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Joint Committee of Inquiry into the Banking Crisis

Witness Statement of

Charles McCreevy

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Statement to the Joint Committee of Inquiry into the Banking Crisis

Charles J. McCreevy

I was Minister for Finance from the 26th June 1997 to 29th September 2004.

The Joint Committee has directed me to make a statement in writing on specific lines of inquiry relating to my role as Minister for Finance. The direction from the Committee on the lines of inquiry do not contain a time frame. As my period as Minister for Finance ended in September 2004 – some considerable time before the banking collapse – my statement deals only with those areas of interest on which I might have some direct knowledge and which would have arisen during my tenure as Minister.

By way of general observation, I am being asked to comment on a number of matters which are really within the remit of the Committee. Furthermore, I have been asked to do this, many years after the events which gave rise to this inquiry. It will not be possible for me to comment on such matters as I was not involved in the decisions made.

In preparing this statement, and as per the Direction from the Joint Committee, I have confined my comments to matters relating to my role as Minister for Finance.

C1.a Inter-departmental contact and the Memorandum of Understandings with other EU States on the issue of banking.

The increasing number of cross border financial institutions and deepening financial market integration led the European Union in the early 2000's to look at the issue of cross border contagion which could arise and effect more than one Member State.

The first MOU's between Member States, Banking Supervisors etc were signed in 2003 and 2005 and were applicable in cross border systemic crisis situations.

I under that the Domestic Standing Group (The Department of Finance, Central Bank and Financial Regulator) which facilitated cooperation at National level was initiated in 2006 and a MOU between those parties was signed in 2007.

Thus, as the effective dates of those MOU's and understandings occurred after my term as Minister for Finance, I do not have any particular knowledge of same.

C3.b Appropriateness of the bank guarantee decision.

This occurred in September 2008 – well after my period in office.

R1.b; R2.a; R2.c; R3.a; R3.b; R3.c:

Effectiveness and appropriateness of the supervision policy and powers.

The effectiveness of the use of supervisory powers.

Adequacy of the assessment and communication of both solvency and liquidity risks in the Banking Institutions and Sector.

Awareness and clarity of roles and accountability amongst the regulatory and supervisory institutions of the State.

Nature and appropriateness of the relationship between the Central Bank (including the Financial Regulator), Department of Finance and the Banking Institutions.

Effectiveness of the communication between the Central Bank and the Department of Finance.

During my time as Minister for Finance there was a clear delineation of responsibilities between the Department of Finance, the Central Bank and later with the Financial Regulator.

The Department of Finance saw our role as providing the legislative framework and dealing with the Governor on broad macro issues. For example, before each budget, the Governor would send a letter concerning same.

The regulation of the financial institutions was the responsibility of the Central Bank / Regulator. We did not interfere and in any event the Central Bank Act

1942 forbade any communication between the Regulator and any other body or persons relating to the prudential supervision of a regulated entity. Supervision, exclusively, was a matter for the Regulator.

I met formally with the Governor every two months approximately. Also, I met him on other occasions throughout the year – for example, at the Informal Ecofin meetings (which occurred at least twice yearly) and at which the Governors of all Central Banks attend with their Finance Minister.

In respect of legislation there was a significant change in the legislative area which culminated in the setting up of the Financial Services Regulatory Authority and the details of which I set out below.

In 1998, the Government agreed in principle to the setting up of a Single Regulatory Authority for Financial Services (the SRA). Interestingly, the idea of an SRA was first mooted as far back as 1989, but it was decided not to go ahead with same at that time.

We requested Michael McDowell to Chair the Implementation Advisory Group. It is important to point out that it was the Government's idea to have a Single Regulatory Authority - not Mr McDowell. In fact, I have never asked him to this day if he thought the idea was a good one or not.

The McDowell Group was comprised of nine persons but it produced two reports. The Majority Report and the Minority Alternative Model.

In coming forward with the proposal for a Single Regulatory Authority, we were conscious of the then fragmented way of supervising and regulating the Financial Services Sector. Involved at that stage were the Department of Finance; the Department of Enterprise Trade and Employment; the Department of Environment; the Central Bank and some other agencies.

Notwithstanding the McDowell Report, it took some time to reach political agreement as to the new structure which culminated eventually in two Acts in 2002 and 2003. There was considerable disagreement and not just between the politicians.

If you read the commentary and stances of various politicians and commentators, there was not universal agreement as to how and where the new authority should be located. I have noted with a certain degree of irony

that most of the politicians and commentators who wished to keep the Central Bank out of the key role at that time, were to the forefront in advocating the return of all powers to the Central Bank post the recent financial crisis.

That was in fact consistent position in the Department of Finance during that debate.

Practically all of the debate in those years centred on the consumer protection angle and little on prudential supervision. This, of course, was hardly surprising because I do not recall anyone being concerned as to the possibility of a major Irish financial institution collapsing. All of the emphasis was on consumer protection and a number of persons did not want the Central Bank involved at all.

This too was scarcely surprising. The background to the idea of a Single Regulatory Authority was the Ansbacher revelations and the Central Bank shipped most of the blame in the eyes of many for not reporting the Ansbacher tax issues. It was ignored that the Central Bank was specifically forbidden under the 1942 legislation from communicating any information which they came across arising from their supervision of banks. In fact, I understand that this issue of confidentiality matter had to be addressed by the Oireachtas when setting up this Banking Inquiry.

Also, the Moriarty Tribunal had one specific term of reference regarding recommendations as to banking regulation. It was decided quite correctly as it turned out – that we could not await the findings of Moriarty. In fact that Tribunal did not report until 2013.

Also the DIRT Inquiry gave ammunition to many that the Central Bank had tolerated this aspect of the regulated institutions and had turned a blind eye to same. This was not the case as a perusal of the evidence of the then Governor of the Central Bank to the DIRT Inquiry will attest.

For completeness, I should also point out that there was not a universal method of regulating financial services in other European Countries or further afield. Our nearest neighbour, the United Kingdom was at that time in transition mode with the establishment of the Financial Services Authority (FSA) and the direct supervision of banks was then being moved outside the Bank of England. Subsequent to the recent financial crisis, they too have effectively brought all the powers back under the Bank of England.

In the context of this Bank Inquiry, I do not believe that the structure of the Authority was a major factor in the banking collapse. During my time as Minister, it was never contemplated as to the remotest possibility that any Irish bank could fail.

There were two separate Bills (in 2002 and 2003) setting up the new structure. When political agreement was reached, we set up an interim Regulatory Authority in 2002 and the Bill underpinning same was one of the first pieces of legislation post the May 2002 General Election. The main purpose of the 2002 Bill was the setting up of the Irish Financial Services Regulatory Authority (IFSRA) within the overall new structure of the Central Bank and Financial Services Authority of Ireland. The establishment of IFSRA was a constituent part of a new Central Bank structure. The IFSRA would take on and develop the Financial Services supervisory functions of the Central Bank as well as handling the regulation of credit unions and the insurance sector. It was to operate as a constituent part of the new bank and had its own chairperson and board. There was provision that the Chairperson, the Chief Executive and some other members of IFSRA would also be members of the new Central Bank and Financial Services Authority of Ireland.

I mentioned during the debate on that Bill that it was the intention to have a second Bill to deal with the remainder of the recommendations contained in the McDowell Report. This second Bill was enacted in 2003 and dealt with matters such as the establishment of Financial Services Ombudsman; the setting up of Consumer and Industry Consultative Panels; Penalties and Appeals etc.

As the new structures were in the embryonic stages of development before I ceased as Minister in 2004, I can only comment in a cursory way on the co-operation and integration of the new bodies. However, during the setting up of IFSRA and during the transition phase, I was strongly of the view that the level of co-operation between the new Chair of IFSRA and the Governor of the Central Bank was excellent. Both individuals went to great lengths to smooth the integration process which I understood to be very difficult given the range of matters to be decided and especially the staffing issues.

The new structure allowed the Central Bank to concentrate on the macro level and to produce financial stability reports which contain guidance for the Financial Regulator to follow. IFSRA had responsibility for individual entities

under their remit. I should also point out that the Secretary General of the Department of Finance was always an ex-officio member of the Board of the Central Bank.

I have decided to deal with some items under these Lines of Inquiry under the reference **R6.b** which I think is the more appropriate area for my response.

R1.c Appropriateness of the macroeconomic and prudential policy

R2.b Nature and effectiveness of the operational implementation of the macroeconomic and prudential policy

I would strongly defend the policies pursued during my time in Government and would contend that the economy and public finances were in an exceptional healthy state when I ceased as Minister for Finance in September 2004.

There are many indicators for this period to justify this assertion; spectacular economic growth, full employment, the ending of emigration after one hundred and fifty years; rises in all levels of social expenditure; finance surpluses generated which led to a reduction in the Debt/GDP ratio to 30% approx, massive infrastructural spending (particularly on the road network); the setting up of the National Pensions Reserve Fund and many other indicators.

Thus, I would contend that the policies pursued were both appropriate and prudent.

R4.a Appropriateness of the expert advice sought, quality of analysis of the advice and how effectively this advice was used.

R4.b Impact of the reliance placed upon information and reporting from statutory auditors of the banks

R4.c Analysis and consideration of the response to contrarian views (internal and external)

As I have referred to in other parts of this statement, there was a clear demarcation between the Department of Finance and the Central Bank/

Regulator. Thus, I would not have been privy to any expert advice which was sought by the regulator.

In my time as Minister expert advice was received from both external and domestic institutions and individuals.

In the normal course of events, we received regular reports from the European Commission, the IMF, the OECD and all such reports were put into the public domain for consideration.

At national level, we received reports from the ESRI, the Central Bank and in addition from trade union bodies, universities, private sector economists, academics et al.

I think that the arguments advanced concerning the Department of Finance lacking sufficient number of specialist advisors are spurious. One thing we were not short of was advice coming from all quarters.

The views of all bodies and experts were always in the public domain, debated freely and conclusions drawn.

On the question of reporting from statutory auditors of the banks, I cannot recall such matters ever being discussed in the department. This would have been regarded as a matter entirely for the Regulator.

Theme: Clarity and effectiveness of the Government and Oireachtas oversight and role.

R5.a Effectiveness of the Oireachtas in scrutinising public policy on the banking sector and the economy.

R5.b Appropriateness of the advice from the Department of Finance to Government and the use thereof by Government

R5.c Analysis of the key drivers for budget policy

R5.d Appropriateness of the relationships between Government, The Oireachtas, the banking sector and the property sector

As members of the committee are aware, there are regular debates in the Oireachtas on all and ever matter of public discourse- particularly on the economy, taxation and financial issues.

In my time as minister, there was particular discourse and scrutiny on the banking sector especially during the controversies on the DIRT inquiry; the Ansbacher and related issues; the setting up of the new Central Bank and Financial Regulator. However, as I point out particularly in the section on CBIFSRA, predominantly, the discourse on all of these matters was on consumer protection issues. No individual or no other body ever contemplated the financial collapse of an Irish bank.

In regard to the Line of Inquiry at **R5.b** I believe it is a matter for the Committee to make a finding in this regard as you will have all the information available.

As far as I am concerned, I always received excellent advice from the department officials. I found the finance officials very direct, scrupulously diligent and professional in their approach. No task was ever too great for them and they worked extremely long hours. Furthermore, from my experience of EU Commissioner, I can further attest that officials from the Irish Department of Finance were held in the highest esteem in Europe and were regarded as the brightest and the best among all the Member States.

Regarding the issue at **R5.d**, the normal interactions took place. To the best of my recollection, I attended the annual Bankers Institute dinner and gave the key note address; met at least once with the Irish Banking Federation for lunch. I'm sure that there were some other times that I met with individual bankers. During my time as minister, my main contact was with the Governor of the Central Bank.

In regard to the relationship with the property sector, we would have received representations from bodies such as the CIF, Irish Home Builders Association, IBEC, ISME and various other groupings.

Theme: Relationship with and oversight by international stakeholders

R6.b Quality and effectiveness of European policies and regulations

I am aware that there has been significant changes in European financial services regulation and oversight post the recent financial crisis. Historically EU regulation was fragmented with various committees responsible for aspects of the industry.

The Financial Services Action Plan (FSAP) was published in 1999 with the aim of establishing a single financial market for Europe. In 2004 post the recommendations of Lamfalussy, the Committee of European Banking Supervisors (CEBS) was set up and this has been built upon.

The idea of Domestic Standing Groups (DSG) was recommended by Nyberg to the European Financial Services Committee in 2004. I understand that Ireland formed such a body in 2006/2007.

The rules for the capital requirements for banks were designed internationally following the Basel committee recommendations. There is a notion in some of the Irish commentary of recent years that principle based regulation, also referred to as light touch regulation, was an Irish invention. This is not the case as it had become the international way of doing things in the banking sector, and had resulted from the Basel Committee.

The Basel arrangements were aimed at providing capital adequacy for lenders. In the late 1980's, an international regime for capital standards was deemed necessary in order to provide adequate capital for lenders and to insure a level playing field between international banks.

The Bank for International Settlements (based in Basel) was the body charged with establishing this framework and thus the name for Basel 1, Basel 2 and Basel 3.

Basel 1 was a quite simple, and mechanistic set of rules. It gave risk weightings to the various assets of the banks and banks were required to hold levels of capital against same.

By the 90's banks had become much more sophisticated in their operations and were able to find ways to reduce risk weighted assets. This led to the

introduction of Basel 2 which was a much more complex regime. The intention here was for banks to use their own models to determine their regulatory capital requirements. Also, the purpose of Basel 2 was to develop a culture within each bank and to have a rigorous approach to risk management at all levels of a lending institution.

The European Union incorporated the Basel 2 requirements in the Capital Requirements Directive and it came into effect in January 2007 and all lenders covered by it had to implement same from 2008.

These are the standards under which the Irish regulator before and after the setting up of the new structures operated.

I believe that I should mention here the role of accounting standards.

From many decades (starting from the mid 1960's) there has been a worldwide view that there should be a move to the same accounting standards globally. This idea eventually led to the formation of the International Accounting Standards Board (IASB) based in London. This is an independent body funded from a variety of sources.

Some years ago, the IASB agreed that IFRS (International Financial Reporting Standards) should become globally employed. The European Union was in the vanguard in implementing this and in 2002 it was agreed by the EU that a regulation applying IFRS to all accounts would start from 2005.

There is a view that the application of IFRS led to some anomalies in the reporting of banks financial statements and that these new accounting rules may have contributed in some way to the financial crisis.

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