy: Do you know if the Central Bank implemented any performance management reviews or reporting with regard to the use of the Government guarantee by the banks?

Professor Patrick Honohan: I'm not sure ... Government guarantee ... I'm not sure to what this refers. Obviously, we were ... had ramped up the intensification of what we were doing with the banks in terms of all their management and so on and so forth. They had responsibilities now to the State and ... managed through the Department of Finance, as well as to the Financial Regulator. The Financial Regulator because it's a regulator, Department of Finance because it's managing the guarantee and it was ... and obligations to them. So they, for example, they were ... they had to increase their loans by a certain amount and they had to comply with that and they reported to the Department of Finance on that. We also tracked what was going on there. So, I'm not sure what specifically you're ... there.

Chairman: The summary of that is: the guarantee had been put in place in September 2008, Governor. It was the biggest financial decision made, possibly in the history of the State to date at that time, and did the Central Bank have a role or did it see itself having a role in examining the performance of the guarantee and how it would roll out, having the political decision being made in September or sorry, the verbal decision after the decision?

Professor Patrick Honohan: And then there are a number of developments in that area. For example, there was ... new legislation was required to deal with new bank liabilities. There was the question of confirming or otherwise whether a renewal of the guarantee would be requested from Brussels and in order to do that, we had to satisfy ourselves of the likely liquidity position of the banks and whether they were returning to some form of stability. So, we were very active ... we had to be consulted at all points and legislation ... the guarantee legislation at all points requires that consultation but we would have consulted anyway because we were working very closely together with the new team in the Department of Finance.

Senator Michael D'Arcy: And just to finish, Governor-----

Chairman: Last question so, Senator, thank you.

Senator Michael D'Arcy: Last question. The ELA and the ECB's exposure to Irish financial institutions prior to the bailout, what was the total amount?

Professor Patrick Honohan: So ... I'm sorry I don't have the number but it's a very large number, around 100% of GDP, as far as I can remember.

Senator Michael D’Arcy: €150 billion.

Professor Patrick Honohan: It’s something like that, yes.

Chairman: Okay. You might try and get that figure for this afternoon.

Professor Patrick Honohan: I can get that figure, yes.

Senator Michael D’Arcy: If you could, please.

Chairman: Deputy Michael McGrath.

Deputy Michael McGrath: Thank you, Chair. You’re very welcome back, Governor Honohan. Can I start by asking you about your official report, where you refer to the over-reliance in the financial stability reports from the Central Bank on the annual stress tests and even the stress tests in the summer of 2008 provided a reassuring picture. How has the Central Bank addressed this over-reliance since? And do you view the ECB stress tests as the appropriate mechanism for the Irish banking sector?

Professor Patrick Honohan: Yes. So, an important distinction that I’d make is between the stress ... between stress tests, which start from the presumption that you will know what will happen in a base case and then you say “What happens if things are much worse than we currently believe?” That exercise requires you to know how ... you say “Well, does much worse mean?” You’d have to define an economic situation. GDP will fall, inflation will rise, inflation will fall ... some scenario and then work out what will that mean for the bank’s profit and loss. But the much more important element and the element that wasn’t included in the stress tests of the early 2000s was an “as is” assessment. An “as is” assessment of the recoverable value of the loans, not just the accountants’ value of the loans, which is based on accounting conventions but isn’t really forward looking and this asset quality review dimension, which we started to bring in a very broad aggregative way in 2010 and then, when the BlackRock people were here, in a more detailed loan-by-loan basis. That is what makes a difference and that is what is the linchpin of the ECB’s approach and I think we contributed to that in discussions in the ECB during 2013 to their design of that, that they now have as a centrepiece the asset quality review with the stress test dimension being a sort of secondary. Another reason the stress test is secondary is, you take one scenario, this will be a bad scenario and you might have time to take two scenarios, that scenario. But you can’t imagine all bad scenarios that could happen. Some scenarios will be good for some banks and bad for others. What if the scenario is, oil prices go up ... well, that might be good for some. What if oil prices go down? That is also bad for people. So, yes, the short answer is yes, we have done a lot more and there are many other calculations that we can do in the background but it’s okay.

Deputy Michael McGrath: On page 9 of your witness statement, you refer back to the issue of the guarantee and you make the point that its impact has been over-analysed and I think, for the first time, you put a figure on the potential costs of that decision as opposed to an alternative decision which might have involved trying to bail in the bondholders of Anglo and INBS, and you put a figure of somewhere between €2 billion and €10 billion, possibly. Can you just elaborate on that because very often the guarantee decision is cited as the decision that cost €64 billion? You’re making a fundamentally different point.

Professor Patrick Honohan: Yes, and I thought the only way of focusing attention on this is to put a number. Even though it’s a wide range and there must be massive uncertainty about it because you hear witness after witness saying “We could have done this but it would have

cost a lot.” Well, hello, what was done cost a lot, so let’s get quantitative about this and say how much more, is it actually plus or a minus? And, you know, I’m sure lots of people could challenge those numbers. Why did the numbers work out so low? Partly because the scenario that I’m describing, this is a scenario where you actually knew the losses that were embedded in the banks and you decided to ... try to go for broke and you threaten the ... we don’t threaten but you say “Oh, we’re really go to bail in everybody here.” While there are a lot of decision trees that happen after that, you have to see what are they going to say. Well, they might say “Don’t do that”. They will say “Don’t do that”. But then they say “Will you risk share with us?” Well, what will that lead to? They’ll say “Oh, yes, don’t worry, we’ll look after you, we’ll give you ELA, don’t worry.” So, you’re not quite sure what you will get. You might in the end say “Well, actually we won’t bail them in. That was just a bluff and we won’t bail them in.” If you did bail in, I agree with the witnesses that have said that would be extremely costly in economic disruption and it might cost you €20 billion, easily €20 billion. How would you get to €20 billion? Well, for example, if GDP fell by an additional 2% and then it stayed 2% lower for a couple of years and then gradually got back to the path, very quickly, you’ve got €20 billion there. So, it’s quite ... you lose a lot of what you seem to save by not paying these people that you don’t want to pay. Also, some of the people ... let me say, oh, the bondholders - Irish credit unions, obviously, it’s not going to be mostly, no.

Deputy Michael McGrath: Can I take you, Governor, to September 2010, when the future of Anglo Irish Bank was under serious consideration? And I recall at that time and I believe it was 7 September 2010, when a number of Members of the Oireachtas were invited to a private briefing in the offices of Anglo Irish Bank on Burlington Road and I attended at that time. I think there were, perhaps, over 20 Members of the Oireachtas attended and we received a presentation from Alan Dukes, Mike Aynsley and Maarten van Eden, the chief financial officer, and they made a very strong picture at the time that really, Anglo should be split into a good bank and a bad bank and they highlighted, from their perspective, the risks of being over-dependent on a duopoly of AIB and Bank of Ireland and they stressed the need for a corporate bank to emerge from what remained of Anglo Irish Bank. Now, the following day, the Government made a decision and it was announced rejecting that plan and essentially splitting Anglo Irish Bank into a deposit bank, which would just hold deposits and a recovery bank which would be wound down over a period of time. So can you tell the inquiry what advice were you giving the Government at that time in respect of the decision they were about to make on the future of Anglo? Did you support the proposal by the management team to create a good bank from what remained of Anglo, or did you support the wind-down of the overall entity?

Professor Patrick Honohan: I supported the wind-down, but let me give a bit of background to it. First of all, that new management team that were recruited from all over the world and headed by Mike Aynsley and the chief financial officer - I don’t know exactly what his title was, Maarten van Eden that you mentioned-----

Deputy Michael McGrath: Chief financial officer, yes.

Professor Patrick Honohan: -----and Alan Dukes, of course. And I consider them to be quite able people and very motivated by the mandate they had been given by Brian Lenihan which is: turn this sow’s ear into a silk purse; build an Irish business bank out of Anglo Irish Bank. That’s what they were asked to do and that’s what they came to do. They also had the recovery job, which was the biggest job, but from the very start of my job and I told Brian Lenihan, “I’m really not sure about this business bank idea.” I felt that this was going nowhere. I think they were not going to be able to do it and that the brand was fatally damaged and that it

should be taken out of the market as soon as it-----

Deputy Michael McGrath: Okay-----

Professor Patrick Honohan: -----was safe to do so. So I firmly held that view so when Anglo Irish Bank came up with their plan that you describe - I didn't know about this meeting - but the plan that you describe, which was discussed at official level in July of 2010, I and other officials strongly advocated not to go with that plan and, instead, to go ahead with more or less the plan that was announced by the Government in September-----

Deputy Michael McGrath: Essentially, Governor Honohan, they were lobbying TDs on the eve of a Government decision-----

Professor Patrick Honohan: Yes, a bit odd-----

Deputy Michael McGrath: -----and they were lobbying in favour of ensuring a future for Anglo Irish Bank or-----

Professor Patrick Honohan: Yes-----

Deputy Michael McGrath: -----IBRC, as it subsequently became into the long term. But then the Government made a contrary decision the following day and my question-----

Professor Patrick Honohan: They had already made a decision I would say, yes-----

Deputy Michael McGrath: Well, it was formally made the following day-----

Professor Patrick Honohan: Okay, right.

Deputy Michael McGrath: -----and announced and the management team who had advocated a fundamentally different direction for the bank-----

Professor Patrick Honohan: Yes.

Deputy Michael McGrath: -----remained in place and were charged with responsibility of implementing the Government decision.

Professor Patrick Honohan: Yes.

Deputy Michael McGrath: So was it appropriate that the management team in their entirety remained in place to implement a strategy that they had advocated against and that they were lobbying against?

Professor Patrick Honohan: Oh, well, I don't know about the lobbying. It does seem a little bit odd, but well, there you are-----

Deputy Michael McGrath: That's what it was.

Professor Patrick Honohan: Well, you know I might have to reflect on you know what ... but it's ... I'm not sure that it's entirely wrong. But no, I think that experienced, qualified people should make their case as strongly as possible to the Minister and to the Government and whoever else that it is appropriate to and then, like good public servants, because that is in a sense what they were as the managers of a State-owned bank., although they weren't directly involved in the public services, if ... when the decision is taken, turn around and use your expertise to deliver the rest of the mandate. It wasn't a different mandate; it was a reduced mandate

- shrink the bank, recover on the loans, but don't bother about that other thing about building the business bank. I think Mr. van Eden who was a very effective guy, I think then subsequently he decided, well, that wasn't for him and that was fine. So I think they continued to deliver on that mandate.

Deputy Michael McGrath: Okay, can I ask you about the letter from ECB President Trichet on 15 October 2010?

Professor Patrick Honohan: Yes-----

Deputy Michael McGrath: And this has been published as you know and can I ask you, Governor, is it your view that at that point, the ECB had essentially made the decision that Ireland would need to enter a programme of assistance? And, secondly, do you believe that it was appropriate and in order for the ECB to be raising broader issues such as economic strategy, fiscal consolidation, etc., at that stage, issues that were not directly relevant to the banking system and the monetary system? So had they made the decision by October that Ireland would need to enter a programme in order to contain the eurozone crisis at that stage and was it in order, the issues that were raised around that?

Professor Patrick Honohan: Well, first of all, they didn't have the power to direct Ireland to enter a programme. The idea of Ireland being in a programme was extremely live from the start of September 2010 and we'll get into this in the afternoon in more detail. I remember when we were in Washington in early October for the IMF annual meetings, one of the topics was that resources of the IMF. Do they have enough money to lend? And the example explicitly was given, for example, for Ireland. Oh, we didn't apply for anything so and then when Brian Lenihan and myself and other colleagues met the IMF country team, we discussed in quite a lot of detail what would a programme look like. So Brian Lenihan was very interested in this. So it's completely hypothetical and then I remember meeting with the secretary, the deputy secretary or Under Secretary of the US Treasury because, again with Brian Lenihan, Dr. Brainard and she ... we were explicitly talking in hypothetical terms. I think Brian Lenihan started talking about a programme and if I'm remembering rightly now I said, "Of course, this is entirely hypothetical." But this is early October so it was very, very much in the air and Brian Lenihan's view was I think that he needed time to prepare the ground for a major fiscal adjustment, which would be part of the programme, and he couldn't be rushing into a programme if he didn't have that time. And then he was being told by these officials from the outside, "You don't have time; the markets will not give you political time."

Deputy Michael McGrath: And the appropriateness of the ECB raising broader issues - economic policy, fiscal policy-----

Professor Patrick Honohan: I know you've raised it and I will, I explicitly mentioned I'm going back on it-----

Deputy Michael McGrath: Yes-----

Professor Patrick Honohan: -----but I'd like to cover that in the round, if I may, when we come back to this.

Deputy Michael McGrath: Okay.

Chairman: Okay, thank you. Deputy John Paul Phelan.

Deputy John Paul Phelan: Thank you. Chairman. Welcome, Governor. At the start actually can I just refer briefly to a question from Deputy Murphy about exposure of individuals to several institutions? And you were adamant in your response that it couldn't happen again and we've had a lot of evidence that, you know, several property developers, in particular, were seriously exposed to a number of institutions. Can you briefly outline why that cannot happen again? Did you mean that you, as Governor, in the Central Bank would be aware that the exposures were present or-----

Professor Patrick Honohan: Well, yes, I meant awareness. There's no rule saying you can't borrow from many banks, but the mechanism which we have put in place that will semi-automatically do this for you is the credit register, which actually is not up and running yet; I acknowledge that. But the awareness of this as a question that needs to be asked and drilled down on by the supervisors and now a greatly increased number of on-site supervisors so they're in the bank for weeks and weeks and they are poking around. And, of course, if people are trying to trick the Central Bank, then that's a different matter. It's attempted fraud or something like that.

Deputy John Paul Phelan: Okay, I understand.

Professor Patrick Honohan: It's very difficult to combat fraud but that was not the issue.

Deputy John Paul Phelan: That wasn't the issue and I suppose I'm asking you maybe to give your professional opinion on those exposures that existed and the failure of the previous regulators to identify that as a critical shortcoming. I mean, how did that go under the radar in your opinion that-----

Professor Patrick Honohan: Well, I think it was ... I put it down to the complete lack of ... exaggeration but the lack of attention to the quantification and the estimation of the risk and the quantified understanding of the business model of the banks. The focus was you have talked about principles-based. It's not so much that, but it's the idea that a well-governed bank will never get into trouble with giving those ... don't give me the details about the loans, just tell me have they got a good decision-making structure and is everything decided by the board or by the risk committee, so, yes.

Deputy John Paul Phelan: I want to change tack and ask you briefly again to advise the committee on measures that were taken by the banks, the Central Bank, the Government in the period post-guarantee and pre-bailout by the banks to privately get access to capital. We haven't had much information as to what happened in that regard.

Professor Patrick Honohan: Yes, well, of course, there was a capital raised by Bank of Ireland in April or May of 2010 and it was underwritten by an investment bank. I can't remember how much they raised. €1 billion or something like that and that was in 2010. I'm not talking about the famous one with high-profile investors about a year later. So, they were very keen to stay out of Government control and the Government was very keen that it wasn't going to be landed with a bank that it was ... it wasn't possible for AIB to do that, there was no ... it wasn't as if AIB said, "Oh, easy, we won't be bothered with trying to raise private capital, we'll just get money from the Government." It just ... they would have been completely aware that ... that they couldn't give a convincing story to the markets.

Deputy John Paul Phelan: I also want to ask you in relation to your report from May 2010, on the crisis, you refer to the night of the guarantee and the lead that the Department of

Finance had been taking in the inter-agency meetings during the period immediately prior to it. And you refer to the Central Bank and the regulator as playing a less central role than may have been expected. Do you have any further reflections on that point of view and what role do you feel that the Central Bank and the regulator should have played during that period?

Professor Patrick Honohan: Well, I think that the evidence that you've got here from David Doyle and Kevin Cardiff I think conveys really the essence of what that remark was hinting at. I think that they had taken the view, in the Department of Finance, that all that bank stuff is being dealt with by the Central Bank and the Financial Regulator so that's all right. But as the crisis deepened and as you come into August and September of 2008 they, I think, their level of confidence in that diminished and they felt that they would need to take control themselves and use the expertise also of the NTMA. Now that's all changed now.

Deputy John Paul Phelan: Speaking of using the expertise of the NTMA, I'm not sure if you've followed - I'm sure you haven't followed all of the evidence, you've probably a lot more to be doing than following all of the evidence of ... heard at this committee, but what do you make of the decision or the failure, I suppose, on the night of the guarantee, to have the NTMA consulted, seeing as their, you know their function, which they've been very successful at, in terms of funding the State over the years, that they weren't actually in the room and directly giving their view?

Professor Patrick Honohan: Well, I don't find it all that significant. Basically, my guess is the top two people were out of the country - of the NTMA - Somers and ... this is what we are told, Somers and Oliver Whelan. They were out of the country so ... so you had Brendan who was number three, but you know, when you get into this small ... nobody's going to say, "Where's Somers?" - "Oh he's away," - "Oh okay." They're not going to say "Is there a representative from the NTMA present?" So the officials would have known "Well Brendan, he knows about this stuff," and I think Kevin was sending some e-mail to Brendan to see what happens but you don't ... it's not as if ... I can't imagine Kevin saying "Taoiseach, I think we really ... we can't go on with this meeting without the NTMA present because they're ...". No, so, I don't actually find it all that significant that Brendan would have been kicking his heels outside the room. I'm sure there were other people who could have expressed views outside the room, I don't find it sinister at all.

Deputy John Paul Phelan: Okay. Can I then turn actually to another area that we've had a fair bit of evidence in the last couple of days, the production of IMF reports and OECD reports, going back to your own early days working in the IMF. We've had evidence and I think it was Senator Barrett yesterday touched on it a lot in his questioning of Mr. McCarthy, the tick-tacking that occurs between the Department of Finance and I think it was ... that was for the production of an IMF report, was it Sean?

Senator Sean D. Barrett: OECD.

Deputy John Paul Phelan: It was the OECD, okay, yesterday. And, that corrections were made by very senior officials in the Department of Finance and for instance the IMF, in its initial draft report, had said that there should be some sort of a resolution mechanism established. A line was put through it, delete written beside it, and sure enough, when the report, the final report, was published it wasn't contained therein. What value should we be placing on those types of external reports if there is that level of domestic influence on what the final report is going to be and, by the way, has that changed now? Is there less reliance on domestic-----

Professor Patrick Honohan: I don't have any visibility myself on the OECD relationship - they come and talk to me or to senior staff. But maybe they send a draft along but we don't pay that much attention to trying to influence it or that. Years ago, the OECD reports had the reputation of being negotiated, you've had evidence that it's a tough negotiation, but the IMF is not a pushover in this area. We've had lots of reports from the IMF in the last three years, I think 12 or 15 reports, they welcome clarifications of fact to a draft but they will not be pushed around on their policy recommendations. So I would make ... I would definitely-----

Deputy John Paul Phelan: You would place-----

Professor Patrick Honohan: I would place ... yes, if they get it right. They don't always get it right. If you go back over the history of the IMF reports, some of them in 2002, 2003, were very good on Ireland and some of them are not so good. I actually had the experience, when they came across recently to do a review of our insurance regulation. I met the team and they said "Well Mr. Honohan, we've read your report and you said that it ... the 2006 FSAP review of the Irish financial regulation was not very helpful. We hope to be helpful this time."

Chairman: Thank you very much. Deputy Kieran O'Donnell. Deputy, ten minutes.

Deputy Kieran O'Donnell: Welcome Professor Honohan. Can you discuss the interaction between the Financial Regulator, the Department of Finance and the ECB in relation to legislative changes in regulation? Do you believe that the relationship ensured the Financial Regulator was able to communicate its views and concerns effectively? And the core document is Vol. 2, page 3 to 18, which is the Central Bank of Ireland's annual performance statement, financial regulation 2013-2014.

Professor Patrick Honohan: Okay, well, so this is really specifically about legislation that we at the Central Bank would feel is necessary to get the job done as well as possible. You ... we've achieved a lot in our discussions. The discussions are full and frank. We don't win all the battles and there are a number of things that we have ... sort of given up on because we can see there's no legislative appetite, sometimes because there's advice from the Attorney General that things might require constitutional change. For example, I should be careful to get the facts right here but in respect of fitness and probity, for example. So we have a big regime of fitness and probity now, which is pretty good and better than it was, but supposing we decided that somebody that had been deemed a fit and proper person to be a senior person in a bank and we change our minds or we found new evidence and we thought no, this person needs to be removed - we would have liked in the legislation to have that power to sort of turn the fitness and probity into reverse and through some process to say, you know, with a due process, you're out. But the advice is that this would not be constitutional without the intervention of a court. And so we have to go through a High Court in that ... in such a circumstance. Well, you could imagine in the middle of a crisis, in the High Court. So those are the sorts of things that we discuss, backwards and forwards, and in the end the Department says, you know, on the advice in some cases of the AG and whatever, "You're not going to get this." We get a lot and so we have the communication and it's-----

Deputy Kieran O'Donnell: If a crisis situation arose again-----

Professor Patrick Honohan: Yes.

Deputy Kieran O'Donnell: -----and you had another night of the guarantee, do you have the legislation or does the Government have the legislation, to remove CEOs of banks that

might have to be bailed out by the Irish State?

Professor Patrick Honohan: Well, it's a-----

Deputy Kieran O'Donnell: Yes or no, I suppose.

Professor Patrick Honohan: -----I think the answer is yes, subject to going to a High Court.

Deputy Kieran O'Donnell: Yes, but the High Court could take-----

Professor Patrick Honohan: Actually the High Court is ... it can, you know ... it does ... the High Court recognises emergencies and there are cases where we have had to act quickly in respect of institutions because of ... over the weekend and-----

Deputy Kieran O'Donnell: So you would feel confident that if you needed-----

Professor Patrick Honohan: We have an option. We know it's not perfect but we have an option.

Deputy Kieran O'Donnell: And you could remove them overnight?

Professor Patrick Honohan: Yes, probably.

Deputy Kieran O'Donnell: Okay. Can I just specifically, in the report itself, on page 4 of the report, it states that, on the third paragraph ... the fourth paragraph down: "The revised Code of Conduct on Mortgage Arrears ... which was published in June 2013 provides a strong consumer protection framework in compliance with the [consumer code of conduct of mortgage arrears] will continue to be central to the Bank's work in 2014." Now, I want to bring you, in that context ... yesterday, you published a review.

Professor Patrick Honohan: Yes.

Chairman: Is that the same place now? I'll give you a bit of space here.

Deputy Kieran O'Donnell: Well, it's the same. It's within the report.

Professor Patrick Honohan: Yes.

Deputy Kieran O'Donnell: And you published the report where you had carried out an inspection of seven financial institutions for ... in terms of the code of conduct on mortgage arrears, which is from this document here. Now, you found breaches of that. So the question I suppose I want to ask, do you have sufficient legislation to publish the names of those institutions that breach the code of conduct in respect of people we are dealing with every day of the week, in terms of where their banks are continued to produce legislative ... taking people to court when they've already arrangements put in place, where they're looking for *ad hoc* payments? And, do you have the legislative backup to impose fines?

Professor Patrick Honohan: Yes. We don't want to publish the names because if we do we're not going to have any chance of getting fines. So let me put ... do that ... that's one important issue. We're not trying to protect anybody here, we're trying to protect our ability to continue to engage and, if necessary, impose fines and sanctions through procedure.

Deputy Kieran O'Donnell: Professor-----

Chairman: I'm going to make an intervention here now. Like, there's work that the finance

committee can go away and do. I'm allowing this in the context of the, kind of, picking up the pieces after the crisis and having the proper powers. I'm not going to go specific-----

Professor Patrick Honohan: I think more generally-----

Chairman: -----and I'm not specifically going to go into this case, but the general processes and applications.

Professor Patrick Honohan: It's possible the impression is given that "Oh we've just some findings, oh look a violation, that's it, now I'm going to go on and do something else." This is not the case at all. We had the CCMA since 2009 and the banks pushed back on it very vigorously. But they had to do it and they put their systems in place and they started to deal with the customers in the way we considered to be appropriate. We found, in some respects, that was unworkable, in terms of the numbers of phone calls, and so on and so forth, and so we tightened, we relaxed it in some respects, and tightened it in other respects. The troika wanted us to relax it a lot more, but we wouldn't do that. And so we got the revised one out in 2013 and the banks were still very annoyed with it. But they had to put their procedures in place. We have been monitoring them continuously in the context of the mortgage arrears resolution process, and then we had this other cross-cutting assessment to look, not just at particular cases, but to look at their practice. It's an ongoing process, we continually force them to do more and more. Will we fine them? We might, we might. But we have to be graduated in these things. Are we going to send somebody to jail for the violations? No.

Deputy Kieran O'Donnell: How ... can I just ... in the context, they were set up to protect mortgage-----

Professor Patrick Honohan: And they are protecting mortgage holders.

Deputy Kieran O'Donnell: -----but ... but if you're still finding breaches-----

Professor Patrick Honohan: They're very complicated processes, and it has been very costly for the banks, and I don't care whether it's costly or not for them, but it's very costly for them to put in these procedures which try to ensure that they deal fairly with people. It's not like a switch on and switch off, you have to do this and this and this, and we want to make sure that they're doing it and we've found deficiencies, but we have also found that the banks are, as we knew they were, coming up ... largely coming up to the plate, but with identified deficiencies, which they will fix.

Deputy Kieran O'Donnell: And can I ... would you not get a more effective tool with the banks to make them fully compliant? To publish the names of the institutions that are breaching these-----

Professor Patrick Honohan: We could do that, but-----

Deputy Kieran O'Donnell: And why would you not do that?

Professor Patrick Honohan: -----I'd rather hold ... I'd rather hold the power of potentially ... and I might, we might proceed to go through a sanctions procedure and fine them. So we're leaving that open. If we had ruled that out then we might have chosen to be more open.

Deputy Kieran O'Donnell: You might publish them?

Professor Patrick Honohan: I might fine them.

Chairman: I ... I'm not going to go into an investigation on this, sorry-----

Deputy Kieran O'Donnell: Can I ... can I go back to-----

Chairman: I just need to clarify something. I'm just going to stop the clock a second, I'm not going to go into an investigation on this-----

Deputy Kieran O'Donnell: I'm concluding this point, Chairman, yes.

Chairman: Yes, but like, the issue here is are the procedures in place and are they identifying weaknesses in the system and are they identifying behaviours inside in financial institutions that identify the breaches taking place. The other issue is are there actions and follow-up actions that can be worked upon. But I'm not going to ... I'll take these things in general if we're going to be in the space in the afternoon, but I'm not going to be taking specific investigation matters, certainly matters outside the timeline of the inquiry. So, back to yourself there, Deputy O'Donnell.

Deputy Kieran O'Donnell: Professor Honohan, John Moran, who was a former Secretary General of the Department, was in before us, and he was of the view that the cost of the bailout, the banks' guarantee, would purely boil down to Anglo - that the other banks will effectively fully repay the taxpayer or the investment in them. You've put in a figure of €40 billion. How would you view that pronouncement by John Moran?

Professor Patrick Honohan: It sort of hinges on AIB and if AIB can turn a profit. That would be the bulk of it.

Deputy Kieran O'Donnell: What would be your professional opinion?

Professor Patrick Honohan: Well I ... of course, I'm a professional pessimist, that's what I have to be. So, I'm always interested in the downside. So, I mean, I ... the figures that I gave were based on the ... as I explained out there, the NTMA do a valuation of their loan holdings and they have auditors and that, and I said, "Oh put that in, let's not put a wish ... a hope value in for the recovery in AIB share value ... well the true valuation of the shares when they are sold." He might be right but there's an element, obviously, of upside in that.

Deputy Kieran O'Donnell: Can I go to page 4 of your statement, and you speak about, that on 4 November, that the ten-year bond yields had gone up by 500 basis points.

Chairman: Can you clarify what you're talking about now there, Deputy?

Deputy Kieran O'Donnell: We're talking about effectively the-----

Chairman: -----4 November, what year?

Deputy Kieran O'Donnell: Sorry, apologies, Chairman. Apologies. Well then, can I just go back. Was the NAMA-----

Professor Patrick Honohan: Can I give you a little ... a further answer on your legal question, before you go to ... oh you might run out of the time?

Deputy Kieran O'Donnell: Okay, Chairman, stop ... well, no, I will run out of time, so I'll ask you the question, then you can respond.

Professor Patrick Honohan: Yes, yes.

Deputy Kieran O'Donnell: The lead up to that, if NAMA had not been established, and if the haircuts weren't double what they were expected to be in NAMA, was NAMA the lightning rod for the international markets to look in and say, "Ireland as a country cannot afford to bail out the banks to the level that it's expected to be bailing them out."? It made our bond yields go through the roof and it precipitated us going into a bailout. And, in that context, if NAMA was not established, could we have avoided a bailout?

Chairman: Just deal with the NAMA side of it in terms of the systematic consequences of establishing it, and we'll deal with the bailout this afternoon, Professor Honohan.

Professor Patrick Honohan: I think the true value of the loans would have outed eventually, and it wouldn't have been all that eventual. The banks ... it could have struggled along for a while trying to conceal the losses. They certainly didn't conceal ... they didn't ... at that stage they didn't know, but gradually they would have done their own working and they would have discovered, "Gosh this fella owes this amount here, God, how much are we going to get?" They would not have been able to ... the markets would have discovered, not in as dramatic a way ... but remember that the NAMA losses, the bulk of the NAMA losses were revealed in March 2010, and the market was okay with that, and their ... our spreads ... Ireland's spreads went down in April, first part of April 2010, it was okay with that, it's-----

Deputy Kieran O'Donnell: -----declaration, was ... was there-----

Chairman: Sorry Deputy, you're out of time, I'm going to move on there and we'll deal ... we ... we've the Governor this afternoon as well, and we need to finish for lunch. Deputy Higgins.

Deputy Joe Higgins: Governor, when you came to be ... to the Central Bank in the autumn of 2009, and contrast then with today, 2015, what is your opinion of the Central Bank's detailed knowledge of the banking institutions now, by contrast with then?

Professor Patrick Honohan: Well, we have to know a lot more about it now because of all the information that we've collected. And, I would say the type of our information is also different. What we knew then, and obviously there had been a number of new hires into the banking supervision section then, but they were mostly people with experience ... before ... experience in the Irish banking system. So they knew the banks in a kind of industry knowledge, rather than a clinical scientific ... let's see how many loans that this category of person, this category of person ... we have all of that comprehensive information now. And, in addition I would say that it's not just a question of knowledge, the communication within the Central Bank, among different specialists, is much better now. We have a regime where there's great openness of communication, an openness that can be heard by senior staff, so that I doubt if there are concerns about a particular bank that I would not hear about, and hear about without it being filtered through some kind of a-----

Deputy Joe Higgins: So that ignorance, which was given in evidence here in relation to concentration of lending in special sectors, etc., all that is a thing of the past?

Professor Patrick Honohan: I like to think so, and we ... our banks are relatively simple banks. There are some financial institutions in the State and the IFSC, non-bank financial institutions, which are more complex, and it's a challenge for us to get to understand exactly what they're doing. But, I think, as far as banks are concerned, yes.

Deputy Joe Higgins: If I go to your core document, Vol. 1, page 60, and this relates to a

summary in the Department of Finance of the Bacon report regarding what became NAMA and we take the second last paragraph on page 60, “Also an Asset Management Agency ... would offer prospects for avoiding many of the shortcomings associated with a continuation of the existing bank[ing]-property developer relationships. Potential advantages include ...” and then it gives (i), it gives (ii) and then it gives (iii), which I quote:

... the interposing of a disinterested third party between bankers and clients, which might break “crony capitalist” connections that otherwise impede efficient transfer of assets from powerful enterprises. The latter may seem particularly beneficial in circumstances [and] markets [I think], where ownership concentration and connections between borrower and banks are often very close.

The Lombard Street Research report, which was commissioned by the Construction Industry Federation, in page 8, no need to ... said, and I quote, “The Bacon report is replete with references to ‘crony capitalism’ and the harmful effects this has had.” Can I just ask you, Governor ... as you know, these two institutions wouldn’t be widely believed to be revolutionary socialists or the like but do you agree that crony capitalism adequately describes how land speculators, developers and financial institutions related to each other in the bubble?

Professor Patrick Honohan: To some extent and especially for some banks more than others. I think it is disastrous when you get that kind of close link. The larger banks ... perhaps it’s not as strong a relationship. It is a pejorative term, obviously. I think arm’s length banking is-----

Deputy Joe Higgins: That pejorative term, was it deserved?

Professor Patrick Honohan: I think certainly for some banks it was, yes.

Deputy Joe Higgins: Thank you, Governor. You told Deputy Doherty, if I understood you correctly, that the banks may have been overcapitalised by I think you use a figure of €9 billion and then you made reference to €5 billion of that perhaps being against mortgage arrears, etc. But should that imply two things: one, that the banks should be more forthcoming with writing down unsustainable owner-occupied mortgages and, number two, that the extra €4 billion then of ... if it is overcapitalisation, was this at the expense of public services and with a cost of... I mean the cuts, in current spending in 2012 and 2013 were €3 billion so how can you-----

Professor Patrick Honohan: I did, sort of, sense that in the discussion with Deputy Doherty that there was ... that I seemed to be saying overcapitalisation. I was advocating at a certain point that there should be overcapitalisation. I was saying that what we did in March 2010 was not under-capitalisation - it was about right - and that a large part of what happened was because we were ... it seemed about right but then we discovered €8 billion of NAMA and then another €9 billion was put in because of what BlackRock did. BlackRock were more aggressive in their assumptions about what would be lost, particularly in respect of the deleveraging, which was also part of the sales of loans. They also required ... not BlackRock but the troika required us to reach a higher capital threshold. Now is that overcapitalisation? Well, not really because the international standards keep on moving up and pushing us up in that direction so I’m not sure ... I am very reluctant to talk about overcapitalisation. It would be very much in the bank’s interests to say “Oh we’d like now to write back provisions and to claim that we’ve too much capital.” I don’t think they’ve got too much capital.

Deputy Joe Higgins: Okay.

Professor Patrick Honohan: However, to your other point, whether they should be using the capital they have been given and using the provisions that have been taken against loan losses to more deeply restructure residential mortgages and small business loans when those loans can't be fully paid, yes, I think they should be. I've constantly been saying that but it has to be done on a case-by-case basis because, I think, we also know that there are some people who are holding out in the hopes that they will get some special deal even though they can afford to repay.

Deputy Joe Higgins: Okay. That brings me to page 9 of your written statement, Governor, I quote from the top paragraph in relation to the cost of:

In order to get an overall cost to Ireland of the Ireland-specific banking boom and bust we would need to model how the economy might have performed in the presence of prudent pre-crisis banking practice. A precise quantification of this is impossible, but it is clear that the net cost is well in excess of €100 billion and still growing ...

And then you refer to an *Irish Times* article, which I have read, in ... earlier this year. Could I ask you would you just go a little bit further into which social segments of society, how did the burden fall social-wise? For example, the so-called rich lists in the *Sunday Independent* and *The Sunday Times* would say that in the course of the crisis the top 300 wealthiest people added €35 billion to their wealth. At the same time, the ESRI - "Crisis, Austerity, Recovery: Income Distribution through the Great Recession in Ireland" ... that the poorest 10% of the population suffered an income contraction of 22% or 27% ... taking housing costs. If I go to page 4 of your statement and you say, Governor, "mar a deir an seanfhocal, cibé cé ólfas, 's é Domhnall a íocfas."

Professor Patrick Honohan: Cé hé Domhnall?

Deputy Joe Higgins: Cé hé Domhnall, agus is é a chuirimse chugat ná gurb é Paddy bocht agus Bríd bocht a íoc, agus a clann agus gnáthdaoine, as an tubaiste baincéireachta, seachas mionlach beag a éirigh níos saibhre.

Professor Patrick Honohan: Ach, na daoine saibhre, chaill siad chomh maith. Chaill siad go mór, ach ... Is cuma liom, ach chaill siad go mór. When, what's his name, the French economist Piketty was here-----

Chairman: Don't go into French now, Professor Honohan. I'm trying my best to keep up with you.

Professor Patrick Honohan: When he was here I had a bash at this question of distributional effects. I think you're right. I think the distributional effects of this whole business have twisted against the poor people. Of course, it's very different and age groups ... probably more important than ... there are certain age groups that have lost badly out of it as well as income classes. In the boom period a very broad swathe of society benefited and in the bust period a very broad swathe has lost also. So it's not just the poor people but I think it has ... and I have said that in public that overall net, it has been tilted and the poor have done worse out of it.

Chairman: A final question there Deputy, as Gaeilge or whatever you like. Last question.

Deputy Joe Higgins: As Corkísh.

Chairman: No we don't have translation facilities for that in the Oireachtas unfortunately.

Deputy Joe Higgins: On occasion I have felt like translating for you to various witnesses, Chair, but-----

Chairman: I know the feeling, Deputy, I know the feeling.

Deputy Joe Higgins: Just lastly on the cost again ... sorry we don't have more time to explore this, but Brendan McDonagh, the chief executive officer of NAMA, made what some people might find an astounding statement. In his opening statement, in page 4, 22 April, that, in fact, NAMA paid €10 billion more for those loans - it took €32 billion - when really he said if the real market cost was paid it would be €22 billion, thus giving an extra €10 billion "State aid", in inverted commas, to the banks. Do you agree with that?

Professor Patrick Honohan: I suppose he is saying basically ... this is, like, November 2009, that house prices and that property prices continued to go down. So, in that sense, he could have paid less. Now does this matter? No, because what was worrying me before NAMA - or in the early stages of NAMA - was that he'd pay so much that the bank shareholders would come out with something actually ... and more than they should have. But actually it was down below that - the bank shareholders were wiped out. And so it didn't matter whether it was the ... NAMA was paying the money or the NTMA, through their pension reserve fund, was paying the money. It was all money - the State was the net provider of the capital. So the NAMA purchases ... if he'd paid €10 billion less, the State would just have had to pay €10 billion more out of its NTMA resources. So it doesn't have that effect.

Chairman: Okay, thank you very much, Deputy. I now move to the wrap-up. Just before I do, Governor, I just want to touch upon one question with you and that relates to the issue of foreign deposits repaid through the guarantee and you might be able to touch on this for us. Do you know if the Central Bank tried to analyse the amount of foreign deposits, in particular from French and German creditors, that were on hold with Anglo at the time of the guarantee decision and, in that regard, do you think that knowledge of this number, if it had been to hand - and you can tell us now if it was or not - whether that would have been an advantage in the negotiations with the ECB or IMF over the coming months, following the guarantee and the pre-bailout period?

Professor Patrick Honohan: As you know, a lot of these bonds are not ... the ownership is not identified, so they are hidden, in a way, behind screens of depositories and so forth, so we don't know. To the extent that we can find out, the banking system as a whole - and I don't have anything specifically for Anglo at least to hand - what we do know it, sort of, gives the lie to the idea that it was all German banks and the percentages of the total deposit liabilities coming from Germany, in particular, seem rather low. I won't say a percentage right out now because I don't have it in front of me, but they're rather low, and France particularly low as well, so I think you might ... you often hear that, you also often hear it in respect of Greece, and, "Oh, the German banks; oh, the French banks." Well, the biggest banks in the euro system are the French banks and the German banks, so you do hear a lot about French banks, but in the Irish case, I don't think there's evidence that the Irish banks drew disproportionately from those two countries.

Chairman: Thank you. Deputy Doherty, to wrap up, five minutes, and then Deputy Murphy.

Deputy Pearse Doherty: Professor Honohan, I'm sure you're aware - maybe if you can tell us if you're not - of the NTMA proposal to burn senior bondholders across all of the six

institutions, which came out in March 2011. I've a question, just in ... it's quite interesting, the senior bondholders which they say were unguaranteed at the time, that they would have saved just shy of €8 billion if that proceeded. The question I have for you is, based of your estimates of €2 billion to €8 billion on bondholders being burnt-----

Professor Patrick Honohan: Yes.

Deputy Pearse Doherty: -----given the fact that the NTMA, in 2011, were saying, "We could save €8 billion on unguaranteed bondholders alone"-----

Chairman: What year on you on now, Deputy?

Deputy Pearse Doherty: I'm on 2008. Given that they were saying the unguaranteed bondholders, "We could save €8 billion", how can you justify-----

Professor Patrick Honohan: Okay, fine.

Deputy Pearse Doherty: -----an estimate as low as €2 billion to €8 billion-----

Professor Patrick Honohan: The explanation is that when they say we could save that money, they mean in the cash outlay, they are not taking account of any spillovers into chaos in the domestic economy. That's the factor that reduces the cost. They're not making that calculation at all. Now, in 2011-----

Deputy Pearse Doherty: Yes.

Professor Patrick Honohan: -----when they are making this advocacy, the environment is different. We're in the protection of a programme and so they are right not to make such a big allowance for that. Well, they're not making any allowance at all.

Deputy Pearse Doherty: Well, could one not argue that the €64 billion that was put into the banks through the recapitalisation programme caused the ultimate chaos in the domestic economy, in terms of mass unemployment-----

Professor Patrick Honohan: Yes, and all I'm saying is ... and I absolutely agree that so much damage was caused by everything that happened. I'm not putting it down to the guarantee, but an additional cost would have been incurred if there had been a-----

Deputy Pearse Doherty: Okay. Moving on from that question because-----

Professor Patrick Honohan: Yes.

Deputy Pearse Doherty: But I would appreciate, maybe, if you had papers that came up with those calculations, if they could be submitted to the inquiry if there's calculations that you have. But can I ask you, in terms of the ... again the NTMA, but it's the principle of it ... how could the NTMA be arguing for the burning of senior bondholders, given what we were told along, that senior bondholders would be treated the same as the depositors, yet they argued in that paper to burn senior bondholders in AIB, Bank of Ireland, Anglo, Nationwide and two other-----

Professor Patrick Honohan: It's a good question. Now, this was something that we were puzzling over ourselves, I mean, with the NTMA, the Department of Finance, all through ... especially with the NTMA, I would say, all through 2010. How could this be engineered if the opportunity arose, particularly, I would say, for Anglo Irish Bank? Because it was a terminat-

ing institution, as it turned out. It's not straightforward; there were a number of ideas, but they could have been subject to challenge, as, indeed, some of the bail-ins of subordinated debt were successfully challenged in British courts. So, I actually didn't have sight of that proposal of the NTMA.

Deputy Pearse Doherty: It's not the proposal, it's the principle, and what I want you to confirm or reject is that burning of senior bondholders automatically did not mean that you had to burn depositors in financial institutions.

Professor Patrick Honohan: I believe it would have been possible to design a legal scheme that would have worked that way.

Deputy Pearse Doherty: I appreciate that. Can I ask you, in relation to-----

Professor Patrick Honohan: And I'd say that that, in September 2010 ... 2008, nobody thought that.

Deputy Pearse Doherty: Yes, that's... that's fair. Can I ask you, in relation to solvency ratios, as distinct from minimum capital ratios for the banks-----

Professor Patrick Honohan: Yes, yes.

Deputy Pearse Doherty: So, if a bank ... and we can deal with a bank in 2008, at the time of the guarantee, or any other period-----

Professor Patrick Honohan: Yes.

Deputy Pearse Doherty: -----but it's more the theory. If a bank falls below its solvency ratio, which, I understand, is 8% of capital, what happens? Is it a case that bondholders would have a call, basically that they would look for their ... there would be a default triggered in terms of the market?

Professor Patrick Honohan: Not necessarily. It depends on the exact terms of bond contracts. A fall of a bank below 8% will trigger a regulatory response. They will be required to, very promptly, set out a plan for getting back to that 8% very quickly, but they'd also be in a situation where they can't access the ECB, because ECB will say, "We only deal with solvent banks", so there are a number of triggers.

Deputy Pearse Doherty: But I'm asking ... bonds?

Professor Patrick Honohan: Some bonds ... I don't ... each bond contract will be different. Some bonds will have contracts that accelerate the payment.

Deputy Pearse Doherty: The reason I ask you this here-----

Chairman: Final question now, Deputy.

Deputy Pearse Doherty: Yes.

Chairman: We're going to lunch.

Deputy Pearse Doherty: I have ... and I'm not sure if you're aware of it because it comes from Kevin Cardiff's documents, but it's a letter from Ann Nolan to the Minister, it's in 13 May '09. And it's what you mention yourself in your opening statement, that Anglo were in breach

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of their ratios at a point in time in 2009, and this was requesting the Minister to give them a derogation in relation to this, but it mentions this. It says, “Anglo’s book is such that the bank would be likely to breach the minimum 8% solvency requirement within a short period, which would trigger events of default on the bank’s bonds, resulting in a call of the guarantee.” So the question I have, and again it’s not-----

Professor Patrick Honohan: Yes.

Deputy Pearse Doherty: ----- specific to Anglo, but if a bank goes below 8%, is there bonds that the bank would have issued that they would ... they have a call on them, basically, because they’re now below the solvency?

Professor Patrick Honohan: They could have, and if Ann Nolan briefed like that, she’s the owner ... I mean, the Minister’s the owner, but she would have had full sight of their particular bonds so, you know, absolutely they could have had bonds with those kinds of triggers in them. If she said they had, they had, but I was more concerned to make sure I could keep on lending to them through the ECB so that the Government wouldn’t be called in.

Deputy Pearse Doherty: A bank that falls below 8%-----

Professor Patrick Honohan: Not automatically. It depends on the contract.

Deputy Pearse Doherty: Yes, this is the last thing. A bank that falls below 8%, the solvency ratio-----

Professor Patrick Honohan: Yes.

Deputy Pearse Doherty: -----so let’s take Anglo, that had no access to the markets at that point in time.

Professor Patrick Honohan: They were using ECB funding.

Deputy Pearse Doherty: No, but the question-----

Professor Patrick Honohan: Yes.

Deputy Pearse Doherty: The point I’m saying is, do they become insolvent de facto because ... if they can’t get money from the markets, given that the ECB won’t lend them money if they’re-----

Professor Patrick Honohan: Yes, if the ECB won’t lend them money, but then they can move into ELA. A short period below 8%, well, we would want to see a very prompt correction of that, perhaps with a ministerial letter and I’d want to see the capital fully restored within three months, or else I couldn’t keep giving them-----

Deputy Pearse Doherty: Is that not a case that Anglo was insolvent, based on the 8% capital, on the night of the guarantee, given that it could not access capital markets and-----

Professor Patrick Honohan: This word’s-----

Deputy Pearse Doherty: -----it would not have access to ECB finance?

Professor Patrick Honohan: You know, it was a very-----

Chairman: I’m going to move on then.

Professor Patrick Honohan: Yes, it's ... obviously, this is an extremely stressed bank, but you ... this wonderful word, "solvency", can be a trigger word for certain actions, so people are ... it's like "genocide", people don't want to use the word because it means more than just a casual statement, so 8% threshold is not, in itself, a solvency threshold. That is a minimum capitalisation. Solvency threshold conventionally means zero, but-----

Deputy Pearse Doherty: That's incorrect, sorry, not in the-----

Chairman: Sorry, it's ... I can bring you back in on this when you're questioning and you can return to this this afternoon, Deputy Doherty. Deputy Murphy to wrap up, please, and then we're going to close.

Deputy Eoghan Murphy: Thank you, Chair, and thank you, Governor. Just two brief questions. When the former chairman of the regulator was before us, Mr. Patterson, he talked about in the 1990s, I think 1995, the sectoral risk concentration levels being, what was the word, "relaxed" to attract a large foreign bank into Ireland and then, as a result, in order to apply fair treatment, the standards were relaxed for all the Irish banks. Do you know anything about that?

Professor Patrick Honohan: No, it's a new one on me. It might be true, I'm not denying that it could be true, but I can't find anybody who can remember back that far. It is back into the 1990s, so I wasn't able to ... I did hear that piece of evidence, I wasn't able to confirm or deny it.

Deputy Eoghan Murphy: Thank you. And my last question in relation to NAMA, because in your story of 2010, NAMA comes up quite a bit. The, you know, announcements of the haircuts in March, then again in September. And each time you mentioned them, the prospect of a bailout comes closer into view. So was the work of NAMA delayed, and if NAMA had moved more quickly, are we then talking about bailout negotiations starting sooner or are we talking about avoiding one altogether?

Professor Patrick Honohan: No, not avoiding altogether. No. So, supposing NAMA had been able to wave a magic wand in March 2010 and come up with a complete valuation right there-----

Deputy Eoghan Murphy: Was work delayed? Was there a delay with NAMA moving through in its work?

Professor Patrick Honohan: Yes, it took them until, you know, until way into the autumn before they were finished their valuations. So if they had done it earlier, then we would have had a bigger hole in March and we wouldn't have been able to ... there would have been no prospect of AIB raising the additional capital through sales of assets and so on and so forth. So we would've just ... it would've just brought forward the bad news. And it would have, in my opinion, would have made it unlikely that we would have survived the summer without going into a programme. So, it was inconvenient that NAMA wasn't able to do the job faster, but it was a huge job. It was an unprecedented job.

Deputy Eoghan Murphy: Thank you.

Chairman: Thank you very much, Deputy. I now propose that we break until 2.30 p.m. So with that said, the witness is reminded that once he begins giving evidence he should not confer with any person other than his legal team in relation to the evidence or matters that are being discussed before this committee. With that in mind, I now suspend the meeting until 2.30 p.m. and remind the witness he is still under oath until we resume. Is that agreed? Agreed.

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Sitting suspended at 1.12 p.m. and resumed at 2.42 p.m.

Chairman: If members agree, we will go back into public session? Agreed. And we'll continue our hearings today with Professor Patrick Honohan, Governor of the Central Bank of Ireland. The Committee of Inquiry into the Banking Crisis now resuming in public session and can I ask members and those in the public Gallery to ensure that their mobile devices are switched off. So, welcome back, our witness today is Professor Patrick Honohan, Governor of the Central Bank of Ireland. In this afternoon's session we'll focus upon developments during the Governor's tenure in the period from November 2010 to December 2013 and obviously there will be matters that will be following on from this morning's engagement with the Governor as well that need to be addressed. And Governor, you wish to add to some of your earlier commentary of this morning.

Professor Patrick Honohan: Yes, a question arose about the contractual arrangements that people who did the work on the stress testing in 2011 for the Central Bank, and I probably ended up giving the impression that the Central Bank had .. might not have been carefully designing the contract, so I had the opportunity to look at the contract in the course of the lunch time and ... there's a page of stuff about confidentiality and conflicts of interest. So that, in fairness to staff at the Central Bank, they covered that off to the extent it can be covered off in a contract.

Chairman: Thank you Governor.

Senator Susan O'Keeffe: That leaves questions open then-----

Chairman: And members will have questions that they may wish to address with this, this afternoon.

Senator Susan O'Keeffe: In fairness that will eat into ... that was part of this morning's-----

Chairman: And I may allow some time for that if needs be, if it's on this specific item.

Senator Susan O'Keeffe: Yes, thank you, because obviously it does raise a question. Thank you.

Chairman: All right. Indeed. On the ELA, Governor Honohan, had you an opportunity to address that, as to what was the extent of the ELA exposure to Ireland in around November 2010?

Professor Patrick Honohan: Yes, I asked for the precise number or the total amount, I haven't received that yet so we ... well presumably it'll be texted to me ... certainly ... maybe after the break, I'll give you the precise number.

Chairman: Perfect. Were you observing Mr. Cardiff's testimony yesterday?

Professor Patrick Honohan: I saw some of it, yes.

Chairman: Okay. Just for matters of consistency, there was three items I dealt with him, I just want to get them dealt with now and it'll bring us into the context of this afternoon as well. And the ... this is a question I put to Mr. Cardiff yesterday and if I could put the same question to yourself, Governor Honohan, and the question is, did the structure or design of the bank guarantee, along with its period of duration have any bearing on the Irish State entering a bailout programme two years, two months after the banking guarantee?

Professor Patrick Honohan: Okay. So, it ... it gave ... the guarantee gave a sort of silent window when pressures were building up to a certain date. Now, did it lead to the ... did the guarantee lead to ... if it had been a three-year guarantee, yes maybe the crisis would have been at the end of the third year, instead of the end of the second year, so the timing of when things came to a head was certainly exacerbated by the fact that the funding cliff had built up with a view to the end of the guarantee period. But the, the total sums and the borrowings that had to be made, I don't think were in any way altered by that. And if it had have been a one-year guarantee, the cliff would have just come earlier.

Chairman: Okay. So the discussions that were taking place with regard to the IMF, and broad discussions that a guarantee may be ... or a bailout may be entered into, was that on the basis that the guarantee was going to run out and something significant would have to be done?

Professor Patrick Honohan: Not exactly. I think what ... but I think the ECB's concern was that ... as I warned them, because of the funding cliff, it was inevitable that the ELA would ... which was there already for a year and a half for one bank, would extend to other banks and could build up and that there was no easy prospect to see that repaid in a short period of time. That got them very concerned.

Chairman: And as we know from the, the bailout and from the adjustment programme that came with it, there was quite a significant Exchequer or structural deficit, in and around €30 billion, in regards to the State's solvency, regardless of what the banks were actually requiring in terms of ELA. So, likewise as the question was put to Mr. Cardiff yesterday, could I put the same question to you now again, is, were Irish banks that were covered by the guarantee still solvent and therefore qualifying for ECB, ELA funding at the time of Minister Lenihan's last letter to Mr. Trichet? This was the letter of 21 November 2010.

Professor Patrick Honohan: Yes. The ... as you will recall from my written statement, the definition of solvency is using conventional accounting measures, not looking for possible negative effects of the future. They were judged to be solvent, two of them because they had got, well three of them I suppose, because they had received promissory notes sufficient in value to make them solvent, and the others because of their-----

Chairman: Was there any discussion between yourself and the ECB directly with regard to the potential concerns with regard to the State's solvency, that de facto, if the State was not solvent or was potentially becoming insolvent because of it's ... because of the structural deficit was facing, that the banks were de facto insolvent?

Professor Patrick Honohan: No. I refused to consider the idea that the State would not repay the Central Bank. The State's guarantee or any promissory note or anything like that of the State, as far as the Central Bank of Ireland is concerned, is 100% good. Now that, it may be a controversial view in other places, but I regard the Central Bank of Ireland as an arm of the State and it cannot start saying, "Oh, I don't think the State will pay us back."

Chairman: And just coming back to Mr. Cardiff's initial statement, where he commented upon Mr. Trichet's letter of 19 November 2010 to the late Minister for Finance. He said, "In many ways [the] letter was entirely superfluous, since it was already clear by the time of the letter that the Government was going to opt into a programme." Now, that would imply, in the same way that somebody would apply for a mortgage, you might be many months negotiating with the bank and then you sign off on the mortgage eventually. But speaking on the same related matter, Jean-Claude Trichet, when he appeared at the IEA-hosted event in Kilmainham

on 30 April 2015, speaking in around the same issue, said as “you know, we could also have continued on our side after having gone up to 100% of ... GDP ... to 200% of ... GDP, and why not 300% of ... GDP?”. This relates to the ELA exposure, and we’ll have the ... more exact sum hopefully later this afternoon. He then went on to say, “Then what would the [commission of inquiry been] asking for”, referring to this inquiry, as to what our terms of reference would be. He goes on to say, “You would say, ‘were you totally crazy at the ECB to continue, when we were going into the wall at 100 mph, to continue to provide liquidity and liquidity, and liquidity?’” So, Governor Honohan, can I ask you, was Mr. Trichet right in this regard if this action hadn’t happened and the entry into the programme had been delayed, would the cost of the bailout have even been bigger for Ireland?

Professor Patrick Honohan: Well ... I’d like to say two things about that. First of all, I think he was not correct in saying that the ELA was going to grow up out of all, all proportion. In fact, by that stage, I was presenting projections of ELA which proved to be - and the total access of the banks ... of the Central Bank proved to be reasonably accurate, as these things go. And it wasn’t ... you know, it couldn’t blow out indefinitely, but it does reflect the concern had been there since September, that the Irish ELA was growing and where was it going to go? So they had no perception.

Now, if the access to the programme had been deferred, what would the consequence have been? Well, I’d like to put it this way, I think the need for a programme could’ve been avoided if the ECB had decided - which I think they would consider themselves not wanting to do - if they had decided to say, “It doesn’t matter, we will fund the Irish banks. Don’t you worry about the Irish banks, we trust the Irish State”, then the programme might not have been necessary because the markets might’ve said, “Well, that’s all right then. The banks are going to be okay, so there won’t be any run on the banks”, and the markets are saying, “Yes, we’ll lend to the Irish Government; it’s going to cost them though. It’s going to cost them 7%, 8%, 9%.” So the Irish Government could probably have staggered on and staggered through the crises of 2011 and 2012, when the rates of interest would’ve been ever higher and higher and now we would be saddled with much higher debt servicing costs. So, actually, although the ECB, in a way, by saying ... by refusing to give an open-ended guarantee that the banks would be funded, it actually, inadvertently, did us a favour by allowing the State to go right through those difficult euro crisis years of 2011 and 2012 with the protection of official funding at low interest rates.

Chairman: And the funding you’re talking about now ... just to clarify, is that funding specific to the banks or funding specific-----

Professor Patrick Honohan: Funding for the State.

Chairman: So that’s the Exchequer deficit being-----

Professor Patrick Honohan: Yes.

Chairman: -----being met as well?

Professor Patrick Honohan: Yes.

Chairman: So, by turn, if a programme had been entered earlier than November 2010, would the cost ... or was there an opportunity for the cost to be potentially less?

Professor Patrick Honohan: I don’t think so because if you recall, towards the end of September 2010, the NTMA announced ... or the Minister announced, that the NTMA had enough

cash for several months so it stopped borrowing. And it stopped borrowing because the rates of interest had started to get up to levels where they thought, "How can we justify this? If we were in a programme, it wouldn't cost us this amount." So very little, if any at all, maybe a very small amount, was borrowed at the higher interest rates of 5% or 6%, or something like that, around September. So, we went in, in good time; not too soon, not too late.

Chairman: Okay. So, ultimately, was it your ... I will ask you your opinion, was an entry into a bailout programme necessary by that period?

Professor Patrick Honohan: Yes. As I say, we could've manoeuvred if the ECB had been prepared to provide open-ended assurances for bank depositors, which they don't want to do.

Chairman: And, in any way, did that necessity motivate your thoughts to make a public declaration on what was actually happening at that time?

Professor Patrick Honohan: My motivation for that was focused very much on the outflows that were happening around that time, in those previous days, and the sense of growing panic in the financial sector that the Irish situation was getting out of control. I wanted to say, "It's not out of control. There's discussions in place. The IMF are coming. They have lots of money. They're going to protect us." I know that, subsequently, there's been a lot of ... greater attention on the political dimension, which was not in my mind at all and ... so that's unfortunate. My focus was entirely on the financial stability issues and the credibility of the Central Bank in protecting the financial system and the State in that way.

Chairman: Thank you. So our first lead questioner this afternoon is Senator D'Arcy. Senator, you have 25 minutes.

Senator Michael D'Arcy: Thank you, Chair, Governor. Governor, the independence of the ECB and your own independence, do you feel that they are appropriate?

Professor Patrick Honohan: Look ... yes, I mean these ... I think you can't operate a monetary policy in a stable way if the Central Bank is answerable to the Department of Finance. And that's what happens in some countries, mostly now developing countries, that the central bank is simply, more or less, a division of the department of finance and is answerable to the Minister. But what ... independence ... it's not total independence. There's a clear mandate. You're there to do these things and you're answerable, in our case, to the Oireachtas for matters, the Central Bank of Ireland is answerable to this committee and the other committees of the Oireachtas, so independence doesn't mean a complete free-for-all to do whatever one likes to do. There's a mandate ... several mandates, a detailed mandate.

Senator Michael D'Arcy: Is the ECB the most powerful committee in Europe?

Professor Patrick Honohan: I don't think so, actually. It may be a committee - which in the European structure and Jean-Claude Trichet would always say this and he's probably right - that as an institution, it is organised and disciplined and able to arrive at quick decisions and to implement what it decides to do within its mandate. So, it's very well-organised. And this is one of the reasons why Jean-Claude Trichet stepped forward in the middle of 2010 and then through that period 2010-2011, in an environment where, I believe, he saw that the complexities of decision-making in Europe gave the need for a clear voice, which he would express.

Senator Michael D'Arcy: To your knowledge, does or has the ECB participated in regime change, governmental regime change?

Professor Patrick Honohan: I don't think so. I'm very reluctant to talk about other countries but there are instances and episodes where people might talk about the European institutions as playing a political role in the context of different governments. But I don't think the ECB has been to the forefront in this and I don't ... I can say, you know, in ... I'm absolutely sure that there has been no co-ordinated attempt by the ECB in any way to unseat some democratically appointed government or anything like that.

Senator Michael D'Arcy: If I could read a passage from *Stress Test: Reflection on Financial Crises*, Timothy Geithner?

Chairman: Yes.

Senator Michael D'Arcy: And he says:

At one point that Fall, a few European officials approach us with a scheme to try to force Italian Prime Minister Berlusconi out of power. They wanted us to refuse to support IMF loans to Italy until he was gone. We told the President about this surprising invitation, but as helpful as it would have been to have better leadership in Europe, we couldn't get involved in a scheme like that. We [couldn't] have his blood on our hands.

European officials, are they-----

Professor Patrick Honohan: Don't ask me. I don't know who ... I don't know anything about that so there's no point in asking me. There certainly was no ECB discussion about anything like that.

Senator Michael D'Arcy: Lorenzo Bini Smaghi is a former colleague of yours?

Professor Patrick Honohan: He's a former ... yes, that's right, he's a former executive board member of the ECB.

Senator Michael D'Arcy: He corroborated a story from Timothy Geithner in his publication. Mario Monti, the former European Commissioner who became Prime Minister, in an interview with Alan Friedman in the *Financial Times*, verifies where he was approached five months before he was selected.

Professor Patrick Honohan: By Lorenzo Bini Smaghi?

Senator Michael D'Arcy: No, Friedman was spoken to by the then President of Italy, that he should be on standby to become President or Prime Minister of Italy.

Professor Patrick Honohan: Why are we talking about this-----

Senator Michael D'Arcy: Well, I suppose, what I'm trying to get there, Governor, is, there are only two other agencies involved with the IMF-----

Professor Patrick Honohan: You don't think it could it be the EURATOM or-----

Senator Michael D'Arcy: No, I'm asking you-----

Professor Patrick Honohan: ----- the food and safety organisation?

Senator Michael D'Arcy: I'm asking you was it the European Central Bank, Governor, of which you were-----

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Professor Patrick Honohan: I never participated in any discussions of this type at the European Central Bank. So I'm sure Lorenzo Bini Smaghi has a story to tell there, but it's not-----

Senator Michael D'Arcy: Formally or informally?

Professor Patrick Honohan: Formally or informally.

Senator Michael D'Arcy: Okay, thank you. And your former vice-president of the European Central Bank, Lucas Papademos-----

Professor Patrick Honohan: Yes.

Senator Michael D'Arcy: -----became prime minister of Greece?

Professor Patrick Honohan: Yes.

Senator Michael D'Arcy: Again, it's been described as a *coup d'état*, in spirit.

Professor Patrick Honohan: That's very interesting.

Senator Michael D'Arcy: Can I ask any information about the ECB's ... did the ECB have any role in a former vice-president becoming prime minister of Greece?

Professor Patrick Honohan: No.

Chairman: Okay, I think, Deputy-----

Professor Patrick Honohan: This is a ... I mean, obviously you're talking about very important, powerful, and well-connected people, some of whom have sat on committees at the ECB. And some of the things that have happened in political history in Europe you can ... can obviously be criticised. But the ECB or anything ... any part of it that I've had any dealings with has had no discussions formally or informally about that, and I have no part personally, if that's the question, nothing to do with that at all.

Chairman: Move on from that. Thank you very much.

Professor Patrick Honohan: And no knowledge of it.

Senator Michael D'Arcy: Thank you, Chairman. Mr ... or, Governor Honohan, can I ask about your ... the occasion that you phoned "Morning Ireland"? Was it Thursday morning?

Professor Patrick Honohan: Yes.

Senator Michael D'Arcy: You'd been in ... you were in Frankfurt on that Thursday morning?

Professor Patrick Honohan: Yes.

Senator Michael D'Arcy: Were you in Frankfurt the day before?

Professor Patrick Honohan: Yes.

Senator Michael D'Arcy: Did anybody from within the ECB tell you to make that phone call to tell the people of Ireland that there was a bailout going ... discussions, negotiations, that they were occurring at that stage?

Professor Patrick Honohan: No. But let me add a little bit more colour.

Senator Michael D’Arcy: Please do.

Professor Patrick Honohan: The previous day, if I have it right, I learnt on the Wednesday that on the previous day - maybe the Tuesday or maybe it was earlier that Wednesday - that there had been a discussion, which you’re well aware of now, the Eurogroup of finance Ministers ... where finance Ministers had ... many of them had pressed Brian Lenihan to announce that he was going to apply for a loan from the IMF and the European institutions. And he refused to do that. He said he didn’t have the authority to do that. They were puzzled because they knew that negotiations were going on and they were wondering what was going on. So there was a sense of excitement and concern ... alarm, I would say, in Frankfurt with the people I talked to informally on the Wednesday night. And they were anxious that I should convey to the Minister for Finance the view of those-----

Senator Michael D’Arcy: Who were they, please?

Professor Patrick Honohan: Pardon?

Senator Michael D’Arcy: Who were they?

Professor Patrick Honohan: Members of the governing council. And they were-----

Senator Michael D’Arcy: Could you name them, please?

Professor Patrick Honohan: No, I won’t give names because we’re getting very close to things that I’m supposed not to be talking about, so names are ... they’re all ... they all were at one in saying, “You should be going into a programme.”, and I said, “You know, I think we should be going into a programme too.” I phoned Brian Lenihan, so I came out of the meeting and it was late in the evening, nine or ten Frankfurt time, so eight or nine in this time, and I told him, “Look, they want you to announce a programme, and you know, I think you should.” And he said, “I can’t do that. I’d need a Government decision.”

Senator Michael D’Arcy: On the Wednesday night?

Professor Patrick Honohan: On the Wednesday night. So he was very cross. You know, “Why are they trying to rush me? What’s this?” So he was very cross. There was no talking to him. So I went back into the meeting, my tail between my legs, and I wondered what was going to happen next. And I started to worry that I wasn’t doing enough, that there was a sense of panic - both in the official circles but especially in the market, and they had these outflows - and I thought, “I should be doing something.” And I ... somebody sent me a copy of the *Financial Times*’ leader article, which was saying Ireland should be preparing for a bank run, and I’m sitting down here doing nothing? And the leader in the *Financial Times* says Ireland should be preparing for a bank run when I should be doing something, if I should be preparing for a bank run. So I thought maybe ... maybe if I could say on the radio, “Look, we have loads of money, central banks, we can provide money to these banks, you don’t need to be taking your money out, your money is perfectly safe.” So I took the opportunity in ... not in a meeting but just in a corridor, to ask the relevant senior people, “Will you contradict me if I say the ECB will ... “Don’t worry, ECB will give unlimited money.” Because then I would be armed with a statement that I could make.

Now, let me backtrack that a week before, actually more like two weeks before, when there

were ... outflows were starting to build up, one evening - among many conversations - one evening Brian Lenihan phoned me, I was just outside the Luas on Stephen's Green and he said, "Look, we're hearing from this part of the country and that part of the country that there are outflows. You should make a statement." And I said, "Well, I don't think that's a good idea, because I've no ... I can't just say, "Don't worry, everything will be all right", I have to have some story, I have to have some explanation, justification for this." He said, "Well, look, I'll leave it to you, I bow to your ...". So what did the ECB people say? They said, "We will contradict you, because we cannot give an open-ended guarantee." So I spent the night thinking about what I should do and I decided that, first of all, that time was of the essence, market movements very, very ... you know, once you lose the confidence of the markets it can take a long time to get it back. So I thought, "Now, you must act now." And I thought I'd probably be able to convince people that the Central Bank is going to provide their money, even if I don't give a promise that the ECB ... and I think if you look at the wording of the statement ... of the interview that I gave on "Morning Ireland" you'll see I went very, very close to saying that the ECB would provide all the finances that would be necessary. And then I pulled back, saying, "Of course I would have to ask them, but I don't think they'll say 'No'." And I got away with it. They didn't contradict me. So that was my whole thinking.

Now, was I trying to contradict the Taoiseach? Was I trying to contradict other Ministers who'd said that? No, I wasn't trying to do that. Maybe I wasn't sufficiently attuned to the political happenings that were going on in Dublin because I'd been in Brussels and Frankfurt and, you know, doing all these discussions. When the Taoiseach said ... of the time said, "We're not in negotiations," I took that to be the standard thing ... understood, by informed people, to say, "Oh you're not in negotiations, you're in pre-negotiations", and that it was one of these kind, "Oh, you know, we'll go into the little room, we'll have this round table, and we'll have this square table," that's that what he was ... he wasn't ... so when I said well, we're not ... I didn't say we were in negotiations, we were in discussions, "I hope that, I hope it will be successful, I will suggest that we go into a ...". So I thought I was safe enough on the political arena. I knew they wouldn't be all that happy that I made the announcement but I didn't realise they'd be so unhappy.

Chairman: Can I just clarify one thing, Mr. Honohan?

Professor Patrick Honohan: Yes.

Chairman: Did you instigate the call or did RTE contact you?

Professor Patrick Honohan: No, I contacted them.

Chairman: Okay.

Professor Patrick Honohan: I contacted them, yes.

Chairman: Okay.

Senator Michael D'Arcy: Did you tell either Brian Cowen or Brian Lenihan that you were going to make the call?

Professor Patrick Honohan: No, I didn't, I didn't. No, well, I mean, you know, I don't think I gave that much thought. I was trying to reflect on that, and Kevin Cardiff said he would have liked an hour's notice, and I think it was ... I think my vision was tunnelling down to, "What am I going to say in that?" Obviously, I was going to do it on the basis of my indepen-

dence, I wasn't going to say, "Do you know, do you think I should go on the radio?" I think the answer would have been "No" because it wasn't to place them in a comfortable political position. I don't think I have----

Senator Michael D'Arcy: Should you have contacted Brian Lenihan or Brian Cowen?

Professor Patrick Honohan: No, I talked to Brian Lenihan already, late last night ... and late the night before.

Senator Michael D'Arcy: But to the Taoiseach-----

Professor Patrick Honohan: I could have ... no, I don't think so. It would have been a courtesy to inform Kevin Cardiff or to inform the secretary of the Taoiseach, or just ... it would have been a courtesy which didn't occur to me in the ... in my anxiety to get the message across. But I wouldn't ... I think it would have been a big mistake to have left myself in a position where I was being told, "I know you're independent but don't do this." I think that would have been almost in itself a surrendering of the independence-----

Senator Michael D'Arcy: Yes.

Professor Patrick Honohan: -----that had been given to me for good reason.

Senator Michael D'Arcy: Can I read a passage from a book called *The Default Line* by Faisal Islam? He is Channel 4's-----

Professor Patrick Honohan: Oh yes, the Channel 4 fella, yes.

Senator Michael D'Arcy: -----yes:

Something remarkable happened. Ireland's Central Bank Governor, Patrick Honohan, also a member of the ECB governing council, rang up Ireland's main morning radio show and invited himself on air from Frankfurt. He revealed the likelihood of a bailout worth tens of billions of euro, and that teams from the ECB, IMF and EU were already in Dublin. In fact, Honohan was to chair a meeting with the officials within the hour. Honohan had consulted neither of the two Brians. It felt like a monetary *coup d'état*.

Was it a monetary *coup d'état* by the ECB?

Professor Patrick Honohan: No. First of all, the ECB hadn't any part in it, as I said. They were saying "No" to my request.

Senator Michael D'Arcy: Sorry, Governor, you've said that in the previous day-----

Professor Patrick Honohan: Yes?

Senator Michael D'Arcy: -----that the members of the governing council-----

Professor Patrick Honohan: Yes?

Senator Michael D'Arcy: -----were imploring you to-----

Professor Patrick Honohan: Yes, to ask Brian Lenihan-----

Senator Michael D'Arcy: Lenihan.

Professor Patrick Honohan: -----to go into a programme.

Senator Michael D’Arcy: Yes. And he was-----

Professor Patrick Honohan: And I passed on the message.

Senator Michael D’Arcy: Passed on the message and he hadn’t.

Professor Patrick Honohan: Yes.

Senator Michael D’Arcy: Did you not announce the programme?

Professor Patrick Honohan: I described what was happening up to then. The Government were still absolutely free to say, “Well, we know about the talks and the negotiations, but we think this is not the way to go, and we’re not doing it.” Absolutely free.

Senator Michael D’Arcy: In Kevin Cardiff’s evidence, Governor Honohan, on three occasions he says:

Overall, though, these two days of discussions [this is 14 November] had achieved quite a bit. There was one point of disagreement [though] towards the end of day two [I think]. Mr. Masuch said that his bosses in the ECB would now hope and expect the Minister for Finance would immediately announce a decision to enter a bailout.

Subsequently he says that on another occasion, a number of days later, these discussions were tough, there was great pressure on Lenihan to agree immediately to request an EU-IMF bailout-----

Professor Patrick Honohan: From the Eurogroup Ministers, I think he’s talking about the Eurogroup Ministers there.

Senator Michael D’Arcy: Yes.

Professor Patrick Honohan: It’s not a *coup d’etat* by anybody else. That’s very important. This is a democratic process, the democratically elected Ministers of Europe were saying in the Eurogroup, in a collegial way, “You are in trouble, we are in trouble. You should take action.” And they were right.

Senator Michael D’Arcy: Governor, the members of the ECB governing council were saying to you, for you to implore the Minister to take action, and when he didn’t, did you choose to take that action?

Professor Patrick Honohan: I didn’t take any action. I went on the radio. The Minister took the action of going into a programme several days later. He could have said “No” and I explicitly said that on the radio. I said, “If it’s agreed, I think we’ll go into a programme.” I think it’s very important, these distinctions are very, very important, very, very important.

Senator Michael D’Arcy: And that’s why we’re scoping them, Governor. Did you undermine the negotiation team’s position by doing-----

Chairman: Mind your language, now, you can ask a question, yes, but be careful of any value judgments in it, and you have about seven minutes to go.

Senator Michael D’Arcy: I’m asking a question.

Professor Patrick Honohan: So, your last question is “undermining”. I think, on the contrary. I think it was ... it created an atmosphere in the negotiations. And, you know, I’ve been working with people in international organisations all my life, since I was 21. I know the way they work. And the sense that the Administration of the country and the political system was working in a systematic and co-ordinated way, and that there wasn’t going to be any messing around, and there was proper communication between all the different parts of government, I think that is what really helped us get a very quick agreement to a programme that, financing aspects aside, worked very well for Ireland - and we fixed the financing aspects later. I think it created a good atmosphere, there was no ramping up of asks from the troika side afterwards. There was no sense of that. And they knew the decisions were going to be taken by politicians.

Senator Michael D’Arcy: The letter of 19 November, were you aware of the contents of that letter from President Trichet?

Professor Patrick Honohan: Yes, I was aware of it in general outline, not the exact wording.

Senator Michael D’Arcy: Were you aware that there was a threat to remove ELA?

Professor Patrick Honohan: Yes, and I recommended to Jean-Claude Trichet that he should not send such a letter. I thought it was a bad idea. I told him the letter would leak eventually which amazingly it did, about a year and a half later, I think, and then was subsequently published. Well, I’m not sure whether it exactly leaked, but the gist of it leaked. And I just thought it would, from his point of view, it would put the ECB in a bad light to appear to be making an ultimatum. Now he would claim that it was not an ultimatum, it was merely a statement of what necessarily had to happen. But it was inevitable that in the eyes of the recipient, or even more so in the eyes of the general public when they would read a letter, that it would look like an ultimatum. So I recommended against the letter. However, I also told him, “I don’t think you’ll need this letter because it is clear that we are going into the programme.”

Senator Michael D’Arcy: Okay. In the film “The Godfather”, Don Corleone said it was an offer he couldn’t refuse. Was that letter from Mr. Trichet an offer that the Irish Government could not refuse?

Professor Patrick Honohan: Well, I think that when it arrived it caused a certain amount of puzzlement and Kevin Cardiff implied that. “Why now”? It’s as if, you know, the train has already left the station, and there’s a message coming to say, “Be sure to catch the train.” This had already happened. The wording of the letter in some respects was sharper and more specific than I had imagined. And I actually recall Kevin Cardiff saying, “Look at these terms and conditions exactly.” And when you look down through them some of them were not exactly very easy to comply with. On some interpretations ... well, I said to him, “All they want is entry into the programme. Don’t worry about those details.” So I think that it didn’t actually have as much effect as everybody thinks it does.

Senator Michael D’Arcy: The amounts of €10 billion for bank recapitalisation, €25 billion for banking support and €50 billion for financing the State, what analysis was carried out by the troika to come up with these figures?

Professor Patrick Honohan: You’ll have to ask the troika that. The €10 billion was a sort of round number sum. They wanted to ... as we talked about that this morning, they had the idea they were really focused on the banks: the banks, the banks, the banks. “If we get the banks

recapitalised, Ireland's problems will be solved because Ireland's problems are caused by the banks." So they said, "Why don't you recapitalise them right away?" And we said, "No, we did our sums, you've looked at our sums and you don't see any methodological flaws in them so, you know, we think we know what capital is needed. We admit they could do better with more capital and the market would trust them." So it was a sort of compromise round number figure; put in €10 billion, anyway, and we leave €25 billion in reserve and you can put the rest of that in if needed when the stress test is carried out. So it seemed like a reasonable compromise. In the end we put in, what, €17 billion instead of €10 billion.

Senator Michael D'Arcy: The €17.5 billion from the pension reserve fund, was this a condition of the bailout that those moneys would be used?

Professor Patrick Honohan: Source of the ... oh, the €17.5 billion, yes, absolutely. They didn't want ... the sums of money which were, "We are fully funded until X months away", those were to be swept in as well. That's what that amounts to. Particularly for the IMF, the scale of the lending, after the huge loan they'd made to Greece, was beginning to stretch their resources. They could see that they might have some other loans to make as well, perhaps to Portugal, which, indeed, happened. So we were getting to the outer limit of the sorts of sums of money that they wanted to lend. But they did want to make sure that the programme and the public finances were going to be sorted for three years, so that, at the end of, it we'd be back in the market, but we'd have enough money for three years. And so they wanted to make sure, that's how they allocated it, €17.5 billion from the ... whatever number it is, I can't remember off-hand ... from the pension reserve fund, and then €22.5 billion from each of the agencies, I think that's it.

Senator Michael D'Arcy: The discussions held with the ECB, in particular, Governor, in relation to the burden-sharing for bondholders both senior and subordinated, they were held and they were ... the possibility of burning senior bondholders, raised on a number of occasions. Could you shed some more light on the ECB's refusal and then, subsequently, in a number of years later, we had the bailing-in of bondholders in other jurisdictions?

Professor Patrick Honohan: Okay. So there are two particular episodes: there's one episode which is at the time of the bailout, or the programme, and there's another one then at the end of March 2011, at the time of the stress test. So start with the November 2010. When I got back from Frankfurt on Thursday, 18 November, I participated in the first of these meetings, a high-level meeting, it was quite amusing because we talked about more or less procedural things. We were picking up from what we had discussed in Brussels. It was in Kevin Cardiff's room in the Department of Finance and there must have been about 12 or 15 people there, so it was principals, it was just, the senior people. And after an hour or two we broke, and maybe it was 8 o'clock, and we broke for sandwiches, and during the sandwiches, the IMF representative said, "Of course this is not part of our discussions but what about the bondholders? I mean, there are unguaranteed bondholders, how many of them are there? And just hypothetically, what would happen if there was some mechanism for imposing haircuts on them?" Well, this was the first we'd heard of anything like this, even after two days of meetings in Brussels. And obviously, it was a strange attempt by the IMF to bring back on to the table something which presumably they must have ... had been brushed aside in their pre-meetings with the rest of the troika. So, this was our first idea that one of the institutions, at least, would support some mechanism for burden-sharing with senior bondholders at the banks. We were very excited by this ... on the ... there is a unanimous view on the Irish side that this was a great opportunity. Why? Because now we were in a period of three years, prospectively, protected by official financing

so that any disturbances in the markets could be contained and also the reputation risk of burning bondholders would be greatly diminished if it was at the behest of the IMF, who know about these things. So immediately, this was a great plus. So, there followed in subsequent days, it was clear that the others didn't want this discussion to go greyface and they were uneasy and they said, "I think we should get back to the meeting proper now", and stuff like that. So, there were further discussions, not all of which I was involved in, over the coming ... the next few days. So that's that episode. Were the ECB involved in this? I know, Cathaoirleach, I know this is spoiling your time but-----

Chairman: I am very simply stating, Mr. Honohan, I just need to get through a particular line of questioning with you this afternoon and I note that the Robert Ludlum stuff and all the rest of it can be very interesting and colourful but there are some factual matters relating to what happened here in Ireland that we need to get through.

Professor Patrick Honohan: We'll need to get the specific questions then, because I can go on a narrative indefinitely on this.

Chairman: And if members can rely upon the core documents that we have where we spent months of researching them rather than going down to the library to pick up something that might be a thriller and might help us in our final report as well. What I want to focus in upon, particularly with the question that Senator D'Arcy put to you, is there is a document up on the screen there and it's a statement by Minister for Finance, Brian Lenihan TD, on the EU-IMF programme for Ireland and the national recovery plan and on the end of that statement it says:

There has been much commentary about the need for senior bondholders to accept their share of the burden of this crisis. I certainly raised this matter in the course of ... negotiations and the unanimous view of the ECB and the Commission was and is that no Programme would be possible if it were intended by us to ... honour senior debt. The strongly held belief among our European partners is that any move to impose burden sharing on this group of investors would have an enormous ripple effect throughout the Euro system. [And then he referenced yourself.] That was confirmed [to me] by Professor Honohan in an interview last Monday when he said there was no enthusiasm in Europe for this course of action.

So, how do we have that incongruence, where there is a view that there might be a potential for burning of bond holders and there is a view here where you're saying in Europe, there is no discourse or discussion about that?

Professor Patrick Honohan: Because it's exactly as I said. The IMF team were arguing in favour of this. The European ... the team from the Commission and the team from the ECB were saying, "This is off the agenda, we're not talking about it." And then subsequently, we know that the troika, as a group, with the IMF now on board and back in their, you know, back in the group, went together to Brian Lenihan and told him, "No, the decision has been taken. There is not going to be a programme if you burn the bondholders."

Chairman: Okay, thank you. Deputy Joe Higgins ... no, I'm moving on ... we're way over time, Sir. I'm moving on. You'll come in the wrap-up. Deputy Higgins.

Deputy Joe Higgins: Yes. Governor, in your book of evidence, Vol. 2, we don't need to go there but there is a summary of all changes implemented arising from recommendations of the various reports-----

Professor Patrick Honohan: Yes.

Deputy Joe Higgins: -----into the banking crisis. So, in your opinion, is the current supervisory regime robust enough to prevent another crisis as happened? And, particularly perhaps, in event of a rapid rise of market interest rates and the impact of that on household and commercial debt?

Professor Patrick Honohan: You know, Deputy, the regulatory system is there, the supervisory system is there, it's been improved. Is the economy still an over-indebted economy? Yes. Are there many households over-indebted? Yes. Will their situation be worsened by various shocks? Yes. But this is the working out of a legacy indebtedness. These matters are known and largely understood, so I would say from the point of view of regulation and supervision, we have a sufficient grasp on the situation. Does that mean there could be ... will be no pressures? No, there will continue to be pressures in the work-out. Could there be another crisis, perhaps emerging from some other part of the financial system that we're not talking about on our agenda? You know, the ... yes, I am always concerned that the next crisis will come from where you're not expecting it. So, we have to supervise and regulate those sectors too and some of them are harder to supervise than the banking system.

Deputy Joe Higgins: Okay and in relation, Governor, to the current situation in Greece *vis-à-vis* the euro area and some people would object strenuously to the pressure that Greece is being put under but let's leave that aside. In the case of a euro-related crisis, such as Greece leaving the euro, for example, what would the impact be on the Irish banking system and-----

Chairman: Phone interference there coming in, Deputy Higgins. It may not be yourself but it's coming from the proximity, so please continue to question but I ask members to now turn off their phones.

Deputy Joe Higgins: Yes, and how would the system cope with that?

Professor Patrick Honohan: Deputy, I don't want to be unhelpful but I once answered a question about ... in this area before and I realised it's a very big mistake. It's about another country, it's about a hypothetical scenario, it's ... this whole area is very, very market sensitive. It's very politically sensitive ... just as I am very reluctant to get involved in politics at all, I certainly don't want to describe anything about another country under pressure.

Deputy Joe Higgins: Even theoretically in-----

Professor Patrick Honohan: It won't be taken theoretically by our colleagues behind.

Deputy Joe Higgins: Right. So, now, Governor, an increasing number of insurance companies, hedge funds, asset managers, special purpose vehicles are choosing to domicile in Ireland and the Irish Financial Services Centre and so forth. Funds under management, according to the Irish funds industry, are set to reach to €2 trillion this year and there's been exponential growth in those fundings, 25% in 2014 and 14% increase in quarter one of 2015, which is €234 billion of an increase, bringing it up to €2 trillion. Now, I just want to ask you in relation to where the next crisis might come from, which is a question you kind of posed there. Is it disturbing or not to see in the Irish funds industry promotional material the following, "Through its work with governmental and industry committees and working groups, [Irish funds] contributes to and influences the development of Ireland's regulatory and legislative framework." That's one quote and the second one is:

Irish regulated funds are exempt from Irish tax on income and gains derived from their investments and are not subject to any Irish tax on their net asset value. There are addition-

ally no net asset, transfer or capital taxes on the issue, transfer or redemption of units owned by non-Irish resident investors. ... Non-Irish investors are not subject to Irish tax on their investment and do not incur any withholding taxes on payments from the fund.

A question that arises for me, which I would like to pose to you, Governor, is the finance industry, perhaps, one crisis ahead of the State and the regulatory system? And let me just put it in this context: that in the 2000s, we had evidence here in the 2000s during the bubble, the regulator was assiduously regulating for issues that had taken place in the previous ten years, consumer issues, etc. You have been busy putting in place regulation to try and prevent what happened during the bubble. But here, we have remarkable language and a promotion not unlike what we heard in relation to property tax breaks, etc. So, is it possible that another crisis is developing here, that the Irish State or regulatory system is not on top of?

Professor Patrick Honohan: Okay. No, I think it's a very important question. First of all, some things have definitely improved. The Central Bank does keep a watching eye on the work of the clearing house group but it does not participate in its discussions and we no longer have any responsibility, statutory responsibility for developing the financial sector, which was a goal. We also don't any longer have ... there was an industry panel, a panel of industry specialists, which had certain powers under the previous legislation to poke around in what the Central Bank was doing for as far as regulation was concerned and lobby in that. We don't have that; that was ruled out of the new legislation. The tax matters have nothing to do with the Central Bank. Now, certainly these non-bank areas are ... Ireland is one of the largest centres in Europe for funds. It is also a substantial centre for insurance. We have increased our efforts to supervise the ... Funds is supposed to be simple, but then, mortgage lending was also supposed to be simple. Simple because these funds, the investors are supposed to be sophisticated wholesale entities and there is no risk of them to the payment system or to the general run of things. So, in principle, funds could collapse and the Government wouldn't be entailed.

However, we have to make sure the funds are doing what they say they are doing and that they are set up in accordance with the various pieces of legislation, mainly European legislation on the funds, and we do have a supervisory effort there. It seems to me that the regulation there has become very, very complex, very demanding and we will be increasing our staffing again on that side.

On insurance, we have already identified a sector of insurance which had grown here in the 2000s, a sector which was ... or a product, a range of products under the general heading of variable annuities, which were very complex and rather risky products. We noticed that Ireland was becoming one of the centres for this and we didn't like that because it sounded as if there might be some reasons ... we wanted to make sure that we were regulating it adequately and we weren't just getting these businesses coming here because they were getting some, kind of, lighter run on it. So we scrutinised that very closely, we discovered the risks that are involved and we have imposed much higher capital requirements on the firms that were providing these products and we're satisfied that this is safe. I'll give you just an example from the numbers that I had there. In 2009, insurance supervision, we had 42 people and, in the house at present, we have 96.8 people on insurance. So we are not just regulating ... not just concentrating on the last war, we are looking to the next war and insurance and funds. Funds figures are more complicated because they are mixed up with some other stuff. We have increased there too and I anticipate a further increase as well in the years ahead.

Deputy Joe Higgins: Okay, like, I'm sure the reason that people might wonder and be worried was that evidence was given here and, indeed, you referred to it in your own first report on

the banking crisis, Governor, that a reason advanced for so-called light-touch regulation was because of the Irish Financial Services Centre. So that Irish institutions' regulations wouldn't be heavier regulated in case the IFSC was made to look like an offshore island speculators' paradise or whatever they do on those offshore islands, right. So the question ... and, as you know, *The New York Times* labelled some of what was going on as Ireland being "the Wild West of European finance". The question is ... the number of staff in the regulatory system has not increased anything to the same extent as the funds or even perhaps the amount of funds and the actual funding institutions. So are you confident that the Irish regulatory system knows what is going on in those particular institutions to head off any potential disaster for the future?

Professor Patrick Honohan: One area that I'm not fully confident about is the area of entities which are not, at present, subject to regulation because they are just there. They are not doing things that are subject to European or Irish law in requiring them to be regulated. And we have opened a body of work to try to, first of all, collect data and require such companies to provide data to us so that we can start to understand them and we have already been doing this for about two years. And then in case of firms which we have no right to ask for them for data, we have been going to a sample of firms and trying by nature by means of in-depth interview to understand what line of business are they in to see should there be some additional legislative requirement at the European or Irish level? And in doing this, we are feeding this information into the European, especially the European but also the international system. Because this area of non-bank, non-insurance finance is growing because banks are being more strictly regulated. The flows of money are going out into unregulated entities and we want to make sure that that's not going to cause a problem.

Deputy Joe Higgins: And Governor, do you think it is healthy that those financial institutions and the industry has such a close innings to a Government through the IFSC Clearing House Group where there is ready access to the highest political levels in this State for lobbyists essentially? Is that healthy?

Professor Patrick Honohan: I think if to the extent that successive Governments regard the IFSC and its contribution to employment and taxation as important, I think a degree of interaction is likely to be a consequence of that. I don't think the politicians shouldn't be close at politician level but the officials who make legislation, so the Department of Finance or the Department of industry or whatever enterprise or whatever it's called now, if they want to keep these businesses, they need to understand what legislation ... if this legislation is old fashioned, it will not enable these companies to work. So I don't defend it. It is just part and parcel of wanting to have an international centre.

Deputy Joe Higgins: But Governor, is there a fine line between the equivalent of regulatory capture, which you again mentioned in your first report, and a capture of the-----

Professor Patrick Honohan: Yes, and I think this is one of the advantages of having an independent regulator because as a regulator, we, the Central Bank, don't care whether the companies stay or go and if we put on a regulation which we think is necessary to keep them safe and if that means that a firm says, "I'm outta here, it's just too costly for me to do business", if that is necessary to keep them safe, that's all right. So I think that's a great advantage of the independence.

Deputy Joe Higgins: Okay. Governor, how would describe the Central Bank's current relationship with the banking institutions? And do you perceive a difference in the supervisory relationship with the private banks, they are fully private and those that are in public ownership

or almost in public ownership?

Professor Patrick Honohan: I don't think there is that much difference in the tone of perhaps ... I think there has been a great emphasis on the guaranteed, what used to be guaranteed and is still to some extent, guaranteed institutions some of which are in public ownership because of the risk they posed to the State, so greater emphasis on those banks without neglecting the other ones. But I don't ... it's not and when I ... and I don't meet them all that often ... but when I meet the senior officials of let's say, AIB or PTSB, it's not, "Oh, we're all on the side now whereas those fellows in Ulster Bank and Bank of Ireland are something else." We regard them all as regulated entities and dealt with in the same way.

Deputy Joe Higgins: Okay. And Governor, in terms of further legislation in relation to financial institutions, do you think that more powers are needed to respond to irregularities and to, let's put it frankly, potential so-called white collar crime in the financial area? And in that regard, what do you think of the United Kingdom senior managers regime, which will include the threat of a criminal conviction for senior executives and directors of financial institutions which fail? And you may have seen a week or two ago that the governor of the Bank of England, Mr. Carney, called for very strict punishment, if I am not mistaken imprisonment, for people who act fraudulently or recklessly from the interests of ordinary people in the financial services. What is your view?

Professor Patrick Honohan: So, obviously, when Mark Carney speaks it gets bigger headlines than when I speak, but I do recall at one of the committees - the finance committee - several years ago by now, pointing to similar legislation in Australia, which I invited the legislators to pay attention to. I'm very much in favour of this approach. Cyril Roux was here a couple of weeks ago with you and he said he was sceptical about the effectiveness of fines in ... and I think that's true. I think it very much comes down to individuals. If we're talking about reckless behaviour and negligence, it comes down to individuals. And if individuals are not at risk, then, I think, you're liable to get a number of bad apples. Matthew Elderfield has also spoken about this and he actually shared with me some material that he provided to the ... to the committee and I would endorse what he said. He said that before in public as well ... that it's not just that there's new legislation in Britain. Yes, that's something that we could copy but I think it goes deeper than that. And he's convinced me, and my other colleagues have also convinced me, that we have developed in Ireland, perhaps because of our history and our post-colonial history, we have developed a ... a great potential ... protection of the individual which makes it very, very difficult to believe that there are sanctions in place. So it's very many steps. So I'm very much in favour of more work being done on this, it's not Central Bank business. I understand that the Law Reform Commission is looking into this business of white collar crime and whether our sentencing practices, our procedures and ... you know, what are the all the big reforms that might be needed to make this effective.

Deputy Joe Higgins: Because, Governor, it might almost seem a cliché ... what is often said that, you know, a poor person out there steals a loaf of bread or doesn't ... can't afford to pay their TV licence, they're banged up in Mountjoy for a period of time. But, on the other side of the social prism, those who were responsible for billions going awry never see the inside of a jail. So you think there should be very specific changes to the law to make the people at the top suffer consequences if they defraud or-----

Professor Patrick Honohan: For wrongdoing, absolutely. I certainly think so and I think it has ... it is remarkable, first of all, how long it takes, how heavy the procedures are and how light the consequences.

Deputy Joe Higgins: Governor, in your opening witness statement to us today you say that ... moving on to the bailout, so-called, that exploratory discussions with troika officials were to begin on 4 November but then they were delayed to 14 November.

Professor Patrick Honohan: Okay, let me clarify that. So 4 November I agreed that I was quite happy to have Central Bank officials attend meetings in Brussels - not on 4 November, on 4 November I agreed to that - and I expected those meetings would happen early the following week but they didn't happen early the following week and Mr. Rehn arrived in Dublin on the Tuesday and there was no talk of these meetings. And so I said, "What's going on with these meetings?", I said to his colleague and he said, "Oh, they're coming soon, I don't know.", and then they did happen at the end of that week.

Deputy Joe Higgins: Yes, but you said then it was delayed until 14 November because the troika-----

Professor Patrick Honohan: Yes, they were hammering out ... presumably they were hammering out things like this bailout stuff.

Deputy Joe Higgins: Yes, the troika hadn't its act together so to speak.

Professor Patrick Honohan: Yes, they disagreed.

Deputy Joe Higgins: But then, is it the case that the troika, or elements of it, went into overdrive coming up to 18 November? And there is a thesis, Governor - I'd ask you to comment on it - that, in fact, the ECB acted in such a way and gave signals to the market to bounce Ireland into the bailout. Do you accept that?

Professor Patrick Honohan: Well, I think, first of all, the ECB definitely wanted a bailout. I think that they ... they were ... I'm looking for the word ... well, they were unwise in the statements they made, formally and behind close doors, to the market. First of all, I'll give you an example: on 2 September ... 2 September Jean-Claude Trichet was asked at the press conference, "What about Anglo Irish Bank, blah, blah, blah, blah?" He said, and I brought the quote along with me, it's quite extraordinary ... he said, when everybody knew that Anglo Irish Bank had ... was heavily into ELA and that nobody ... the Irish Government couldn't afford to pay for that, he said "It is clear that that bank is matter for the Irish Government." Yes, there you are, "Do you not share ... [questioner] Do you not share any of the concern that there is in Dublin that the cost of bailing out this specific bank [the reference is to Anglo Irish Bank] is creating an intolerable burden on the Irish state?" Jean-Claude Trichet:

I already responded on this. If I am not mistaken, it is a bank which is owned by the government. So it is the responsibility of the government of Ireland and of the Irish authorities in general to take the appropriate decisions.

Immediately that was taken that, "Oh, okay, so the ELA for Anglo isn't for ever, the Irish Government are going to have to do something about it." I thought that was an unwise thing to say and I told him so. Subsequently, there were other statements, including statements off the record that were relayed to me. They said, "We heard from a very senior official in ECB that ..." so all of that noise was certainly making it difficult for Ireland to build the confidence to stay in the markets.

Deputy Joe Higgins: Does that give credibility to the claim that that was, in fact, a strategy of the ECB?

Professor Patrick Honohan: I don't think so. I think that they hadn't thought through the consequences of their actions. They hadn't thought through the safe way to proceed, which was to not communicate any indication that Ireland was liable to lose access to the markets.

Deputy Joe Higgins: And then, Governor, further ... if negotiations began on 18 November-----

Professor Patrick Honohan: No, they began on the 14th in Brussels. Not formally, they were just discussions, but, in practice, they were negotiations.

Deputy Joe Higgins: Yes. So by 18 November they were well under way?

Professor Patrick Honohan: Yes.

Deputy Joe Higgins: Why then did Trichet write this allegedly threatening letter on the 19th, the next day, threatening this State with rather dire consequences if we didn't formally agree, more or less immediately?

Professor Patrick Honohan: I think because-----

Deputy Joe Higgins: This is ... this is a letter - for the sake of clarity - from Mr. Trichet to the Minister for Finance, Brian Lenihan, on 19 November 2010.

Professor Patrick Honohan: It's hard to understand his motivation. He may have been under pressure from some of the governors - I don't know, they wouldn't have spoken to me - that they were just looking, in a very narrow way, on the growth of ELA and the prospective growth of ELA and they thought this is something that needs to be brought under control - or he may have been motivated by observing what Brian Lenihan was responding ... in the Eurogroup - Trichet, I think, would have been at that meeting, I'm pretty sure he was at that meeting, he would have seen Brian Lenihan saying, "No, no, no", to people who were asking him to go for the programme. So he was probably discounting the information he was receiving from his own staff, the technical staff that had negotiated ... they saying, "Oh, the negotiations are going fine", he probably said, "Well, that's not what I saw in Brussels and also I'm under pressure from some governors who don't like the way things are going." Some combination of that. It seemed unnecessary and behind the curve to me.

Deputy Joe Higgins: Finally, Governor, the euro area summit of 29 June 2012. The political establishment returned from that, by common consent, making very large claims for what was achieved - that it was a seismic result, etc. - in relation to recapitalisation from some European fund, thus replacing Government funding and, therefore, releasing funding for public services, etc. The sentence around which all this turned was, "The Eurogroup will examine the situation of the Irish financial sector with a view to further improving the sustainability of the well-performing adjustment programme". Governor, what did you make of this at the time? Did you accept or were you ... agreed with the type of claims that were made by the Government leaders in relation to what that meant? And is it the case that nothing has come of it?

Professor Patrick Honohan: So, I wasn't part of the discussions on that. It came out, I thought this was a good step forward, this gives a clear political signal for achieving whatever we can achieve in terms of improving the financing arrangements around this. And various initiatives were taken after that, some suggestions were ... different types were retained from different parts of the ... of the ... administrative group in Dublin, you know, the Department of Finance, the NTMA and so on. My idea was that the whole financing arrangement around An-

glo Irish Bank, this was the mechanism that would work best and, all in all, I suspect, although there was no explicit link, and everything was done strictly in compliance with a ... with central banking legislation, and with contracts of law, the financial advantage to the State of the way the Anglo Irish Bank liquidation worked out, and the way this thing, this promissory note, was structured around that, was probably seen by the political, other ... the Ministers in other countries, as being at least part of the delivery of that political commitment. They hadn't delivered it but they probably thought, "Well, you got the promissory note."

Deputy Joe Higgins: That's all? That's all?

Professor Patrick Honohan: Well, I'm afraid it's quite a lot actually. It's quite a lot.

Deputy Joe Higgins: Yes, but we were led to believe that billions would be pouring from some fund to replace funds that were committed to the banks and that then they were going to restoring society, public services, etc.

Professor Patrick Honohan: This was ... some of the ... some mechanisms could have been false savings. This one was a real saving and we made sure that it was designed in such a way that it's actually quite advantageous, so-----

Deputy Joe Higgins: Is it not putting the debt into 2050 on the children of children unborn?

Professor Patrick Honohan: It's greatly reducing the servicing cost. Greatly reducing, by billions. So, it really is advantageous.

Chairman: Thank you. Thank you, Deputy Higgins. Just a ... on one matter from Deputy Higgins, and just returning to something earlier as well, Deputy Higgins raised the issue with regard to white collar crime. And even moving aside from white collar crime there's the issue ... the difference between bankers and banks. When your colleague was here recently, Mr. Roux, a question was put to him and you addressed that at the moment. I'm just looking online there, because I was actually looking for the exact page that I was speaking to him about the time, but I just noticed now that, seven years on from the crisis, €150 billion in bank fines and penalties, and ... that is dated 30 April 2015, that's a CNBC website, it wasn't *The Wall Street Journal* one that I was looking for. However, I see in *The Wall Street Journal*, on 18 June 2015, "Fines aren't for fair markets, for lasting change we need a system of accountability and standards." How do we address this, Professor Honohan? Years on from the crisis, the biggest financial meltdown this country has ever faced, a financial crisis at a global level, and we still see behaviour in financial markets that fines are running into billions ... multiples of the sum that this country actually required in funding.

Professor Patrick Honohan: Yes. Okay, well ... while that's a very big and broad question, I'll just say, from the Irish point of view, we also are participating in this fines business, and we have a lot of administrative ... 13 cases against banks in the last five years, monetary penalties €11 million, not as big as the American ones because they have much bigger banks and so on and so forth. In addition, there, I will recall, even though we're not to go too far into this, but there have been convictions of bankers here, of senior bankers here, and there are administrative sanctions procedures which could add to those, so action is being taken. But I would stress that our ... I think the work of the Law Reform Commission should be attended to and acted on. Law Reform Commission recommendations aren't always acted on and, like we saw, the bankruptcy was sitting around for years. But this should be acted on because I think we won't get effective results if there's a sense that individuals can go away scot free.

Chairman: All right. I just want to deal with one other matter, and if I can get a particular document up on screen there. Professor, this is a letter to yourself of 25 October 2012. The letter is from Minister Noonan and it relates to the Minister for Finance writing to you requesting that you present the Government proposal to the economic management council, EMC, of 8 November 2012, covering the liquidation of IBRC and the replacement of the promissory notes with long-dated Government bonds.

And if I can go to the second page of that, because the second page is where the ask actually is, and it's the very last paragraph there with bullet points. It says, "The ECB agree, as a minimum, to a long-term [this is what they're asking you to go to Europe and talk to the ECB about] weighted average life for Government and Government guaranteed marketable bonds, in line with the proposal." The other ask that they ask you to take to the ECB is, "The ECB agree that the Central Bank of Ireland will affirm to the market that it will hold these bonds to maturity in order to ensure the financial stability of Ireland." And the third ask they're asking you to take to the ECB is that, "The MFI status is retained for IBRC, for technical reasons, post liquidation, until the assets are sold." It concludes, "Absent agreement on these key issues the proposal will not proceed." So these are the key requirements to set up the liquidation of IBRC. Could you outline to the committee this afternoon, the reception this proposal was ... how the ECB received this proposal?

Professor Patrick Honohan: So, bullet points 1 and 3 were fully agreed by the ECB, and so the average life of Government bonds that were used in this transaction was 34.5 years. My idea was 40 years and it was whittled away to 34.5, which I thought was long enough. The second point was challenged by ... on legal grounds, by ECB staff, who felt that a commitment to hold the bonds to maturity would create serious concerns about possible inconsistency with Article 123 of the treaty. Our lawyers in both the Central Bank and independent lawyers, were engaged by, I believe the ... well, either Central Bank or by the Government, I can't remember, felt that this argument was wrong and that we could hold them to maturity. But, the ECB held out very firmly and said there had to be a prospect of disposing of these bonds so that they would not be held to maturity.

And, over the following months, there were detailed discussions and negotiations, and in the end a form of wording was agreed where ... which was acceptable to the Government, despite the statement in the letter, which said that they would be disposed ... the bonds would be disposed of as quickly as possible, subject to financial stability conditions.

So, you can see the financial stability argument is there, and then, in addition, there was a schedule which was a minimum schedule, and that minimum schedule was back-loaded, but it was going to ensure that the bonds were disposed of well before maturity, thereby disposing of the bulk of the legal concerns.

So, I would say we ... those three principles were there and we had to ... Irish side had to concede, to some extent, on the second one. Turned out, however, because of the financial structure of the bonds, floating rate notes and so forth, that the great fall in interest rates and in the spread of the Irish Government against German bonds, that this second condition no longer was vital for the concerns of the Department of Finance and the fiscal concerns of the Government, that actually, disposing of the bonds into stable financial conditions at these lower spreads gave you as much advantage as hanging onto them, in terms of the profit flow of the Central Bank. So, actually everything has worked out. The design was fail-safe and it has worked quite advantageously. So the Central Bank has since then been disposing of these bonds and continues to do so. The financial stability conditions allow that and it's disposing of them more

rapidly than envisioned and will continue to do so.

Chairman: Thank you. I now invite Deputy Phelan, after which I propose that we'll take a short coffee break. Deputy.

Deputy John Paul Phelan: Thank you, Chairman. Good afternoon, Governor. I have a few ones at the start, kind of, like questions that you might have set yourself, maybe, in a previous life. I'd ask you to discuss ... there's a quote from Vol. 1 of the core documents, it's an IMF survey, 19 December 2013, "Ireland's Economy Back from the Brink, But Continued Progress Needed". The quote I want to put to you is this ... you needn't even find it, I'll put it to you, "And on the financial side, regulation and supervision, which were deficient in the run-up to the crisis, have been revamped." Discuss briefly.

Professor Patrick Honohan: Well, yes, I mean, a lot of things have been done and as, I think Cyril Roux explained to the committee, of course we now have a new wave of redoing the banking supervision, because now the European thing has been set up. But in the early years, and it wasn't just for banking because we were paying attention to the other non-bank sectors as well - great increase in staffing; separation of the enforcement task from supervision; separation of the policy design, very complex European policies, separation of that from day-to-day supervision so that the day-to-day supervisors are clear to go; hiring of experienced outside people who weren't caught up in what had happened to lead this in the first instance and now the training up of internal people; a change I think also in the culture. We've done formal things to change the culture of the organisation - there are management things - and informal ways of changing the culture, bringing in things like all staff meetings and, I hope, creating an atmosphere where nobody is afraid to speak up and say, "I think you're going the wrong way."

Deputy John Paul Phelan: Has there been anybody who has had the opportunity? I am not enquiring for names, who-----

Professor Patrick Honohan: I was just thinking how I would convince the committee that ... someone might, "How would you encourage this?" And I think the way to encourage this is - and it has happened but not deliberately because of this - is promote some of them, you know. So if somebody, "He's always saying..." There's one particular chap who says, "Well, that's a very good point, Governor, but...", so, you know-----

Deputy John Paul Phelan: Similar to politics in some way then.

Professor Patrick Honohan: Yes. So, anyway, I think that cultural thing is important, that the sense of challenge that people are entitled to. Now, there'll be some people who'll say, "Yes, I challenged him; it didn't get me anywhere at all", because you have to be, you know, convincing as well.

Deputy John Paul Phelan: Can I just move quickly to another question on outside advice. Can you outline the type of external advice now sought and received by the Central Bank to facilitate the delivery of supervisory responsibilities, and in what circumstances does the Central Bank seek such external support, from whom do you seek it and to what extent do you avail of it, I suppose, in the ongoing work?

Professor Patrick Honohan: Well, we have spent a lot of money on consultants, including lawyers but also financial services firms. What do we use them for? Well, it, sort of, has evolved to ... And I would like to have the situation where we are only relying on consultants to be, if you like, body shops, where we want to do a big thing that involves a lot of people and

we don't want the people all the time. To some extent, that's what we did in 2013 for the asset quality review. We engaged a lot of financial service firms to be doing this loan-by-loan assessment, but in the earlier years of the crisis we drew on advisers like Barclays Capital ... the Department of Finance had Rothschilds, which we had a problem ... Boston Consulting Group. They provided experts who were very broad in their experience and were able to bring new ideas from left field at a time when we needed to consider lots of different issues. We have also used consultants to fill holes in our staff. For example, at the moment, for a particular reason in the enforcement area, we have felt the need to employ additional on one or two big projects which we weren't able to fill the staff locally.

Deputy John Paul Phelan: ...just as a matter of interest, again without getting into too much specifics-----

Professor Patrick Honohan: Well, in that case, it would have been important that they would have legal background.

Deputy John Paul Phelan: I now want to turn briefly again to the discussion that was had earlier with Senator D'Arcy, although I don't have any movies or books with me, but in your statement, you referred to the 19 November letter as being "gratuitous", which is, some might say, a somewhat strong word, in light of the fact, as you said, that discussions had already commenced. Why did you yourself feel the need to go on "Morning Ireland" on the 18th and could it not be said that that might be perceived by some to have been gratuitous itself?

Professor Patrick Honohan: Yes, well, my focus was entirely on creating an atmosphere in the country that the situation was in hand, we were seeking the assistance, the assistance was available to us and that things were not out of control. That was the communication that I felt I needed to make.

Deputy John Paul Phelan: Did you ask the Minister or any member of the Government to make a similar interjection before you made that phone call?

Professor Patrick Honohan: No. The idea to do something like this came to me late in the evening. I had already had this conversation with Brian Lenihan and I knew he wasn't going to say anything about going into a programme. I think he would have expected me to provide the assurances rather than the other way round. As I said, he wanted me to do that a couple of weeks before, so, no, I just thought it was my responsibility to do that and not just hang around and see what happens.

Deputy John Paul Phelan: I suppose the point I am getting at and it's not my own point, it's a point that has been made by politicians and commentators, is that your intervention was perceived by some to perhaps stray beyond an economic intervention, that is was close to the edge of almost a political intervention. Do you think that that criticism-----

Professor Patrick Honohan: I don't think so because if you look at - because this has been published in various places - the text and I think it holds up. I think I made a very explicit statement at one point in that I said: "This is not my call; it's the Government's call." So she asked me what ... Rachel, she said, "So it would be a big loan?" I said, "If it's agreed", so everything was very conditional. What I wanted to say was there is work going on, things are in hand. So I don't think that anybody could construct out of it that I had eliminated the power of the Government to say "No" or to do anything else or to hold out for six months or... They could have done that.

Deputy John Paul Phelan: Can I ask you did it have any immediate effect on the pace of deposit withdrawals, which was part of the reason that you had expressed for making the call?

Professor Patrick Honohan: It had a bit and the spreads on Irish Government paper went in. But then the following, if you remember then early the following week if I am not mistaken - maybe it was the week after - but there was a certain point where the coalition was announced to be at the end. The Green Party said, "Well, we are out of here when all this is sorted out and there's a budget." I think the markets then did not like that. The markets didn't like the deal either; they didn't like the interest rate; they had heard the rumours about the bank bail-in and they discovered there is no bank bail-in, bondholders bail-in; they didn't like that; they thought Ireland had not been given a good deal, which we agreed with, but it was the best we could do. Eventually it was an okay deal, but for that moment it wasn't, so the markets said, "No, this isn't going to work."

Deputy John Paul Phelan: Do you believe that your intervention brought forward the eventual agreement on a bailout deal?

Professor Patrick Honohan: I don't think so, no. I think it was well on its way.

Deputy John Paul Phelan: Can I ask you-----

Professor Patrick Honohan: I, sort of, suspect that Brian Lenihan was casting around for a way of closing the political circle and somehow he would be able to ... There's another thing I said in the interview, I said it could be "a precautionary amount of money". He was hoping, "Maybe, I won't have to borrow it, it will just be precautionary." Of course, he knew that was off the table by that stage. I think he just hadn't found a way of communicating it so it obviously did political damage to him; that's for sure.

Deputy John Paul Phelan: Okay. I want to refer to your evidence from earlier where you spoke about the groundwork being laid by Mr. Lenihan in early October 2010 for the bailout. On the political side or, indeed, on the official side, who was involved in that groundwork? Was it just himself or ... You said that the early groundwork for a bailout was taking place in October 2010. Do you believe that anybody else within the Government would have been aware of such groundwork?

Professor Patrick Honohan: I can't remember exactly where I said that but I think that I'm talking there about the various officials in the Department of Finance, that you've been talking to and will be talking to, also the Central Bank and NTMA. As far as the political communication, my line of sight into Government was almost entirely through the Minister for Finance. I also had access to the Taoiseach but I didn't speak to him all that often, so I assumed that all of that was being fully communicated to the appropriate Ministers in the Government. It seems it wasn't but---

Deputy John Paul Phelan: Okay. My brief closing one ... it's been raised by a number of members of the inquiry with different witnesses about the nature of your role as Governor of the Central Bank and your role as a member of the governing body of the ECB and I just really want to firstly ask you, is there a laid-down protocol as to how the functions work together? And, secondly - my time is up today so I have to put it all together to you - can there be a position where those roles conflict? And I just really want to firstly ask you is there a laid down protocol as to how the functions work together and, secondly, this is ... my time's up, so I have to put it all together to you, can there be a position where those roles conflict?

Professor Patrick Honohan: Yes, there could be. Look, it's clear enough to me that the Central Bank ... you may not realise this, but the Central Bank is set up as ... it is, since the Maastricht treaty and that, the Central Bank is part of the euro system and that ... its main function is to be part of the euro system and setting monetary policy for Europe. And then, in addition, if they don't interfere with that function, the Central Bank can be given other responsibilities like supervising insurance companies, like giving advice to the Government, or to the general public, economic analysis and advice. So this is a separate mandate and so, as Governor, I have the ... my first task is to set monetary policy in Europe, but I also have the separate mandate to advise and analyse the economy and provide advice and it's in that role, that second role, that I can completely be free to tell the Minister for Finance, "The ECB want you to do this, but I'm telling you that the best course of action for you is to do that which is different."

Deputy John Paul Phelan: Have you ever had to do that?

Professor Patrick Honohan: Yes, but so ... but when it comes to setting interest rates for Europe, it could actually be a situation where it would be better for Ireland to have higher interest rates but better for Europe as a whole to have lower interest rates and, in that case, because that is clearly the European mandate, then I'd have to say, "Sorry, Ireland, we're going to have the lower interest rates."

Deputy John Paul Phelan: Thank you.

Chairman: Yes, I just have one question relating to that and I was going to deal with it after the break but, seeing that we're on that topic, I'm just going to take it now.

Professor Patrick Honohan: Yes.

Chairman: Drawing on from Deputy Phelan's question, and I'm sure others may want to ask it as well, is ... do you have a view on the risks, or the potential risks, to Ireland's financial stability given the dual supervisory regime of the ECB and the Central Bank of Ireland because ... and what that might represent?

Professor Patrick Honohan: Yes. So, this is ... it comes to be even more complicated because now the euro system, the treaty has been interpreted to give the euro system the role of supervising the Irish banks. So, supposing there was a situation, which we don't imagine now, where there was a need to resolve an Irish bank and this was going to cause some stress and pressure on Ireland, previously we were the supervisor and we could take account. Will the SSM take account? Well, it'll certainly have the information to take account and I think that's why, in addition to supervision, a separate resolution regime has been set up, and eventually it will be funded and eventually that problem will be resolved. But it is a potential conflict, but it doesn't reside solely in the Central Bank anymore.

Chairman: Okay, with that said, I now propose that we take a short break, to resume again at 4.30 p.m. In doing so, I just want to remind the witness that once he begins giving evidence, he should not confer with any person other than his legal team in relation to the evidence or matters that are being discussed before the committee. With that in mind, I now suspend the meeting until 4.30 p.m. and remind the witness that he's still under oath until we resume. Is that agreed? Okay.

Sitting suspended at 4.13 p.m. and resumed at 4.36 p.m.

Chairman: So I propose that we go back into public session to continue our proceedings

with Governor Honohan this afternoon. Is that agreed? Agreed. And our next questioner is Deputy Eoghan Murphy.

Deputy Eoghan Murphy: Thank you, Chair, and thank you, Governor. I just want to pick up on that area of discussion that we left off on before the short break. And it's in relation to your role then when it actually came to negotiation, when it came to that period of time in 2010. Because you talk in the book, *In Calm and Crisis* ... you wrote a chapter on Brian Lenihan about the Deauville declaration and how, essentially, in terms of market confidence, the die was cast and there was going to be an application for a bailout. So, at that point, is there no turning back in your view? Was that it?

Professor Patrick Honohan: Well, I mean, the Deauville declaration, as markets started to appreciate what it meant, was a departure from tradition, where traditionally, if governments into trouble but they should be able to get out of it, the IMF would come in, provide a loan to tide them over. Now the Deauville declaration seemed to be saying, "Oh no ... if governments are in trouble, first hit has to be taken by the private bondholders and then there'll be assistance." So, actually, Jean-Claude Trichet was very much on top of this, he could see the ... the market dynamic that was going to follow from this because he'd understood all these debt negotiations over years and years and he was very alarmed at this development. It took the markets a few days to realise that, but then it added to ... step by step, other pressures came on and as the spreads on Irish Government debt went up and up, that was the trigger for me to recognise that things couldn't get back. Could they have recovered from the Deauville declaration? They tried to say, "When we talk about this, it'll only be later, not now." But the markets-----

Deputy Eoghan Murphy: It was done.

Professor Patrick Honohan: I don't see it as the only ... the only factor, no.

Deputy Eoghan Murphy: It seems clear that the ECB was in favour of Ireland entering a programme from September of 2010. But, was that ever communicated to you from Mr. Trichet or the board, that we think, the ECB, that Ireland should apply for a programme?

Professor Patrick Honohan: The first time it was communicated in any, sort of, formal way was in ... what date are we talking about, I guess it was 11 November when ... no, it's Friday, 12 November, after the famous discussion in Seoul. But from September, informally, colleagues at the ECB were saying, "Don't you think you should be thinking, don't you think you should be talking to the EFSF people, the IMF?" So there were these informal suggestions, in a collegial way, and I emphasise that. There's a tendency for people to look for demons here and in particular, Jean-Claude Trichet who is a very forceful and definite person, really felt himself to be - and I believe was - a friend to Ireland. When Ireland wasn't doing what he thought they should be doing for their own good, then he got sort of schoolmarmish about it but it was very much ... he felt it was the right thing to do.

Deputy Eoghan Murphy: An ECB team came to Dublin in September but in October ... towards the end of October, the 25th, a team from Ireland went to Brussels. And this was effectively ... from what's in Kevin Cardiff's long statement, the first salvo in the opening-----

Professor Patrick Honohan: Which date are we talking about again?

Deputy Eoghan Murphy: 25 October, an Irish delegation goes to Brussels.

Professor Patrick Honohan: Yes. That's right. I don't think the Central Bank was involved

in that at all. I would have been aware of that meeting but-----

Deputy Eoghan Murphy: He says he goes in ... they attend the first part of the meeting with the Commission and it maintains “for a brief moment the fiction that the ECB was present to deal mostly with banking matters”. So, just commenting on that idea of this fiction, that they were only there to deal with banking matters, the role of the ECB played, were you kept informed of the role that they were taking in the negotiations, and did they overstep the mark?

Professor Patrick Honohan: Well, they are two very different questions. I wasn’t kept very closely informed of what they were doing because ... and, in fact, the governing council, and this is true for all the programmes, the governing council of the ECB, which is my interaction with the ECB machinery, it does not examine the details of the programmes and minimum wages and, you know, social welfare payments and tax rates. None of that is discussed by the ECB governing council. The ECB is somewhat distant from the negotiations but, of course, it’s a powerful figure because it holds the purse strings on the banking system.

Deputy Eoghan Murphy: Mr. Cardiff writes about that being a fiction, that they’re somewhat at a distance, that while they haven’t signed an agreement, they’re there at the negotiations. They are playing a part in those-----

Professor Patrick Honohan: That’s right. And they’re very powerful. Even though they are not providing any money in the loan, they are providing money through another channel through to the banking system. So it’s a very complex relationship.

Deputy Eoghan Murphy: Had they that authority though? Do the ECB officials have the authority to be in the room, getting involved in those, kind of, detailed discussions that are outside the-----

Professor Patrick Honohan: They have the authority but they are required under the ESM treaty, I think it is, now, that these sort of loans require the ECB to be present at it, in this liaison role. So they have been mandated by the European Council and by the political structure to be there. Now is that a good idea or not? I think it’s not a good idea but it is not something that they have simply taken on themselves; they have been given that mandate.

Deputy Eoghan Murphy: Okay. Coming then to the end of the negotiations, and you have written in that same chapter in the Lenihan book:

It was on Friday, 26 November that the Troika staff told Brian in categorical terms that burning the bondholders would mean no programme and, accordingly, could not be countenanced. For whatever reason, they waited until after this showdown to inform me of this decision, which apparently had been taken at a very high level teleconference to which no Irish representative was invited.

We spoke about that teleconference with Mr. Cardiff and we’ve had another evidence, but, what do you mean, “For whatever reason, they waited until after this showdown to inform me of this decision?” Should you have been party to those discussions?

Professor Patrick Honohan: Well, not exactly, but I wonder why they didn’t have me in the room or did they feel-----

Deputy Eoghan Murphy: The ECB?

Professor Patrick Honohan: The ECB, yes - no, the ECB and the troika. I mean, there

was a meeting with Brian Lenihan and I don't know who else was there, Kevin Cardiff and his Department of Finance staff. I just wondered why did they feel that I would be in an awkward position since ... but I wouldn't have been in an awkward position because they knew which side of the table I was on, on the Irish side all of the time. However, I knew fairly quickly afterward but it was a bit odd, I thought, when we had discussed as the Department of Finance, NTMA and Central Bank all along.

Deputy Eoghan Murphy: Sorry, you'd be on the Irish side of the table-----

Professor Patrick Honohan: Yes.

Deputy Eoghan Murphy: -----all the time? That's ... and that's clear to you in your role and that's the role-----

Professor Patrick Honohan: Yes.

Deputy Eoghan Murphy: -----you had taken at the negotiations. Okay. Talking about the interest rate that was agreed because Mr. Cardiff says there was a little less solidarity in the interest rate from the ECB and you said that we didn't like the interest rate on the table in the negotiations.

Professor Patrick Honohan: Yes, now, the ... as I understood it, but the NTMA people might have a little bit more visibility on this because that was really their special bailiwick. The principle that had been adopted by the European lenders was that they would charge the same interest rate as the IMF and the IMF has a set of rules and you just have to look it up. But why is it uncertain and complex? Well, the IMF ... it depends on what multiple of your quota and what would be included with the ... would the reserve tranche be included or not? The loans will be in SDRs ... well, do you want to hedge the risk of SDRs against euros? So it's quite complicated and there were some decisions to be taken by the Irish side and it worked out, in the end, when we swapped into euros at this number, whatever it was, 5.75, 5.8 ... when we started, we thought it was going to be around the five mark, but when the sums were done, it was ... it worked out even higher.

Deputy Eoghan Murphy: This issue of less solidarity, I mean what-----

Professor Patrick Honohan: Well, I mean, the ... as I say, there wasn't any discussion that it was ... *fait accompli* ... that already political decision had been taken in Europe. We will charge the European ... the IMF interest rate. Well, that was a high interest rate because of what a high multiple of our quota we were borrowing from the IMF. We were borrowing really high percentages and I could've imagined that being overridden as it subsequently was, by a sense that, "No, no, this doesn't make sense. We're all in Europe here. Everybody else in Europe can borrow money at much lower interest rates, why are we imposing this very large surcharge?" And that was brought down in June 2011. It would have been nice if that had been ... if that sense had been there earlier on. But Greece hadn't got that so why could we expect it? Both Greece and Ireland got it pretty soon after that, but I don't think there was any room for manoeuvring. The complexity of European negotiations means you can't just say across the table, "And okay, and about the interest rate, are we okay then with it ... you know, take three percentage point off it?" No, there are parliaments, there are 19 governments and so on and so on.

Deputy Eoghan Murphy: My final question then is, in relation to the ... moving to January, February, March 2011, and there was a view in the Department of Finance at the beginning of 2011 that burden-sharing might then be acceptable. There was a view that perhaps the view

of Mr. Trichet, in the ECB, had shifted. Were you aware of that at the time? Did you sense that-----

Professor Patrick Honohan: Well, actually-----

Deputy Eoghan Murphy: -----and what ... where did it come from?

Professor Patrick Honohan: Yes. I actually ... we never committed to not burning the bondholders. We committed to not including the burning of bondholders in the programme but we never signed any document that said, “We will never burn bondholders.” So, it was still there for attitudes to shift and I remember saying to ... even before the election, saying to Brian that, “Well, there’s a big payment coming up for Anglo, have you thought about doing something on that?” And he said, “I can’t go against the whole of the G7.” He thought it was politically, internationally politically inconceivable. So that one went. I think it was subsequent to that that there ... that the Department of Finance, and they had more visibility on this than I had, had a sense that the Europeans were weakening on the issue of bail-in, especially for Anglo and INBS. Now, I ... also I wrote to the Minister, and I think it’s in evidence that was provided to you by the Central Bank. I wrote to the Minister, the new Minister, Michael Noonan, offering my advice on this matter, and I said, “Look, the ECB are firmly against, for going-concern banks, but it is possible that they would accept a bail-in for the ... for Anglo and INBS.”

Chairman: Final supplementary there, Deputy.

Deputy Eoghan Murphy: So did you give that sense to the Department, that burden-sharing might be acceptable then?

Professor Patrick Honohan: From what Kevin has said, I think he picked up ... well, maybe that ... maybe I was the only route. But I think he may have got some independent, because he was meeting, we were all meeting the officials of the troika, including the officials of the ECB. He could have picked it up independently, I think he probably did.

Deputy Eoghan Murphy: And just to clarify a point, you said all of the G7 were against burden-sharing, but weren’t the UK in favour of it on that teleconference call?

Professor Patrick Honohan: Okay. Ireland is not a member of the G7. We hear at second and third hand what happened at the G7 conference call, so I’d only be repeating hearsay to say what countries were in favour.

Chairman: Thank you very much, Deputy. Senator Sean Barrett. Senator, ten minutes.

Senator Sean D. Barrett: Thank you, Chairman, and welcome back, Governor. You, in your presentation on page 9, you model the cost of our troubles in this regard as €100 billion, compared to how the economy would have performed “in the presence of [a] prudent pre-crisis banking practice”. From watching it, what do you think happened to Irish banking? I think, you know, a most conservative, straight banking system, which ended up with the highest rate of bailout, I think after Iceland, in the world. Did you see in your studies what was happening in Irish banking?

Professor Patrick Honohan: I think what happened was, first of all, they had never any experience for 100 years of any big banking problem, so there was something small in the 1970s. So you’d just ... I’d say every banker ... it wasn’t part of their ... the potential that there’d be bankruptcies and they’d all lose their jobs. They may have thought, “Well, we’re taking some

risks here and things might go wrong, we might have a few years of bad profits and the stock prices might go down.” But they just couldn’t imagine, from the long history of stability, that anything really bad could go wrong. Secondly, everything was going so well in Ireland. We had the Celtic tiger period, people were flooding into the country, they would need houses and money is so cheap now that we’re in the euro, it costs nothing. It makes ... so there was a kind of myth, a foundation myth of this bubble, which lots of people bought into. And then they thought, “Oh, and anyway, if anything goes wrong, well we have super risk control mechanisms. We have hired people with maths PhDs, and they have complicated models which show nothing can go wrong and we know...”, and then they look across to USA, which was shovelling out money into mortgages. They look at Britain, shovelling out money into mortgages and it seems like, well, this is the way to go. So the just ... those were the influences that drove them. Why did they not dig deeper? I don’t know. They all ... you’ve had them here, and they all feel bad about it, because they can’t really understand why they didn’t have a second guess and that nobody came to them in the way that says, look, there a number of checks you should be doing here and if the regulator is not doing it, you better be doing it. And anyway, they should have done it anyway, even if the regulator wasn’t doing it.

Senator Sean D. Barrett: In relation to the world as we plan it ahead, Governor, how would we decide what’s the optimal rate of credit growth in an economy like Ireland? Obviously something below 25% per annum, but is there a formula which you’ve come across in your studies?

Professor Patrick Honohan: Well, the formula for any bank is not to grow too fast because you’re not going to be able to control the credit, and if you’re getting-----

Senator Sean D. Barrett: Yes?

Professor Patrick Honohan: -----if you’re getting borrowers like that, they’re borrowers that are being refused elsewhere etc, etc. So there’s a too high, but is there a too low? I think a planned economy, could think of it in those ways, we work in a market economy and it’s an outcome, an outcome of decisions taken on a good assessment of risk.

Senator Sean D. Barrett: Are we protected now against sectoral concentration in construction and in commercial property, in particular?

Professor Patrick Honohan: Well, it certainly is not happening all that much. Actually, the banks are still very concentrated in ... in the old kind ... that’s all they do. But, actually, around the world, that’s all they do - they lend money to ... to personal sector to build houses. By the way, on those sectoral concentration limits - and there was a mention of them earlier on and why they came in - I checked, I said, “Are they still in force or are they not? You know, give me a clear answer.” And the answer is, they are still in force. None of our local banks are violating them at present. How could that be, when they’ve got all these mortgages? Because mortgages, personal lending, were not included in the sectoral limits. So ... but, in fact, there’s an overlay of many other controls, so that even if there’s some banks doing offshore business that are in violation of that - technical violation - they are being ... they are being told, “It’s okay because we have this other check on you”.

Senator Sean D. Barrett: If we decide that X - we’ll use that - is the optimum rate of growth and credit, how can we separate that X in allocating it to the pillar banks and non-pillar banks? Would your successor have to intervene at that level?

Professor Patrick Honohan: No, I know ... I think this is ... as I say, we could have a State-controlled planned system of credit. I would not recommend it. Then you would have to answer those questions and there isn't really an established methodology for it. Explaining and interpreting the growth of credit is something that has been quite difficult for, as you can imagine, I know, that ... econometricians to do, because sometimes credit grows because there are good opportunities for the future and people want to borrow for that, and sometimes credit grows because there are bad situations happening and firms have to borrow to fill holes in their in their balance sheets.

Senator Sean D. Barrett: How do we compare, in regulatory regime and procedures, now to international comparisons? And, I suppose, *The Economist* raises Canada, Australia and Singapore as places which regulated banks and didn't get into the kind of difficulties that other countries did.

Professor Patrick Honohan: Well, I hope they're not the next ones. Only being completely facetious but where we-----

Senator Sean D. Barrett: They may send for you, of course, in your career change.

Professor Patrick Honohan: But, well, there are these international standards. We've been assessed against them again. We have the ... you saw the - and it's in the documents - the latest FSAP report on ... or not FSAP, but the IMF's ROSC on banking, they found four things that they wanted us to fix, including more independence for the Central Bank, by the way. Whatever. So we are constantly being assessed and reviewed against best practice but there's nothing to compare with common sense and making sure that you understand what you know and what you don't know.

Senator Sean D. Barrett: Openness and communication and nobody afraid to speak up. Can that survive when you depart, because we've had witnesses here who very obviously don't believe in openness and communication? And with you being absent from the principals in future, I just would be worried about that. It's not common yet in the Central Bank, the banks themselves or the Department of Finance.

Professor Patrick Honohan: Well, I think we are moving to a more open environment. It's an expectation now. Previously, there wasn't an expectation and I think that if senior managers in the Central Bank, if directors in the Central Bank, argued for less openness and less transparency and less challenge, there would be concrete policy decisions to point to that say, you know, "Why are you moving against that?" I think we ... okay, you can never be sure that ... culture change takes a long time and it is about culture change.

Senator Sean D. Barrett: In the list of mortgage misdemeanours, you didn't name the individual banks. Doesn't that contrast with the UK, where a man was deprived of his knighthood and the fines were imposed on named banks? Is this light-touch regulation?

Professor Patrick Honohan: Actually, in my report ... I hope you're not talking about the CCMA, but, in my report, the banks were mentioned X, Y, Z and A, B, C. By the way, Senator, you believe that you have the code, but it's very complicated, because every time bank A comes up or bank X comes up, they're rotated, so the same bank isn't identified. Originally, I had all the bank names there. The legal adviser to the bank said, "You'd better not". I thought the banking inquiry would ask me to provide a key which, under 33AK, I would, of course, be happy to do and maybe it wouldn't be ... I don't mind doing that but I don't think it really mat-

ters because we know there were faults everywhere. I would be quite comfortable about being open about that. Some things that are confidential at one moment, five, six, seven, eight years later are not confidential. But that's a very difficult judgment call.

Senator Sean D. Barrett: The Chairman reserves the right to ask that question.

Chairman: Just one question there, Senator, please.

Senator Sean D. Barrett: When you were announcing your retirement, you seemed to express the view that the next Governor should not be a person like you which ... could you describe the ideal next Governor? What you had in mind when you said in that?

Professor Patrick Honohan: No ... well ... I didn't really want to imply that. I wanted to imply that the ... there are certain activities which were crisis-related activities which I rolled up my sleeve at and got very much involved in and now the environment is different and I could roll up the sleeves even further or wear different sleeves and start a new period of time. And maybe I wouldn't be as good, I don't know if I'm any good, but I'm not sure I'd be playing to my strengths, put it like that, in the newer environment. So, that ... I would do my best. The newer environment would be where, you know, for example, Deputy Higgins is saying what about making sure we know everything about the non-banking decisions and so forth and that's very detailed work and meticulous and, you know.

Senator Sean D. Barrett: Did you imply an administrator rather than an academic as the next Governor?

Professor Patrick Honohan: Nothing wrong with an academic-----

Senator Sean D. Barrett: Hear, hear.

Chairman: All right, good point to conclude on, Senator Barrett. Senator O'Keefe.

Senator Susan O'Keefe: Thank you, Chair, as a non-academic. In 2002, Mr. Honohan, you said you were observing about the change in legislation that created the division in the Central Bank and the regulator and you said, "The division of responsibilities contain the hazard of ambiguous lines of responsibility especially in the event of a systemic crisis." So, I'm just wondering whether now you believe that the changes ... the regulatory structure introduced in 2010 has addressed the ambiguity of responsibilities or is there more work to be done?

Professor Patrick Honohan: No, I think that very complex structure that was put in place ... you could quite clearly see the danger that exactly happened. I didn't, obviously, foresee it but it was obvious that this structure did not make sense. But it wasn't the cause of the crisis. They have the powers and so on and so forth.

So, we have now ... we have a system which is still quite complex and, in fact, has become a little bit more complex because of the euro system, the SSM role, and you can see them struggling in the euro system ... us struggling with quite similar issues. The supervisory board being separate from the governing council but in that case they have protected it. The governing council takes all the final decisions. The supervisory board, which is the one that Cyril Roux sits on for Ireland, they do all the donkey work but it's not as in our former structure here that they didn't have to refer to the Central Bank board. They do in the ECB.

I think we've ... one issue which I've been very attentive to is that because of the SSM's rules, the risk of a barrier in information between the banking supervision and the rest of the

Central Bank re-emerged, so we're being very careful that we collect the information in such a way and under such authorities that the necessary information can still flow to the Central Bank.

Senator Susan O'Keeffe: In Vol. 3, page 13, there is a letter written to you by Mr. Michael Noonan, the Minister for Finance, and it refers to ... it's a letter about the IBRC and the prom note. What I just wonder is, it says:

As you aware a proposal, to address these issues, has been prepared and presented to the Economic Management Council [EMC]. The Council has given approval for the submission of the proposal to the ECB for assessment and for consideration [...] I request, therefore, [that you do that].

And I'm just wondering whether that's the line of authority now. Is it to the economic management council? Is it to the Minister for Finance? Is it to the Cabinet?

Professor Patrick Honohan: So, the reason this letter was written. It's not as if it was the first time I'd heard of this proposal.

Senator Susan O'Keeffe: Of course not.

Professor Patrick Honohan: The reason was this ... I suppose ... I mean, the Economic Management Council ... it is a Minister is appealing to the authority of the Economic Management Council. He's not saying, "Don't take it from me, take it from the Economic Management Council." He is presumably using this letter with the Government. So, I'm not sure I should speak to why he is doing that. He is requesting me, because I am somebody who deals with the ECB, to do something on his behalf. But he is also saying that it has a further weight, not just the Minister for Finance's weight, but it has the weight of the Economic Management Council. That is how I have interpreted that.

Senator Susan O'Keeffe: Okay, would you routinely then get letters of this kind?

Professor Patrick Honohan: Never got it. Never got a letter referring to the Economic Management Council. Never-----

Senator Susan O'Keeffe: Never?

Professor Patrick Honohan: Never before or-----

Senator Susan O'Keeffe: Never since?

Professor Patrick Honohan: Never since, I don't think so.

Senator Susan O'Keeffe: So this was the one, okay.

Professor Patrick Honohan: They must have decided, the lawyers must have decided they wanted this.

Senator Susan O'Keeffe: Okay, fine. Let's go back to the BlackRock thing if we may. You kindly said you had checked-----

Professor Patrick Honohan: Yes-----

Senator Susan O'Keeffe: -----over lunch and you might just indicate what it is that you checked and then we can just go over.

Professor Patrick Honohan: I checked the contract-----

Senator Susan O’Keeffe: Yes.

Professor Patrick Honohan: I thought I was going to be able to look at it here but maybe if I can ... I checked the contract and sure enough, not very surprising, there is confidentiality clauses in it. I’ll give you the sense and the gist of it.

Senator Susan O’Keeffe: We can probably take your ... okay, when you are ready, in your own time.

Professor Patrick Honohan: But the contract, here we are. Okay so there is one section in the contract. Section six, next page: confidential information: all information regarding this agreement, parties, business and their subsidiaries and affiliates, the client data, any pre existing IPR, blah, blah, blah, shall be kept in confidence by each of the parties hereto. These confidentiality obligations shall not apply to information lawfully in the public domain. BlackRock acknowledges that it has been notified of its obligations under Section 33AK, as amended, and it undertakes to inform all respective employees, servants, agents and third party contractors.

And then it says in another section of the contract which is before that. It says, while BlackRock does not make a market in the assets covered by this agreement, BlackRock or its affiliates, for itself or on behalf of its clients, may own positions in such assets or the individual securities underlying them, whether long or short and BlackRock and its affiliates, for itself or on behalf of its clients, shall not be restricted from transacting in them. BlackRock shall ensure the precaution to safeguard against conflicts of interest including, but not limited to Chinese walls, shall be put in place internally.

So this apparently is the sort of standard contract that one would put in to protect against that. Is it a sufficient protection? Some people might argue that but it’s as best as we can do.

Senator Susan O’Keeffe: And just remind us, the contract that you had with ... the Central Bank had with BlackRock had was, I think you said it was you paid quite a lot of money, was it €15 million or €20 million did you say?

Professor Patrick Honohan: Well there were, some things were ... they had subcontractors as well, so they didn’t get all that money.

Senator Susan O’Keeffe: But there’s-----

Professor Patrick Honohan: But the whole thing cost, well it was all published in our annual report. But I think it’s €20 million or €30 million I think.

Senator Susan O’Keeffe: €20 or €30 million-----

Professor Patrick Honohan: Is it €30 million? Yes, okay.

Senator Susan O’Keeffe: And so by March, in March 2013 they were still, they were coming back to do another set of stress tests, isn’t that correct?

Professor Patrick Honohan: Yes, we teed them up to do .. because the troika, this was one of their bad ideas. They said, ‘‘You’ll do a stress test every year’’, and I said, ‘‘This is not a good idea’’, and we managed to get them to not do that. Why was it not a good idea? Because the situation had not clarified any more and if they had put a stress onto a stress and tried an-

other stress, there would be endless amounts of Government money going in. So we managed to get them to postpone the stress test until the very end of the programme. But we were very far into it and we engaged BlackRock to do other work in, I guess, well it might have been the end of 2012, was it? Some time like that and they did some work and it was useful and interesting and valuable for us going forward. But then we said, “No, we are not continuing with this because we are not continuing with a stress test of this type.” And we did a different, more limited exercise at the end of 2013 and then the SSM stress test in 2014, we didn’t engage BlackRock for that.

Senator Susan O’Keeffe: Okay, so given in that year they did take a stake in Bank of Ireland, at 3%, would you now-----

Professor Patrick Honohan: Now, in fairness to them, I don’t ... I think their investment arm ... they are a huge company and their investment arm thought, “Oh, yes what about those Irish ... Ireland seems to be coming well ... Ireland, we will take what is it? Oh, Bank of Ireland, let’s take 3%.” You may think 3%, that’s a huge ... but they are just a huge investment firm and I doubt very much if they violated the terms of that contract and said, “Oh, let’s check with the guys who know in Dublin”, no.

Senator Susan O’Keeffe: I was actually going to ask whether or not in future, one might write the contract differently?

Professor Patrick Honohan: Well, I ... no, apparently this is the way you protect against that. Now if somebody wanted to and I don’t think for a minute that they would. But if somebody wanted to say, “We will use all that information”, would that be a very robust protection? Well what can you do if people don’t want to? But I don’t for a minute suggest that they did.

Senator Susan O’Keeffe: If I could go ... if I might go back please to the RTE radio interview. Just to check, on Tuesday, 16 November, Wolfgang Schäuble it is understood and reported that he has asked Mr. Lenihan to announce his application for aid after the meeting that had taken place that day and that Mr. Lenihan had said no, that he didn’t want to be put ... he said “I wouldn’t participate on that basis; my Government had the sovereign right to decide how it conducted these discussions.” Then I understand from what the evidence you have given here today, that you had a phone call with Mr. Lenihan and you said he was cross, he didn’t understand “why are they trying to rush me” and you said that you thought it was a good idea that he announce. Is that correct?

Professor Patrick Honohan: Yes.

Senator Susan O’Keeffe: So Mr. Schäuble had asked him to announce, you asked him to announce, and he said “No”?

Professor Patrick Honohan: It is not announce, I asked him, or I suggested that it would be a good idea to apply, not to announce, it wasn’t about announcing, it was about applying. They wanted an application. That’s what they ... only with an application could they continue to negotiate it. So the discussion in Brussels wasn’t about an announcement, it was about an application. I made an announcement about the discussions going on which were common knowledge to many, many people. I did not announce an application because there hadn’t been an application and wasn’t until the following Sunday.

Senator Susan O’Keeffe: Okay, so when ... when you went on the radio - I have the transcript here:

Rachael English: And you can confirm that they will be giving us a loan?

Patrick Honohan (Governor of the Central Bank): Well if it's agreed. If it's agreed of course yes.

Rachael English: And when you say if it's agreed, I mean why else would they be here?

[And then you go on and say there's an expectation and so on.]

Rachael English: So it is your understanding then, that there will be a loan, and that we will have to accept it?

Patrick Honohan (Governor of the Central Bank): It's my expectation that that would happen yes absolutely.

[And then at the end she says] Listeners are getting on to us, they're looking for absolute clarity here.

[And you said] Look it's not my call. It's the Government's decision at the end. It's my expectation that this [is] what is definitely likely to happen. That's why the large technical teams are sitting down discussing these matters.

So I'm wondering, Mr. Honohan, how would it have been possible for any member of the Government at that point to come along behind you and disagree with that, which you have suggested earlier?

Professor Patrick Honohan: I think it would have been very easy for them to do so, if they wanted to. But they didn't want to. They wanted to have a programme, they just couldn't imagine, or the Minister and the Taoiseach, whoever knew about it, the whole machinery was moving in that direction. But they could have said "No, no". I mean ... I don't want to ... there are other countries where we have seen lengthy debates - when somebody says I think there will be a programme and other people say there won't be a programme, there will be an agreement, there won't be an agreement, this person thinks there will, that person thinks there won't - going on for months and months. So, I don't think if the ... if ... supposing the troika had said ... had suddenly presented a new demand, and you had already heard from I think Kevin Cardiff's evidence of suggestions in the background, that other things might have come into play ... I don't want to talk about but he's mentioned ... supposing that had come onto the table? I think the Government would have said, "This is not what we're in for here, no, no, back away; we're not doing this."

Senator Susan O'Keeffe: But, do you accept finally-----

Chairman: Final question, Senator.

Senator Susan O'Keeffe: Finally, Mr. Honohan, do you accept though that really on that morning, you did pretty much copper-fasten the fact that there was going to be-----

Professor Patrick Honohan: It was already copper-fastened. It was already copper-fastened, it was a done deal by the day before, that was what was going to happen. They could have gone out of it but the whole momentum was moving in that direction.

Chairman: Thank you Senator. Senator Mark MacSharry.

Senator Marc MacSharry: Thanks very much and thanks Governor again. Just on that

point so, what was the impact among colleagues in the ECB after you had done this? Was this something they were pleased about, did they say “Well done Governor for doing that?”

Professor Patrick Honohan: Yes, I wasn’t very comfortable about that because there was a sense of “Oh now, everything’s going to be all right now”, and because ... and I felt, well I’m doing this for the stability of Ireland and for reassuring people in Ireland, not to appease some people around the table. There were one or two people who thought, you know, doing it for us. No, I mean that would be ridiculous, you know ... how could you have any respect for yourself, if you were doing it because there was some pressure around the table?

Senator Marc MacSharry: Was that a reasonable insinuation or complexion for people at home to draw? That the Governor was over for the ECB meeting and pressure was applied and off he went-----

Professor Patrick Honohan: I think it’s ... I can understand why people did it and it puts you in an awkward position. In this case, the interests of the ECB and the interests of Ireland were aligned. They are not always aligned.

Senator Marc MacSharry: Can you describe the respective roles of the Irish authorities in the shaping of the implementation of legislative change in respect of bank regulation? And how has this changed during your tenure?

Professor Patrick Honohan: Well, I don’t know what ... legislation is the responsibility of the Government. The drafting of financial legislation is largely the responsibility of the Department of Finance but in the case, for example, of bankruptcy legislation it’s the responsibility of the Department of justice, and we’ve been very much involved in ... so, the role of the Central Bank is in advising, in suggesting legislative changes that seem to be needed to deliver our mandate, and in helping on matters which might not be in our mandate, but for which we have expertise. For example, in bankruptcy legislation, we were asked ... bankruptcy legislation in considered, in many financial circles, to be quite aggressive and anti-creditor legislation. And, of course, they wanted to know is the Central Bank on board for that. And we said “Yes, we’re on board for that, even though it is in that direction.” And then so that way of technical advice. The Attorney General and parliamentary draftsmen of course had ... they were advisors to the Government on making sure the legislation hangs together, makes sense, is coherent with other pieces of legislation, is constitutional and so on and so forth. But I’m not an expert on that.

So the role of the Central Bank is to advocate for some legislation and to help in the technicalities. A lot of legislation is transposition of European directives. Directives set out what needs to be achieved, but the Irish legal system is a particular, and the legislation has to be designed coherent with the rest of Irish legislation. So, we would have experts, sometimes we second them, sometimes they just work with committees to try to make sure that that legislation gets transposed promptly and effectively.

Senator Marc MacSharry: And on the issue of mortgage arrears, which you have highlighted as an issue that still lingers as something that more needs to be done on, while there’s no legislative change during the period, there’s codes of conduct and so on, what agency, in your tenure, has provided the leadership in what ought or should be done with regard to that issue?

Professor Patrick Honohan: Well, I would mention the bankruptcy ... or, insolvency legislation. This is a big part of dealing with the mortgage arrears, and I’ll play the role that we had there. We had a number of powers in the Central Bank and used them. Firstly with the code of

conduct on mortgage arrears, that's under consumer protection power. And then we used the ... our powers under prudential supervision which, in ways, are more ... they're ... we've greater powers in that case and we use them. They might have had the side-effect of accelerating the resolution and easing the situation of borrowers, but they had ... the principle effect was to make sure that the banks would sort their problems promptly, because we felt that they were placing ... they were ... they were prolonging the risk situation by not dealing with the mortgage arrears promptly. So, we used our prudential powers to oblige the banks to meet certain targets. We had already used, not formal powers, but we had already used informal powers to get them to ramp up, dramatically, their capacity to deal with the mortgage arrears situation. So we felt we were taking the lead to that extent, in using existing legislation.

Senator Marc MacSharry: Okay. As opposed to Government?

Professor Patrick Honohan: Yes, because the legislation was there and ... yes.

Senator Marc MacSharry: Okay and just on that mortgage arrears issue, was the engagement with banks and the drawing up of insolvency legislation and the efforts to deal with this issue, did it deal predominantly with simply telling banks "sort out your problem", or did it take any position in defining what forbearance should look like or what tools should be used, what suite of tools should be used by individual institutions?

Professor Patrick Honohan: To some extent we did that, and it's sort of innovative. It's not what's done in other countries and people are looking at it, not always favourably, many people outside thinking we're too sympathetic to the debtor. By defining this sustainable solutions and defining what would be sustainable in terms of a restructuring. We also, of course, when they can't find a restructure, there is the recourse of the courts. But, we defined what sustainable would look like and we talked very much about the split mortgages, which had been used, actually ... people said "Oh they'll never use them", but actually they're using quite a lot of them there, I think, there should be more use of that.

Senator Marc MacSharry: Is there data on the amount of use?

Professor Patrick Honohan: Yes, that is published on a regular basis.

Senator Marc MacSharry: You say it is quite a lot, is it?

Professor Patrick Honohan: It is quite a lot, it is growing, yes.

Senator Marc MacSharry: How does one underwrite a split mortgage?

Professor Patrick Honohan: Well, I mean, you have to make a judgment on the prospects of the particular individual.

Senator Marc MacSharry: Is the criteria for that in any way determined by the Central Bank?

Professor Patrick Honohan: Let me say, what we tried, what we had the ambition earlier on was to say "Look, let's have a mechanical rule, let's see if there is a mechanical rule which could allow the banks to sort the people who can pay from the people who can't pay and give it a standard haircut." We couldn't find a mechanism. All mechanisms which we designed were going to involve too many additional losses and therefore additional burdens on the taxpayer going to people who didn't need the help. So it has to be judgment case by case. So how do you underwrite it? Underwriting a loan is an art rather than a science.

Senator Marc MacSharry: But there is nothing say, throughout the period, to have told the bank, “Look, focus more on the consumer.” It’s just get your money as quick as you can and get on with it.

Professor Patrick Honohan: Well neither that but these banks are stand-alone entities, they are subject to prudential regulation and consumer protection legislation. They are not subject to mandate from the Central Bank to give away money. That’s not, we don’t have that power. Probably the constitutional issues would even arise but nobody should expect the Central Bank to do that because the Central Bank has not been given the mandate to decide who gets to not repay their loans.

Senator Marc MacSharry: Should they have had input in that regard?

Professor Patrick Honohan: No I don’t think so, I think it would be ... how could we do it, 100,000 cases? It is an interesting question though.

Senator Marc MacSharry: Yes it is.

Professor Patrick Honohan: If it had been a smaller problem and the Government wasn’t under such financial pressure, I could imagine a solution which would have been a little bit more expensive but would have sorted the problem earlier.

Senator Marc MacSharry: Could more be done by yourselves in the Central Bank in that regard, in terms of the design of tools and who is getting looked after and who isn’t, to put it crudely?

Professor Patrick Honohan: We’re out of ideas.

Senator Marc MacSharry: Okay. Just two other very last questions. Did the Minister share your opinion of the urgency of entering the programme?

Professor Patrick Honohan: Yes I think so. Well, I think he did. I think he saw that the writing was on the wall and he was trying to find a way of getting something better somehow.

Senator Marc MacSharry: Did you feel he was battling other political entities either within his party or the Government to try and-----

Professor Patrick Honohan: I think he was, no I think he was truly trying to get to a situation where he had a package that could be welcomed by his political colleagues and the general public. There probably wasn’t any such package.

Senator Marc MacSharry: Finally, during the period from when you took over, what was your sense of the performance of the Taoiseach and the Minister of Finance? For example, was it assured, confident, in control or did you have a sense that it was incoherent and disorganised? Indeed can I just put a second point to that; what was the impression of your colleagues in the ECB and around the meetings over there, of the performance of those same two gentlemen and their Government?

Professor Patrick Honohan: Well, I suppose I am obviously much more close to the Minister for Finance, Brian Lenihan, and I think he was very much admired by his colleagues at the Eurogroup, admired and liked by Jean-Claude Trichet and others. That is certainly ... I have less visibility at the ... what people, you know, the European Council, I didn’t have any visibility into that for the Taoiseach. But I would say domestically, to the extent that I was at a number of

meetings with the former Taoiseach, Brian Cowen, I found him to be a very business-like and effective chair and in charge of any meeting that I was at, courteous, in command of the situation and that was what I saw. I know that ... I think there were a number of hard things that had to be ... not hard things that had to be said, just bad news that came out from time to time. The Quinn event, when we had to intervene in the insurance company and despite ... that must have been a body blow to the Taoiseach. And, despite that, he was very conscious that this is a very serious problem, I'm ... and I ... you know, and he sometimes doesn't get that image but I found him to be businesslike. But my main dealings were with Brian Lenihan, I mean, I only had a very few one-on-one meetings with the Taoiseach. It was mostly in environments in which he was the chair.

Senator Marc MacSharry: Thank you.

Chairman: Thank you, Professor Honohan. Thank you, Senator MacSharry. Deputy Michael McGrath.

Deputy Michael McGrath: Thank you very much, Chair. Governor Honohan, do you judge the IMF country reports and OECD reports as an important information instrument aid in banking regulation, banking supervision and financial stability issues?

Professor Patrick Honohan: So, the IMF reports sometimes are about the economy at large and so on and so forth and sometimes they provide useful information and they assemble the information in a very orderly way and sometimes I do learn a bit from them - "Oh, I see, yes. No, that's a good point, I hadn't seen a note in that way." So I think they are valuable. They ... we then have the particular reviews of regulatory practice, which were done sector by sector. We had the banking one. I think that's included in the documents that were provided, so it's, obviously, one of interest. We didn't ... and I mentioned that there were four things they wanted us to fix. We didn't agree with two of them, but we're doing them anyway. And maybe we didn't agree with three of them but, you know, they're serious people. It's ... you don't ... there's room for professional disagreement on a number of things and we know in the past they didn't catch everything in Ireland - far from it in 2006 - but that doesn't mean we shouldn't listen to them.

Deputy Michael McGrath: Okay. Did you-----

Professor Patrick Honohan: OECD, yes, yes, also useful. More of economic advice generally, rather than, you know, very specific and detailed.

Deputy Michael McGrath: Did you get the figures for the ELA exposure?

Professor Patrick Honohan: Yes, I did. So, if we talk about the total exposure of the ELA, plus normal operations, it rose from €62 billion at the end of August 2010, and I'll give it to you month-by-month then: to €100 billion at the end of September; €109 billion at the end of October; and €131 billion at the end of November. Now, the ELA component of that, it was €12.7 billion at the end of August; it went to €26 billion at the end of September; €33 billion in October; and €45 billion at the end of November. The peak day for exposure of the euro system and the Central Bank to the Irish banking system was actually 24 February 2011, when it reached ... instead of end of November, I told you, €131 billion; 24 February was €153 billion. Now, the reason it spiked on that day, because that was the day when the deposits were shifted from Anglo Irish Bank to the purchasing bank so it was that manoeuvre around that.

Chairman: This is billions now, not millions?

Professor Patrick Honohan: They're billions, yes.

Deputy Michael McGrath: They sure are.

Professor Patrick Honohan: Yes, they are, yes. So, I think you can see why Jean-Claude Trichet ... especially the ELA, because there's always a sort of, "Oh, ELA is very bad. That means they're not really normal collateral." You can see those numbers doubling in September and going up again. You can see why he was saying, "Wow, when is this going to stop?"

Deputy Michael McGrath: So, towards the end of November 2010, the total exposure of the ECB to the Irish banking system was €131 billion-----

Professor Patrick Honohan: Yes.

Deputy Michael McGrath: -----of which ELA was €45 billion?

Professor Patrick Honohan: That's correct.

Deputy Michael McGrath: Was that effectively State guaranteed, Governor?

Professor Patrick Honohan: Yes, it was, it was.

Deputy Michael McGrath: The €45 billion or the €131 billion?

Professor Patrick Honohan: No, just the €45 billion.

Deputy Michael McGrath: €45 billion.

Professor Patrick Honohan: Now, when I say "guaranteed", it wasn't a good enough guarantee, I'd say, for the ECB to be really comfortable about it, but we had various ... we had securities from the various banks and, by that stage, I think they were all in ELA. They were good quality securities and we took them at ... we allowed them only a very steep haircut on their nominal value, so there'd be bundles of loans. But that would be the first line of defence for us but, in addition, we had a letter from the Minister for Finance. And this had been a practice that was established before I arrived and it would have been in anticipation of an ELA. It was a decision that had been taken in 2007, how they would do this thing - that the Minister would write a letter saying that it would be his intention to seek Government approval and Oireachtas sanction, or whatever it was, for the moneys, if it turned out that they failed. Now ... so, it was a ministerial guarantee, but it wasn't binding; it wasn't part of Ireland's debt. It wasn't binding in the same way. It was like a political guarantee rather than a legally binding one.

Deputy Michael McGrath: But the sovereign was standing behind-----

Professor Patrick Honohan: It was-----

Deputy Michael McGrath: -----the ELA?

Professor Patrick Honohan: The Minister for Finance was standing behind ELA, yes. And that's quite important. And I was very conscious of that because every bit of ELA you were giving was putting the State on the hook.

Deputy Michael McGrath: Did you say earlier, Governor, that the ECB would never have withdrawn ELA?

Professor Patrick Honohan: I was talking about September, would they have given this

large amount of ELA in September 2008. Would they ever have withdrawn ELA? Well they ... later, in 2010, 2011-----

Deputy Michael McGrath: Yes.

Professor Patrick Honohan: Jean-Claude Trichet sent the letter. He said, “Unless you go into the programme, we’ll withdraw ELA.”

Deputy Michael McGrath: Yes.

Professor Patrick Honohan: Supposing there had been a turbulent meeting of the Government here on that Saturday or Sunday saying, “No, no we will not go in, never”, supposing there had been that and he hadn’t made the application on Monday, would Jean-Claude Trichet have withdrawn ELA on that occasion? I don’t think so. But he-----

Deputy Michael McGrath: So it was a game of chicken.

Professor Patrick Honohan: It was a game of chicken but ... not real ... a game of chicken, it’s you know, you either fall over the cliff or you don’t fall over the cliff. But it would not like that, because the ECB could say, “Well, this is a very bad situation and so as a result of that we are going to apply this additional rule, this additional cost, this additional, exceptional, supplementary burden”, which they have the right and power to do. So, unfortunately for Ireland, there always is the potential in this situation for a graduated pressure, and this is something that is not often recognised. People say, “Oh, they would always have given ELA.” Probably they would, but maybe on terms that would make it very, very uncomfortable and costly.

Deputy Michael McGrath: On the evening of 18 November, when you stepped out of the informal gathering of the ECB, was it a meeting-----

Professor Patrick Honohan: Yes.

Deputy Michael McGrath: -----or was it an informal-----

Professor Patrick Honohan: No, yes.

Deputy Michael McGrath: -----gathering. You stepped out to make the call to-----

Professor Patrick Honohan: Yes.

Deputy Michael McGrath: -----Minister Lenihan, presumably you relayed the contents back to your colleagues when you went back in.

Professor Patrick Honohan: Well, I’m not sure that I did actually, because it was none of their business really.

Deputy Michael McGrath: Okay. But did anyone suggest to you, within the realm of the ECB, that you should consider making a public statement?

Professor Patrick Honohan: No, no. This was all my idea. I did ... I remember one of the people I spoke to asking, “Will you contradict me if I say” ... he said to a journalist ... claimed that he had been behind the phone call; quite the contrary. He almost scuppered the idea of a phone call by not giving me that ammunition.

Deputy Michael McGrath: You said, Governor, that there was excitement and alarm at

ECB level on 18 November. You made contact with Minister Brian Lenihan, the following day you made the statement on “Morning Ireland”. On 19 November, Mr. Trichet issued the infamous letter to Brian Lenihan, which contained what I think can only be described as a very direct and explicit threat. Is it the case that the ECB, come hell or high water, was determined that Ireland would get into a bailout?

Professor Patrick Honohan: I think that Jean-Claude Trichet, and the other members of the governing council, could not understand why Ireland had not already applied for it’s own sake. And yes, they wanted it for the stability of Europe as well, but they couldn’t understand why Ireland wasn’t doing it for it’s own sake. In fact, Ireland was doing it but, you know, it just hadn’t taken the formal application step. So I don’t think it was ECB versus Ireland; it was ECB saying, “Come on, Ireland, come on, you know you have to do this.” It’s a bit different.

Deputy Michael McGrath: Yes.

Professor Patrick Honohan: And that’s why I think Jean-Claude Trichet said to the group, you know, when you were in the Royal Hospital, he was saying, “I only gave advice.” Yes, but you see he has to stay within his mandate. It’s advice, it’s saying, “I’m operating a system here where we are absolutely on the limit of what we can lend you and so it’s my responsibility to tell you that you’re at the limit, so you better go in.” Now, then he gives helpful advice about the measures that should be taken in the programme which, I think, those too are gratuitous. But that’s what central bankers do all the time to governments, they tell them, you know, “You should have a better budget and it should be like this.” I try to avoid doing that, you know, expect for when I really am being helpful. But it would have been standard behaviour of a central banker, and he was a national central banker before he was a European central banker so, it wouldn’t have been very surprising. Though when it comes it three years later it looks a bit odd. You say, “Well, how does that sit with your mandate?” I think it, sort of, sits with the mandate. He’s not actually threatening, he’s just saying, “Here’s the situation. We’re at our limit. We’re at the situation where we are placing our legitimacy at risk by extending ever-increasing amounts of ELA.” Should it have been a deadline ultimatum? No.

Deputy Michael McGrath: Just to clarify - you don’t believe it was a threat.

Professor Patrick Honohan: No, I think it was taken as a threat but I think that he is ... he is also entitled to see it as reasonable advice from the ECB. I told him it would be interpreted as a threat.

Deputy Michael McGrath: So you would have seen it as a threat.

Professor Patrick Honohan: It has a double effect. He’s within his mandate but it’s certainly going to be seen as a threat and taken as a threat, and it was taken as a threat.

Deputy Michael McGrath: Finally, Chair, on the issue of the involvement of the ECB in the question of burden sharing, both in November 2010 and in March 2011, Kevin Cardiff’s description of what Mr. Trichet said at Kilmainham was that it was a fallacy that the ECB simply advised Government.

Professor Patrick Honohan: Yes. So it’s a similar sort of situation. Now, why did the ECB ... there’s a funny situation there, and I’m sorry to be circumstantial again, a Chathaoirleach, but ... so we had ... end of March - we’d done all this stress testing the BlackRock people and so on - and we have come out with a number, which has ... we thought we could have got away with a little bit less and then they thought ... anyway, we got a number and we got a big document

shows exactly how it's calculated, and we're already to go and ... well, is the ECB going to say "Yes, this is a good decision and the Irish banking system can move forward?" And then the Government shares with the ECB staff, and the troika staff generally, the ministerial statement which they're planning to make.

Deputy Michael McGrath: At the end of March ... 31 March?

Professor Patrick Honohan: The end of March.

Deputy Michael McGrath: Yes.

Professor Patrick Honohan: And for some reason they include the idea that maybe they will bail in the bondholders - not absolutely, but maybe - if things ... if the capital situation worsens. It's not an absolute, it's a maybe. And the ECB ... I'm just kind of trying to project the ECB's view, they're being asked to say "Great idea. Ireland's programme ... they've ... recapitalising the banks and we think it's a great idea." But if in the statement it also says "And, you know, we might burn the bondholders", ECB looks as if it's endorsing burning the bondholders, which it doesn't want to do. So it certainly doesn't want to do that, to endorse the statement, so they say "Take out the mention of the burning of the bondholders." That's the way it happened, so ... why-----

Deputy Michael McGrath: Mr. Cardiff said-----

Professor Patrick Honohan: -----why they put it in the speech-----

Deputy Michael McGrath: Mr. Cardiff said he received an instruction-----

Professor Patrick Honohan: Oh no, he got an instruction-----

Deputy Michael McGrath: -----from the phone ... over the phone-----

Professor Patrick Honohan: -----yes, sure ... sure, yes.

Deputy Michael McGrath: -----from Frankfurt.

Professor Patrick Honohan: They said "We won't give a favourable statement unless you take out the reference to the burning of the bondholders." But the thing I couldn't understand ... I was in favour of finding ways of burning those Anglo bondholders but you either do it or you don't do it. You don't say "Oh, we might do it." So I ... it was ... I think ... I think it was a very peculiar action.

Deputy Michael McGrath: And was there a decision made to actually do it?

Professor Patrick Honohan: I ... we should have actually done it or not.

Deputy Michael McGrath: But that decision was not made, you're saying, to actually do it?

Professor Patrick Honohan: No, not that I saw it. Not that I saw.

Deputy Michael McGrath: Okay. Thank you.

Chairman: Thank you very much, Deputy. Deputy Pearse Doherty.

Deputy Pearse Doherty: Thanks. Professor Honohan, I have ten minutes and ten ques-

tions, and leading from Deputy McGrath's question, should the Government at that time - in 2011 - have announced in the Dáil, without talking to the ECB, that they were going to burn the bondholders in Anglo Irish Bank, in your opinion?

Professor Patrick Honohan: I actually don't think they should have. If they'd managed to get the ECB on board, then they should have done it. And we know that even the governor of the Bundesbank ... the president of the Bundesbank was in favour of that and there would have been others as well. But it was the majority view in the ECB. So they hadn't sold the message ... doing it with ... against the views of the ECB would have caused ... cost more than the gain from that and certainly would have put paid to whatever happened later in the promissory note.

Deputy Pearse Doherty: What was the ECB likely to do in reaction to the Government taking a unilateral decision?

Professor Patrick Honohan: Well, I would just say, we'd never have got the promissory note thing. That alone is much more than the burning of the bondholders. At that point, the €5 billion left, so.

Deputy Pearse Doherty: Would they ... would ... could they have switched off the ELA at that time?

Professor Patrick Honohan: Yes, they could have done lots of stuff.

Deputy Pearse Doherty: Okay. In terms of the recommendations in the 20 pages of recommendations-----

Professor Patrick Honohan: They wouldn't have ... sorry, they wouldn't have cut off ELA.

Deputy Pearse Doherty: They wouldn't have cut off ELA.

Professor Patrick Honohan: They wouldn't have. They would have done other things, which would have been-----

Deputy Pearse Doherty: Okay. In terms of the recommendations that's in the core documents, the 20 pages of changes that you've introduced, is there any still outstanding from previous reports and are there any plans to introduce these changes in the future? Are there any gaps in your implementation of the necessary changes?

Professor Patrick Honohan: Yes, there probably are a few things. On banking we are in the process of ramping up the numbers again, which will go to filling one of the gaps the IMF found. They said we didn't pay enough attention to the ... what are they called ... insignificant banks, something ... not high impact, but low impact firms. They wanted us to do more which may or may not be terrific use of funds, but hopefully when we get the legislation sorted on the charge back of supervision, institutions will pay for it. So we have to do more on that, and there's more to be done on insurance with a move to Solvency II, there's a lot more to be done on that. So there are ... but I think that's a constant battle, and what worries me is that the constant battle may lead to a bigger and bigger institution which will be harder and harder to manage. But that's a different matter.

Deputy Pearse Doherty: Professor, when you-----

Professor Patrick Honohan: Sorry, there's a few other bits of legislation. I don't want to give the impression ... there are a few outstanding things, but that's normal.

Deputy Pearse Doherty: Maybe that's something you could submit to the committee at a later stage, if you wouldn't mind?

Professor Patrick Honohan: Yes, I think we could do that. I don't want though to take you up on your offer to do a big analysis of those costings, that's for future years I think.

Deputy Pearse Doherty: Okay.

Chairman: I get awfully concerned when you write to me, Governor, so please don't.

Deputy Pearse Doherty: Governor, in 2011 you responded to a question that I put in relation to the programme of assistance, or the bailout, you said, "I was not all that happy with the negotiations, not that I think it was a bad deal." You went on to say, "There were a lot of missed opportunities", and you went to give a specific example. You said, "For example, the managing director of the IMF, Christine Lagarde, last week proposed that the EFSF should now be able to inject capital directly into banks, not just lend money to governments. This is not agreed in Europe." You went on to say:

To my mind, we could have developed something like this and instead of Irish taxpayers' money being put into banks, the EFSF's money would be put into them and it would own 99.8% of AIB. This would have reduced the indebtedness of the State and lowered the risk.

Was this something that you were suggesting at the time, or something that could have been done?

Professor Patrick Honohan: Yes, I suggested that to a couple of influential people in Frankfurt, but also to the troika people. They said, "You know that's a very interesting idea but forget it, we don't have a mandate to do that, the IMF doesn't do that. The FSF doesn't have it in its mandate." I suppose what I thought was that maybe negotiations would go on for longer so that we could say, "Well it's not in your mandate now for the EFSF but why don't we develop that." But, you know, it just was too far out of their realm.

Deputy Pearse Doherty: You did say that at the time, that it was put together more quickly than was really strictly necessary. Do you believe that the Government should have held out longer and tried to get these points across the line?

Professor Patrick Honohan: I don't think they would have been got across the line, I mean we're five years later and none of that has been done now. The EFSF has not ... the Spaniards took a big loan in 2012, the Government borrowed the money and put it into the banks. Same model. I don't think ... you know, a couple of weeks here and there.

Deputy Pearse Doherty: How could it be a missed opportunity if it couldn't ... if you believe it couldn't have been achieved?

Professor Patrick Honohan: A missed opportunity for them, for Europe. Not a missed opportunity for Ireland in the sense that ... if we'd only done this they would have easily agreed.

Deputy Pearse Doherty: You also said that ... in terms of the markets and the response to the bailout, you say, "The markets didn't like the fact that there was no bail in."

Professor Patrick Honohan: Yes.

Deputy Pearse Doherty: So the markets, in your view, were expecting that there would

be a bail in?

Professor Patrick Honohan: I think the markets had factored in something like that. The prices ... yields had gone up and prices gone down for bonds, because they said, "Oh, there's going to be bail in here." So that when the ... the markets, of course, anybody holding these bonds wouldn't have liked it but the potential buyers of Irish Government paper would have been pleased. There's lots of investors, there views are not all aligned.

Deputy Pearse Doherty: Future bondholders wanted the troika programme to agree to burn some existing bondholders.

Professor Patrick Honohan: In the sense that ... when I say they liked it, I don't care whether they like it or not, I'm saying what will be the price at which Ireland can borrow? And when I say the market would like it, I mean the market would have been prepared to lend to Ireland at a lower rate if they had found that, as a result of the package, Ireland was less indebted.

Deputy Pearse Doherty: Okay. Can I ask you just quickly on reckless lending, reckless misconduct and you've given your comments on this before, but just for the inquiry's sake, do you believe that reckless lending/misconduct should be an offence? It's not under Irish law at this point in time. By bankers.

Professor Patrick Honohan: I have a general idea that something of that type should be introduced and some of that has been introduced in the UK. It's not something that I've studied in detail-----

Deputy Pearse Doherty: Yes.

Professor Patrick Honohan: -----it's not an easy thing and it won't be easy to get convictions even if it is introduced but, I think, it's worth doing.

Deputy Pearse Doherty: Okay. In relation to the stress tests that were carried out by BlackRock, have you done an analysis on the accuracy of those stress tests given that the injection of capital that went into the banks were based on a three-year scenario and the three years is up? I want to particularly pay attention to the residential mortgage losses that were expected to incur over the three-year period, which was €9.5 billion. Did the four institutions, which obviously excludes Anglo and Nationwide, did they incur a €9.5 billion of losses in residential mortgages?

Professor Patrick Honohan: In so far as the residential mortgages are concerned, the BlackRock model assumed that there'd be a lot of actual losses incurred in a short period of time. And that's because they were applying a model that worked in the United States, where you stop paying, you walk away, the bank seizes the property, sells it, and they've realised the loss and they're out. That's not how it happens here as we know. So what's happened since then is that the actual rate of arrears increased faster than the BlackRock model predicted but the rate of losses has been much slower. There have been very few actual losses realised.

Deputy Pearse Doherty: The banks were capitalised on the basis of €9.5 billion losses that would've been accrued-----

Professor Patrick Honohan: And-----

Deputy Pearse Doherty: -----up until last year.

Professor Patrick Honohan: And I believe that they will ... yes, but they will actually incur those losses, they'll just have happened later and later.

Deputy Pearse Doherty: In your view, what portion of those €9.5 billion have the four banks accrued so far in losses?

Professor Patrick Honohan: Very little, because they make provisions against future losses but the losses are not actually accounted for in their books until-----

Deputy Pearse Doherty: They're not writing them down ... their debts-----

Professor Patrick Honohan: Yes, yes.

Deputy Pearse Doherty: -----but they were capitalised-----

Professor Patrick Honohan: But to bring it to a conclusion, even in the case where they have ... suppose they have a loan and they're pretty sure they're only going to ... they're going to repossess the property. It's still there. The loan is worth 100, the provision might be at ... it might be 80 or 90, or 50, or something ... some number, and ... but the loss will not be incurred until they actually sell the house.

Deputy Pearse Doherty: Even though they were capitalised four years ago for that purpose.

Professor Patrick Honohan: Yes, but they'll need it. They'll need it.

Deputy Pearse Doherty: Okay, can I ask you in relation to the accelerated capital sales of the Anglo bonds now that the Central Bank hold and that you're selling them above what was the minimum requirement-----

Professor Patrick Honohan: Yes.

Deputy Pearse Doherty: -----are all of those sales more beneficial to the Exchequer at this current point in time than it would be to hold on or just sell the minimum amount?

Professor Patrick Honohan: We've done some ... quite a lot of work on this because it's something that's of great interest to the Department of Finance. It shouldn't be something that ... of any particular interest to the Central Bank and I think we have ... we're pretty convinced ... of course, there's uncertainties in here, what happens if you held onto them? What price would they be sold at later? And so on and so forth.

Deputy Pearse Doherty: Not in the future. I'm talking about now. If you hold ... if they're held by the Central Bank, there's a rotation in terms of how the money goes back-----

Professor Patrick Honohan: It depends. If you sell them now, you get something and then ... relative to what? Relative to selling them later. What will happen later? So there is this element of uncertainty in it but it is our belief that the faster sales that we have been doing are advantageous, net advantageous to the Exchequer.

Deputy Pearse Doherty: In the long term?

Professor Patrick Honohan: No, actually ... it actually accelerates the benefit to the Exchequer-----

Deputy Pearse Doherty: Okay.

Professor Patrick Honohan: -----because the cash ... it comes in faster. You might get more money over a longer period of time but it'll be way in the future.

Deputy Pearse Doherty: Okay. Can I ask you-----

Professor Patrick Honohan: And we're continuing to sell those-----

Deputy Pearse Doherty: -----Kevin Cardiff gave evidence here that there was, kind of, a secret group of individuals that were looking at contingency planning in relation to the potential exit from the euro. Can I ask you, were you part of those discussions?

Professor Patrick Honohan: I really don't want to talk-----

Deputy Pearse Doherty: Okay.

Professor Patrick Honohan: -----about contingency matters but-----

Deputy Pearse Doherty: That's fair enough.

Professor Patrick Honohan: -----you can imagine that we do lots and lots of contingency stuff.

Chairman: Is the name "Johnny Logan" familiar to you?

Professor Patrick Honohan: No, I'm not familiar with that reference, but ... no, and we're ... you know, and anything to do with ... but I won't say that, there are some contingency things that we look at and we didn't bother to tell the Department of Finance about, but there's a good communication.

Chairman: Okay, thank you.

Deputy Pearse Doherty: Can I ask you ... the Chairperson was asking ... the Chairperson was asking a question in relation to ... at the opening of the session, in relation to the ELA ... or the solvency of the State and the provision of ELA and obviously you needed to believe that the banks were solvent and a guarantee provided that satisfaction but the State had to be solvent for you to be able to be ... to ensure that the ELA could ... that the banks were solvent. And you mentioned you always took the Government at its word. The question is, did the ECB ever raise issues in relation to the fact that the country was becoming insolvent, i.e., that it needed to get into a programme because the markets were shutting them out?

Professor Patrick Honohan: This would not have been raised formally by the ECB, but I know that some people would have said to me, "Oh, yes, it's all very well for you to take the Government's guarantee." But that would be ... I'm not talking about-----

Deputy Pearse Doherty: But is that not hugely significant, because is it not, and correct me if I'm wrong here, it's not your final call in relation to issuing ELA to the banks?

Professor Patrick Honohan: Yes, exactly, exactly.

Deputy Pearse Doherty: Because the ECB-----

Professor Patrick Honohan: They can say ... the ECB can say, by a ... it has to be a super majority. They can object to the ELA, and they could object on a number of grounds.

Deputy Pearse Doherty: Okay.

Professor Patrick Honohan: They could object because the sums are too big and it's really interfering, or they could object because it's ... there is the risk that there might be a loss to the Central Bank, which might make it insolvent and that wouldn't be good and so on. So there are lots of reasons that they might want to object.

Chairman: Sorry, Deputy, just to wrap that up, because I'll be coming back to that one myself, because I had that noted.

Deputy Pearse Doherty: Okay. There was one last question, because I've got to nine and I would be ashamed just to miss the last one.

Chairman: Okay, ten so. Quickly.

Deputy Pearse Doherty: You mentioned in response to, I think it was Deputy Higgins, in relation to the option about how did we fulfil this commitment of breaking the game-changer, you know, the banking and sovereign link.

Professor Patrick Honohan: Yes.

Deputy Pearse Doherty: And you put forward the promissory note restructuring. You said there were other options put forward. Can you explain to us what those other options were put forward? Was one of those options, for example, looking for the retrospective recapitalisation of the banks through the ESM, which was what was promised at the time, or at least suggested by the Minister for Finance and others?

Professor Patrick Honohan: Yes. No, I recall that that was an option and fine it had ... it really wasn't in the Central Bank's bailiwick. I think it was pursued to an extent by the Department of Finance. But I think it was put on the back burner because it wasn't going anywhere politically, and the one we got was the one that had actual-----

Deputy Pearse Doherty: What do you mean by it wasn't going anywhere politically? Did it hit a brick wall? Like, did it ... where, when you say it wasn't going anywhere, was a request made or was feelers put out in relation to this?

Professor Patrick Honohan: I think feelers were put out but, as I say, that was entirely in the Department of Finance's bailiwick. I wouldn't have been doing any of the negotiation on that, so-----

Chairman: Thank you.

Deputy Pearse Doherty: Okay, thank you.

Chairman: Deputy O'Donnell.

Deputy Kieran O'Donnell: In the context of changes required, how exactly are contrarian views, if any, now considered and incorporated by the Central Bank? And what reflections do you have and what actions do you now take in reference to contrarian views expressed? Can you give some examples?

Professor Patrick Honohan: Yes. Well-----

Deputy Kieran O'Donnell: I might give one example of my own. You can feed it in.

Morgan Kelly, when he wrote a piece, a good, I think, colleague, on 7 May 2011 in *The Irish Times*, he basically spoke about, “[And so] the Honohan Doctrine that bank losses could and should be repaid by Irish taxpayers ran its predictable course with the financial collapse and international bailout of the Irish State.” So how did you take on views, contrarian views, internally and externally?

Professor Patrick Honohan: Well, you know, yes, it’s ... it hasn’t worn well, that piece that Morgan Kelly has written. It’s one of his polemics in the 18th century style. Not one of his best though. It’s a, kind of-----

Deputy Kieran O’Donnell: In what way?

Professor Patrick Honohan: Well, it’s a, kind of, a piece of imaginative fiction, I think. And it’s predictive ability has been-----

Chairman: Allow the Governor answer the question there without interruption, please. Governor, continue please.

Professor Patrick Honohan: It has been woefully wide of the mark in terms of its predictive ability. It was naive in the description of the negotiating leverage that we had, very limited as it was. It was poorly informed in regard to the motivation of the players, the key players, and the behaviour of the key players. And I think it very badly misrepresents both the opportunities and the strategies of the Irish side, suggesting that there was some missed opportunity. There are all sorts of funny things about the piece. It doesn’t really hang together. Now, it was a contrarian view, yes, but it was a contrarian view, in this case, after the event. Now, sometimes he was ... he was very much, you know, be careful, because this is happening. I mean, he made lots of important contributions on a number of issues, of course, the property lending, and the residential mortgages, that was, sort of obvious, but he ... that ... he was wrong on this, he was wrong also, as we know now, on the stress tests of 2014 on what was going to be used to damage the Irish business sector. And he also tries to present the Central Bank, or me, as being a great advocate of paying banks before everybody else, which I think is very, very unfair. I didn’t do the guarantee. I tried to get as ... claw back as much as possible.

There was a crunch time for a decision on these issues in September 2010, when we were coming to the cliff. And that’s why I included in my statement that footnote elaborately setting out what I thought about at the time, which was six months or eight months before he produced that article. So it wasn’t as if we were just sitting there saying “Ah sure, everything’s all right, oh, suddenly we’re in a programme”, no, we seriously considered this and we decided it was not safe to do something like this and that if there had to be a restructuring, it should be in a different environment later. And probably I did have, as I mentioned before, an idea that, you know, what ... the best way to restructure if it should become necessary, which it hadn’t. And then he advocated, he explicitly advocated in the article, cutting public expenditure at a stroke. Well, that’s like adding a super-charged austerity, an extra €30 billion or something of super-charged austerity ... like, why? Why did he want that? It doesn’t make any sense. If he’s going to be a defaultist, which in a way he was and in a way he wasn’t, he was saying “Bankruptcy is disastrous”, but he did want us to default on the guaranteed bonds; so it’s hard to say whether he wanted it or not, well, you would not default before you had run the course of borrowing as much as was going, so ... and Brian Lenihan had no game plan for holding out for six months. And if he had, which he didn’t, he could still have held out for six months, it was nothing to do with me.

And there was lots of stuff. He said that ... I had a look at it recently, so, because I knew, I think you mentioned it earlier on, and he said “This all comes down to arithmetic.” Okay, that’s true, I am very much in favour of that. He said, “In 2014 the debt of the Irish State will be €250 billion.” Well, actually it was €203 billion and that’s a difference. So, look, I have a lot of respect and a lot of time for Morgan Kelly. I was pretty annoyed with the article, as you can imagine, because it sort of undermined that we were working to save the State.

Deputy Kieran O’Donnell: Can I ... just one point of clarification just around that whole bailout. The letter that came from Trichet to Lenihan on 15-----

Chairman: Before you go on there, Deputy, can I come back to the root of the question, because the supplementary was about Morgan Kelly, but the other question is, how does the Central Bank now deal with contrarians?

Professor Patrick Honohan: Contrarians, yes. Well, I mean, this is back largely to the question ... first of all, we have internal whistleblowing procedures as well as external whistleblowing procedures, so if somebody in the organisation is not getting a hearing, which can be slightly different, it can be administrative things as well as policy things, and that stuff comes through. But there’s also a culture of things as well. As I described, I tried to create an atmosphere where challenge is not only tolerated but encouraged and that people know if they speak up with an idea, they’re not going to be squashed down. So, it’s a constant battle to do that.

Deputy Kieran O’Donnell: Can I just go back to the point ... the letter that went ... it’s just to get full clarification, the letter that came from Trichet to Lenihan on 15 October made no reference to applying for a bailout.

Professor Patrick Honohan: Yes.

Deputy Kieran O’Donnell: So ... and then suddenly, just over a month later, 19 November, they’re being asked to apply for a bailout. And in that period, ELA ... the funding for banks jumped by nearly ... it went from €62 billion up to €109 billion. It was nearly 76% of a jump, which is €47 billion. So the question, really, I want to ask was that ... what was the key factors that ... that suddenly there was a change in just a month, from saying, “We’re not looking for a bailout, we want you to implement your plan”, and suddenly, very much demanding to apply for a bailout. Was it around ... effectively, you said it was going to be ... the *Financial Times* said there could be a run on the Irish banks. What was the key factor that Trichet came out, in a month’s time, from not looking for a bailout, to - from 15 October, to 19 November, just over a month later - looking for Ireland to apply for a bailout?

Professor Patrick Honohan: Well, he wasn’t saying Ireland can do it without a bailout in October, he just wasn’t raising that spectre. I don’t want to try to understand and deconstruct exactly why he wrote different letters at different times. You’ll notice, in particular, in that letter - I don’t know whether to mention this because it, kind of, may be irrelevant - he showed me the letter in advance, I didn’t make any comment on it but, in particular, I didn’t bother to correct the fact that he attributed the position of Tánaiste to Brian Lenihan. I did that to make sure that nobody in Dublin thought that I’d written the letter.

Deputy Kieran O’Donnell: Which letter was that?

Professor Patrick Honohan: 15 October, I think.

Deputy Kieran O’Donnell: So you were consulted on that letter?

Professor Patrick Honohan: I was consulted but ... I mean, I was shown. He didn't say, "What do you think of it?" He said, "I'll show you as a matter of courtesy", something like that. And I didn't give an opinion on it. It was just a ramping up of things. The markets had lost confidence on Ireland by the middle of November. The spreads were up, that was my indication that I was looking at. I think probably other senior ... we know about the meeting in Seoul in the margins of the G20 meeting, again it was a G7 meeting and I think following that, Trichet had the sense that there was a general sentiment that there is going to trouble, it has to be lanced.

Deputy Kieran O'Donnell: And when you came out on the "Morning Ireland", who was your audience, who were you speaking to?

Professor Patrick Honohan: I was actually speaking to, if you like, middle Ireland, the people who were saying "Joe is taking his money out of the bank and Susan is taking it and I'm going to take my money out too because nobody seems to be doing anything and there's papers all over the place."

Deputy Kieran O'Donnell: So the main reason you came out was you were worried about the run on the banks?

Professor Patrick Honohan: The run on the banks.

Deputy Kieran O'Donnell: That was the key reason you came out?

Professor Patrick Honohan: Absolutely. And not only to stop the run, because it could finance the run through ELA but to create the sense "It's okay, things are under control, we're going to get this back. Because the IMF are here and they've got lots of money."

Deputy Kieran O'Donnell: And reflecting back, you're shortly in the departure lounge, reflecting back, how do you feel your term as Governor went? What were the high points, the low points and what would you have done differently?

Professor Patrick Honohan: Look, I think the ... it wasn't mentioned so much here today, I do think and it's something Morgan Kelly did criticise, I think we didn't ... the first stress test in March 2010, I think ... I think that wasn't done as effectively as I would have liked. I think the consequences weren't very severe but it was a type of mistake which I knew could be made and I made it. So, that's a pity. A lot of other things I would have done slightly differently but which are, I think tactical errors but not strategic errors. So, I don't think I set things in the wrong direction, which is very important because I think some other countries went very badly wrong.

Deputy Kieran O'Donnell: And the final question is, a fundamental issue really. One of the key issues that happened in the whole crisis was that you had very large borrowers with loans across institutions, which each institution wasn't aware of. How can we ensure that that doesn't happen again?

Professor Patrick Honohan: You're absolutely right. The big property development loans ... if you think about it, when we say it might be about €40 billion, John Moran may think it's less than €40 billion, the losses ... the NAMA losses there, that €40 billion between the face value and the value NAMA paid, that's the €40 billion. So, if there hadn't been the developer losses, of course, there would be a certain ... a lot of trauma in the banks but we wouldn't have had that big burden. So, in terms of the banking losses, it would have been bearable. We know the credit register is there to provide full information about what the loans are but it should have been visible to everybody. There shouldn't have been this "Oh, Mr. So and So says

he's worth €300 million, so we'll take that as part of the collateral. Does he have €300 million, no. We asked him for an audited account and he wouldn't give it us." I mean no ... the banks themselves, they don't need a regulator. The banks themselves won't go in for that nonsense any more but the regulator will be tracking who are the big borrowers, what are you exposed to, what are the risks.

Deputy Kieran O'Donnell: Thank you.

Chairman: Just to move to wrap up, I just have two outstanding questions myself with you, Governor, and I just want a final point of clarification. If I could ask you, kind of moving towards the present now, what was your view of the quality of the boards of the Irish banks when you took over as Governor in September 2009 and what is your view of the board now?

Professor Patrick Honohan: I actually ... I don't actually meet the boards of the banks myself. That's something that's done obviously by my deputy and his head of finance, Ms Donnelly, and so forth. I don't get involved in meeting lots of bankers. I, of course, meet the chief executive and the chair. I don't ... I am told that they are satisfactory. They get their fitness and probity. I would not be sufficiently well-informed to say, "I'm happy to say that they are all super-duper brainy people now and they were no use before the crisis." I just don't have that sense of visibility. What we do know is, that the people before the crisis, were highly respected members of the Irish business community so-----

Chairman: Okay. And as the new structures evolve post-crisis, we have the Central Bank of Ireland annual performance statement financial, we have the engagement of the European supervisory authorities and so forth. Now, could I ask you one of the probably single most major measures that was put in place - the Single Supervisory Mechanism. How well has that been implemented?

Professor Patrick Honohan: Well, so it's actually an amazing that they have put this with 1,000 people in the building in Frankfurt together in a very, very short period of time. It's ... I am a great believer in taking banking regulation away from national pressures and perspectives. It is always risky changing regulatory structures. It is somewhat bureaucratic; it is somewhat slow in its decision-making, though when there were crucial decisions that we have needed to have taken, we have managed to accelerate them. I am cautiously optimistic.

Chairman: Thank you. And just coming back, Deputy Doherty had raised it following the earlier question. I am just still trying to get a shape on this. Deputy McGrath in his line of questioning, kind of, took you through a, kind of, date-by-date calendar of events that took place in November of 2010. We know from earlier engagement with Mr. Cardiff yesterday that discussions with regard for the need of some, sort of, structured programme or bailout programme or programme for assistance was in the ether maybe as early as March 2010. We even know that shortly after the bailout was put in ... or the guarantee was put in place there was correspondences between Mr. Beausang and Mr. McDonagh in the NTMA with regard to the two-year funding cliff and all the rest of it. But in that period from September to November 2010, could you give us an indication as to ... and give us clarity as to how if, or how so any discussion took place at an ECB level in regards to concerns about Ireland's sovereignty? Was this being discussed at the board table or was it being discussed at a kind of an ante-room or having a cup of coffee afterwards or was this a live issue in Frankfurt and with our European partners?

Professor Patrick Honohan: It was not being discussed formally at the governing council. Well, not there. But senior staff officials of the ECB were primarily concerned about the fiscal

adjustment ... that they felt the fiscal adjustment needed to be accelerated to stabilise the debt profile and also, I think they also had in their idea the idea that the Irish Government might in some way take over the ELA from Anglo Irish Bank and do that through some, sort of, programme. So that was from September. You know, in the margins in, “I’d like to meet you about this.” Leading up to those discussions that Mr. Cardiff has described in September and then the ECB came in October ... and then so, yes, those discussions were being held but I wouldn’t call it pressure at that stage, not until 12 November, the Seoul, in the end of the Seoul meeting.

Chairman: Okay, I’m going to wrap up and I am going to invite in Senator D’Arcy and then Deputy Higgins. Senator D’Arcy.

Senator Michael D’Arcy: Thank you, Chairman. Governor Honohan, I just want to read a line from Kevin Cardiff’s statements. And this is in relation to leaks from early November until the actual bailout:

If it is the case that hidden sources were using leaks of inaccurate information to bounce Ireland into a bailout, then the people concerned were not just undemocratic, but antidemocratic. They ought to be asked to explain their actions but they would first have to admit them.

Was the ECB leaking against Ireland in that period prior to the bailout?

Professor Patrick Honohan: I think leaking ... the knowledge I have and probably the Department of Finance have better sources of information about things, but the knowledge I have from people who came are that they heard maybe one or two individual senior staff members suggesting that Ireland was, you know, in a bad situation, wasn’t going anywhere. That’s not exactly leaking, briefing more, which I ... and I don’t believe it was a co-ordinated policy by some shadowy people at the ECB who had decided to do this. I think it was carelessness and imprudence.

Senator Michael D’Arcy: I don’t know if that’s a “Yes” or a “No”, Governor.

Professor Patrick Honohan: Well I think it’s probably a “No”, because if you have the ... a very blank, it was the ECB undemocratically briefing, no, because they’re individuals. The ECB, when it takes actions, takes actions in the name of the governing council. The governing council wasn’t doing that, no.

Senator Michael D’Arcy: Are you aware that there were individuals briefing from the ECB?

Professor Patrick Honohan: I was told, I was told. Yes.

Senator Michael D’Arcy: I just want to go back to finally, Governor, the terms and conditions of the actual bailout. It was a poor deal for Ireland, the terms and conditions.

Chairman: Be mindful of making value judgments.

Senator Michael D’Arcy: I can state that statement because-----

Chairman: No you can’t.

Senator Michael D’Arcy: I can, the Governor said so on 19 January 2015. In your paper.

Professor Patrick Honohan: But I also say it was ... at that point ... but the financing con-

ditions could be improved and they were improved. So in the end it was a really good arrangement.

Senator Michael D’Arcy: But why did you agree to a poor deal at that stage?

Professor Patrick Honohan: Because ... the ... not agreeing would have led to a much deteriorated situation for the Irish people: tax rates, spending, Government spending would have had to be compressed much more. It was better to take the bird in the hand and sort out the cost later. These ... it isn’t ... it’s not us versus the ECB or us versus the IMF. They hadn’t arrived at a good solution at that stage, but I was confident that fallbacks were better than ... by going ahead than by resisting. And I was right.

Senator Michael D’Arcy: Can I just read a line from your own statement, on 19 January, addressed to the IMF, CEPR Central Bank conference, “As designed in November 2010, the EU-IMF Programme of assistance was acknowledged to be one that lacked a strong probability of success.”

Professor Patrick Honohan: Yes, and I’ve just told you what happened. Since it didn’t have a probability of success, it was altered. The financing conditions were altered dramatically, the costs and the maturity of the loans were dropped and the arrangements for dealing with IBRC were turned very greatly in the favour of Ireland. And, in addition, the recapitalisation of March was well below, far below what had been pencilled in in the programme. So although at the start it wasn’t a promising programme it became a very effective and successful programme for the Irish people.

Senator Michael D’Arcy: What was your belief at the time that the programme was signed? You signed with the Minister for Finance in relation to the IMF moneys or the request. What was your belief at the time? Did you believe at the time it would be successful, not forwarding ... by forwarding yourself into the future, that something may alter subsequently?

Professor Patrick Honohan: I thought it was quite possible that it would not be a success. I thought it was quite possible ... and in fact it was amended before it became not a success. So.

Senator Michael D’Arcy: Why did you sign if you thought-----

Chairman: I am moving on.

Professor Patrick Honohan: Because I told you that was the best ... it was the best way forward. We will borrow this money, we will commit to all these things, we did all those things and as we did them, they said “And by the way we’re going to lower the interest rate.” And that was the best way forward.

Senator Michael D’Arcy: Was it the only way forward?

Professor Patrick Honohan: Yes.

Chairman: Thank you. Deputy Higgins.

Deputy Joe Higgins: Yes, Governor, sorry but I have to ask you one or two technical issues.

Chairman: Thank you, we wanted to get these covered earlier in the meeting, but we’ll take them now.

Deputy Joe Higgins: Based in relation ... reference to Vol. 1, Honohan, page 139 onwards. And it's the IMF "Detailed Assessment of Observance of Basel Core Principles for Effective Banking Supervision."

Professor Patrick Honohan: Yes.

Deputy Joe Higgins: And the 2013 assessment ... so Ireland was judged to be materially non-compliant in four areas as against the Basel core principles and they would be: 1, Independence, accountability and resourcing; 2, Supervisory techniques and tools; 3, Transactions with related parties; 4, Abuse of financial services relating to money laundering. etc. So can I ask you why was it anticipated that the Central Bank would be deemed non-compliant and if you anticipated that, why were these issues not addressed in advance and have you addressed them since?

Professor Patrick Honohan: Yes, well okay. Two of those, and in a later page I meant to bring it with me ... photograph it and bring it with me but I didn't ... in a later page at the end of that report the authorities' response is given and it states clearly what we think of those four recommendations. We actually don't agree with two of them but we're going to do them anyway and they both relate to the application of significant regulatory resources to deal with less significant institutions. And, we don't think that that's really necessary, but we will certainly do it because we want to be fully compliant. The independence of the Central Bank issue is really a matter for the Government. It's not about the independence of the Governor, which is assured, but it's actually ... relates to the ease and ability with which the Minister could act to remove any or all of the members of the Central Bank commission, and it's thought by the IMF, from their experience with, I suppose, different countries where political environment is different, that the members of the Central Bank commission should be independent of the Government, so that they can take tough decisions without fear of being removed from office. That's largely the recommendation, so that's a matter for the Department of Finance. I can't remember what the fourth one is offhand, but-----

Deputy Joe Higgins: The money laundering issues.

Professor Patrick Honohan: I think that's also a resource issue. But, anyway, we are dealing with that. We are ramping up on money laundering, and we were aware at the time that ... money laundering responsibilities are shared between different entities, and we were ... we did have the sense that we hadn't got the full panoply of regulations, but I understand that the staff in there has increased.

Deputy Joe Higgins: Actually, in Ireland's response, Governor, it says, "The Irish Authorities acknowledge that branches of foreign banks have not been inspected, and while this is considered to be consistent with our risk focused approach to AML supervision, branch inspections will be performed." Now, that just leads me into my second last question, which is the figure of €2 trillion in the IFSC and such funds and insurance, corporations, etc., which is realised this year. That's 2,000 times €1 billion euro, it's huge. These financial funds are domiciled in Ireland, hedge funds, insurance, banking, etc. If one of ... a serious one of those collapsed, does the State have any responsibility for the debts that would accrue?

Professor Patrick Honohan: No.

Deputy Joe Higgins: No.

Professor Patrick Honohan: No. And nobody in the Central Bank would say, "Ah now,

you're not really responsible for this, but really you ought to pay." There wouldn't be any question about it.

Deputy Joe Higgins: But, could it ever arise, for example, that some of the same arguments could be deployed that followed the original collapse-----

Professor Patrick Honohan: I don't think so.

Deputy Joe Higgins: -----that this will affect the reputation of the sovereign and push up borrowing costs, etc?

Professor Patrick Honohan: I could imagine some people making those arguments. They won't come from the Central Bank and they wouldn't have any real force. It is true that in the post-Lehman's crisis in the United States there were ... some money market funds were actually rescued with an insurance programme that was brought in there, but that was a different environment in which they were a central part of the functioning of the New York and the US money market. These entities are entirely offshore, or, not entirely, but largely offshore and really have no interaction with the functioning of the Irish economy. Can I mention that the four ... I'll look back when I was checking to see everything here, and it said, "What do other countries do?" Denmark was the last of the advanced economies that had one of these Basel core principle assessments before ours, which was recently published, and I'm happy to say that we're on par with Denmark, that they also had four-----

Deputy Joe Higgins: Mr. Honohan, my last question is this. You won't be before the banking inquiry again, I expect, and then you are departing to other-----

Chairman: I'll let you write me a letter, Governor. I might have to talk to you again, but go on.

Deputy Joe Higgins: -----pastures. Can I ask you just a general question? You've mentioned the markets here on a number of occasions, and how the markets respond to this and that. And since the financial crisis surfaced, and then intensified, this is something that became virtually a daily routine. Every austerity cut, every cruel cut to social welfare, to pensions, to low paid public sector workers, etc., in every media outlet, virtually, the question put to economic pundits was: "Is this enough for the markets? Will the markets be satisfied with this? Will they be reassured? Will it convince them?" Governor, do you think it's consistent with the principles of democracy and the democratic society that the financial markets which are huge financial institutions, hedge funds, etc. - unelected, unaccountable and faceless - that they wield such power over society and the lives of hundreds of millions of people? Is that consistent with democracy in how the European financial markets work?

Professor Patrick Honohan: One answer to that is, when we got into such serious trouble we said, "No we are not going to accept this tyranny of the markets which would demand that we cut everything down to no borrowing." We sought the protection of the international official community, the IMF and our partners in the European institutions, to basically shut the markets out of Ireland for a while until we got our act together. So I agree that there are points at which it is just not acceptable to follow the dictate but you know-----

Deputy Joe Higgins: Let me just ask you, many people would say and we related earlier, we had the ECB saying, "You stand behind your banks." What does that mean except that the people have foisted on them the gambling debts of their private financial institutions. So what is that except the bail out of the market by the people. And are they not the same markets, inci-

dentially, that made a bonanza in the bubble, exactly the same, which led famously *Rolling Stone* to refer to one of them as a “vampire squid wrapped around the face of humanity [...] jamming its blood funnel into anything that smells of money?”

Chairman: Before you reply. I am going to bring matters to a conclusion when you do reply because I won't be bringing Deputy Higgins back in on this and if you wish to continue this up in the restaurant or something I'd be more than likely to join you to listen to it. But I do need to bring matters to conclusion so if you could respond to Deputy Higgins's position there and we'll bring matters to a close, Governor, please?

Professor Patrick Honohan: All I will say about that is, and I think I was trying to be very careful in my May 2010 report which in general was quite critical of what had happened in September 2008. I am sure that Brian Lenihan, Minister for Finance, when he was setting the scene there and recommending what should be done was not in thrall to the financial markets or playing to their ... He was trying to protect the normal functioning of the Irish economy and employment and that was his goal in the actions that he took in September 2008.

I think it is easy for people to get trapped by saying “Oh the financial markets want this, the financial markets want that.” But the truth of the matter is we do interact with ... we borrow, we borrowed large sums of money. And the financial markets are not just a single entity but they respond to the same impressions about whether they are going to get repaid or not and that is a reality which has nothing to do with or without democracy. It is to do with the way in which the world is interrelated in terms of trade, in terms of finance and borrowing and lending. If we want to shut ourselves out of that and become an autarchic society it will be a very poor society and that's not the choice that people make.

Chairman: Professor Honohan, as Deputy Higgins said, this is I think your third engagement with us as part of the inquiry and most likely your last. Is there anything else you would like to add by means of further comment or suggestion because this inquiry is as much about the future as it is about the past by means of your closing remarks today?

Professor Patrick Honohan: I am just glancing down a few notes that I took in and I am happy to say that I think there is nothing else for me to add at this stage. Thank you very much.

Chairman: Do you think our work has added to your report?

Professor Patrick Honohan: I think it has enriched the understanding of the sorts of people who are taking decisions and the sorts of pressures they were under. I don't think it has changed the conclusions of my report. There is some enrichment but I don't think it has altered my view of the whys and whats.

Chairman: Thank you. With that said I would like to thank Professor Honohan for his participation today with the inquiry and for your previous assistance and engagement with the inquiry on other dates. In that regard I now formally excuse the witness and bring matters to conclusion and the meeting is adjourned until 3.30 p.m. on Tuesday, 30 June 2015.

The joint committee adjourned at 6.20 p.m. until 3.30 p.m. on Tuesday, 30 June 2015.