Statement of John Moran, Secretary General (2012-2014)

Mr Chairman and Members of the Committee

I welcome the opportunity to be here today and hope that my testimony will be helpful to the Committee.

I should perhaps for the record remind the committee that I joined the Central Bank in July 2010 to head up the supervision of wholesale banks, becoming more centrally involved in the issues before the Committee only in 2011 when appointed Head of Banking Policy and Restructuring in the Department and, during 2012, Secretary General of the Department. For that reason, I confine my observations to matters arising after 2010.

I had been directed to make a written submission on nearly 20 diverse topics of inquiry. It would not have been possible given the restrictive word count to do justice to each. So, with your prior agreement, rather than provide short (and probably not so instructive) text for each topic, I first made more general observations pertinent to the range of items.

My observations were first presented some weeks ago under the following headings:-

- Ireland's crisis was not just a banking problem but very much a fiscal one
- Burning the bond-holders - not the silver bullet solution
- The civil service and the political process
- The Department's relationships with the NTMA and the Central Bank
- Changes in the Department of Finance.

I have supplemented them (unfortunately lengthening the statement) as per your recent request with material on the following additional topics:

- Role of EU (ECB, Ecofin)
- IBRC
- Relationships and efficacy of the Department of Finance, the Central Bank, Government and Oireachtas (including management of contrarian views), and
- Appropriateness of advice given to the Government.

A <u>Our crisis was not just a banking problem but very much a fiscal one</u>

People like watching thriller TV programmes or movies, accustomed to plots with high-suspense and good guys and bad guys. They have wanted the drama of Ireland's economic collapse to be couched in terms of irresponsible over-paid bankers, reckless developers, the night of the bank guarantee, and the burning of these faceless bondholders. It makes good TV as they say! But the reality is more mundane.

A simplistic rhetoric has been entertained that if we had not had a collapse of Lehman Brothers and the Irish banks and had burned the "vulture funds", we would have had no issues.

One thing is for certain: our property price collapse led to awful widespread destruction of personal wealth and to a growth in unemployment, poverty and emigration. But the sad reality is that it was the acute lack of fiscal capacity at Governmental level that restricted flexibility in how we might minimise the impact of those problems.

The fiscal rectitude we are experiencing since was more accurately a result of the perilous structure of Ireland's fiscal income (mainly taxes) and expenditure. Revenues collapsed as spending commitments continued and even increased to protect the vulnerable. This caused recurring deficits which had to be painfully funded by piling yet more debt onto the back of future generations.

People like repeating that we have put 64 billion into the banks. This is true and it is a horrendous burden to shoulder. But it was a once off expenditure and we should hope to recover perhaps half of that.

People talk a lot less about the fact that each year we have also loaded debt onto the country to pay for on-going annual deficits, none of which we'll get back. This debt may end up being be more than three times the net cost of the bailout of the banks. According to one observer, the factual position is that, of the 7.5 billion in interest payment faced by the State in 2015, only around 800 million is bank related. Today, we are giving ourselves public services, wages and payments for which we ourselves are not paying and leaving the bill to our children and their children.

This all should not be forgotten.

Nor should we forget the fact that without austerity measures which have reduced the recurring over-spends, the debt would be even more and would keep growing every year the corrective measure is further deferred.

Prior to the crisis, the country was building tens of thousands of houses surplus to its medium term annual requirement. Government spending had been increased and taxes reduced assuming that this excess activity was not only justified for that year, but worse, would continue into the future – it was a quicksand. No one had provided for what might happen to stamp duty, capital gains taxes, PAYE revenues and social welfare payments or even to spending or wages in the economy and people's standards of living if construction were to resize to 25,000 units of output, a more sustainable quantum – and that even if we had managed a soft landing on property prices.

Second order impacts arising from excessive public sector payroll increases and unsustainable property prices had also in turn led to excessive wage demands in the private sector and loss of competitiveness in the real economy. Even parts of the exporting economy which should have been thriving in a then growing global economy were in fact losing market share.

It is true that it is important to understand why the government, the civil service, the regulator or even the banks themselves had not done more to restrict the excessive growth of the property market and prevent the dramatic collapse of the banks.

It is important to know why and how the government took decisions around the bank collapse which added further pressure on the State's funding capacity.

But I believe it is equally important, and perhaps even more important, that we understand for future proofing our state what was it in the structure, operation, and DNA of the organs of our state, the political system, the civil service, the broader public sector that allowed this precarious fiscal situation to develop. The decision processes related to the collapse of the banks might give useful hints to find the answer to that more general question.

We should ask, why had we not structured our tax system more sustainably? Why had non-recurring stamp duty not been sensibly converted into annuity tax revenues like property tax or water charges? Why had unusually high stamp duties and capital gains and PAYE taxes from an overblown property sector not been put into a rainy day fund for unemployment payments when things would not be so rosy? Why were the windfall gains spent to throw oil on the fire itself?

Had these alternative routes been taken, how much less painful might the last couple of years have been when the rug was taken out from under our fragile structure by the rapid withdrawal of international wholesale funding in 2008? With a better underlying fiscal position, we might well have been able to shoulder the burden of capitalising the banks without austerity measures or a bailout.

Where was the debate recommending these alternatives, which might not have been so politically popular? How did the decisions get made? Why did no political party manifesto contain proposals for the introduction of property taxes, charges for the consumption of water, more appropriate burdens of sustainable taxes to pay for necessary public services, the reductions of public sector pay back to long term sustainable levels? And when we say the Irish public played no role in the crisis, ask would we have voted for such a party making those promises in the 2007 election?

These type of questions could form a helpful backdrop to the inquiry's assessment of the robustness of our governance structures, looking forward.

B **Role of EU (ECB - Ecofin)**

You have specifically asked me to give some observations about the role of the EU (ECB and Ecofin).

My early impressions of the role of the EU was as part of the troika implementing the bailout. In early 2011, it seemed to me that elements of the troika were not very experienced and well set up for the task at hand. That said, this was new territory for almost everyone, bar perhaps the IMF.

I can, for example, recall very strained discussions with especially the ECB team trying to explain why it was simply not possible to comply with their demand that we sell tens of billions of mortgage loans in the UK in a matter of months to repay the ECB without having a fire sale to the great disadvantage of the Irish banks and state. At that stage, we had earned little credibility with them, so we only prevailed and avoided the fire-sale by involving external advisors like Barclays Capital to validate our own views. The ECB would certainly now have better skills to understand what was possible in those markets without advice from Barclays Capital or from us.

But recalling what I said above, had we not had to fund large fiscal deficits for 2010 and for the foreseeable future thereafter, of course, the State's negotiating power either with the international markets or indeed with the European and IMF backstop funders would have been very much stronger. We might never have even had a shut out of markets and might have avoided a troika bailout entirely or helped it be more limited in its terms.

But that was not to be. Without troika funding from some source in early 2011, the lights would have had to be turned out, not perhaps in the banks who may have been able to rely on the support of the ECB as liquidity provider of last resort, but in the public services of the country. This scenario is being re-enacted by Greece as I write this submission.

So the best approach under the circumstances and that we adopted was to work together with all of the parties of the troika and other EU national governments, develop a sense of mutual trust and respect, use our developing credibility arising from robust implementation of the things we knew had to be done anyway to position us to have robust pushback to demands we considered to be unreasonable. And of course because this was a troika and so their individual views might not always be the same meant we needed to think and move carefully on each issue taking advantage of these dynamics to negotiate each review over the line.

But it was not all plain sailing. There were issues where we held opposite views of course. But both sides always tried to reach a solution which worked and I think that approach has served Ireland well when you look at its performance since 2010 compared to others.

I would however mention that over the three years, there was always a professional approach from the troika members, sometimes less understanding than would have been helpful by some members of the political implications of some of the decisions, and other times very commendable work put in by the troika technical teams to really understand the implications of decisions in the economy.

Of course, the evolving role of the EU now means much greater oversight by the European Commission and the Ecofin of national budgets which if done well should help Ireland avoid many of the mistakes of the past and also provide a role for Ireland in preventing mistakes being made in other countries too which could have negative flow back impact on us.

C <u>Burning Bondholders – not a Silver Bullet Solution</u>

You asked in your recent letter for me to give observations simply on "IBRC". Clearly, I am not able to discuss matters before the Commission of Inquiry. I have thus picked two other aspects.

(a) What might have happened if we had achieved more burden sharing in 2011?

In simple terms, the state's direct loss from the banking collapse is ultimately likely to be most of the taxpayer money contributed to IBRC. We might reasonably expect now to recover the $29 billion we put into the on-going banks as a whole. We may get some money back from the liquidation but in excess of 30 billion of money, a huge sum, has still been lost by the pre-2011 decisions to support the creditors of IBRC, including retail depositors.

There are many reasons to justify why senior and not just junior creditors might have borne more of the cost of the collapse witnessed in the Irish economy and banking system. But, by the time I got involved in these issues in 2011, this question was significantly less meaningful. The guarantee had already been issued and the decision to fund the repayment of the creditors of Anglo and INBS with the promissory note payments had been taken.

In making the decisions we took in March 2011, we had to consider various factors:

- Only 16 billion of unguaranteed senior bondholders remained in the covered banks in March 2011, 3.7 billion in what became IBRC and, of note, over 5 billion in Bank of Ireland for which little comparative capital was required;
- While a large sum, this needed to be compared to the value to be secured by keeping the European and IMF lenders on side. Recall that shortly afterwards a very significant interest rate reduction was negotiated, which at the time was calculated to generate a benefit in the order of 9 billion.
- It also needed to be compared to the implications of default on future funding costs of the banks, especially on-going ones.

- Unless we could have gotten the ECB onside and they were very much opposed in March 2011 and vocal about that, the funding implications to the banks and their retail depositors of a withdrawal of Central Banking funding support had to be considered as had their right to refuse to sign off on troika disbursements to a state fast running out of cash.
- Senior unsecured creditors would include depositors to the banks, including ordinary retail depositors and other banks in our system, would they like in Cyprus have had to bear pain too?;
- And for certain, doing burden sharing would have been complicated legally as
  - Depositors still ranked pari passu with bondholders
  - Capital had already been introduced into many of the banks reducing the hole to be filled by burden sharing
  - The 6 banks were 6 individual legal entities and you cannot use a hole in one bank to justify a loss to a creditor in another different and solvent bank.

In rushing to over emphasis the impact of this decision, let's also not lose sight too of a simple fact much over-looked in ill-founded public debate --- Burning senior bondholders a route resisted by the troika, especially the ECB, was not going to be the solution to our problems in 2011. We needed actions with repeating annual impact to reduce the deficit on an ongoing basis and prevent an annual build-up of debt.

To help explain why burden sharing did not work better, let's first recall a number of important points related to burning bond holders:-

- Senior bank level indebtedness (which remember includes deposits as well as bondholders) is generally repaid by new borrowing at the level of the banks (in our case significantly from the ECB). This was to be repaid in time from the activities of the bank, not government monies, except in so far as these were government monies borrowed to fill capital holes in the banks.
- By March 2011, most of the earlier unsecured borrowings were already replaced with secured borrowings from the ECB system or ELA.
- Burning bondholders may have increased the value of our stake in the relevant bank for the future or allowed us to borrow less money to inject it into the bank to keep it afloat or pay its creditors. But it is a once off benefit and certainly does not generate cash income at the level of the state to pay greater government expenditure either that year or on a recurring basis as would by comparison an annual dividend from Bord Gais.

What does this all mean?

At best, burning bondholders in 2011 would have been legally very complicated, would have generated a smaller debt to GDP by only a small number of percent compared to a then total debt in excess of 100% of GDP, and decreased the annual fiscal effort during recent years by only the amount of the interest payable on that debt. It would not have taken away the need for other austerity measures but, done with the consent of the troika, it would have significantly and safely improved taxpayer buy-in to the programme and helped social cohesion.

At worst, doing it without troika consent, we might have had lower long term debt but may have not benefited from the reductions in interest costs on the EU bailout, have had recurring increased borrowing costs for the on-going banks meaning higher borrowing costs in the real economy, have had liquidity issues and capital controls for the banks had the ECB forced Central Bank support to dry up, and not been able to draw on programme money to keep the lights on in a country running fiscal deficits.

(b) IBRC and the Promissory Note

The Committee is aware that the decision to introduce capital into IBRC using the promissory note was already taken by the time we were fixing the banking system in 2011.

I have been thinking of how best to explain the options facing us in terms of a promissory note restructuring.

> Imagine a household where Jack who cannot find a job is staying at home to look after the recently arrived new baby. His wife Sophie has had a salary cut to 1200 per month and that the salary is now less than the cost of food (400) and mortgage payments of 1100. Their bank, is still willing to lend 300 euros each month under the mortgage allowing them to live. Credit card bills of 5,000 also however exist from once off items purchased for the new arrival but cannot be repaid and are building up at very high interest costs.
>
> Jack's in-laws propose paying off the credit card bills to stop the high interest rate and agreed for repayment in 20 years or after their salaries improve by more than the 300 monthly deficit.
>
> Jack's mates say just tell the bank they simply will not repay the credit card bill. Sophie wants to accept her parents offer and doesn't see how the bank will continue to lend them 300 monthly to live if they announce they are never going to pay the credit card debts.

And so it was with the Irish State.

- Like with Jack and Sophie, revenues were not enough each month to pay the bills and so Ireland had to keep borrowing for current expenditure from the troika or from the markets.
- Like Jack's credit card bills, the promissory note was an existing contractual promise by the state to pay money over time with high interest rates.
- To keep making the annual pro-note payments, so long as we had access to troika money, we only had to borrow money to make it.
- That was replacing debt with an equal amount of debt so making the payment did not require increases in taxes of the state or force us to reduce other public spending.
- The game plan, like with Jack's credit card debt, had to be to replace the debt carrying high interest rates with obligations with lower interest rates and long maturities with the assistance of the ECB.
- <u>It was a legal commitment</u> of a government needing to borrow other money every month. Reneging on a commitment of the state, like Jack and Sophie, would have made it impossible or at least more expensive to get more money to keep paying the bills. Remember, a 1% rise on the cost on 200 billion of debt costs over 2 billion a year.

Jack's bank forgiving him his credit card debt completely would not generate 5,000 euros of actual cash to go spend immediately on other purchases. Equally for Ireland, not making an annual repayment would not have generated free cash to pay for extra government spending that year.

It would merely have meant that we would not have the burden of the long term low cost borrowing which replaced it, debt we can repay when our situation gets better in the future.

Like Jack and Sophie we had already committed to put in the pro note cash. We owed the debt. So the approach taken was not to destroy Ireland's reputation by reneging on a commitment but rather to find a way to essentially refinance the promissory note obligations using the lowest interest rates and longest maturities possible. While this did not take away all the burden of the original decision, it made it a lot more affordable and deferred the burden to a time when we will be in a better position to pay.

Another point to note is that because of the very significant release of funding pressure on the state from that transaction, our other borrowing costs also went down which meant that funding the 60 billion or so of debt used to fund annual deficits also became more affordable.

The only other point I might make is it might be instructive for you to contrast the process leading up the decision around the promissory note with that of other earlier major decisions you are examining. The Committee will be aware of the similarly critical nature of the tactical decisions involved for example whether to it was advisable to proceed unilaterally or with the "unanimous noting" by the ECB.

In particular, I would draw attention to:-

- the role of lead-up discussions at the Economic Management Council,
- the debates taking place in the Department itself,
- the involvement of other departments, notably, the Department of Foreign Affairs and the EU division of the Department of an Taoiseach to help decide on strategy,
- the extensive pre-consultation at official and Ministerial level in capitals across Europe,
- the resources put into preparing in advance the legislation and road map for the day,
- the use of skilled resources seconded into the department from one of our own banks, Allied Irish Bank,
- the discussions at the Principals' group and other inter-action with the NTMA and the Governor,
- the debates held in the Department of Finance to brief the Minister of opposite views about choices but also to inform the papers being prepared,
- how those papers, one of which is included in the Core Document pack were structured for example to identify specifically the risk factors.

D The Civil Service and advice to the Political Process

You asked me specifically to comment on the appropriateness of advice to Government. I do not think it appropriate for me to speculate on the wisdom of specific advice given by prior Secretaries.

But I do think that important questions can be raised about the process of how and what advice is generated and how it is communicated to Government. I may not be the first to identify these issues but I share them from my somewhat unique perspective as a recent "outside" holder of a Secretary General position.

- Firstly, I found it surprising, how little debate on strategic issues for Ireland was, or could be, led publicly by civil servants. I was very fortunate to have a Minister willing to let me engage in that type of debate but it seems other Ministers might even have openly discouraged this in the past.

Officials are criticised for not engaging more outside their own departments but when they do venture out into public debate, are they supported by the public and their public representatives or are they rather attacked almost as political targets especially when they are expressing uncomfortable truths? Thought should be given to what is in Ireland's best interests.

My own experience was to suffer (what I still consider to be) unacceptable interference by the media into my personal life when I dared to stimulate discussion on key choices on housing policy which I felt needed to be addressed and which were coming down the tracks from where we saw things. These included the choices facing our urban planners about housing types and location. I was even subjected to inaccurate public criticism by some even then current politicians for stating facts in a neutral but truthful way about repossession statistics in the country. A number of years later, we are only now having more mature debates about these important issues of housing policy.

Unless the system robustly defends (not attack) civil servants acting in good faith, is it fair to expect them to be more vocal and point out alternative, however unpopular, political choices or to protest loudly when perhaps a wrong decision is being contemplated?

- Secondly, I was surprised how little proactive debate about strategic longer term choices for Ireland was taking place even in private within the corridors of power in ways that involved the full broader leadership team of all of the government departments. I had imagined I would be stepping into a cauldron of debate about all sorts of important issues about the long term future direction of the country and whether we were on the right track.

Perhaps the crisis had crowded out this debate – if it happened before. But should our political system not encourage this more and not allow or demand the time to be crowded out by an agenda dictated on short termism? Do we really have the right structures as a state to encourage wide ranging cross disciplinary debate about future spending priorities or infrastructural needs or how we define the country we want to leave for the children of the nation and their children?

When spending is broken up rigidly using departmental expenditure headings based on last year's spend and holistic spending choices are hosted in a different department than that where analogous tax expenditure decisions are made, do we have the right structure to identify weaknesses or to make reformative decisions permitting reallocation of resources to new or longer term or less visible priorities? The housing sector issues we faced in 2006-2007 and those we have again in 2015 show how root and branch cross-departmental action and resource reallocation from some budgets may need to be involved to avoid significant negative impacts for other budgets like social welfare. Does our system permit this?

- Next - elected representatives have a nature and role different to those employed in public administration, whether for a fixed term or for their entire career. But both must work well together. I observed on both sides what I would say are some unhelpful perceptions of a lack of equilibrium in relative status given to political decision makers and the public service (especially the civil service). I recommend the inquiry to question if we have achieved an unqualified environment of mutual respect to encourage truly free debate across the system.

- The Cabinet is the primary hub of decision making in Ireland, where not just the decision about the bank guarantee took place but indeed all major government decisions.

  How does advice get to this forum? Is it the right choice in 2015 that civil servants, with the background technical detail, from relevant departments are excluded from the debates at Cabinet? What if during the debate someone raises a novel technical point not addressed in the supporting papers? Should Ministers well-versed in one department's activities be expected without the presence of some of their own civil servants who might have broader experience to be held responsible collectively for all decisions? Should exceptions be made if the government memo cannot be circulated to all other departments a couple of weeks beforehand for comment?

  When I came to the Department in 2011, I had no reason to imagine it to be so. It seemed natural that I was asked to lead over two nights a seminar to brief those cabinet members with questions on detailed technical issues related to the complex bank restructuring and the recapitalisation decisions of March 2011. I thought it was always like that but it seems not so. My early surprise instead was that I was not expected to present the material officially the following day at Cabinet and participate and help any debate. Instead I was asked to wait outside in case needed while the debate took place.

  Each system has its own merits. I just mention this as it was in stark contrast to how some other high level decision fora operate, for example, the Central Bank Commission. There, for the same issues in 2011, key staff were involved in the prior evening's seminar and also the discussion at the Commission for that agenda item, even if they might not be present when the actual "go" "no-go" decision takes place after the debate.

  Is it right to retain in 2015 traditions developed when the world was less complicated, fast and inter-connected?

- Another interesting aspect of the operation of Cabinet and the sub-committees of Cabinet is how status updates of the deteriorating economic and banking system health come to and are discussed or not by cabinet ministers and their respective officials, back in 2007 and 2008 and nowadays.

  When final critical time sensitive decisions have to be taken, are Ministers already well informed about all of the background, even if the exact tactical decision and precise supporting facts might not be available along the way?

  Were periodic health checks of the Irish economy, of the world economy being debated together even if no specific decision needed to be made?

  Did the absence of a state-wide risk assessment framework, a system wide risk register and risk committee, of course, mean that it was unlikely to have a government memorandum to trigger this discussion formally at Cabinet?

  Are things better now in terms of our Cabinet spending time on periodic reviews of the performance of and risks to the system? Or is debate only triggered by a memorandum to require specific political action/decision, where a specific piece of legislation is coming for approval or where some report into the latest political issue has been published or needs to be commissioned?

Certainly, the quarterly review of the troika process and the periodic reviews of the Action Plan for Jobs are examples of a good practice. How much cross Cabinet debate takes place though when the annual reports of departments are presented (notably, in the absence of the relevant Secretary General), to sign off on the output of those departments and their priorities for the upcoming years? How well do Cabinet colleagues point out to a Minister gaps in his planned work-scope to make sure nothing important falls between the cracks? Do the Cabinet debate together for example the Quarterly Central Bank Reports, reports from the OECD, or from the IMF when they are published?

- Another surprise was to discover that former governments seemed, at least so the story goes, to have discouraged (even banned) the idea of meetings of secretary generals as a group to discuss policy unless their Ministers were present.

I had expected to find much more robust debate among the civil service team as a leadership group of the issues facing the country. I would have expected to equally see fora for the civil service leadership to debate the same issues I had just mentioned above, the IMF or OECD and other reports on Ireland, the Central Bank or Department of Finance's views of the state's finances, the Department of Public Expenditures views of priorities for spending to future proof the country for the future and so on.

Is this happening at the Cabinet table for a period beyond the next election? If it is not happening there nor at Secretary General level, where could it happen? Is it appropriate if the vacuum is being filled by cross Ministerial political advisor discussions only? What about only by less structured reactive bilateral, perhaps tri-lateral, departmental discussions?

The troika process meant I did not notice this vacuum quite as quickly as I might in my earlier years as there was already a driver to help encourage more system-wide thinking of priorities. After the exit from the bailout though, those macro discussions seemed replaced by a lesser level of engagement, perhaps more like what I understand seems to have existed beforehand.

And if it can't happen without the government ministers, I am left to wonder when was the last time the Taoiseach of Ireland, all of the key Ministers and their Secretaries General and perhaps the advisors stepped out together for a "senior management" one or two day offsite to discuss together the priorities they see facing the country? It may be interesting for you to ask similar questions as you analyse what was happening or not happening when the country really found itself in a mess during the crisis.

- I arrived as the Department of Finance was being restructured into two separate departments. Maybe this also accentuated the gap. Perhaps in the past with a Department of Finance responsible for the civil service, for policy advice on broad economic direction as well as for distribution of spending among departments, this absence was less critical. Also, in a somewhat closed system or recruitment, there was always the fall back that a long time civil servant always seemed to "know who to ask" or "know someone who knows the right person to get that done" from having worked with people over the years. But in the system now set up to encourage integration of people at all levels from diverse backgrounds and even from other countries, the existence of a more formalised robust system to encourage cross-disciplinary debate, thinking and action is even more critical. Large multinational companies, with ever transient work forces have spent much time trying to perfect the ways to encourage this. Perhaps there is learning there.

- Oireachtas committees might also help by acting as a forum in which technical civil servant experts together with public representatives may discuss matters freely and publicly.

  But some committees prefer interrogative styles rather than debate among equals. Also, debates are often done department by department rather than involving officials from across the system relevant to a subject matter. Does the adversarial nature of some Oireachtas committees encourage the type of informed cross party political debate which might serve the country well into the future?

  Why, for example, would those posing the questions not simply always provide at least their preliminary questions or areas of inquiry in advance with precision? Would that not facilitate better preparation for the discussion? We all know how much better our answers were when the lecturers gave us hints as to the exam questions in school.

  This should not be an exam to catch out the civil servant or department with surprise questions but should rather be a public debate of the issues to inform. What is important should not be just a soundbite to get exposure on the 6pm news or in newspapers but rather the substance of the matter. Equally problematic, from many departments' perspectives, success seems to be measured by having nothing reported about the discussion at all as that suggests no problems were identified. Is this the right way to encourage good debate and highlight important issues to the public?

  The Committee might interrogate what system of Committee operation ensures the important but often boring subjects and advice thereon are not squeezed out by the search for sound-bites or desire to cover the very recent topical matter.

  Those still wondering what I mean by this, should look to see how few deputies questioned me at my last PAC appearance on the important matters of governance I raised in my opening address, which I had taken the pain to prepare and distribute in advance. I had thought of it as an opportunity to focus on longer term challenges facing the department, how we were working to be more efficient in use of resources and public money and how we had been working to address the structural issues identified in earlier reports on the Department. These are now similar questions to those before the Committee but not ones which concerned many deputies that day.

  If the political process and public interest value the importance of these governance issues before the problem arises, then they should show also leadership to encourage time be spent to understand and debate them even if the news at 6pm may be less enthusiastic about covering them.

It is not my intention to be critical of one side or the other. Each part of the system has obvious strengths. I have hoped simply to raise aspects of the operation of the system which appeared to me at least (an outsider to the existing system) to be areas where perhaps the system operating in 2011-2014 remains based on traditions, many emanating from the establishment of the state or even older Whitehall days, which are not quite the same elsewhere. Our system might still be correct but in the aftermath of yet another major failure to protect the citizens of the country, I would suggest at least a re-evaluation of suitability is in order.

E The Department's Relationships with the NTMA and the Central Bank

(a) 2011 banking policy governance changes

My early observation to the Minister in 2011, was that it had been complicated up to that point to move decisively and cohesively on the bank restructuring as there were essentially three different actors, (i) the Minister and the Department's banking policy unit, (ii) the NTMA's shareholder management unit, and (iii) the Central Bank team supervising the banks and coming up with resolution strategies.

In early 2011, the Central Bank alone had engaged the necessary (but not inexpensive) advisors of the quality required to manage the key PCAR process but the Minister (or NPRF) was the shareholder of the banks. Additionally, the CBI was the only institution which had in earnest begun the recruitment of the necessary extra staff to handle the extent of the crisis.

Better cooperation and communication was I believe an initial positive outcome of my own move from the Central Bank team to the Department and by our decision to move the NTMA team physically and from a governance point of view into the Department. The head of that team, now sat not just on the management structure of the NTMA but now equally on the Department's management team. Key officials of the former Department's banking unit were embedded into his team and created an integrated team of both experienced corporate finance professionals and experienced civil servants to assist me and the Minister in the complex job at hand. Closer cooperation with the PCAR banks also meant finally that the investor public quickly regained confidence that Ireland was operating to a single coherent plan of action.

Certainly, the process of tapping into the best advice for the tough decisions was made much more seamless with officials from this banking unit readily participating also in discussions around the Economic Management Council table. The experts were readily available to and directly embedded in the Department's process of advising the Minister rather than have their advice transferred from the NTMA to the Minister by other Department officials or memorandum. I would suggest that these changes helped the better evolution of decision making about, for example, the removal of the guarantee or the restructuring of the promissory notes.

(b) Governance of the NTMA and the role of the Department

There are a number of observations I might also proffer about the way in which the NTMA had been operating in early 2011. We have heard at least anecdotally the way in which the NTMA teams seemed to be less involved in the key decisions around the guarantee.

- The original structure set up for the NTMA seemed intended not to prioritise strong flows of two way information between the agency and the Department in ways to encourage the expression of views by Department officials on activities within the remit of the NTMA and vice versa. The CEO of the NTMA regularly reported directly to the Minister and sought permission to take various funding decisions, but most typically not in the presence of officials of the Department whose views could only be solicited often after the fact.
- Additionally, since the Department's Secretary General was merely a participant on the CEO of the NTMA's *advisory council* (not a board with a binding authority as a matter of governance) any role of the Secretary General in day to day NTMA activities was also very limited.
- No one from the NTMA attended the Department's management meetings.

- The relationship *de facto* worked well but much of this was down to good inter personal relationships not *de jure* protections. Had that former element broken down, the structure had few of the checks and balances one might like to see to deal with a concentration of very considerable power in the role of the CEO of the NTMA. This was even more important with the expanding role being suggested with the development of New Era and the Strategic Investment Fund.

As a result, during my tenure as Secretary General and with the strong support of John Corrigan

- a new "Financing the State" unit in Merrion Street reporting directly to me and staffed by another very experienced finance practitioner (seconded to the Department from the NTMA) helped break down barriers and improve Departmental analysis and understanding, and
- very important governance changes were introduced by statute:-
    - A board appointed by the Minister would henceforth manage the NTMA and the CEO would be answerable to the board.
    - There would be a Chairman who would also be appointed by and available also to the Minister.
    - There would be a statutory position for the Secretary Generals of both the Department of Finance and the Department of Public Expenditure and Reform on the NTMA board, and *ergo* a role for both in the management of the Agency.
    - An independent investment committee would be responsible for the investment decisions of the SIF.

(c) Communications between the Department, the Central Bank and the NTMA

The Secretary General of the Department serves as an ex officio on the Commission of the Central Bank, a role which has raised concerns among officials of the IMF when asked to opine on the required independence of the Central Bank from political interference.

In the absence of other alternatives, this bridges discussions between the Central Bank management and those of the Department on key strategic matters. But it is limited in effectiveness on account of the restrictions on the Secretary General arising from Section 33ak. Informal discussions between the Governor and the Minister or between officials of both institutions would otherwise be the only channel.

We need further bridges therefore. During my time at the Department, a body referred to as the Principals Group, involving key officials from the Central Bank, the NTMA and the Department also met (sometimes weekly or even more frequently) to deal especially with operational issues associated with the bank restructuring and the bailout negotiations.

Many other countries have relied on such a tri-partite forum as a real discussion forum to assess future risks and the robustness of a state's responses to those challenges. The challenge for Ireland was to move the agenda of this meeting away from operational issues and into the areas of financial stability of the economy, of the financial sector and of the state's funding, seen perhaps by some as areas of their own exclusive competencies. The Inquiry may have seen and have their own views on the correspondence between the agencies as to changes which we tried to make so that the operation of the committee became more strategic in focus.

F Changes made to the Department and embracing contrarian views

As already mentioned, I set out in detail for the PAC measures we had taken to reform the operation of the Department in the years I was Secretary General.

I cannot improve the description by restating it in new words here. I would therefore commend the members of the Inquiry to the full text of that statement.

You have specifically asked me though to consider the management of contrarian views and so I will just comment a little specifically on that.

Chairman Brian Patterson already spoke to you about the culture based on a strong hierarchy he found in the regulator. Much of what I observed in the Department of Finance at the outset was similar. This is not just a private – public sector divide. There are many private companies too where the boss's views are well quite simply the boss's views and not to be challenged too.

Ironically, what I found was not that all of the senior managers individually wanted it that way in the Department but tradition is strong. It took a long time for people to get accustomed to calling me John not "Secretary General". The new practice of senior officials including myself more randomly turning up to meetings, just popping up unannounced at a colleagues workstation to ask a question by walking around the building, asking other colleagues to lead meetings even if a more senior colleague was present, changes in dress codes, all helped to disrupt the old traditions. Hiring a senior HR professional skilled at culture change was important to structure these changes.

I will particularly repeat for you one of the paragraph of my PAC speech last year:

> "For that, further embedding of a culture of openness, of internal and external challenge and peer review, of risk management and robust and innovative policy formulation is key. This is not easy stuff though. It requires ensuring adequate investment to have access to the best talent and information. It means learning to listen. It means embracing an environment often lacking in organisations across the world of open, free and honest debate and mutual trust where everyone's views are well received and cheap shots avoided. It requires the nurturing of talent so as to create the leaders of tomorrow who need to be instilled with a sense of creativity to develop policies for a changing world but also a sense of conviction and courage to be able to identify the next problem and shout stop when it is needed."

I would point out today that it takes continuing leadership to break down these traditions. All staff not just senior staff have to be comfortable expressing views. Junior staff who know the dossier better anyway, should be present where possible and indeed perhaps lead the exposition of the details for key discussions with the Minister, Secretary General or policy committee.

People need to get comfortable working with each other and that there are no recriminations from asking what might seem like a stupid question (but may be the best one) or suggesting alternatives.

Frequent offsite all day planning meetings with the extended management team were also a key part of that journey. They had stopped happening as people were afraid to be publicly seen leaving their day to day policy priorities to take time out (or what they almost saw as taking time off) to debate broader issues for the department or the economy. Up to the end of my tenure we continued to have detailed offsite and robust debate about the right governance structure for the department and whether we were going far enough to reform the way we operated.

Bringing in speakers from other backgrounds and disciplines to make people think differently and stimulate more open debate are all techniques used in other well run companies and were techniques we used too. It is a great equaliser when you get to debate together a subject like the role of the human brain in winning teams with a neuroscientist from TCD where no one of our management team was an expert or perceived to be! It is all about getting that team to get comfortable expressing views freely about an issue, taking them outside their comfort zones and also perhaps stimulating different thinking about their own problems facing them daily.

The pre-existing governance structures of the department did not help though. The only meeting of the senior team of the Department as a unit was a weekly forum called the MAC where typically assistant secretaries met with the secretary general once a week. The Wright report talks about that committee a bit. I think it is an important point that the "A" stood for advisory and so the committee members saw themselves as having limited roles in the management of the Department or areas beyond their core areas of responsibility. This was an important detail as they saw their role as advising the Secretary General about what to do with their area and perhaps offering views more broadly but with no real role or responsibility to do so. We tried to change this to make it clearer that everyone in the room was to have a management not just an advisory role, and not just for their own area but also across the department and so should play a greater role in collective decision making not just for the operation of the department but also the advice going to the Minister. Members were to feel free and in some ways under an obligation to express their own thoughts and those of their teams especially if against a course of action.

We changed the way information flowed too. Lots more open circulation of information. People in the Department of Finance outside the Fiscal and tax division should not first learn about budget decisions when the Minister is standing up in the Dail. Weekly updates from each section came not just to the Secretary General but went to that entire management group who were encouraged to pass on the highlights of all to their own teams too. A weekly 30 minute forum of principal officers was initiated to make sure that the key priorities and issues were being shared with the broader management team. We left a 30 minute period in the schedule in case the discussion needed to run on and interestingly that became a key moment of cross departmental bilateral informal communications after the formal run through.

Process for submission of approval papers for the Minister were changed so that specifically they had to go by the Secretary General's office and that the views of the officials in charge of risk, finance and ops and legal needed to be recorded to inform the Secretary General and the Minister and posterity, not just the recommendation of the division head sponsoring the advice. When people found they did not always have the time to follow these steps with paper files, we changed it to a computer based submission which mandated these steps before submission.

A policy committee was introduced to have more robust debate about new policy ideas, not just restricted to senior management. An enhanced risk function and risk committee separated from policy development was introduced to have more robust debate about where it might go wrong into the future and to discuss whether key risks were abating or more should be done. We worked to make the internal audit and Audit Committee more meaningful. I believe that these continue to operate but Derek can no doubt talk to that later.

But what was most important is that the leadership made it clear in these ways that they wanted to see these other points of view and encourage cross disciplinary debate and the generation of new ideas and concerns.

CLOSING REMARKS

By way of closing context, I would just add:-

- I joined the Department of Finance in March 2011, after many of the decisions the subject of the inquiry had been taken. I therefore had to make decisions and recommendations based on the reality of these decisions. Speculation as to what might have happened had they been otherwise was never going to be a productive use of valuable time while we were fighting the crisis "24-hour-7";
- I have to be conscious not just of my obligations under the Official Secrets Act 1963 Act but also the obligations of Section 33ak of the Central Bank Act, 1942;
- Without a team of people to help me reanalyse history and files in detail (which anyway are not in my possession), the above observations are based largely on recollection which I hope is not incomplete or coloured with the passage of time and subsequent events;
- I would refer you to the more detailed Annual Reports of 2012 and 2013 published by the Department during my tenure. These present a more comprehensive description of matters I have not had the space to elaborate on here as fully as I would have liked.
- I am sure that my successor has made further refinements beyond those described and perhaps modified the approach I have set out. I understand he will be appearing separately before the Committee and my content should therefore be read accordingly.
- As I mentioned at the outset, covering 20 items in such a short submission was never likely to do justice to the importance of each of the items and I welcome the opportunity to be able to elaborate more today.